INITIAL DECISION RELEASE NO. 1116
ADMINISTRATIVE PROCEEDING
FILE NO. 3-17253

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of JAMES A. WINKELMANN, SR. and BLUE OCEAN PORTFOLIOS, LLC	INITIAL DECISION March 20, 2017

APPEARANCES: Benjamin J. Hanauer and David F. Benson for the Division of Enforcement, Securities and Exchange Commission

Alan M. Wolper, Heidi E. VonderHeide, and Michael A. Gross, Ulmer & Berne LLP, for James A. Winkelmann, Sr., and Blue Ocean Portfolios, LLC

BEFORE: Jason S. Patil, Administrative Law Judge

SUMMARY

This initial decision finds that Blue Ocean Portfolios, LLC (BOP), and James A. Winkelmann, Sr., willfully violated Securities Act of 1933 Section 17(a), Securities Exchange Act of 1934 Section 10(b) and Rule 10b-5, and Investment Advisers Act of 1940 Sections 206(1) and 206(2), and that Winkelmann caused BOP's violations and willfully aided and abetted BOP's violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1). This initial decision also finds that BOP willfully violated and Winkelmann caused BOP's violation of Advisers Act Section 206(4) and Rules 206(4)-2 and 206(4)-7, and that BOP and Winkelmann willfully violated Advisers Act Section 207.

I impose the following sanctions as to Winkelmann: an industry bar, a cease-and-desist order, disgorgement of $415,000 plus prejudgment interest, and civil penalties of $187,500. I also impose a cease-and-desist order as to BOP.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission issued an order instituting proceedings (OIP) on May 19, 2016, pursuant to Section 8A of Securities Act; Section 21C of the Exchange Act;

Sections 203(e), 203(f), and 203(k) of the Advisers Act; and Section 9(b) of the Investment Company Act of 1940, against Respondents Winkelmann and BOP. A hearing was held in St. Louis, Missouri, on October 4-7 and 13-14, 2016. The admitted exhibits are listed in the revised record index issued by the Secretary of the Commission on January 27, 2017. Post-hearing briefing is complete.[1]

B. Summary of Allegations

In summary, the OIP alleges that Respondents made fraudulent misrepresentations and omissions and breached their fiduciary duty in the course of their offerings of securities of BOP. OIP at 2. Winkelmann is the principal, chief executive officer, chief compliance officer, and manager of BOP as well as the manager of the limited liability company that owns 100% of BOP. *Id.* BOP 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. *Id.* Respondents offered and sold BOP securities, or royalty units, primarily to BOP's advisory clients, raising $1.4 million from twenty-four investors, nineteen of whom were BOP advisory clients. *Id.* at 2-3. The royalty units offered investors a right to a percentage of BOP's cash receipts until BOP had repaid a specified amount ranging from 2.25 to 3.0 times the original investment amount. *Id.* at 3. The offering memoranda represented that the primary use of investor proceeds would be to increase BOP's advertising budget and expand its advertising reach. *Id.*

The OIP alleges that in the course of four offerings, Respondents made the following material misstatements and omissions in offering documents and to advisory clients: (1) overstated BOP's success in converting advertising spending into new revenue for BOP; (2) failed to disclose and explain the inherent conflicts of these offerings and stated that Winkelmann's and the investors' interests were aligned; (3) failed to disclose sanctions imposed by the Missouri Division of Securities on one of Winkelmann's business associates, whose radio show BOP had engaged and touted in offering materials as the focus of its advertising campaign; (4) failed to disclose that BOP could, and did, pay significant sums of money ("management fees") to three entities owned and controlled by Winkelmann; (5) failed to disclose that Winkelmann repeatedly chose to pay his investors the minimum returns possible while increasing his own compensation; and (6) misstated amounts BOP royalty holders had been repaid and amounts BOP had raised in its third royalty unit offering. OIP at 2-5; More Definite Statement. The OIP additionally alleges that through their conduct during these offerings, Respondents breached the fiduciary duty they owed to their advisory clients who they had

[1] Citations to the hearing transcript are noted as "Tr. __." Citations to the parties stipulated facts are noted as "FOF __." *See James A. Winkelmann, Sr.*, Admin. Proc. Rulings Release No. 4350, 2016 SEC LEXIS 4242 (Nov. 15, 2016). Citations to the Division's exhibits and Respondents' exhibits are noted as "DX __" and "RX __," respectively. Citations to the Division's post-hearing filings are noted as "Div. Br." and "Div. Reply." Citations to Respondents' post-hearing filings are noted as "Resp. Br." and "Resp. Reply." Citations to the parties' proposed findings of fact and conclusions of law and their responses to proposed findings of fact and conclusions of law are similarly noted. Citations to a document's Bates number omit the alphabetical prefix (e.g. "BO") and any preceding zeros.

offered and sold the royalty units and did not comply with the Advisers Act custody, compliance, and reporting provisions. OIP at 2, 5-7.

As a result of this alleged misconduct, the OIP alleges that: (1) Respondents willfully violated Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1), and Winkelmann caused and willfully aided and abetted BOP's violations; (2) Respondents willfully violated Securities Act Sections 17(a)(2) and 17(a)(3) and Advisers Act Sections 206(2), and Winkelmann caused BOP's violations; (3) BOP willfully violated Advisers Act Section 206(4) and Rules 206(4)-2 and 206(4)-7, and Winkelmann caused BOP's violations; and (4) Respondents willfully violated Advisers Act Section 207. OIP at 7-8.

Respondents deny these allegations of wrongdoing. *See* Answer; Response to More Definite Statement. They state that they retained "experienced outside legal counsel which specializes in advising clients in all aspects of securities, regulatory, and compliance issues" to author and create the royalty unit offering documents. Answer at 2. Respondents assert eleven affirmative defenses, including reliance on advice of counsel. *Id.* at 11.

II. FINDINGS OF FACT

I base the following findings of fact and conclusions on the entire record and the demeanor of the witnesses who testified at the hearing, applying preponderance of the evidence as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 100-04 (1981). All arguments and proposed findings and conclusions that are inconsistent with this decision are rejected.

A. Respondents

1. James A. Winkelmann, Sr.

Winkelmann is the current CEO, chief compliance officer (CCO), and manager of BOP. Tr. 423, 437. Winkelmann has worked in the securities industry since 1981. FOF 17. Before forming BOP, Winkelmann owned a brokerage firm from 1987 through 2008 and an investment advisory firm from 1988 until 2010. FOF 19. Winkelmann also operated an insurance agency called Longrow Insurance Agency, Inc., and an automatic teller machine company called Blue Ocean ATM, LLC. FOF 30. Winkelmann has passed FINRA exams Series 4, 7, 24, 63, and 66. FOF 23.

Winkelmann has extensive experience in financial services sales, management, administration, compliance, and regulatory relations. FOF 18. He has served as the chairman of the Missouri Securities Industry Association, the treasurer of a publicly traded mutual fund, and an expert consultant on securities disputes involving sales practices and disclosures. FOF 20-22.

In June 2010, following a personal health scare involving a cancer diagnosis and at the advice of his estate planning attorney, Winkelmann formed a family partnership called 23 Glen Abbey Partners, LLC, to own BOP. FOF 31. Winkelmann's wife and children owned Glen Abbey and Winkelmann managed it. *Id.* Winkelmann conveyed his interest in BOP to Glen Abbey in the first quarter of 2011, effective as of January 1, 2010. FOF 42.

In addition to his securities businesses, Winkelmann was the manager of his son's parody clothing company; in 2010, that company, along with Winkelmann and his son, were sued by The North Face Company for trademark infringement. Tr. 1440-41. As part of that lawsuit, Winkelmann and his son agreed to a consent injunction. Tr. 1443; DX 205 at 1. In 2012, the North Face alleged that Winkelmann and his son were in violation of the consent injunction based on another parody product. Tr. 1443-44. Neither Winkelmann nor his son contested this allegation because Winkelmann was fighting cancer and his son was busy with college. Tr. 1444-45. As a result, the court issued an order finding Winkelmann and his son in contempt for violating the consent injunction. DX 205.

2. Blue Ocean Portfolios, LLC

BOP is an investment advisory firm formed in August 2009. FOF 2, 32. It was founded by Winkelmann and Bryan Binkholder, with each owning 50% of the firm. FOF 32; Tr. 412-13. At all times, Winkelmann has been BOP's CEO, manager, and CCO and had ultimate decision-making authority. FOF 34-35. According to Winkelmann, "the buck stopped" with him. Tr. 437.

In the first quarter of 2010, BOP began entering into advisory agreements with its first clients. FOF 38. Prior to forming BOP, both Winkelmann and Binkholder had advisory clients at the separate advisory firms they each owned and operated. FOF 39. When BOP was formed, all of Winkelmann's and some of Binkholder's legacy clients became BOP clients. *Id.*

BOP was initially registered with the State of Missouri, but, in April 2011, as a result of an increase in its assets under management (AUM), it became registered with the Commission. FOF 2. From June 2012 to April 2013, BOP returned to being registered with Missouri, before again becoming Commission-registered in April 2013. *Id.*

BOP provides its advisory clients with portfolio allocation services and charges clients an advisory fee, based on a percentage of a client's assets under BOP's management. FOF 3; RX 1 at 7-8. Its clients are a mix of individuals and small-to-midsize institutional clients. RX 1 at 5. BOP's investment approach focuses on portfolio allocation, choosing investments in low-cost index funds rather than individual stocks and bonds. Tr. 1242.

B. Other Related Parties

1. Don Weir

From 1986 to 2008, Don Weir and Winkelmann were each 50% shareholders in the financial services firm Winkelmann owned and managed. FOF 25. In September 2008, Winkelmann learned that Weir had apparently misappropriated millions of dollars' worth of gold coins and bullion from Weir's advisory clients. FOF 26. After Weir's crimes came to light, Winkelmann closed the brokerage firm that he and Weir had owned and operated, but continued to operate his investment advisory firm, Longrow Insurance Agency, and Blue Ocean ATM. FOF 29-30.

Weir was criminally charged, pled guilty to mail fraud, and was sentenced to seventy-eight months' imprisonment in *United States v. Weir*, No. 4:09-cr-149 (E.D. Mo. Sept. 30, 2009). FOF 27. Winkelmann was never charged in connection with Weir's scheme. FOF 28.

2. Bryan Binkholder

In April 2009, Winkelmann heard Binkholder's *Financial Coach* radio show and then reached out to him. FOF 32. By August 2009, Winkelmann and Binkholder decided to go into business and formed BOP. *Id.* In addition to co-owning BOP, Binkholder was initially a BOP advisory representative. FOF 33.

In January 2010, BOP began sponsoring the *Financial Coach* radio show. FOF 40. Later in 2010, Winkelmann learned that Binkholder was being investigated by Missouri securities regulators. FOF 41. When Winkelmann learned this, he told Binkholder that until the end of the investigation, Binkholder needed to rescind his membership in BOP, no longer talk to clients, and no longer "have anything to do with" BOP. *Id.* Despite this admonishment, Winkelmann allowed Binkholder to stay involved with BOP during 2010-2011. Tr. 415-16. Winkelmann and Binkholder continued to share office space and employees, and Binkholder remained as an owner and advisory representative of BOP until March 2011, when Winkelmann removed Binkholder. Tr. 416-17; RX 4 at 16; FOF 42. At this point, 23 Glen Abbey owned 100% of BOP. FOF 42. Once Binkholder stopped being a BOP advisory representative, Winkelmann took responsibility for Binkholder's legacy clients that had become BOP clients. FOF 43.

On February 1, 2011, BOP and Binkholder entered into a "Solicitor's Agreement," which required Binkholder to use his "best efforts" to solicit and refer clients to BOP. DX 456 at 1. The agreement provided that Binkholder's "primary role" was to "introduce and assist each Solicited Client in establishing a relationship with [BOP] which will include introducing prospective clients and providing information about [BOP]." *Id.* The agreement additionally noted that under a separate marketing and sponsorship agreement, Binkholder "is compensated for being a paid spokesman of" BOP. *Id.* at 2.

On March 23, 2011, BOP entered into an exclusive marketing agreement with Binkholder as a vehicle for paying Binkholder and driving prospective advisory clients to BOP. FOF 47; DX 5. Under that agreement, BOP agreed to sponsor the production of, and reimburse Binkholder's expenses relating to, Binkholder's websites, social media sites, radio shows, television shows, and book publications. DX 5 at 2. Additionally, BOP agreed to pay Binkholder monthly compensation at least equal to the compensation Winkelmann received from BOP. *Id.* BOP also agreed to purchase at least $2 million in life insurance on Binkholder's life, and allow Binkholder to choose a beneficiary for half of the policy's value. *Id.*

The marketing agreement obligated Binkholder to: (a) "prominently and exclusively display and promote Blue Ocean services on all its web based, radio and television shows, productions and social media sites"; and (b) "exclusively enable Blue Ocean to generate leads from [Binkholder's] websites, social media sites, radio shows, television shows, speaking engagements and book publications." DX 5 at 2. Binkholder's radio show generated "a lot" of leads per week for BOP; during the investigation, Winkelmann testified that it generated seventy to one hundred leads per week. Tr. 425-27.

In late December 2011, Winkelmann learned that the Missouri Division of Securities barred Binkholder from acting as an investment adviser. FOF 56. Winkelmann first saw the bar order on December 27 or 28, 2011. *Id.* The bar order found that "Binkholder offered and sold promissory notes in entities under the ownership and/or control of Binkholder ('Binkholder Entities') to Binkholder's investment advisory clients." DX 84 at 3. The order additionally found that "Binkholder did not disclose to investors . . . the potential conflict of interest that could affect the advisory relationship between Binkholder and the investors." *Id.*

On February 29 and March 1, 2012, BOP and Binkholder signed an amended exclusive marketing agreement, which was effective as of February 28, 2012. DX 106. BOP agreed to continue sponsoring Binkholder's shows and Binkholder agreed to continue to promote and generate leads for BOP. *Id.* at 2. BOP also agreed to pay Binkholder at least $7,000 per month, in addition to reimbursing Binkholder for expenses associated with his shows. *Id.*

On November 16, 2012, Winkelmann first learned of the federal criminal investigation into Binkholder when one of his clients emailed Winkelmann a copy of a grand jury subpoena the client had received. FOF 57. Winkelmann immediately suspended payments to Binkholder from BOP under the exclusive marketing agreement and severed BOP's joint dealings with Binkholder. FOF 58.

In 2015, Binkholder pled guilty to four counts of wire fraud and was sentenced to 108 months' imprisonment in *United States v. Binkholder*, No. 4:14-cr-247 (E.D. Mo. May 15, 2015), *aff'd in part and rev'd in part*, 832 F.3d 923 (8th Cir. 2016). FOF 58.

3. Greensfelder Hemker & Gale, P.C., and Michael Morgan

Greensfelder Hemker & Gale, P.C. (Greensfelder), is a law firm located in St. Louis, Missouri. FOF 51. Michael Morgan was an experienced attorney who specialized in securities law and regulatory compliance. *Id.* Winkelmann engaged Morgan and Greensfelder in anticipation of the royalty unit offerings and to provide compliance advice to BOP in connection with certain day-to-day operations, including advice regarding the content of certain of BOP's Forms ADV. FOF 51-52.

C. Royalty Unit Offerings

Winkelmann "constantly" monitored BOP's revenues and expenses. Tr. 439. In 2010, BOP generated $120,451.74 in advisory fees, incurred expenses of more than $198,000, and ended 2010 with an annual net loss of more than $36,000. FOF 44. As of December 31, 2010, BOP had $163.50 in its bank account, $3,263.50 in total assets, and $43,654 in total liabilities. FOF 45. At the ends of the month in January, February, and March 2011, BOP had in its bank account $17,103.63, $8,806.54, and $239.16, respectively. FOF 46.

After consulting with outside counsel, Winkelmann decided to offer royalty units in BOP because he had been unsuccessful at obtaining a loan from the bank; Winkelmann wanted to expand BOP's advertising efforts and increase its AUM. Tr. 439-40, 445-46. In order for BOP to implement its desired business plan to expand the business, the royalty unit offering was "critical" to fund the effort. Tr. 446-47. Overall, BOP issued four rounds of royalty unit investments. *See* RX 1-4.

Through the royalty unit offerings, BOP intended to increase its advertising presence and spread its core message of low-fee, allocation-focused investing. RX 1 at 8-9; RX 2 at 10-12; RX 3 at 7-9; RX 4 at 8-9; Tr. 1242-43. BOP's advertising strategy was to selectively advertise by pursuing sources that were successful at bringing in new clients and eliminating sources that were unsuccessful or minimally successful. Tr. 861, 1252, 1298-99. BOP tracked the success of each advertisement, and advertisements that generated sufficient revenue were pursued and those that did not generate revenue were cut. Tr. 463-64, 861-63, 1292, 1317.

The structure of each of the four royalty unit offerings was essentially the same: investors contributed capital to BOP in exchange for the right to receive a certain minimum percentage of its cash receipts. FOF 7, 9, 11, 13. Additionally, the first round royalty unit entitled investors to a warrant providing an option to purchase 1% of BOP for $100,000, while none of the other royalty unit offerings included a warrant. *Id.*

The percentage of cash receipts to which the royalty unit holder was entitled depended on the offering and ranged from 0.05% to 0.25% per royalty unit. RX 1 at 10; RX 2 at 15; RX 3 at 13; RX 4 at 13; Tr. 1259-60. Because investors were paid based on cash receipts, they received their regular percentage payment regardless of whether BOP was profitable that same period; payments were paid before expenses. Tr. 188-89, 277, 300, 1274-75. Investors were entitled to receive their percentage payment until their principal had been repaid at the stated multiple (2.25 to 3 times the principal, depending on the offering). RX 1 at 10; RX 2 at 15-16; RX 3 at 13; RX 4 at 13.

None of the offering memoranda imposed an obligation on BOP to repay the royalty unit holders within a specific time period. DX 124 at BOP 9378; RX 1 at 98; RX 3 at 132; RX 4 at 146. Instead, the subscription agreement warned that the royalty "may never be paid in full by the Company and the Royalty is not required to be paid in full before any scheduled date." DX 124 at BOP 9378; RX 1 at 98; RX 3 at 132; RX 4 at 146. The second, third, and fourth offering memoranda disclosed that investors should initially expect to receive the minimum percentage of cash receipts required by each royalty unit and that "larger and larger portions of the cash receipts" would be used to pay back the royalty unit holders once "recurring, sustainable profitability is achieved." RX 3 at 4, 14; RX 4 at 4, 14; *accord* RX 2 at 6, 16. They also stated that once BOP achieved profitability, the plan was to pay at least 50% of the profits until payback was achieved. RX 2 at 16; RX 3 at 14; RX 4 at 14. The third and fourth memoranda predicted that investors could expect to receive the bulk of their return in years three through five. RX 3 at 14; RX 4 at 14.

The first offering memorandum stated that "[u]nder the planned expenses and advertising assumptions," BOP would be "cash flow positive at approximately $150 million in AUM," which it hoped to achieve within twenty-four months. RX 1 at 13. The $150 million in AUM figure was revised down to $124 million in AUM for the second, third, and fourth offering memoranda with the same timeline of twenty-four months. RX 2 at 18; RX 3 at 16; RX 4 at 16.

The offering memoranda described the revenue from AUM as "recurring and valuable." RX 1 at 5; RX 2 at 5; RX 3 at 3; RX 4 at 3. BOP's client acquisition cost, or efficacy of the money spent on advertising, was a key business driver.[2] RX 1 at 9, 11; RX 2 at 5, 13, 16; RX 3 at 3, 11, 13-14; RX 4 at 3-4, 11, 13. According to the second, third, and fourth offering memoranda, "[t]he key indicator on the advertising efficacy is to determine how much advertising is needed to generate one additional dollar in new recurring revenue," which the memoranda described as the advertising conversion (or yield) factor. RX 2 at 5; RX 3 at 3; RX 4 at 4.

The offering memoranda explained that high advertising yield factors and low advertising budgets would reduce investor returns and lengthen the payback period while low yield factors and higher advertising spends would increase investor returns and shorten the payback period. RX 2 at 16; RX 3 at 14; RX 4 at 14; *see* RX 1 at 12 ("[T]he rate of return will also depend on the conversion rate of the advertising budget . . . ."). In the first offering memorandum, BOP hoped to keep the ratio lower than 0.40, while that figure rose to 0.80 in later memoranda. RX 1 at 13; RX 2 at 17; RX 3 at 15; *see* RX 4 at 15 (noting that the key business driver will be the ability to keep the factor "low"). In the long term, BOP wanted to eventually achieve and maintain a factor of 0.50. RX 2 at 5; RX 3 at 3; RX 4 at 4.

The four offering memoranda disclosed that since its inception in August 2009, BOP had been financed by Winkelmann's personal and family capital. RX 1 at 10; RX 2 at 15; RX 3 at 12; RX 4 at 12. The first three offering memoranda also mentioned that BOP had been financed by Binkholder as well, while the fourth offering memorandum omitted reference to Binkholder's financing. RX 1 at 10; RX 2 at 15; RX 3 at 12; RX 4 at 12.

One of the key risks disclosed by the offering memoranda was "running out of capital before the cash flows turn positive." RX 1 at 13; RX 2 at 18; RX 3 at 16; RX 4 at 16. The memoranda warned that an unforeseen event could slow down or prevent the cash flow from turning positive, which would result in lower returns for investors, lower bonus payments for the employees, and a delay in any potential distributions to the owners. RX 1 at 13; RX 2 at 18; RX 3 at 16; RX 4 at 16.

The four offering memoranda warned that if too few royalty units were issued, BOP could run out of cash, resulting in a decreased advertising budget and thus a lower return for investors. RX 1 at 10; RX 2 at 16; RX 3 at 13; RX 4 at 13. However, the second, third, and fourth offering memoranda recognized also that the fewer number of units issued, the better for BOP's owners and employees because "[t]he fewer dollars that need to be dedicated to royalty payments, the higher the profits to the owners and the higher the employee bonuses." RX 2 at 16; RX 3 at 13; RX 4 at 13.

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[2] This advertising ratio and BOP's disclosures regarding the ratio are discussed in more detail in the "Advertising Ratio" section *infra*.

The four offering memoranda also warned that although the higher payment of royalties per month would increase investor returns, it could also erode BOP's working capital and jeopardize the advertising budgets. RX 1 at 11; RX 2 at 16; RX 3 at 14; RX 4 at 14.

Each subscription agreement contained a warranty that the subscriber had not relied upon any representations or information other than that provided by BOP pursuant to the offering memoranda and an integration clause confirming that the agreement was the entire understanding between the parties. DX 124 at 9376, 9380; RX 1 at 96, 100; RX 3 at 130, 134; RX 4 at 131, 136. The subscriber also had to acknowledge that BOP had not provided any investment advice to the subscriber. DX 124 at 9375; RX 1 at 95; RX 3 at 129; RX 4 at 130.

The subscription agreement warned that the royalty units could not be resold or transferred by the subscriber in the absence of an effective registration statement or a satisfactory opinion of counsel stating that registration was not required. DX 124 at 9376; RX 1 at 97; RX 3 at 130-31; RX 4 at 131-32. The subscriber acknowledged that the royalty units were subject to restrictions on transfer and agreed not to offer or sell the security for two years without prior written consent from BOP. DX 124 at 9374; RX 1 at 83, 94-95; RX 3 at 127-28; RX 4 at 124, 129. The agreement also warned that due to these restrictions, the investment would be highly illiquid and most likely had to be held "indefinitely." DX 124 at 9375, 9377; RX 1 at 95-97; RX 3 at 129-31; RX 4 at 130, 132.

Between April 16, 2011, and February 25, 2014, over the course of four private offerings, BOP raised a total of $1.4 million from a total of twenty-four royalty unit investors located in Missouri, Illinois, and Indiana. FOF 1. Nineteen of these investors were BOP advisory clients.[3] DX 455. As of April 2, 2012, at least seven of the royalty unit holders were not accredited. FOF 50.

As of the third quarter of 2016, BOP had paid a total of $525,672.51 to the royalty unit investors in the four rounds of offerings and still owed them $3,320,577.49. FOF 14-15. Through October 2016, BOP had timely made all minimum payments due to the royalty unit investors in each of the four offerings. FOF 16.

1. First Round Offering

For the first round offering, between April 16 and July 13, 2011, BOP issued twenty-six royalty units, raising a total of $650,000, to fourteen investors, ten of whom were BOP advisory clients. FOF 6. Each royalty unit was offered in $25,000 increments and granted the investor a minimum of 0.25% of BOP's monthly cash receipts until the investor had been repaid $75,000 (three times the original investment). FOF 7. The explicit terms of the offering provided that there was no set timeframe within which the full repayment needed to be made. *Id.* Each first round royalty unit also entitled investors to a warrant providing an option to purchase 1% of BOP for $100,000. *Id.*

[3] Seven investors testified at the hearing: Bryan Swift, Jason Grau, Thomas Dixon, Arthur Buckowitz, James Hipsky, Michael King, and Thomas Swardson. All seven were also BOP advisory clients. DX 455.

a. Offering Memorandum – March 31, 2011

In the first round offering, BOP sought to raise up to $1 million "to increase the advertising budgets and to make needed additions to the sales and administrative staff." RX 1 at 5. BOP planned to issue up to forty royalty units to accredited outside investors, with each unit costing $25,000. RX 1 at 10. Each unit entitled the investor to receive no less than 0.25% of BOP's cash receipts on a monthly basis until the investor received a total of $75,000. *Id.* Once investors received their $75,000, they would also have the option to purchase 1% of BOP for $100,000. *Id.* at 12.

The first round offering memorandum included a detailed overview of BOP's sales and marketing plan, which it hoped would attract new leads and, ultimately, increase BOP's revenue. RX 1 at 8-9. The offering memorandum disclosed the exclusive marketing/sponsorship agreement with Binkholder and explained how his radio show drives leads to BOP. *Id.* at 8. It also explained that Binkholder receives "a monthly retainer that is tied to the overall revenues of [BOP] regardless of where the leads came from," but that he would receive "no direct compensation" from any BOP client for investment advisory services, insurance products, or revenue of any kind. *Id.*

The memorandum represented that BOP would use "a substantial portion of the proceeds of this offering and future cash flows" to pay for advertising for both BOP and *The Financial Coach Show*. RX 1 at 8. It further stated that the proceeds would be used "exclusively" for BOP's operations. *Id.* at 12.

The first offering memorandum contained two charts describing two scenarios showing the anticipated payback times based on the monthly percentage of revenues paid per royalty unit (ranging from 0.25% to 1.5%) and the "New AUM Cost Per $1MM" (ranging from $1,000 to $5,000). RX 1 at 11-12. The first scenario was based on twenty-four units issued, 0.25% royalty, a monthly advertising budget of $15,000, and advertising cost of $2,500 for each new $1 million in AUM. *Id.* at 11. The second scenario was based on forty units issued, 0.50% royalty, a monthly advertising budget of $25,000, and advertising cost of $4,500 for each new $1 million in AUM. *Id.* at 12.

The rate of return to investors depended on several variables, including how fast the recurring revenue stream grew, the conversion rate of the advertising budget, and the valuation of client portfolios. RX 1 at 12. Also, the table was based on an assumption that BOP would generate $5.5 to $6 million per month in new AUM. *Id.* at 11-12. However, BOP never generated close to that much new business per month. Winkelmann agreed that the higher the new AUM per month assumption for the table, the faster the payback time. Tr. 1472. For the first scenario, the table does not contain information allowing an investor to calculate the payback time for minimum 0.25% payments where the new AUM cost per $1 million is $3,000 or greater; for the second scenario, an investor is unable to calculate the payback time for minimum 0.25% payments where the new AUM cost per $1 million is $5,000 or greater. RX 1 at 11-12. The scenarios do disclose that it could take 9.7 years to pay back investors in the first scenario and 6.9 years in the second. *Id.*

The two repayment scenarios were based on certain financial assumptions. BOP cautioned that "no one can predict the future; actual rates of returns will depend on several variables" and that investors considering the royalty units to "realize the sensitivity of the key drivers that will impact their return," such as the number of units issued, the monthly advertising budget, new AUM cost per $1 million in AUM, and the royalty per unit. RX 1 at 10-11.

b. Communications about the Offering

Before circulating the first offering memorandum, Winkelmann began informing certain prospective investors of the upcoming offering. Tr. 495. For instance, on February 16, 2011, Winkelmann wrote a letter to Scottrade CEO Roger Riney, which described the royalty unit investment – at this stage described as $100,000 per unit for 1% of cash receipts – and asked if Riney would be interested in investing. DX 7. The letter stated that BOP "already ha[d] 4 units reserved from friends and family members." *Id.* At this point in time, because the offering had not begun yet, BOP had not completed the sale the four units and had not yet raised the $400,000. Tr. 497, 1367; DX 455 (chart, the accuracy of which was stipulated to by the parties, FOF 4, showing list of investors per royalty unit offering noting the date purchased as the date a subscription agreement was signed or date of check/signed wire agreement).

BOP began offering royalty units to investors in April 2011 and circulated the first offering memorandum to potential investors including advisory clients and unaccredited (non-high net worth) investors. Tr. 495, 506, 510-11; RX 1.

On April 25, 2011, Winkelmann sent an email to potential royalty unit investor Dan Bean, writing, "thank you for pointing out the ambiguity in the offering document. I read it again several times and agree with you that it could have been written much better – certainly not my best effort." DX 32. Winkelmann agreed that his email exchange with Bean put him on notice that there could be ambiguities in the first offering memorandum to which Winkelmann needed to pay close attention. Tr. 545.

On May 9, 2011, Winkelmann sent an email to Binkholder, with the subject line "Royalty Units" and the body of the message "We need more!" DX 44. Winkelmann testified that he was conveying to Binkholder that BOP "need[ed] more money from the issuance of the royalty units." Tr. 553-54.

On May 10, 2011, advisory client Mark Funfsinn emailed Winkelmann with questions about the royalty unit offering memorandum regarding residency requirements, legal advice, logistics of the transfer of funds to BOP, and option to purchase. DX 45. Winkelmann replied writing, "I understand the document is not perfect and I appreciate that you took the time to review." *Id.*

On May 17, 2011, Winkelmann sent an email to his advisory client Mike King, writing, "[i]f you are going to do the Royalty Unit you will need to get with Sara for the IRA paperwork. So far we have raised about $650,000 we are going to close the offering at the end of May." DX 50; Tr. 556. As of May 17, 2011, BOP had only received signed subscription agreements or funds totaling $425,000. DX 455.

2. Second Round Offering

BOP initiated the second royalty unit offering on March 10, 2012. RX 2; Tr. 659-60. Between March 29 and May 22, 2012, BOP issued fourteen royalty units, raising a total of $350,000, to ten investors, seven of whom were BOP advisory clients. FOF 8. Each royalty unit was offered in $25,000 increments, and granted the purchaser a minimum of 0.25% of BOP's monthly cash receipts until the investor had been repaid $62,500 (2.5 times the original investment). FOF 9. The explicit terms of the offering provided that there was no set timeframe within which the full repayment needed to be made. *Id.*

a. Offering Memorandum – March 10, 2012

In the second round offering, BOP sought to raise up to $350,000. RX 2 at 5. BOP planned to issue up to fourteen royalty units to outside investors, with each unit costing $25,000. RX 2 at 15. Each unit entitled the investor to receive no less than 0.25% of BOP's cash receipts on a monthly basis until the investor received a total of $62,500. *Id.*

The second offering memorandum contains a table showing how long it would take for investors to be paid back, depending on the percentage of monthly receipts paid by BOP, ranging from 0.25% to 1.50%. RX 2 at 6. For 0.25% royalty unit rate payouts, it would take 128 months, or 10.67 years, for investors to be repaid. *Id.* At the 1.50% payout, it would take 44 months, or 3.67 years, for investors to be repaid. *Id.*

Another table in the second offering memorandum shows payback timeframes based on the advertising factor (ranging from 0.50 to 0.90) and the monthly payment percentage of BOP's revenues (ranging from 0.25% to 1.50%). RX 2 at 17. Payout times based on the minimum payment percentage range from 108 to 132 months, or nine to eleven years, while payout times based on a 1.50% payout ranged from 39 to 46 months, or 3.25 to 3.8 years. *Id.* Winkelmann agreed that an investor would be unable to calculate their payout time for advertising ratios greater than 0.90. Tr. 674-75.

Similar to the first offering memorandum, the second memorandum disclosed the exclusive agreement with Binkholder and that BOP sponsored *The Financial Coach Show* and website and owned the leads. RX 2 at 10. Unlike the first memorandum, the second does not mention Binkholder's compensation from BOP. The memorandum explained that BOP would use "a substantial portion of the proceeds of this offering and future cash flows" to pay for advertising for both BOP and *The Financial Coach Show*. RX 2 at 12.

The second offering memorandum disclosed that BOP planned to use the royalty unit proceeds to expand its advertising reach, syndicate its sponsorship of Binkholder's radio program to other smaller markets around St. Louis, improve the creative aspects of the advertising message, and pay for general and administrative expenses. RX 2 at 6. It noted that other office locations were being considered and that the proceeds could be used to launch those offices. *Id.* at 7. BOP also disclosed that the proceeds could also be used "to fund other revenue-producing activities that are directly or indirectly related to [BOP's] business activities" and that these activities would need to have the potential for recurring revenues for BOP. *Id.* at 6-7.

The second offering memorandum also mentioned BOP's previous offering and stated that 6.25%, or $21,875, of the proceeds raised in the second offering would be paid to the first offering's unit holders. RX 2 at 15.

b. Communications about the Offering

On October 18, 2011, Winkelmann sent an email to Binkholder attaching BOP's financial statements. DX 70. Winkelmann wrote, "I am just a little worried! Our burn rate is higher than we want – the AUM is lower than we projected. We need to stop spending and start closing!" *Id.* Winkelmann was conveying to Binkholder that BOP's expenses were higher than anticipated and BOP's revenues were lower than anticipated. Tr. 560-61.

On October 20, 2011, Winkelmann emailed royalty unit investor and advisory client Jason Grau. DX 71; Tr. 563. In that email, Winkelmann presented positive information about BOP and represented that BOP "grew 14.5% for the quarter." DX 71. The email did not contain information regarding BOP's lower-than-projected AUM that Winkelmann and Binkholder discussed by email two days earlier. *Compare* DX 70, *with* DX 71; Tr. 563-64.

On February 27, 2012, Grau emailed Winkelmann and asked if his royalty unit "payback [is] going as you planned, if not what is being done for adjustments to get back on target." DX 104 at 2. Winkelmann replied that the "payments/revenue growth are a little behind projections but we are not worried revenues are steadily growing." *Id.* Winkelmann did not provide any additional negative information about BOP's finances. *Id.* Winkelmann testified that BOP's payments to royalty unit investors were not as high as projected, even before any regulatory investigations. Tr. 604-05.

3. Third Round Offering

Despite having serious health issues at the time, Winkelmann decided to proceed with the third round offering in September 2012. Tr. 689-91. For the third round offering, between September 20 and October 15, 2012, BOP issued eleven royalty units, raising a total of $275,000, to four investors, three of whom were BOP advisory clients. FOF 10. Each royalty unit was offered in $25,000 increments, and granted the purchaser a minimum of 0.10% of BOP's monthly cash receipts until the investor had been repaid $56,250 (2.25 times the original investment). FOF 11. The explicit terms of the offering provided that there was no set timeframe within which the full repayment needed to be made. *Id.*

Winkelmann stopped the third offering immediately upon learning that Binkholder was under federal criminal investigation in November 2012. FOF 58. At that time, more than a month had passed since the last third round investor had invested. DX 455.

a. Offering Memorandum – September 1, 2012

In the third round offering, BOP sought to raise up to $650,000. RX 3 at 3. BOP planned to issue up to twenty-six royalty units to outside investors, with each unit costing $25,000. RX 3 at 13. Each unit entitled the investor to receive no less than 0.10% of BOP's cash receipts on a monthly basis until the investor received a total of $56,250. *Id.*

The third offering memorandum contained a chart showing the payback times ranging from 133 months, or 11.08 years, for the minimum payout to 22 months for a 0.85% payout. RX 3 at 4. Another table shows payout timelines based on the advertising ratio (ranging from 0.50 to 0.90) and monthly payback percentage (ranging from 0.10% to 0.85%). RX 3 at 15. The chart reflected that in order to get paid back in three to five years, BOP would have to use a monthly payout percentage greater than 0.25% (more than twice the minimum percentage). *Id.*

The third offering memorandum contains similar disclosures regarding BOP's relationship with Binkholder as the second memorandum. *Compare* RX 3 at 8, *with* RX 2 at 10. The memorandum explained that BOP would use "a substantial portion of the proceeds of this offering and future cash flows" to pay for advertising for both BOP and *The Financial Coach Show*. RX 3 at 9.

The third offering memorandum disclosed that BOP planned to use the royalty unit proceeds to expand into the Chicago market, expand its advertising reach, syndicate its sponsorship of Binkholder's radio program to other smaller markets around St. Louis and Chicago, improve the creative aspects of the advertising message, and pay for general and administrative expenses. RX 3 at 4-5. It noted that other office locations were being considered in addition to Chicago and that the proceeds could be used to launch those offices. *Id.* at 5. BOP also disclosed that the proceeds could be used "to fund other revenue-producing activities that are directly or indirectly related to [BOP's] business activities" and that these activities would need to have the potential for recurring revenues for BOP. *Id.* at 5.

The third offering memorandum also mentioned BOP's previous offerings and stated that 10%, or $65,000, of the proceeds raised in the third offering would be paid to the previous offerings' unit holders. RX 3 at 12.

b. Communications about the Offering

On April 23, 2012, Winkelmann sent identical emails to the royalty unit investors. *See, e.g.*, DX 129-32; Tr. 677-78. In those emails, Winkelmann wrote that BOP "should again exceed our projections," followed by positive projections of BOP's AUM and revenue growth. DX 129-32. In the emails, Winkelmann apprised the investors that BOP was "planning another raise in royalty units in May (Round 3) for a potential new Blue Ocean branch office in Chicago." DX 129-32. The emails continue: "The majority of the proceeds are used to fund our advertising campaign which is a key component to our recurring revenue growth. Please let me know if you would like to review the Royalty Unit Round 3 material when it becomes available." DX 129-32.

On August 1, 2012, Winkelmann emailed advisory client Funfsinn, asking whether Funfsinn would like to review the upcoming third round royalty unit offering. DX 167. He wrote, "[s]imilar units issued last year have paid back the outside investors $4,961.95 so far. We are projecting the return for the IRR in our Royalty Units will be above 20% - all depends on how fast we grow."[4] *Id.*

On August 24, 2012, Winkelmann wrote identical emails that were sent to each of the royalty unit investors. Tr. 685-86. In addition to notifying each investor of his or her "payment summary report" for the royalty units, the email provides an update on BOP's AUM and projected AUM for the future and apprised investors of the upcoming third round royalty unit offering. DX 172. The email states: "Please let me know right away if you are interested in participating in this round as we have many prospective investors and will give preference to the current royalty holders." *Id.*

On October 2, 2012, Winkelmann sent separate emails to each royalty unit investor, and asked them if they were interested in investing in the third round royalty units. *See, e.g.*, DX 197-99. He wrote:

> So far we have brought in $325,000 of the $650,000 that we have planned. If we place the entire $650,000 each of your royalty units will receive an additional $1,625 from the issuance of this round. So, I am estimating your royalty check that will be issued in November will be approximately $2,000 per unit, including $1,625 from the round 3 placement and $400 from revenue based royalty share. Please let me know if you would be interested in seeing the round 3 offering or if you know of anyone interested in participating in our growth going forward – the units are $25,000 each.

DX 197-99.

On October 10, 2012, Winkelmann wrote a letter to William Jennings, which he sent to Jennings along with the third round offering materials. DX 203; Tr. 714. He represented that BOP had "raised $400,000 out of the $650,000 so far." DX 203. As of October 10, 2012, BOP had only received funds or signed subscription agreements totaling $250,000. DX 455.

4. Fourth Round Offering

In the fourth offering, BOP sought to raise up to $375,000. RX 4 at 3; Tr. 766-77. However, during the offering, which lasted from February 15 to 25, 2013, only two investors bought a total of $125,000 in fourth round units. Tr. 767; FOF 12. BOP issued twenty-five royalty units to the two investors, each of whom was also a BOP advisory client. FOF 12. Each royalty unit was offered in $5,000 increments, with a minimum purchase of five royalty units per investor, and granted the purchaser a minimum of 0.05% of BOP's monthly cash receipts until

[4] During the hearing, Winkelmann testified that the $4,961.95 figure was inaccurate and should have been $2,671.98. Tr. 682. He testified that he only later learned that the $4,961.95 figure was an error. Tr. 682.

the investor had been repaid $12,500 (2.5 times the original investment). FOF 13. The explicit terms of the offering provided that there was no set timeframe within which the full repayment needed to be made. *Id.*

Before Winkelmann could raise additional funds in the fourth round offering, he voluntarily agreed to the Missouri Securities Division's request that BOP stop issuing royalty units. Tr. 767-68, 770-71.

a. Offering Memorandum

The fourth offering memorandum was dated February 15, 2013. RX 4 at 1. In the fourth round offering, BOP sought to raise up to $375,000. RX 4 at 3. BOP planned to issue up to seventy-five royalty units to accredited outside investors, with each unit costing $5,000 and a minimum purchase of five units. RX 4 at 13. Each unit entitled the investor to receive no less than 0.05% of BOP's cash receipts on a quarterly basis until the investor received a total of $12,500. *Id.*

The memorandum contained a chart showing "months to payback" based on a 0.90 advertising ratio and a range of monthly payout percentages ranging from 0.05% to 0.30%. *Id.* at 4. The chart shows that if BOP kept payments to the minimum 0.05%, investors would be repaid in 176 months, or 14.67 years. *Id.* The chart further reflects that if investors were to be paid back in five years, BOP would need to pay at least four times the minimum monthly percentage. *Id.* The memorandum contains another chart showing "Months to Payback" based on advertising ratios ranging from 0.50 to 1.30 and monthly payout percentages ranging from 0.05% to 0.30%. *Id.* at 15. According to that chart, if an investor was going to be paid back in five years, BOP would need to quadruple the minimum monthly payout percentage and keep the advertising ratio at 0.50 or better. *Id.*

The fourth round offering memorandum explained that BOP had terminated its third round offering after learning of the federal subpoena and State of Missouri investigation and had only been able to raise $275,000 out of a planned $650,000. RX 4 at 5. As a result, BOP was experiencing a cash shortage, and up to $19,100 of the fourth round proceeds would be used to pay BOP's rent and payroll. *Id.* The memorandum warned that if BOP failed to raise at least $50,000 before March 1, 2013, it would have a four to five week gap in funding and there could be consequences, including the inability to fully fund advertising and staff in both the St. Louis and Chicago offices. *Id.* BOP needed at least $200,000 to fully fund St. Louis and at least $375,000 to adequately fund both St. Louis and Chicago. *Id.*

The fourth offering memorandum also mentioned BOP's previous offerings and stated that 11.7%, or up to $43,500, of the proceeds raised in the fourth offering would be paid to the previous offerings' unit holders. RX 4 at 12.

The fourth round memorandum disclosed that it no longer sponsored *The Financial Coach Show* or Binkholder. RX 4 at 9. Instead, BOP's offering proceeds would go toward a new radio show and other advertising. *Id.* The memorandum explained Binkholder's relationship with BOP as a "member" and "advisory representative" from September 2009 through March 2011, when his membership was terminated. *Id.* at 16. After that, Binkholder's relationship with BOP continued with BOP's sponsorship of his radio program. Also, Binkholder retained office space at BOP. *Id.*

The fourth offering memorandum disclosed a risk of regulatory enforcement issues due to the State of Missouri's investigation into Winkelmann and BOP and a risk of material adverse effects to BOP as a result of that investigation. RX 4 at 16-17. For the first time, BOP disclosed that on December 29, 2011, the Missouri Secretary of State and the Missouri Division of Securities entered into a consent order with Binkholder that prohibited him from acting as an agent or investment adviser representative in Missouri and levied certain fines based on a finding that Binkholder did not disclose to investors potential conflicts of interest and had allegedly commingled investor funds. *Id.* at 16. It also disclosed the fact that in November 2012, federal grand jury subpoenas had been served on the custodian of certain royalty units that were issued in the second offering as part of an investigation into Binkholder. *Id.*

b. Communications about the Offering

Winkelmann provided the fourth offering memorandum to three prospective investors, each of whom had previously purchased royalty units in prior offerings: Bryan Swift, Mike Ursch, and Carrie Gamache. FOF 59.

On December 1, 2012, BOP client and royalty unit investor Ed Mahoney asked Winkelmann about the performance of his royalty unit investment. DX 210; Tr. 716-18. At that time, Mahoney had only been repaid $3,778.54 on his first round investment and $1,870.09 on his second round investment, and BOP still owed him over $131,000. DX 210. In addition to inquiring about the status of his royalty unit investment, Mahoney asked about how he could sell his units if he wanted to. Tr. 719. In response Winkelmann wrote:

> I want to emphasize that there is not market for the royalty units that you purchased in your IRA. However if you would like I would attempt to find a buyer for your existing units – of course there would be no guarantee that I could find a buyer or that the terms would be favorable to you. I have no way of knowing what the offer would be and would only be in a position to convey to you the terms of any offer – if and only if an offer would surface.

DX 210. Winkelmann did not inform the fourth round royalty unit investors – BOP clients Swift and Gamache – that Mahoney had asked about selling his royalty unit. Tr. 721-23. Winkelmann testified that Mahoney did not respond to his offer to find a buyer. Tr. 724-25.

On December 12, 2012, Winkelmann emailed Swift and attached BOP's financial projections for 2013. DX 211. Those projections showed BOP running out of money by February 2013 if no changes were made and the business continued its advertising spending at the current rate. *Id.* at 3. Winkelmann wrote, "I need to come up with a deal – I am hesitate [sic] to go back to some of the investor/clients with bad news – need to be careful not to start any rumors." *Id.* at 1. Winkelmann testified that in the face of these projections, BOP made significant reductions to expenses. Tr. 731. Winkelmann agreed that Swift was different than the other royalty unit investors in that Swift was provided access to important information about BOP that the other investors were not. Tr. 731-32.

By January 30, 2013, Winkelmann was informing prospective investors about the fourth round offering and asking them if they would like to receive offering materials. DX 234.

On May 20, 2014, royalty unit investor Ed Mahoney emailed Winkelmann, writing:

> [D]o you have an idea of how much money you will need before the royalties [are] paid in full. I will turn 74 this year. . . . [I]t looks like the amount in royalties paid to me is a thousand dollars for the quarter which would be four thousand a year . . . I think I have about 120 thousand coming at 4 thousand a year that would be thirty years.

DX 302. Mahoney wrote this email before the start of the Division's investigation. Tr. 825.

D. Advertising Ratio

BOP's advertising ratio – also known as the advertising rate, advertising factor, conversion rate, conversion ratio, and advertising yield – was a very important metric for BOP. Tr. 447-48; RX 1 at 9. Stated simply, BOP's advertising ratio represents the relationship between the amount BOP spent on advertising over a fixed period and the new recurring revenue – which is a percentage of new investment advisory assets under BOP's management – that resulted during that period, or from that advertising. Tr. 471-72, 476-77, 1457-58. So, for example, if each $2,000 BOP spent on advertising in 2011 resulted in $10,000 of new recurring annual revenue, the advertising ratio for that 2011 spending would be 0.2 (derived by dividing $2,000 by $10,000). Logically, the lower the advertising ratio, the better for BOP and more attractive to royalty unit investors, because a lower ratio denotes advertising spending that generates greater proportionate revenue, while the higher the advertising ratio, the less desirable. If the advertising ratio were 1.0 or greater, it would denote the generation of less new recurring revenue than the amount spent on advertising. Winkelmann repeatedly represented to royalty unit investors that the advertising ratio was the "key factor" or "key driver" for BOP's business. Tr. 448-49. BOP devoted significant resources to continuous and meticulous tracking of its advertising ratio. Tr. 449, 463-64, 861-63, 1292.

Throughout the course of the investigation and administrative proceeding, Respondents' position on how the advertising factor was calculated has changed. During the Division's investigation, Winkelmann testified that BOP calculated the advertising ratio that BOP disclosed in the offering memoranda by dividing (a) total advertising spending for a given period by (b) the amount of new recurring revenue that BOP generated during that same period. Tr. 449-50, 1450. During his investigative testimony, Winkelmann could not explain the discrepancies between the advertising ratios disclosed in BOP's offering memoranda and the ratios presented to him by the Division that were calculated using BOP's financial records.[5] DX 159; Tr. 72, 1447; *see also* Tr. 1177-78.

[5] The Wells Notice, issued after the completion of the investigation, did not mention the advertising factors contained in the offering memoranda. DX 341. Winkelmann's Wells

During the hearing, Winkelmann claimed that his investigative testimony was inaccurate. Tr. 453-54. He testified that he did not anticipate being asked about the advertising ratios during his investigative testimony. Tr. 453. However, more than four months prior to Winkelmann's investigative testimony, BOP received a Commission subpoena for nine categories of documents, one of which was for: "All Documents that support or tend to support the 'advertising conversion factor' (also referred to as the 'factor' or 'advertising factor') referenced in each of the Blue Ocean Certificate of Royalty Units offering memoranda." DX 309 at 8-9 (of 9 PDF pages).

After stating at the hearing that his investigative testimony was incorrect, Winkelmann initially testified that the numerator of the advertising ratio was revenue. Tr. 455. After a lot of confusion on Winkelmann's part, he later testified that revenue was the denominator of the advertising ratio. Tr. 455-58. He testified that the numerator component of the advertising ratio was advertising spending. Tr. 458, 460, 467-68. Winkelmann testified that advertising includes "messaging to entice an individual to take action," including BOP's sponsorship of a radio show. Tr. 491. Winkelmann elected to exclude BOP's direct payments to Binkholder for his activities, including his radio show, to promote BOP. Tr. 491-95. Winkelmann did so without consulting an accountant, Internal Revenue Service instructions, or the Financial Accounting Standards Board; he did it "with intuition." Tr. 494-95. By contrast, BOP treated as advertising expenses both the payments BOP made directly to another one of its paid spokesmen, radio show host Charlie Brennan, and the payments made to KMOX, the radio station which aired Brennan's show. DX 86; RX 1 at 8; RX 2 at 10; Tr. 1298. Winkelmann acknowledged that had BOP included such Binkholder payments in the advertising ratio calculations, the factor would have increased. Tr. 493-94.

Winkelmann ultimately testified that the denominator component of the ratio was new recurring revenues that resulted from a period of advertising, as opposed to new revenues generated during the period of the advertising. Tr. 471-72, 476-77, 1457-58. Winkelmann agreed that he did not describe this method during his investigative testimony. Tr. 472, 477. This explanation of how BOP calculated the advertising ratio – using revenues resulting from a period of advertising – is a method described in Respondents' prehearing brief, expert report, and post-hearing brief. Tr. 1125-26, 1459-60; Resp. Prehr'g Br. at 2; RX 125 at 7; Resp. Br. at 4, 22. According to Winkelmann, BOP could calculate the ratio using multiple "look back" periods of spending. Tr. 467-69. Winkelmann agreed that the longer the period of advertising BOP looked back at to calculate the advertising ratio, the more reliable the ratio would be. Tr. 485-86.

Notwithstanding the importance of the advertising ratio to BOP, up to and including the time of the hearing, for the preceding reasons, and the reasons that follow, I find that Winkelmann exhibited an incomplete, imperfect understanding of how the advertising ratio was calculated. Winkelmann's subordinate, Jennifer Juris,[6] calculated the advertising ratio in a variety of ways, and from the ratios that she calculated, as reflected below, Winkelmann

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submission did not specifically address how BOP calculated the advertising ratios presented to investors. DX 345, 346; Tr. 1451.

[6] Jennifer Juris is also known as Jennifer Elbert. In this initial decision, I will refer to her as Juris.

typically selected or included a ratio that reflected most favorably on BOP in its offering memoranda and written communications with investors.[7] Tr. 967, 972, 980-82; DX 176.

One of Juris' responsibilities at BOP was to monitor and analyze its advertising spending and results. Tr. 863-64. One of the documents that Juris maintained at BOP was a "master tracking sheet," which recorded, among other things, the date when a client heard a piece of advertising, when a client transferred funds for BOP to manage, and the size of the client's account at the time it was transferred to BOP. RX 6; Tr. 863, 865-68. Starting in January 2012, Juris also maintained an advertising spending report, which tracked (a) advertising spending for certain months, (b) the amount of new AUM generated *as a result of* a given month's advertising, and (c) the amount of new AUM generated *during* a given month of advertising. Tr. 873, 876-77, 889, 942-45; *e.g.*, RX 36 (monthly report for February 2012). When asked whether Winkelmann or Juris had the more accurate account of how BOP calculated the advertising ratio, Winkelmann testified that Juris' account was more accurate. Tr. 1461-62.

In advance of the hearing in this matter, the Division asked Michael Collins, a staff accountant with the Commission, in the capacity of a summary witness, to calculate BOP's advertising ratios using BOP internal financial information. Tr. 55-56, 71, 88, 96, 101, 104; DX 440-44. For any given time period, Collins calculated the ratio by dividing BOP's advertising spending during that period by the new recurring annual revenues generated during that period. Tr. 72-73:3. Collins believed this methodology was consistent with the methodology Winkelmann described during his investigative testimony, which Collins attended. Tr. 73-77.

The Division's calculations, based on data compiled during 2012, rely on at least some data BOP did not have prior to that time.[8] Tr. 85, 92, 98-99, 103-04, 106; *see* DX 159, 396. As a result, Respondents object to Collins' calculations. Resp. Br. at 18-27.

1. Advertising Ratio in the Four Royalty Unit Offerings and Related Correspondence

The primary means by which Winkelmann disclosed BOP's advertising ratio to prospective investors was in the four offering memoranda that he issued to sell BOP royalty

[7] For instance, by the time of the fourth offering memorandum, BOP's monthly report produced three advertising factors. *See* RX 120. Factor One was calculated based on the revenue brought in by the leads generated during that month, Factor Two was calculated based on all revenue brought in during the month from new clients based on when they signed their account papers, and Factor Three was calculated based on all revenue brought in for new clients' assets that were transferred to BOP during that month. Tr. 904-06, 967-68.

[8] DX 159 was created in June 2012. Tr. 919-20, 928; *compare* DX 159, *with* RX 54 at 5474. Although Winkelmann testified that DX 159 was the type of document that BOP used to track the advertising ratio, in the spring of 2012, BOP changed its fee assumption from 1.0% to 0.77% in calculating its estimated revenues. Tr. 487-89, 926-28. Data compiled after this change would be different from the data compiled before this change. Tr. 928-29.

units. Winkelmann alone decided what financial information – including the advertising ratios – to disclose to investors in the offering memoranda. Tr. 940-42. In the offering memoranda and promotional correspondences, BOP did not disclose its method for calculating the advertising ratio beyond stating some advertising expenditure and the approximate AUM and revenues resulting therefrom. Tr. 484-85, 756; *see also* RX 1-4.

a. First Offering

On February 16, 2011, Winkelmann wrote a letter to Scottrade, Inc., CEO Roger Riney, which described the royalty unit investment and asked if Riney would be interested in investing. DX 7. Winkelmann's letter to Riney also stated: "We are spending about $2,200 to land $1 million in new AUM that generates approximately $9,000 in recurring annual revenue." *Id.*

By contrast, BOP's first offering memorandum, dated March 31, 2011, represented that "each $1 million in AUM generates roughly $8,000 in new recurring annual revenues."[9] RX 1 at 1, 5. It stated that since June 2010, BOP's advertising and sales system had been generating about $2 million in new AUM per month, with total AUM as of March 24, 2011, at approximately $40 million, which generated $320,000 in recurring annual revenue. *Id.* at 5. The first round memorandum also represented that BOP was spending approximately $5,500 per month on advertising, which was generating $25,000 in new annually occurring revenue and that "if this trend continues, each $10,000 in new recurring revenue will cost Blue Ocean Portfolios $2,200 in advertising - a 22/100 ratio." *Id.* at 9. Winkelmann testified that BOP based the 0.22 ratio on new recurring revenues generated during the month of February 2011. Tr. 519-21. Respondents' post-hearing brief further explains Winkelmann's testimony, stating that the 0.22 ratio cited in the first offering memorandum was calculated by taking the approximate average per month in advertising spending from June 2010 through February 2011, and dividing it by an approximation of BOP's most current revenue data, which was as of February 2011. Resp. Br. at 7-9. From June 2010 through February 2011, BOP spent, on average, $5,178.93 and brought in $21,314 in new revenue in February 2011, yielding an advertising factor of 0.24.[10] DX 159 (1% of new AUM $2,131,408); RX 8, 22, 23. Respondents also state that this calculation was backed up by BOP's own internal data for January. Resp. Br. at 9 (dividing January's advertising spending ($3,024) by January's estimated revenue based on new AUM ($13,514) yields a factor of 0.22).[11] However, using Respondents' same methodology for February 2011 results in an

[9] The memorandum explained that BOP's gross annual revenue from new retail accounts was 1% on the first $500,000, 0.75% on amounts between $500,000 and $1 million, and 0.50% on amounts over $1 million. RX 1 at 5.

[10] Respondents approximated $5,500 in advertising spending per month and $25,000 in new revenue. Resp. Br. at 8-9.

[11] According to DX 159, January's new AUM was $1,351,432. Although DX 159 states that $10,406 was estimated to be generated from that new AUM, as discussed *supra*, in spring of 2012, the fee assumption was changed from calculating 1% of AUM to .77% of AUM. One percent of $1,351,432 is approximately $13,514.

advertising ratio of 0.47, over twice as high as the 0.22 factor. DX 159 ($10,054 February advertising spend divided by $21,314 (1% of $2,131,408)).

In a subsequent section of the first offering memorandum, BOP represented that: "[t]he current conversion rate is $2,200 per $1mm. So currently each $2,200 spent in advertising is converting to new annual renewable revenue of $8,000." RX 1 at 11. Winkelmann agreed that $2,200 divided by $8,000 is approximately 0.28, which is different from the 0.22 advertising ratio disclosed earlier in the memorandum. Tr. 523-24.

The first offering memoranda also represented: "the key business driver will be the ability of management to persistently convert advertising spending to new clients and new recurring revenues at a ratio of less than 4/10. Higher conversion ratios will cause the payback period to be drawn out lowering investor returns." RX 1 at 13; Tr. 531.

Collins prepared DX 440, a summary exhibit, which compares the 0.22 advertising ratio disclosed in the first offering memorandum to Collins' calculations of the ratio using advertising and revenue data: (1) from January 2010 to March 2011, (2) from January 2011 to March 2011, and (3) for March 2011. DX 440; Tr. 86-87. Collins used the 2010 advertising spend and annual revenue data contained on BOP's 2010 Profit and Loss (P&L) statement, DX 35. Tr. 72, 82. The 2010 advertising spend data on DX 35 is consistent with the 2010 advertising spend data on BOP's 2010 "Advertising Transaction Detail by Account" report, RX 8. Tr. 82-83. For DX 440, Collins used the advertising spending and revenue data for the first three months of 2011 contained in DX 159. Tr. 72, 85. Based on the 2010 data contained in BOP's P&L statement and the 2011 data contained in DX 159 (which was created in 2012 based on different data than what was used by Winkelmann in 2011, *see supra*), Collins calculated BOP's advertising ratio for January 2010 to March 2011 to be 0.37, its ratio for January 2011 to March 2011 to be 0.44, and its ratio for March 2011 to be 0.37. DX 440. According to Collins' analysis, when compared to the most conservative of these numbers (0.37), the 0.22 ratio cited in the first offering memorandum was overstated by 67%. *Id.*; Tr. 87.

Recalculating Collins' figures to account for the 1% management fee assumption used before spring of 2012, *see supra*, yields the following advertising ratios. BOP's recalculated advertising ratio for January 2010 to March 2011 is 0.34, its ratio for January 2011 to March 2011 is 0.34, and its ratio for March 2011 is 0.28.[12] When compared to the most conservative of these numbers (0.28), the 0.22 ratio cited in the first offering memorandum was overstated by 27%.

On April 25, 2011, Winkelmann sent an email to potential royalty unit investor Dan Bean that stated, in part:

[12] January 2010 to March 2011: $60,340.41 in advertising spend divided by $175,088.12 in revenue. January 2011 to March 2011: $18,685 in advertising spend divided by $54,636.38 in revenue. March 2011: $5,607 in advertising spend divided by $19,807.98 in revenue.

> Last quarter our assets under management increased $11 million. The new recurring annual revenue that will be realized from these new assets is about $100,000. We spent approximately $22,000 last quarter in advertising to generate this new business. So we are investing 22 cents and getting back 1 dollar in recurring revenue.

DX 32. Winkelmann agreed that he was referring to the first quarter of 2011, which had ended at the time of his email. Tr. 544.

On May 3, 2011, Winkelmann wrote a letter to advisory client Mark Funfsinn advising him of the royalty unit offering. DX 40; Tr. 546. Winkelmann's letter to Funfsinn stated: "We are spending about $2,500 to land $1 million in new assets that generate approximately $8,000 in recurring annual revenue." DX 40. $2,500 divided by $8,000 results in an advertising ratio of 0.31, which differs from the 0.22 ratio disclosed in the first offering memorandum of March 31, 2011. Tr. 547-48; *compare* RX 1 at 9, *with* DX 40. Winkelmann testified that the figures contained in the email to Bean and the letter to Funfsinn came from BOP's financial records that were available at the time. Tr. 1367-68.

On December 20, 2011, Winkelmann sent an email to Binkholder with the subject line: "Blue Ocean Cash Projections." DX 83. Winkelmann wrote:

> We are going to end the year with about $230,000 cash. Since June 1st we have spent $502,000 and the AUM have increased by $20 million. On an annualized basis that means that we will have spent $1 million to increase AUM by $40 million. Or in other words we will have spent $3.14 in total expenses on every $1.00 in recurring revenue. From just the advertising expense perspective we would have spent a total $164,000 since June or annualized amount of $328,000. So we are spending approximately $1.03 in advertising on every $1.00 in new recurring revenue. Of course this is at least twice as high as we projected last winter. The result is at this pace we are approximately $250,000 under capitalized and will run out of cash in April or May. If we want to put real salaries of $10,000 each into the mix for next year then of course the number is much higher – more like $575,000 under capitalized.

Id. Winkelmann's email to Binkholder presented two options. The first was reducing total monthly expenses by $18,000. *Id.* Winkelmann wrote, "[t]his would mean cutting advertising and general office expenses. Basically watching every penny spent – which means probably cutting the $2,000 per month that we each get.....more pain and suffering!" *Id.* (ellipsis in original). At the time of the email, Winkelmann and Binkholder were each receiving $2,000 per month from BOP. Tr. 584. The second option was:

> Raise additional $1.8 - $2.0 million in capital for the general purpose of funding the Chicago office. This may be more work but also more reward since the pro-forma would include at least $8,500 for each of us each month. This would be a bonanza if we could get the new AUM cost per million down to $6,500 per million over both offices from the $10,000 per million that we are spending now.

DX 83. Winkelmann testified that of the two options, it would be better for him to receive $8,500 per month as opposed to $2,000 per month. Tr. 586. He further testified that the "bonanza would be for the AUM conversion" and "not for us individually." Tr. 586. Winkelmann concluded, "I figure we should be bold and raise Blue Ocean Royalty 2 with a conversion rate of 2.25x." DX 83.

Contemporaneous financial materials relay BOP's advertising expense summary from June through November 2011 and contain an "Action Plan" of reducing monthly advertising spending by $7,000 and increasing Winkelmann's and Binkholder's monthly compensation by $8,000, to $10,000. DX 395 at BO 5317; Tr. 590-92.

On January 20, 2012, Winkelmann sent an email to royalty unit investor James Zenner. DX 91; Tr. 593. In that email, Winkelmann stated:

> In 2011 we spent $214,000 in advertising and increased the AUM by $24 million which equals approximately $240,000 in new recurring revenue. So [for] each $0.89 in advertising spent returned $1.00 in new <u>recurring</u> annual revenue. If you recall from our business plan last March, we were projecting a much more favorable conversion of approximately $0.30 in spending for each new dollar in recurring revenue.

DX 91. Winkelmann also wrote that he had decided to lower BOP's monthly advertising spending by $7,000, from $19,000 to $12,000 per month. *Id.*

On January 27, 2012, Winkelmann emailed Juris, asking her to keep a "running line chart that tracks monthly add spend v monthly conversion factor." DX 94. He added, "[t]he lower we get that conversion factor the better." *Id.*

On February 8, 2012, Ed Mahoney – a royalty unit investor, BOP advisory client, and Winkelmann's relative through marriage – emailed Winkelmann and asked whether his royalty unit investment's growth "depend[ed] on you getting more customers" and whether "the worth of your company grow[s] any way other than new customers." DX 97 at 878; Tr. 597. Winkelmann replied that "[l]ast year we spent $0.78 in advertising to obtain $1.00 in recurring revenue" and "[s]o far this year we have spent $0.56 to obtain a new $1.00 in recurring revenue." DX 97 at 877. Winkelmann conveyed to Mahoney that BOP's advertising ratio for 2011 was 0.78. Tr. 599. He also explained that BOP's revenues depend on its AUM, the royalty unit investor's rate of return depends on how fast the revenues grow, and the bulk of investor returns would be in years three to five, when AUM is projected to be $150 to $200 million. DX 97.

b. Second Offering

On February 22, 2012, Winkelmann emailed Zenner, asking him if he wanted to review the second royalty unit offering. DX 102. In that email, Winkelmann wrote, "[i]n 2011 we spent an average of $0.78 in advertising to generate $1.00 new dollar in recurring revenue," which is an advertising ratio of 0.78. *Id.*; Tr. 603.

On March 7, 2012, Winkelmann emailed Sara Meystadt and Juris edits and comments he had made for the second round offering memorandum. DX 110. A comment on the document pointed out that the advertising yield factor for 2012 was a different number than it had been "earlier." *Id.* (0.59 factor versus a 0.50 factor); Tr. 608-09.

The second offering memorandum, dated March 10, 2012, stated: "In 2011, this [advertising] 'factor' was 0.79. Or in other words, Blue Ocean Portfolios spent $0.79 in advertising to buy $1.00 in new recurring annual revenue." RX 2 at 1, 5. Later in the memorandum, BOP represents that the advertising yield factor "is the key driver" of BOP's model and that in 2011, the factor was 0.78 and so far in 2012, the factor had dropped to 0.62. *Id.* at 16. According to the memorandum, BOP's advertising and sales system had been generating at least $2 million in new AUM per month, with total AUM growing at a rate of 20% per quarter to approximately $65 million, with annual recurring revenue of about $506,000.[13] *Id.* at 5. The memorandum also states that during 2011 BOP spent $328,000 in advertising that resulted in $204,000 in new annually occurring revenue and currently BOP was spending approximately $15,000 per month in advertising, which was converting to approximately $2.42 million in new assets that generated $24,200 in new annual recurring revenue. *Id.* at 5, 13 ("[R]ecurring annual revenues increased from approximately $200,000 at the end of 2010 to $404,000 at the end of 2011."). Winkelmann was unable to explain how BOP arrived at the 0.79 advertising ratio for 2011 in his investigative testimony, prehearing brief, expert report, or post-hearing brief. Tr. 664-65; *see* Resp. Br. at 13-15. At the hearing, Winkelmann testified that BOP calculated this factor by dividing its advertising spending for the year of 2011 by new recurring revenue that resulted from, or could be traced to, the 2011 advertising. Tr. 661-63. However, $328,000 in advertising divided by $204,000 in new annually occurring revenue equals a factor of 1.61.

BOP additionally represented in the second offering memorandum: "the key business driver will be the ability of management to persistently convert advertising spending to new clients and new recurring revenues at a factor of less than 0.80. Higher conversion ratios will cause the payback period to be drawn out, thus lowering investor returns." RX 2 at 17. Winkelmann agreed that BOP did not disclose to second round investors that in the first offering memorandum, BOP had represented that the key driver to its business was keeping the advertising ratio below 0.40. Tr. 676-77.

According to Juris, BOP's advertising spending report for February 2012, RX 36, created during the first week of March 2012, was the most recent report available at the time of the second offering memorandum. Tr. 873, 912. That report calculated the advertising factor for any given month by dividing the advertising expenses for the month by the amount of recurring annual revenues from new AUM generated *during* that month. RX 36; Tr. 873-75, 878, 945-46. The report determined the amount of annual revenues by multiplying the new AUM generated in

[13] The memorandum explained that gross annual revenue from new accounts was 1% on the first $500,000, 0.75% on the next $500,000, and 0.50% on the balance in excess of $1 million. RX 2 at 5. Institutional investors received an even more beneficial fee structure based on the size of the account. *Id.*

a given month by 0.01, which assumed a 1% management fee, not a 0.8% management fee. Tr. 879, 937-39. For the February 2012 report, the advertising factor (based on revenues generated during the month of advertising) for February 2012 was 0.67, for January 2012 it was 0.74, for December 2011 it was 1.02, and for November 2011 it was 1.45. RX 36. Using the February 2012 report, for the December 2011 through February 2012 period, the factor was 0.79.[14] *See* RX 36. Juris testified that had BOP calculated the February 2012 monthly factor using revenues resulting from February 2012 advertising, the factor would have been 1.76. Tr. 948.

Collins prepared summary exhibit DX 441, which compares the 0.78 advertising ratio for 2011 disclosed in the second offering memoranda (and repeated in the third and fourth offering memoranda) to Collins' calculations of the ratio using BOP's advertising and revenue data for 2011 contained in DX 159. Tr. 88-89, 92. The 2011 total advertising spending amount on DX 159 ($230,957) is within one dollar of the 2011 yearly advertising spending ($230,958) contained on (a) RX 18, a BOP "2011 Advertising Analysis" spreadsheet, and (b) DX 86, a chart breaking down BOP's advertising spending by month and category.[15] *Compare* DX 159, *with* RX 18, *and* DX 86. Based on the 2011 advertising spending and revenue data contained in DX 159, Collins calculated BOP's 2011 advertising ratio to be 1.28. DX 441. According to Collins' analysis, when compared to that figure, the 0.78 ratio in the offering memoranda was overstated by 64%. *Id.*; Tr. 96. Collins also calculated BOP's advertising factor by including the payments BOP made to Binkholder in 2011 with the advertising spending contained in DX 159. DX 441. Collins determined that including the Binkholder payments results in a 2011 advertising factor of 1.46. *Id.* According to Collins' analysis, compared to that figure, the 0.78 ratio cited in the offering memorandum is overstated by 87%. *Id.*; Tr. 96. Recalculating Collins' figures to account for the 1% management fee assumption used before spring of 2012, *see supra*, yields an advertising ratio of 0.98 for 2011.[16] When compared to the ratio of 0.78, the ratio cited was overstated by approximately 26%. Recalculating Collins' Binkholder advertising ratio using this data yields a ratio of 1.12; when compared to the ratio of 0.78, the 0.78 ratio was overstated by approximately 44%.[17]

Collins also prepared summary exhibit DX 442, which compares the 0.62 "current" advertising ratio disclosed in the second offering memorandum to Collins' calculations of the ratio using advertising and revenue data (1) from March 2011 through February 2012, (2) from December 2011 through February 2012, and (3) for February 2012. DX 442; Tr. 96-97. In making these calculations, Collins used BOP's 2011 advertising and revenue data contained in

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[14] Divide total advertising spend of $58,689.49 by total revenue of $74,430.

[15] Similar to DX 159, DX 86 was not created in 2011. DX 86 is part of a series of documents produced to the Commission in response to Item 4 of the subpoena served by the Commission during the 2013 examination. *Compare* DX 86, *with* DX 395 at 5329; *see* DX 395 at 5300.

[16] One percent of $23,467,801 is $234,678. Advertising spend for 2011 of $230,957 divided by 2011 annual revenue of $234,678 is 0.98.

[17] The advertising spend for 2011, including payments to Binkholder, of $263,132.44 divided by 2011 annual revenue of $234,678.01 is 1.12.

DX 159, and used the 2012 data contained in DX 396 at page 5639. Tr. 98-99. Based on Collins' calculations, BOP's advertising ratio was 0.90 for February 2012, 0.96 for December 2011 through February 2012, and 1.28 for March 2011 through February 2012. DX 442. According to Collins' analysis, using the most conservative of these numbers (0.90), the 0.62 ratio contained in the second offering memorandum was overstated by 46%. *Id.* Collins also calculated these numbers including BOP's payments to Binkholder and found that BOP's advertising ratio was 1.27 for February 2012, 1.16 for December 2011 through February 2012, and 1.48 for March 2011 through February 2012. *Id.* Using the most conservative ratio (1.16), the 0.62 ratio was overstated by 87%. *Id.*

c. Third Offering

On August 9, 2012, Juris emailed Winkelmann about the third round royalty unit offering materials. DX 169. She wrote:

> Exhibits should all be updated to reflect round 3 figures and/or updated versions of documents. The executive summary is saved in there as well. The only thing that needs to be updated on that is the 'factor' number used throughout the document. It references .62 and .51. The Acquisition Cost photo you have included shows .64 as the factor for May and .51 for June. We just need to be consistent on whatever number we use in the document.

Id.; Tr. 683. The final third round offering memorandum did not reference either a 0.62 or a 0.51 current advertising factor. *See* RX 3.

In the third round offering memorandum, dated September 1, 2012, BOP represented that the current advertising factor was 0.67, "[o]r in other words, Blue Ocean Portfolios spends $0.67 in advertising to buy $1.00 in new recurring annual revenue." RX 3 at 3. Winkelmann testified that the factor would be different depending on the current month used to calculate the factor. Tr. 693. Winkelmann agreed that the third memorandum does not disclose a change in the method used to calculate the advertising ratio or that the advertising ratio could differ based on the particular "snapshot" in time used to calculate the factor. Tr. 695-97, 706.

The third round offering memorandum stated that BOP's advertising and sales system had been generating at least $2.8 million in new AUM per month, with total AUM growing at a rate of 18.50% per quarter to approximately $85 million, with annual recurring revenue of about $675,000.[18] RX 3 at 3. Later in the third memorandum, BOP represented that:

> Blue Ocean Portfolios is spending approximately $15,000 per month on advertising which . . . is converting to approximately $2.8 million in new assets that are generating $31,000 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising - a 67/100 ratio or an "advertising conversion factor" of 0.67.

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[18] BOP disclosed the same fee structure for non-institutional investors as it had in the second offering memorandum. RX 3 at 3.

Id. at 11. However, $15,000 divided by $31,000 equals 0.48, as opposed to 0.67. *See* Tr. 703. Also similar to the second memorandum, the third memorandum represented that the advertising yield factor "is the key driver of the Blue Ocean Portfolios model. This advertising factor for 2011 was 0.78." RX 3 at 13.

BOP's July 2012 advertising spending report was generated in early August 2012, and was available to BOP when the third round offering memorandum was being prepared. RX 54 at 62-75; Tr. 898, 913. The July 2012 report, like the February 2012 report, tracked (a) advertising spending for certain months, (b) the amount of new AUM generated *as a result of* a given month's advertising, and (c) the amount of new AUM generated *during* a given month of advertising. RX 54 at 63; Tr. 900-01. The July 2012 report calculated the monthly factor in the same way the February report did: advertising spending for a month divided by anticipated new annual revenues generated during that month. RX 54 at 63; Tr. 901 That report also included "[t]railing 6-month" factors, which were calculated in two ways: (1) by finding the average of the advertising factor (adding up six months of factors and dividing by six); and (2) the geometric mean factor, which was a complicated calculation done through an excel formula. RX 54 at 63; Tr. 901-03. For the July 2012 report, the factor for July 2012 was 3.0, the trailing 6-month (January-June) average factor was 0.71, and the trailing 6-month (January-June) geometric mean factor was 0.69. RX 54 at 63. Winkelmann did not include any of these factors in the third offering memorandum. RX 3 at 3, 11, 13. The July 2012 data contained in the August 2012 advertising report was the most recent monthly report BOP had available at the time the third offering memorandum was prepared, but BOP had continuous access to the firm's actual data and could calculate the factor at any time. Tr. 909-10.

Collins prepared summary exhibit DX 443, which compares the 0.67 "current" advertising ratio disclosed in the third offering memorandum to Collins' calculations of the ratio using advertising and revenue data (1) from September 2011 through August 2012, (2) from June 2012 through August 2012, and (3) for August 2012. DX 443; Tr. 101. In making these calculations, Collins used BOP's 2011 advertising and revenue data contained in DX 159, and used the 2012 data contained in DX 396 at 5639. DX 443; Tr. 102-03. Juris testified and Winkelmann confirmed that the entirety of the data on DX 159 would have been available to Winkelmann when BOP was preparing the third offering memorandum. Tr. 488-89, 953.

Based on Collins' calculations, BOP's advertising ratio was 1.02 for August 2012, 0.77 for June 2012 through August 2012, and 1.02 for September 2011 through August 2012. DX 443. According to Collins' analysis, using the most conservative of these numbers (0.77), the 0.67 ratio contained in the third offering memorandum was overstated by 14%. *Id.*; Tr. 104. Collins also calculated these numbers including BOP's payments to Binkholder and found that BOP's advertising ratio was 1.47 for August, 1.25 for June 2012 through August 2012, and 1.19 for September 2011 through August 2012. DX 443. Using the most conservative ratio (1.19), the 0.67 ratio was overstated by 78%. *Id.*; Tr. 104. Collins' calculation of the advertising ratio for July 2012 was 0.63. DX 443. Recalculating the three- and twelve-month calculations to end in July 2012, the data available at the time the third round offering memorandum was being drafted yields an advertising factor of 0.61 for May through July 2012 and 0.87 for August 2011 through July 2012. *See id.*

d. Fourth Offering

The fourth round offering memorandum, dated February 15, 2013, represented:

> for . . . 2012 the [advertising] factor was 0.89%. Or in other words, Blue Ocean Portfolios spent $0.89 in advertising to "buy" $1.00 in new recurring annual revenue. In 2012 Blue Ocean Portfolios invested approximately $307,000 in advertising and the AUM increased approximately $35 million from $57 million to $92 million. Resulting recurring revenues increased by approximately $262,000 to approximately $725,000 annually.

RX 4 at 1, 4. $307,000 divided by $262,000 results in an advertising ratio of 1.17, not 0.89. *Id.*; Tr. 746.

The fourth round offering memorandum stated that BOP's advertising and sales system had been generating at least $2.6 million in new AUM per month, with total AUM growing at a rate of 15.50% per quarter to approximately $98 million, with annual recurring revenue of about $725,000.[19] RX 4 at 3. In a subsequent section, the fourth round memorandum represented: "$10,000 per month on advertising . . . is converting to approximately $2.8 million in new assets that are generating $31,000 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising – an 89/100 ratio or an 'advertising conversion factor' of 0.89." *Id.* at 11. $10,000 divided by $31,000 results in an advertising ratio of 0.32, while $6,700 divided by $10,000 results in a ratio of 0.67. Tr. 752-53. The fourth offering memorandum additionally represented that the advertising yield factor "is the key driver of the Blue Ocean Portfolios model. This advertising factor for 2011 was 0.78. In 2012 this factor was 0.89." RX 4 at 13.

BOP's December 2012 St. Louis advertising report[20] contained three monthly factor calculations: advertising expenses for a month divided by (a) new annual recurring revenues *resulting* from the month's advertising expenses (Factor 1); (b) new annual recurring revenues based on new client accounts that were signed up *during* the month (Factor 2); and (c) new annual recurring revenues based on new client accounts where the client funds were transferred to BOP's management *during* that month (Factor 3). RX 120 at 1; Tr. 904-05.

The December 2012 St. Louis report also reported trailing six-month and trailing nine-month factors for each of the three factors, along with a trailing twelve-month factor for Factor 3. RX 120 at 1. According to that report, for St. Louis the trailing six-month factor was 2.00 for Factor 1, 1.22 for Factor 2, and 1.02 for Factor 3. *Id.* The trailing nine-month factor for Factor 1 was 2.01, 0.91 for Factor 2, and 0.85 for Factor 3. *Id.* The trailing twelve-month factor for

[19] The memorandum describes the same fee structure for non-institutional investors as the second and third memoranda. RX 4 at 3.

[20] For BOP's December 2012 advertising, there was a separate report for BOP's St. Louis and the recently opened Chicago office. RX 120 at 1-2; Tr. 903.

Factor 3 was 0.89. Tr. 905. The trailing twelve-month factor for Factor 3 across the St. Louis and Chicago offices was 1.12.[21] *See* RX 120 at 1-3.

Collins prepared summary exhibit DX 444, which compares the 0.89 advertising ratio for 2012 disclosed in the fourth offering memorandum to Collins' calculations of the ratio using BOP's advertising and revenue data for 2012 contained in DX 396 at 5639. Tr. 104-06.

Using the data in DX 396, Collins divided BOP's 2012 advertising spending by its new recurring revenue for that year, which calculates to an advertising ratio of 1.02. DX 444; Tr. 106-07. According to Collins' analysis, compared to that figure, the 0.89 ratio for 2012 in the fourth offering memorandum is overstated by 14%. DX 444. Collins also calculated these numbers including BOP's payments to Binkholder and found that BOP's advertising ratio was 1.34 for 2012, which he found was overstated by 51%. *Id.*

E. Legal Advice Received by Respondents for Royalty Unit Offerings

Winkelmann retained his friend, the late Michael Morgan, and his law firm Greensfelder to assist him in drafting and reviewing each of the four BOP royalty unit offering memoranda and their disclosures. Tr. 1247, 1318-19, 1325; FOF 51, 53-55. Morgan was an experienced attorney who specialized in securities law and regulatory compliance and he was knowledgeable about securities offerings and regulatory filings. FOF 51; Tr. 1319. After talking with Morgan, Winkelmann settled on a royalty unit structure for the offerings. Tr. 439-40, 1246-48.[22]

Under the engagement, Greensfelder did in fact review and revise each offering memorandum. FOF 53; Tr. 378, 1325-26; RX 113 at 1-6. Winkelmann prepared the initial draft of the offering memoranda, which included an overview of BOP's advertising campaign as of that period. FOF 53. Morgan, his Greensfelder colleague Giles Walsh, and Winkelmann exchanged several drafts of the offering memoranda before they were finalized and distributed to investors. RX 106 at 30-47, 52-54, 112-29, 321-37, 357-73, 377-92, 440-60, 525-839, 844-1040, 1209-1509, 1974-80, 1986-92, 2079-2154. For the first round offering, Greensfelder also reviewed and edited a business plan for BOP that was drafted by Winkelmann. Tr. 1347-48; RX 106 at 112-29.

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[21] Advertising cost for St. Louis for 2012 was $227,672 and advertising cost for Chicago for September to December 2012 was $69,660 for a total of $297,332. RX 120 at 1-3. Estimated new revenue for St. Louis for 2012 was $261,756 and total revenue for Chicago for September to December 2012 was $2,574 for a total of $264,330. *Id.*

[22] The Greensfelder invoices evidence at least one billed conversation between Morgan and Winkelmann prior to the time Winkelmann emailed Morgan a draft that outlined the royalty unit structure. *See* DX 277 at 1; RX 106 at 30-47; *see also* RX 106 at 1-2 (Feb. 3, 2011, email from Morgan to Greensfelder attorneys regarding a conflicts check for Morgan's representation of BOP in connection with a financing and a Feb. 15, 2011, email from Winkelmann to Morgan mentioning the royalty units).

Morgan and Walsh also drafted other documents associated with the offerings, including the subscription agreement and royalty unit certificate, a cover letter used to transmit the offering materials to investors, and the warrant included in the first round offering. FOF 54; RX 106 at 66, 70-71, 85-90, 93-107, 110-11, 137-50, 224-83, 317-20, 472-87, 495-524, 1042-86, 1510-36; Tr. 1325-26. Greensfelder also drafted the exclusive marketing agreement with Binkholder and provided Winkelmann and BOP advice about the risk disclosures that were included in each subscription agreement. Tr. 1326, 1347.

Winkelmann also recalls relying on Morgan's oral advice that there was "no problem" selling royalty units to BOP advisory clients because the offerings did not pose a conflict of interest. Tr. 1249-51. Winkelmann's account is irreconcilably contradicted by the subscription agreements drafted by Greensfelder, in which each royalty unit investor was required to "represent" and "warrant" that BOP "has not provided any investment advice" to the investor.[23] RX 1 at 95; RX 3 at 129; RX 4 at 130; DX 124 at 9375. There is no reasonable explanation for how Morgan, who drafted the subscription agreement, could conclude that there was "no problem" selling royalty units to BOP's advisory clients to which Winkelmann had provided, and continued to provide, investment advice. Stated a different way, if Morgan's view was that there was no problem in Winkelmann selling royalty units to investment advisory clients, Morgan would surely not have included the preceding representations and warrants by investors that would effectively prohibit such an arrangement. Because of that consistent, unequivocal language in the documents prepared by Greensfelder, I conclude that Winkelmann's recollection is mistaken and that he has failed to satisfy his burden in proving that Morgan advised Winkelmann that he could sell royalty unit to his advisory clients.

F. Winkelmann's Compensation and Conflict of Interest Issues

The royalty unit offering materials did not disclose any potential conflict of interest, and Winkelmann never discussed conflicts or potential conflicts with the royalty unit investors. Tr. 550-51, 780-83. In fact, the royalty unit memoranda explained that the concept of royalty financing "appears to be a compelling way for the investors, owners and employees to align their interest" because "the revenue streams are both recurring and growing." RX 1 at 5; *see* RX 1 at 15; RX 2 at 6, 22; RX 3 at 4, 20-21; RX 4 at 4, 21. This was so, as explained by the second, third, and fourth offering memoranda, because the "royalty holders have an incentive to refer business and to see the business revenues grow into other areas." RX 2 at 15; RX 3 at 13; RX 4 at 13. BOP sought to "keep the interest of the investors, employees, customers, and owners of [BOP] aligned at all times." RX 1 at 11. The memoranda also make the following additional representations indicating the absence of conflicts:

- BOP "attracts clients who are fed up with conflicts of interest prevalent at the broker/dealers where representatives/advisors make more money selling one security over another." RX 1 at 6; RX 2 at 8; RX 3 at 6; RX 4 at 6.

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[23] The only reference to advice regarding clients investing in their investment adviser in Greensfelder's bills is from February 2013 when Walsh billed 0.7 hours "[r]esearch[ing] limits on clients investing in investment adviser." DX 277 at 6033.

- BOP "creates value for its clients by eliminating conflicts of interest." RX 1 at 7; RX 2 at 9; RX 3 at 6; RX 4 at 7.

- "The plan is to . . . be the 'go to' solution when investors are fed up with the conflicts of interest from their advisor/broker. This message is currently being broadcasted through advertising." RX 1 at 8.

- "The expansion capital in the form of Royalty Units is a way to fund growth, provide immediate cash flow stream to the Royalty Unit holders, and align all interests for returns at relatively low risk." RX 1 at 15; RX 2 at 22; RX 3 at 20-21; RX 4 at 21.

Additionally, a PowerPoint presentation attached to the first three offering memoranda describes BOP as "Eliminat[ing] Conflicts." RX 1 at 115; *see* RX 2 at 124 (noting "Conflict Free Wealth Management"); RX 3 at 143 (same).

BOP never implemented any written policies or procedures relating to disclosure of conflicts of interest for the royalty unit offerings. Tr. 783-84. Winkelmann testified during the investigation that an investment adviser selling its own securities to its advisory clients could create a conflict of interest. Tr. 779. During the hearing, he testified that BOP was not selling, but "issuing" its securities, a distinction based on the fact that a seller would be buying the securities elsewhere and marking them up for a profit. Tr. 779. Winkelmann recognized that conflicts of interest could have a negative impact on investor returns. DX 423; Tr. 380-81.

While there does not appear to be any dispute that the royalty unit holders' receipt of their minimum guaranteed payment is not imperiled by a conflict of interest, there is a potential conflict of interest posed by each of Winkelmann's decisions to pay the royalty unit holders any amount in excess of the minimum payment, because that additional money competed directly with his own compensation. *See* Tr. 700-01. Respondents state that "a central issue in this dispute is whether that conflict exists, given that investors were paid out of revenues earned and not out of profits (meaning expenses like manager salaries had no impact on the investors)." Resp. Response to Div. PFOF ¶ 118. While this is correct with respect to the minimum mandatory percentage payment that came out of gross revenues, for anything in excess of that minimum, Winkelmann had discretion to, on the one hand, increase the percentage paid to royalty unit holders, or on the other, use the monies for other purposes, such as to increase his compensation. Tr. 700-01, 813. According to BOP's own offering documents, such a conflict was important, because in addition to the advertising ratio, higher monthly percentages paid to investors – more than the minimum – were a significant factor in allowing investors to be paid back years sooner than they would otherwise. *See supra*; *see, e.g.,* RX 1 at 11-12; RX 2 at 17; RX 3 at 15; RX 4 at 4. Although the first offering memorandum disclosed that Binkholder would receive a monthly retainer as part of BOP's marketing plan, the second and third memoranda did not disclose that both Winkelmann and Binkholder would receive compensation increases. RX 1 at 8; Tr. 668, 671, 700-01.

In addition to the potential conflict of interest attendant to paying more than the minimum monthly return, another conflict was posed by what to do with the monies received from each offering itself. In other words, a potential conflict existed between the investors, who presumed their monies would support BOP's profit-making aims, and Winkelmann, who might use investors' money to enhance his compensation. That conflict was demonstrated in correspondence with Binkholder in which Winkelmann discussed a prospective royalty unit offering as a means to increase each of their monthly compensation from $2,000 to $8,500, the equivalent of an annual raise of $78,000 for each. DX 83 at 1; Tr. 586. Contemporaneous with that correspondence, Winkelmann's internal BOP financial materials contained a plan to reduce monthly advertising spending by $7,000 – which would presumably decrease the firm's revenue – in order to increase his and Binkholder's monthly compensation to $10,000 each. DX 395 at 5317); Tr. 589-92. By raising more money from royalty unit investors, Winkelmann could increase his own compensation. Tr. 587.

Winkelmann did make money from BOP's issuance of royalty units and BOP's resulting expansion. Tr. 1484. Over time, BOP paid Winkelmann directly, and through his companies and partnerships. DX 446, 457-59; Tr. 111-14, 116, 119, 774-75, 777, 1486. According to Winkelmann:

> The purpose of . . . distributions to [23 Glen Abbey Partners] was to compensate Mr. Winkelmann, as Founder/CEO of Blue Ocean Portfolios, for his service to the company. Mr. Winkelmann did not take any salary in 2011 or 2012. And in 2013, Mr. Winkelmann only took a salary of $900 per month. Blue Ocean Portfolios' regular distributions to 23 Glen Abbey Partners were made in lieu of Mr. Winkelmann's salary in 2011 or 2012 or a larger salary in 2013.

DX 298 at 4. According to Winkelmann, in 2012, BOP paid 23 Glen Abbey Partners $125,007 in lieu of paying Winkelmann a salary. DX 298 at 4, 8. In 2013, BOP paid 23 Glen Abbey Partners $182,200 in lieu of paying Winkelmann a salary, and paid Winkelmann an additional $7,200 in salary. DX 298 at 4, 8.

Between August 2011 and March 2012, BOP paid Winkelmann's insurance agency, Longrow, at least $41,000 in "management fees" even though Longrow provided little in exchange. DX 457. In July 2012, Winkelmann settled a lawsuit related to Weir's misconduct against himself, BOP, and some of Winkelmann's other companies. DX 170.[24] As part of the settlement, Winkelmann agreed to pay $50,000 to the plaintiffs, which BOP paid. *Id.* at 8896, 8921; Tr. 800-01. The settlement obligated Winkelmann, as opposed to BOP, to pay $50,000 to the plaintiffs. DX 170 at 8896 ("James shall pay $50,000 to Plaintiffs on or before January 10, 2013."); 801-02. Pursuant to the settlement agreement, plaintiffs forever released any and all claims asserted against all defendants, including BOP. DX 170 at 8897-98. Winkelmann never reimbursed BOP for any part of the $50,000. Tr. 804. Winkelmann agreed that the money BOP used to pay Winkelmann's $50,000 settlement obligation could have been used to pay the royalty

[24] DX 170 is labeled as a confidential settlement agreement. DX 170 at 8894. It contains a provision requiring the parties to hold the agreement and each of its terms "in strict confidence." *Id.* at 8903. Because the harm resulting from disclosure would outweigh the benefits of disclosure, DX 170 will be placed under seal. *See* 17 C.F.R. § 201.322(b).

unit investors "[i]f there was sufficient cash flows." Tr. 803. Winkelmann never disclosed to the royalty unit investors that he used $50,000 in BOP funds to settle this debt. Tr. 806.

Between October 2011 and September 2012, BOP paid more than $46,000 to another one of Winkelmann's companies, Blue Ocean ATM. DX 457 (three approximately $10,000 payments directly to Blue Ocean ATM and one cash payment of $16,000 with the memo "ATM (arrow to the right)"). Winkelmann testified that these payments were loans. Tr. 777-78. In August 2013, Blue Ocean ATM had a concession to have four ATM machines at the Festival of Little Hills. Tr. 809. Prior to the festival, Blue Ocean ATM did not have the $70,000 needed to fill the ATM machines at the festival. Tr. 809-10. At the time, BOP had approximately $100,000 in its bank account. Tr. 810. In order to fill the machines, Winkelmann caused Blue Ocean ATM to borrow $70,000 from a bank, with the collateral for the loan being the funds in BOP's bank account. Tr. 810-13. In an email to the bank requesting that BOP funds be used as collateral for the Blue Ocean ATM loan, Winkelmann wrote:

> Blue Ocean Portfolios, LLC has enough in the operating account to lend out this cash . . . . Unfortunately this creates a bunch of regulatory scrutiny by the SEC when they examine Blue Ocean Portfolios – nothing illegal just a hassle. I would rather avoid moving money back and forth between the two companies.

DX 274 at 910. At the time, BOP was being examined by the Commission. Tr. 814. Blue Ocean ATM realized $4,000 from the festival. DX 375. Winkelmann never made Blue Ocean ATM pay BOP or the royalty unit investors for using BOP funds as collateral. Tr. 815, 818-19, 822. *But see* DX 375 ("Because [BOP] assets were used to generate this revenue [from the festival], in reviewing this activity we believe that your subscription . . . is entitled to 0.50% of this revenue amounting to a royalty to you of $20.00. . . . Since it has been our practice to pay royalties over and beyond what has been due to you in the past there are no additional monies due to you now."). Winkelmann had the discretion whether to use the BOP funds as collateral for Blue Ocean ATM or to distribute those funds to the royalty unit investors. Tr. 812-13.

G. Winkelmann's Awareness of his Fiduciary Duties

In 2011, Winkelmann understood that as an investment adviser he owed a fiduciary duty to his advisory clients. Tr. 373-74. As part of that duty, he had to be honest with them, act in good faith and solely in their best interests, be loyal to them, make full and fair disclosure of all material facts, and disclose any potential or actual conflicts of interest. Tr. 374-76. He testified that this duty only extended as far as the accounts he was managing; for instance, Winkelmann believed that he was not acting as an investment adviser with respect to the royalty units, and thus did not owe an advisory client a fiduciary duty with respect to any investment made in the royalty units. Tr. 374-75, 1244-45, 1255, 1505. Instead, Winkelmann testified that he was acting "as a founder of a fast-growing business" that was offering securities as part of a capital raise. Tr. 1255; Resp. PFOF ¶ 166.

BOP required its employees to strictly comply with the fiduciary duties owed to advisory clients. Tr. 374; DX 3 at 10065 ("Strict compliance with the provisions of the Code shall be considered a basic condition of employment with [BOP]."); DX 4 at 10166 ("Failure to abide by our policies may expose you and/or the firm to significant consequences, which may include disciplinary action, termination, regulatory sanctions, potential monetary sanctions and/or civil and criminal penalties.").

BOP's code of ethics "is based upon the principle that [BOP] and its employees owe a fiduciary duty to [BOP]'s clients." DX 3 at 10065. As part of that duty, the code explained that BOP employees are required to avoid putting their own interests ahead of clients, taking inappropriate advantage of their positions within BOP, and any actual or potential conflicts of interest or any abuse of their position of trust and responsibility. *Id.* The code stated that Advisers Act Section 206 prohibits BOP and its employees from "engaging in fraudulent, deceptive or manipulative conduct" and that compliance with this "involves more than acting with honesty and good faith alone" and that BOP "has an affirmative duty of utmost good faith to act solely in the best interest of its clients." *Id.* The code notes that "[t]he excellent name and reputation of [BOP] continues to be a direct reflection of the conduct of each employee." *Id.* The code does not limit that fiduciary duty to client accounts, as opposed to the clients themselves. *See* DX 3; *see also* DX 4.

BOP's policy and procedures manual also discusses the importance of BOP's reputation and its fiduciary duty to its advisory clients. DX 4 at 10166. The manual states that BOP "has a duty of loyalty and to always act in utmost good faith, place our clients' interests first and foremost and to make full and fair disclosure of all material facts and in particular, information as to any potential and/or actual conflicts of interest." *Id.* As part of this duty, the manual explained, a fiduciary "must eliminate conflicts of interest, whether actual or potential, or make full and fair disclosure of all material facts of any conflicts so a client, or prospective client, may make an informed decision in each particular circumstance." *Id.* at 10188. The manual also noted that any trading conflicts should be resolved "in the client's favor." *Id.* at 10207.

BOP used its fiduciary status as a marketing tool and a means to attract and retain clients. For instance, BOP gave its advisory clients a "Plain Language Compensation & Conflicts of Interest Disclosure" form. DX 228; Tr. 391. In a section titled "Fiduciary Role," that form states that BOP "***always*** acts <u>in a fiduciary role for the client</u> and only offers options and recommendations in the clients' best interest." DX 228 at 1.

BOP's radio advertisements stated the following:

- "Nobody can guarantee investment results. However, unlike most other investment firms Blue Ocean Portfolios will guarantee that they will always put their client's interests first and will never receive commissions or undisclosed compensation." RX 1 at 31.

- "Blue Ocean Portfolios' sole duty is to increase the odds of their clients achieving favorable investment outcomes. They do this by eliminating conflicts of interest with their clients." RX 1 at 32.

- "Do you know that when you walk into your wealth advisors office, your stock broker, your insurance agent, do you know what's going on through their heads? How much money they're going to make from you on that transaction. Why would you ever subject

> your wealth to these conflicts of interest? . . . Your advisor, your broker should be working for you, not against you." RX 2 at 53.

They also advertised that Winkelmann had written a report called "What Your Broker Isn't Telling You" and offered a free copy. RX 1 at 32. The report explains that most financial advisors face a "conflict of interest dilemma" because they have more than one constituent to serve, including providing for their families, complying with their compliance managers, and satisfying their sales managers. *Id.* at 34. The report states that BOP "eliminates conflicts of interest, hidden fees, and commissions that are unfortunately embedded in most investment firms, mutual funds, advisors, and brokers." *Id.* at 41. It also represents that BOP has gained many clients "because they are frustrated and have concluded that their broker or wealth advisor has violated their trust and they need a different type of relationship." RX 2 at 48.

In September 2011, Winkelmann was awarded the "Registered Fiduciary" certification and gave the following quote for a press release in response to how his new certification would further set BOP apart:

> Public concern over scandals and financial excesses in the industry are at an all time high, and rightly so. I chose to pursue Registered Fiduciary Designation as a means to provide further validation to the public that we are fiduciaries. Unlike the vast majority of wealth management companies that hold themselves to a suitability standard we, at [BOP], at all times put our clients' interest first. This independent designation is just another step in the right direction to confirm what we've stood for all along.

DX 67 at 2. On September 15, 2014, BOP announced this certification on its website explaining that the "certification ensures that [Winkelmann] and, by extension, [BOP] will always put the interests of the client first. All too often we have seen financial professionals putting their own well being ahead of their clients'." DX 310. The website explained that Winkelmann was "committed to always acting in the best interest of clients, using the skills, ethics and focus on the client needs that the Certification represents." *Id.* Winkelmann stated that the certification process "offers comfort in the knowledge that our firm has been found worthy of this distinction" and that "we have always been dedicated to our clients and this award gives us the independent confirmation of this policy." *Id.*

Winkelmann also would frequently remind his advisory clients of the fiduciary obligations that he owed them. Tr. 396. On January 16, 2012, Winkelmann emailed Buckowitz his advisory account quarterly update. DX 90. In it he wrote, "[u]nlike the majority of wealth advisors, we assume a fiduciary role for our clients. This means that [BOP] most always put your interest first . . . . This does not mean that we are satisfied; a fiduciary's duty can never be satisfied. We are always looking for ways to improve your odds." *Id.* He sent identical emails to his other advisory clients. Tr. 397-98.

On April 11, 2012, Winkelmann emailed Buckowitz another quarterly update and wrote:

> [BOP] was designed to be a true fiduciary for our clients. Our legal duty is to always put the interest of our client first. Since we do not sell or underwrite securities, we can provide unbiased advice that is not corrupted by the compensation that varies from one security to another. . . . The result is that our clients have better odds of achieving a favorable outcome.

DX 127. Winkelmann sent identical emails to BOP's other advisory clients. Tr. 398-99.

On January 18, 2013, Winkelmann wrote a letter to Buckowitz, which stated: "[BOP] provides fiduciary investment management services for your account(s) at Scottrade. We do not sell securities and our services are limited to providing allocation advice and management for your account(s). As a fiduciary, we are legally compelled to put your interest first at all times." DX 462.

On May 13, 2013, Winkelmann emailed Buckowitz and wrote, "[a]s your fiduciary, we are compelled to seek out the optimal investment allocation and vehicles for our clients." DX 463. Winkelmann sent identical letters to BOP's other advisory clients. Tr. 402-03.

As of October 2016, BOP's website contained the following representation: "Fiduciary is a legal term that defines a duty to others. By definition and practice, a fiduciary must place their clients' interests first. A fiduciary duty is never fully satisfied, they must always seek ways to do what is best for the clients . . . as a fiduciary [BOP] must, at all times, put the clients' interests first. Div. PFOF ¶ 11; Resp. Response to Div. PFOF ¶ 11; Tr. 1523-24.

H. Custody Rule and Advice from Counsel

Under the terms of the royalty unit offerings, investors were entitled to a minimum percentage of BOP's monthly cash receipts. From May 2011 through May 2012, BOP's practice was to accrue in BOP's bank account the percentage of cash receipts due the investors and then pay the accrued amounts on a monthly basis. FOF 67. Starting in May 2012, Respondents decided to change the monthly royalty unit payments to quarterly payments because calculating and distributing the payments on a monthly basis was "a needless administrative burden." Tr. 1385; RX 77, 104; FOF 68. Winkelmann testified during the investigation that for the period between when the cash receipts came into BOP's bank account and when they were paid to investors, the accrued funds were owed to the investors. Tr. 785-86.

Although the initial royalty unit certificate mandated monthly payments to royalty unit investors, Winkelmann recalls that before he changed from monthly to quarterly payments, he spoke with Morgan, who did not seem concerned and told him the adjustment was "no big deal" and that Winkelmann should notify the investors that he was going to change the process and ask if they have issues with it. Tr. 785, 1387. Winkelmann announced the change to quarterly payments in late April 2012. RX 77; Tr. 1386. However, the Greensfelder invoices for March, April, and May 2012 do not reflect a billed consultation between Winkelmann and Morgan occurring. DX 277 at 6000-07. Further, the emails between Winkelmann and Greensfelder attorneys during this time do not show such a consultation occurring between January and May 2012. *See* RX 106 at 440-1205. Even if the change was "no big deal," because it was inconsistent with the preexisting contractual arrangement with investors, it is unlikely that, without any documentation or record, Morgan would simply dismiss the issue. Before reaching that conclusion, at a minimum, Morgan would have to review the language regarding payments, then determine whether the change would require a supplemental agreement by the parties, or was provided for under a preexisting clause, and even if so, what form of notice may be required. The detailed exchanges between Greensfelder and Morgan on other issues, as well as the specificity of Greensfelder's invoices, are conspicuously absent on this issue.

Prior to Winkelmann's investigative testimony in February 2015, Respondents took the position that BOP did not have custody of client assets; in fact, between June 2011 and November 2014, BOP filed at least twenty Forms ADV that represented that BOP did not have custody of client assets. Tr. 797. As a result, before that time, BOP did not (a) maintain royalty unit investors' funds in a separate account for each investor under that client's name, or in accounts that contain only the investors' funds under BOP's name as an agent or trustee for the investors; (b) notify each royalty unit investor in writing of the qualified custodian's name, address, and the manner in which the investor's funds were held; (c) have a reasonable basis, after due inquiry, for believing that the qualified custodian sent account statements directly to each royalty unit investor at least quarterly; or (d) have an independent public accountant perform a surprise examination of the royalty unit investors' funds which BOP held in its operating account. FOF 70. BOP's policies and procedures manual, dated February 5, 2012, stated:

> As a matter of policy and practice, [BOP] does not permit employees or the firm to accept or maintain custody of client assets. It is our policy that we will not accept, hold, directly or indirectly, client funds or securities, or have any authority to obtain possession of them, with the sole exception of direct debiting of advisory fees. [BOP] will not intentionally take custody of client cash or securities.

DX 96 at 10636, 10649.

Beginning in February 2015, BOP began filing Forms ADV which represented that BOP had custody of client assets, which were the accumulated funds for eighteen royalty unit investors who were also BOP's advisory clients. Tr. 791-92. BOP's associated brochures after this time stated:

> In regards to the approximately eighteen [BOP] clients who have also subscribed to royalty interests in the company; [BOP] is considered to have custody of the accrued royalties payable to these clients for a period of time of less than thirty days between the time that the royalty is accrued by [BOP] and the time the royalty disbursements are paid out to these same clients/investors.

E.g., DX 331 at 13. Also around this time, Winkelmann established a new BOP bank account that would automatically sweep and segregate approximately 15% of BOP's incoming cash that was owed to the royalty unit investors. DX 328 at 9583; Tr. 790-91. Respondents did not revise BOP's policies and procedures manual to reflect this change. *Compare* DX 333 at 10464, 10478 (policies and procedures manual dated March 24, 2015), *with* DX 96 at 10649 (policies and procedures manual dated February 5, 2012).

BOP also engaged Greensfelder to provide compliance advice to BOP in connection with certain of its day-to-day operations, including advice regarding the content of certain of BOP's Forms ADV.[25] FOF 52; Tr. 1388-89; DX 277 at 5992, 6008, 6028, 6037, 6040; RX 113 at 49, 54. One issue Greensfelder specifically advised on was whether BOP had "custody" of royalty unit investments. Because investigations of BOP were focused on the custody issue, Winkelmann and his attorneys discussed it several times in 2014. RX 106 at 2400, 2404-05, 2407-08, 2415. At that time, at least, if not before, Winkelmann relied upon Greensfelder's determination that the Firm did not have custody of the royalty units. *Id.*

I. Investor Testimony

1. Division Witnesses

a. Arthur Buckowitz

Arthur Buckowitz is sixty-one years old and works as a construction director. Tr. 338-39. Buckowitz was a legacy advisory client of Binkholder. Tr. 339-40. In 2010, Buckowitz became a BOP advisory client. Tr. 440. After Binkholder was barred from being an investment adviser, Winkelmann became Buckowitz's adviser representative. Tr. 340. Winkelmann did not tell Buckowitz why Binkholder had lost his advisory license. Tr. 349.

Winkelmann brought the royalty units to Buckowitz's attention. Tr. 343-44. Before investing in royalty units, Buckowitz read the second round offering memorandum. Tr. 344. He was favorably impressed by its representation that BOP was getting a larger return from a smaller amount of advertising. Tr. 346. Prior to investing in the royalty units, Buckowitz spoke with Winkelmann and came to believe the royalty units were a good investment. Tr. 348. Winkelmann never discussed any conflicts of interest that could have existed between Winkelmann and Buckowitz. Tr. 348. Winkelmann also did not disclose that he could use Buckowitz's investment proceeds to increase Winkelmann and Binkholder's compensation. Tr. 348-49.

On April 5, 2012, Buckowitz purchased two second round royalty units, for a total of $50,000, with a check from his BOP-managed IRA account. Tr. 347. The investment constituted eight to ten percent of Buckowitz's portfolio. Tr. 347-48, 349. Buckowitz completed and signed a subscription agreement in connection with his purchase. Tr. 360. When he signed the agreement, Buckowitz understood that the royalty unit may never be paid in full and was not required to be paid in full before a set date. Tr. 365.

[25] BOP filed at least thirty-eight Forms ADV during the relevant period. DX 1, 15, 16, 20, 28, 58, 65, 75, 93, 105, 117, 148, 150, 152, 155, 196, 201, 217, 222, 257, 259, 263, 266, 268, 273, 276, 281, 283, 285, 295, 300, 304, 308, 314, 332, 335, 340, 343. Winkelmann signed, controlled the contents of, and caused to be filed with the Commission BOP's Forms ADV. FOF 69.

On April 23, 2012, Winkelmann sent Buckowitz an email that said that BOP was planning a third round royalty unit offering. DX 131 at 1-2. In that email, Winkelmann asked Buckowitz if he "would like to review the Royalty Unit Round 3 material when it becomes available." *Id.* at 2; Tr. 350-51. On October 2, 2012, Winkelmann sent Buckowitz another email informing him about the third round royalty unit offering, and asking Buckowitz whether he wanted to review the offering materials. DX 198 at 1-2; Tr. 352.

Buckowitz never made another royalty unit investment, because he "had no interest in investing anymore [in BOP]." Tr. 352-53. Buckowitz later transferred his portfolio and stopped using BOP as his adviser, because he had "a trust issue" with BOP. Tr. 353. Buckowitz's royalty unit has paid him back approximately $25,000 of the $125,000 he is owed on the investment, and he is not on pace to be paid back within the seven or eight years he understood it would take for BOP to pay him the full $125,000 on his investment. Tr. 353-54.

b. Jason Grau

Jason Grau is thirty-eight and works as a livestock feed salesperson. Tr. 618-19. In early 2011, Grau contacted BOP and became Winkelmann's advisory client, after first hearing about BOP on Binkholder's *Financial Coach* radio show. Tr. 619-20. BOP then managed approximately $100,000 for Grau. Tr. 620.

While Winkelmann was Grau's adviser representative, Winkelmann presented the royalty unit investment option. Tr. 621. Grau read the first round offering memorandum Winkelmann provided. Tr. 625. During their discussion prior to investing in the royalty units, Grau asked Winkelmann if there would be any issues regarding conflicts of interest. Tr. 621-22, 654-55. In response, Winkelmann told Grau that the investment was permissible. Tr. 622. On April 22, 2011, Grau purchased three first round royalty units for a total of $75,000. DX 43 at 8853-54; Tr. 621. Grau completed and signed a subscription agreement in connection with that purchase. Tr. 643. At that time, Grau understood that BOP may never pay the royalty in full and they are not required to be paid in full by a certain date. Tr. 647.

Prior to that investment, Winkelmann did not tell Grau that BOP could use Grau's investment to increase Winkelmann's compensation. Tr. 622-23. Grau would have wanted to know if Winkelmann would use Grau's investment to increase Winkelmann's compensation, as it would have lowered Grau's interest in the investment. Tr. 623. Grau would also have wanted to know if BOP incurred higher expenses to generate revenue than the first offering memorandum stated. Tr. 628-29. Grau also would have wanted to know that Binkholder was under investigation by the Missouri securities regulators, because Grau understood that sponsorship of Binkholder's radio show was a key aspect of BOP's advertising plan. Tr. 626-27. Winkelmann never informed Grau that Binkholder was barred from being an investment adviser in late 2011, that Binkholder was the subject of a federal criminal investigation, or that Binkholder had pled guilty and was sentenced to prison for defrauding investors. Tr. 627-28.

On April 23, 2012, Winkelmann emailed Grau, informed him of the upcoming third round royalty unit offering, and asked if Grau would be interested in reviewing the third round offering materials when they became available. DX 129; Tr. 632-33.

Grau has since transferred nearly all of the $100,000 BOP was managing, because Grau did not trust what was going on at BOP. Tr. 633-34.

c. Thomas Swardson

Thomas Swardson is a retiree who became a BOP advisory client in August 2012. Tr. 10. Swardson was introduced to BOP after reviewing Binkholder's "Financial Coach" website. Tr. 10-11. In August 2012, after meeting with Winkelmann, Swardson transferred $710,000 to BOP's management. Tr. 11-12. This $710,000 constituted the entirety of Swardson's retirement savings. Tr. 12. In Swardson's discussions with Winkelmann, Winkelmann frequently discussed the subject of fiduciary duties. Tr. 12-13. Winkelmann told Swardson that part of Winkelmann's fiduciary duty was to put Swardson's interests ahead of Winkelmann's. Tr. 13.

In September 2012, Winkelmann brought the royalty units to Swardson's attention. Tr. 13. Winkelmann told Swardson that he should expect his principal investment back within two to three years, and that he would get paid the full 2.25 times his investment in approximately five years. Tr. 13-14, 17. Before Swardson invested in the royalty units, Winkelmann told Swardson that the first and second offerings were "ahead of schedule" and that BOP's growth was ahead of schedule. Tr. 14. Winkelmann also told Swardson that Winkelmann wanted to open an Indianapolis office, and that Swardson could become a BOP employee and work in that office. Tr. 14-16.

Prior to investing, Swardson read the section of the third round offering memorandum which represented that BOP's advertising factor for 2011 was 0.78. Tr. 18. After reading this section and speaking with Winkelmann, Swardson believed that BOP was spending $0.78 in order to bring in $1 in new business. Tr. 18. Swardson would have wanted to know if BOP's 2011 advertising factor was greater than 1.0. Tr. 19.

Prior to investing, Swardson read the section of the third round offering memorandum that represented that the royalty unit investment appeared to be "the most compelling way for the investors, owners, and employees to align their interests." Tr. 20-21. Winkelmann never told Swardson that their interests would not always be aligned, and never mentioned that any conflicts of interest existed between Winkelmann and Swardson. Tr. 21-22. If Winkelmann planned to increase his personal compensation rather than increasing royalty unit payments to Swardson, that would have affected Swardson's decision to invest. Tr. 22.

In addition to the preceding oral and written representations about the offering, Winkelmann did not advise Swardson one way or the other, whether he should invest in the offering. Tr. 37, 1252-53.

On October 15, 2012, Swardson purchased one royalty unit for $25,000, by deducting the funds from his BOP-managed account. DX 347 at 9781, 9791; DX 455; Tr. 17. Swardson completed and signed a subscription agreement in connection with the purchase. Tr. 33-35. At that time, Swardson understood that the royalty may never be paid in full and was not required to be paid in full before a set date. Tr. 41-42.

Winkelmann never told Swardson that Binkholder had been barred from being an investment adviser. Tr. 23. Had Swardson known this, he likely would not have invested in the royalty units. Tr. 23-24.

Approximately one year after he invested, Swardson became concerned that BOP was only paying him the minimum royalty payment, so he asked Winkelmann why royalty unit investors were being paid the minimum, but never received an explanation from Winkelmann. Tr. 47-49. Swardson, who received $3,443 in royalty unit payments at the time he testified, believes the royalty unit investment underperformed his expectations at the time he invested. Tr. 24. At this rate, Swardson will not receive his principal back for twenty-nine years, and he will not receive his full royalty payments for more than sixty-five years, at which point Swardson would be 135 years old. Tr. 24-25. Swardson's royalty investment is still paying "[a]t the absolute minimum." Tr. 46. Swardson is no longer a BOP advisory client. Tr. 24.

2. Respondent Witnesses

a. Thomas Dixon

Thomas Dixon manages a company that imports and sells consumer fireworks. Tr. 1418. Dixon and Winkelmann belong to the same church and have known each other for fifteen years. Tr. 1418-19. Dixon considers Winkelmann to be one of his closest friends and advisors. Tr. 1422. Dixon testified that he would "trust [Winkelmann] with anything that I have." Tr. 1431.

Dixon has been an advisory client of BOP since April 2011. Tr. 1422. Prior to investing in BOP royalty units, Dixon was not sure whether to invest $25,000 or $50,000, and he discussed that decision with Winkelmann prior to investing. Tr. 1423. In May 2011, Dixon purchased two first round royalty units for a total of $50,000. Tr. 1423. Dixon funded his royalty unit investment with a transfer from his BOP-managed IRA account. Tr. 1426, 1430. The advertising factor did not play a part in his decision to invest. Tr. 1421.

b. James Hipsky

James Hipsky sold product identifications for his entire career. Tr. 1029-30. Hipsky learned of Winkelmann and BOP on the radio while he was looking for someone to manage his and his wife's investments. Tr. 1030. Hipsky was a BOP advisory client at the time Winkelmann presented him with the royalty unit investment opportunity in the spring of 2012. Tr. 1037-39. The advertising ratio was not a factor in his decision to invest. Tr. 1035. Hipsky purchased a royalty unit for $25,000 in the spring of 2012. Tr. 1037-38. He faults the instant proceeding as one of the reasons BOP is not performing as well as expected. Tr. 1032-33.

On August 24, 2012, Winkelmann emailed Hipsky and asked if he would be interested in participating in the third round royalty unit offering. DX 485 at 677. Hipsky responded that he would "sit this one out" and not make an additional royalty unit investment at that time. *Id.* at 676; Tr. 1042-43.

c. Michael King

Michael King does sales and marketing in the hospital equipment industry. Tr. 992. King, a friend of Winkelmann's for over twenty-five years, attended Winkelmann's wedding. Tr. 993, 1004-05. When King was between hospital equipment jobs, Winkelmann hired him as an employee and advisory representative of BOP, where he worked from November 2009 through October 1, 2011. Tr. 993-94, 1005, 1009. King trusts Winkelmann. Tr. 1027-28.

King purchased a total of three royalty units in the second and third offerings. Tr. 997-98, 1007, 1011-12. At the time of his royalty unit purchase, King was a BOP advisory client who funded his royalty unit purchase with a transfer from his BOP-managed IRA account. Tr. 1012, 1015. King is still an advisory client of BOP. Tr. 1005.

King voiced his opinion that the instant proceedings are a "classic case of prosecutorial overreach." Tr. 1026-27.

d. Bryan Swift

Bryan Swift owns a printing company. Tr. 1051-52. He has known Winkelmann for seven years and they are close friends. Tr. 1052, 1058-59. Swift's brother, Shepherd, was a BOP employee and adviser representative from October 2011 to February 2014. Tr. 1059.

Winkelmann originally presented Bryan Swift with the royalty unit opportunity. Tr. 1053, 1060. In April 2011, Swift purchased four first round royalty units, for a total of $100,000. Tr. 1061. Swift is a high net worth investor, in that his $100,000 first round royalty unit investment constituted less than 0.1% of his total assets. Tr. 1054-55. Winkelmann later approached Swift about purchasing additional royalty units, but he did not purchase any additional units at that time. Tr. 1061, 1063-64. In February 2013, Swift purchased $50,000 in fourth round royalty units. Tr. 1072-73. Swift was an advisory client of BOP each time he purchased royalty units. Tr. 1059.

When he invested in the fourth round royalty units, Swift was aware that BOP was experiencing financial difficulties. Tr. 1074-76. Swift testified that when Winkelmann approached him with an offering, he "was always there for him, whatever he needed," but that he would "invest prudently." Tr. 1064. One of the reasons Swift invested in the fourth round units, in light of the issues facing BOP, was that he wanted to help his friend. Tr. 1076.

J. Expert Testimony – R. Craig Palubiak

Respondents' expert on advertising and marketing, R. Craig Palubiak, provided an expert report that served as his direct testimony.[26] RX 125; Tr. 1235 (Palubiak's report was admitted unconditionally without objection by the Division). Palubiak holds a bachelor's in business and an MBA, both with concentrations in finance and marketing. RX 125 at 13. He serves as an adjunct professor for graduate and undergraduate business programs in marketing strategy. *Id.* He has published three books. *Id.*[27] His first book *Ten Action Items for Winning Companies* (2011), earned public praise from the managing partner of financial services firm Edward Jones. *Id.* at 13. His second book, *Ten Tactics for Successful Family Companies* (2013), earned similar praise from the CEO of Stifel Financial Corporation. *Id.* His third book, *Drive Profits Today* (2014), addresses real world sales and marketing issues facing businesses. *Id.*

Here, Respondents retained Palubiak to provide expert opinions in the following four areas:

(1) "The methodology, computation and accuracy of the process and data created and utilized by Blue Ocean and Jim Winkelmann pertaining to the return-on-investment (ROI) of their advertising program." RX 125 at 5; Tr. 1121-22.

(2) "The wide spectrum of acceptable approaches in the domestic business community for determining and computing the ROI on advertising campaigns (promotion mix)." RX 125 at 2; Tr. 1122.

(3) "The various avenues of advertising utilized by Blue Ocean." RX 125 at 2; Tr. 1123.

(4) "[T]he activities between Bryan Binkholder and Blue Ocean under the Exclusive Marketing Agreement(s) in the Blue Ocean placement memorandums pertaining to their accounting and cost allocation." RX 125 at 2; Tr. 1124.

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[26] The Division also tendered its own expert, Arthur Laby, whose expert testimony will be addressed in the conclusions of law. The Division retained Laby to opine whether Respondents' conduct in marketing and selling royalty units to BOP advisory clients and other investors was consistent with applicable standards of conduct in the securities industry with respect to disclosure, fiduciary obligations, and other matters. DX 363 at 2. Laby is a law school professor who conducts research on securities regulation and the fiduciary relationship, including the standard of conduct expected of investment advisers. *Id.* at 4. Previously, Laby worked for the Commission in its general counsel's office and division of investment management. *Id.* at 4-5. Laby has his B.A. from the University of Pittsburgh and his J.D. from Boston University School of Law. *Id.* at 4.

[27] Palubiak was also contributing author to *Global Jumpstart: The Complete Resource for Expanding Small and Midsize Business* (1999), by Ruth Stanat and Chris West. RX 125 at 5.

Of Palubiak's continuing thirty-five-year career in business, five positions are particularly pertinent to his expertise in this case. First, as vice president of sales and marketing at Enterprise Rent-a-Car from 1982 to 1990, he was

> tasked with the design and implementation of the marketing and advertising components of the corporate leasing program plan which resulted in a 30% increase in annual revenues. It required [him], along with [his] subordinates, to develop return on investment analysis (ROI) of the corporate advertising budget and report defendable results back to senior managers. This experience led [him] to develop an expertise on the various and sensitive components that need to go into a defendable ROI determination.

RX 125 at 4. Second, as the president of Optim Consulting Group for approximately twenty years, he has provided "strategic marketing consulting services to executives." *Id.* His "corporate clients retain Optim to assist them with new product rollouts, market expansions and ROI analysis of the advertising and marketing campaigns." *Id.* Third, under his leadership from 2000 to 2005, manufacturing company "American Loose Leaf implemented comprehensive advertising and marketing campaigns" based on methods he developed to "track both the investment in advertising and results." *Id.* Fourth, as executive vice president of sales for Siboney Learning Systems from 2005 to 2007, Palubiak "was responsible for aligning the marketing and advertising campaigns with reorganized sales and distribution channels." *Id.* at 4, 12. He developed a system "to track lead sources and reconcile these lead sources back to advertising spends." *Id.* at 4. Fifth, from 1998 to 2007, under his direction as chairman of an automation systems company, "senior managers developed ROI metrics on sales, marketing and advertising in a fashion that best reflected both the investments and results." *Id.*

Palubiak continues to provide business advice on strategy, marketing, and advertising across all industries, regionally, domestically, and globally. Tr. 1106. Palubiak testified that the general approach to advertising, marketing, consulting, and sales applies across industries, including the securities industry. Tr. 1106-07. He could easily advise, and has been asked to advise entities like Edward Jones, on different ways to approach their marketplace from an advertising and marketing perspective. Tr. 1108-09. Palubiak has worked with many different formulas and approaches to marketing and advertising. Tr. 1116. Here, in addition to reviewing various relevant documents, *see* RX 125 at 5-6, Palubiak interviewed Winkelmann and Juris with respect to their advertising approach and the "advertising factor," which Palubiak describes as the return on investment (ROI) of advertising. Tr. 1113-16; RX 125 at 10.

According to Palubiak, "[t]here is no single, standard way of calculating the ROI of an advertising campaign; indeed, this means that even if two such calculations yield differing results, neither is necessarily wrong." RX 125 at 7; *see id.* p. 10 ("Calculating the ROI on advertising campaigns is as much an art as a science."). With respect to Respondents' approach, in Palubiak's opinion,

> Blue Ocean and Winkelmann initiated a reasonable technique, closely monitored and recorded the outcomes, made changes to the Blue Ocean advertising strategies along the way based on information collected, and operated the business

> on the basis of such information. This practice was as good as I have ever seen; the care and detail that went into the Blue Ocean Advertising Analysis was remarkable. The advertising campaigns resulted in steady growth of the AUM, revenues and investor returns up until the time that the advertising campaigns were all but eliminated . . . .

Id. at 9. Palubiak noted that "[i]t is rare to see small or even large companies develop and utilize a lead tracking / advertising analysis system to the level that Blue Ocean did." *Id.* at 7; *see* Tr. 1139-40, 1153. He further found:

> From [his] review of the four Blue Ocean offering memorandums, the Blue Ocean financial statements, the master advertising file and the monthly advertising analytical reports[,] it is apparent that Blue Ocean invested remarkable amount of resources into their ever evolving goal of efficiently spending their advertising dollars in a manner that would produce the best outcome measured in new client engagements and recurring AUM fee based revenues.

RX 125 at 10. Palubiak testified that like BOP, "at Edward Jones, all these firms in St. Louis, they routinely, continuously modify their promotion mixes, the digital aspect, the radio aspect; they're changing their dynamic every single day." Tr. 1138-39. While acknowledging that Winkelmann's account of BOP's advertising mix was not completely accurate, he credited BOP for "phenomenally detailed records of what [it had] done" and for "continuously trying to improve" its accounting on a monthly basis. Tr. 1139-40. Palubiak saw no evidence that Winkelmann ever manipulated any data in computing the advertising ratio. Tr. at 1234. Specifically, he saw no evidence that Winkelmann manipulated either the revenue figures or time-periods used to calculate the ratio in order to make it look more favorable. Tr. 1234-35.

One area that Palubiak believed BOP should improve in calculating the advertising ratio was to take into account "continuing streams of revenue from year to year." Tr. 1153. Palubiak explained that Winkelmann's advertising ratio "wasn't showing ongoing revenues for the next year, next two years," etc., from advertising spending, and Palubiak viewed it as a "significant factor" that should be included. Tr. at 1146; *see* Tr. at 1129, 1159-60; RX-125 at 6 ("This open-ended aspect of future recurring revenues is significant and valuable as compared to most other type of companies which are dependent on new sales every period to account for total revenue."). Without it, BOP's advertising factor "understates how effective the Firm truly was." RX 125 at 10. Winkelmann "was being very conservative" by calculating the advertising ratio based on a year of revenue as opposed to "a lifetime's worth of anticipated revenues" attributable to the advertising. Tr. 1161; *see* Tr. 1142, 1147 ("It was a very conservative approach in my mind that he wasn't tracking the appropriate stream of revenues coming from that activity."), 1160; RX-125 at 10. Winkelmann could have counted estimated future revenues to judge the return on each advertising spending. Tr. 1164.[28] When the revenues from long-term customer

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[28] Palubiak noted that BOP's approach, while conservative, was not inappropriate, because "there is no one correct way to calculate ROI" from advertising, RX 125 at 10, but that BOP was "not calculating the trailing advertising dollars as everybody else does at the major firms." Tr. at 1145.

retention are "factored in, the true return on investment" from advertising spending that first resulted in new customers "extends well past the first year of revenue and results in a higher ROI." RX 125 at 10.

Finally, Palubiak found that under the exclusive marketing agreements with Binkholder, "Blue Ocean's practice of recording payments to Binkholder as a 'Consultant' was appropriate and not misleading" because of "the many ongoing and various consulting services that he provided which do not fall under the category of advertising." RX 125 at 9. Based on Palubiak's review of email correspondence and interview with Winkelmann, Palubiak found that Binkholder provided consulting that went beyond the scope of advertising spending, such as industry research, employee incentives and supervision, office configuration and phone systems, marketing and demographics, website design and functionality, video recordings, and vendor management and supervision. *Id.*; Tr. 1199-1200, 1204-05, 1207-08, 1210-11. Palubiak "routinely" receives as much money as Binkholder did in a similar consulting capacity, which is not recorded as advertising spending. Tr. 1140, 1210.

III. CONCLUSIONS OF LAW

A. Antifraud Violations

Respondents are charged with willfully violating the antifraud provisions of the Securities Act, Exchange Act, and Advisers Act, and Winkelmann is additionally charged with causing and willfully aiding and abetting BOP's violations.[29] OIP at 7. Specifically, the Division argues that Respondents: (1) misrepresented the advertising factor and how it was calculated in the four offering memoranda as well as in communications with investors; (2) failed to disclose negative information about Binkholder in the second and third offering memoranda; and (3) failed to disclose actual and potential conflicts of interest while making positive assertions regarding a lack of conflicts. Div. Br. at 36-39, 43. The conduct violating one of the antifraud provisions may also violate other provisions, as they proscribe similar misconduct. *See United States v. Naftalin*, 441 U.S. 768, 773 n.4, 778 (1979); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363 n.4 (9th Cir. 1993); *SEC v. Berger*, 244 F. Supp. 2d 180, 192 (S.D.N.Y. 2001); *SEC v. Blavin*, 557 F. Supp. 1304, 1315 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985).

Exchange Act Section 10(b) prohibits the use or employment of any manipulative or deceptive device; specifically, Section 10(b) and Rule 10b-5, "in connection with the purchase or sale of any security," prohibit: (1) employing any device, scheme, or artifice to defraud; (2) making material misstatements of fact or statements that omit material facts; or (3) engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. "[C]onduct that produces a false impression" is deceptive, and thus violates Exchange Act Section 10(b). *Dennis J. Malouf*, Securities Act Release No. 10115, 2016 SEC LEXIS 2644, at *20 (July 27, 2016). Such conduct "encompasses

[29] Willful means that the respondents knew what they were doing. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (a finding of willfulness does not require intent to violate the law, but merely intent to commit the act which constitutes the violation).

'making' a misrepresentation; it also encompasses, among other things, drafting or devising a misrepresentation." *Id.* at *20. Similarly, Securities Act Section 17(a), "in the offer or sale of any securities," prohibits: (1) employing any device, scheme, or artifice to defraud; (2) obtaining money or property by means of any material misstatement of fact or statements that omit material facts; or (3) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit. 15 U.S.C. § 77q(a). Unlike Section 10(b), a finding of manipulative or deceptive conduct is not required for a violation of Section 17(a). *Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *43.

Investment advisers may violate Sections 10(b) and 17(a) by "failing to correct a material misstatement in violation of a fiduciary duty to do so." *Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *30, *47. For advisers, a "breach of duty of disclosure may be viewed as a device or scheme, an implied misrepresentation, and an act or practice, violative of all three subdivisions" of Section 17(a) and Rule 10b-5. *J.S. Oliver Capital Mgmt., L.P.*, Securities Act Release No. 10100, 2016 SEC LEXIS 2157, at *27 n.27 (June 17, 2016) (citations omitted).

Advisers Act Sections 206(1) and 206(2) prohibit an investment adviser from (1) employing any device, scheme, or artifice to defraud; or (2) engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any current or prospective client. 15 U.S.C. § 80b-6(1), (2). Sections 206(1) and 206(2) "prohibit investment advisers from misstating material facts or omitting facts necessary to make a prior statement non-misleading." *Anthony Fields, CPA*, Securities Act Release No. 9727, 2015 SEC LEXIS 662, at *58 (Feb. 20, 2015). Additionally, "Section 206 prohibits 'failures to disclose material information, not just affirmative frauds.'" *Montford & Co.*, Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *51 (May 2, 2014) (quoting *SEC v. Wash. Inv. Network*, 475 F.3d 392, 395 (D.C. Cir. 2007)), *pet. denied*, 793 F.3d 76 (D.C. Cir. 2015). Investment advisers may be found liable under Sections 206(1) and 206(2) "for their fraudulent conduct regardless of whether they 'made' misstatements." *Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *54.

Section 206(2) further establishes a fiduciary relationship between the adviser and its clients, and imposes on the adviser "duties of 'utmost good faith, and full and fair disclosure of all material facts' and 'to employ reasonable care to avoid misleading [its] clients.'" *Bernerd E. Young*, Securities Act Release No. 10060, 2016 SEC LEXIS 1123, at *38-39 (Mar. 24, 2016) (alteration in original) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963)). "These fiduciary responsibilities also include a 'duty to disclose any potential conflicts of interest accurately and completely, and to recognize . . . a potential conflict.'" *Timbervest, LLC*, Advisers Act Release No. 4197, 2015 SEC LEXIS 3854, at *15 (Sept. 17, 2015) (ellipsis in original) (quoting *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003)), *appeal pending*, No. 15-1416 (D.C. Cir.).

To prove a violation of Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1) and 206(2), any misstatements or omissions must be material. A representation or omission is material if there is a substantial likelihood that a reasonable investor would have considered the misrepresented or omitted information important in deciding whether or not to invest and if disclosure of the omitted fact would have significantly altered the total mix of information available to the investor. *See Basic, Inc. v. Levinson*, 485

U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Moreover, a person who discloses material facts "must speak fully and truthfully, and provide complete and non-misleading information with respect to the subjects on which he undertakes to speak," and incomplete disclosures "implicate a duty to disclose whatever additional information is necessary to rectify the misleading statements." *SEC v. Curshen*, 372 F. App'x 872, 880 (10th Cir. 2010); *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 944 (7th Cir. 1989).

Scienter is required to prove violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1); a showing of negligence is sufficient to establish violations of Securities Act Sections 17(a)(2) and 17(a)(3) and Advisers Act Section 206(2). *Bernerd E. Young*, 2016 SEC LEXIS 1123, at *64-65 & n.67; *J.S. Oliver Capital Mgmt. L.P.*, 2016 SEC LEXIS 2157, at *12; *Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *46-49, *54; *see Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *53. Scienter is defined as a mental state consisting of an intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter can be established through recklessness. *Bernerd E. Young*, 2016 SEC LEXIS 1123, at *64.

To establish aiding and abetting liability, the Division must prove that: (1) a primary violation occurred; (2) the aider and abettor provided substantial assistance to the primary violator; and (3) the aider and abettor acted with the requisite scienter – at a minimum, extreme recklessness. *Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *86. An individual who aids and abets a violation is also a cause of that violation. *See id.* To establish that Winkelmann caused securities law violations, the Division must prove that: (1) a primary violation occurred, (2) respondent's act or omission was a cause of the violation, and (3) respondent knew, or should have known, that his conduct would contribute to the violation. *Robert M. Fuller*, Securities Act Release No. 8273, 2003 SEC LEXIS 2041, at *13-14 (Aug. 25, 2003). Negligence is sufficient to establish causing liability if scienter is not an element of the primary violation. *See KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *82-83 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

1. Advertising Factor

With respect to the Division's fraud allegations regarding the advertising factor, I find that Respondents did not willfully violate, and Winkelmann did not cause or willfully aid and abet any violations of, Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1) and 206(2). Although the findings of fact demonstrate that there were many ways BOP could have calculated, and did calculate, the advertising factor, and BOP did not specifically disclose its methodology of calculating the advertising factor to investors, the Division failed to meet its burden of proving that these various advertising factors and lack of disclosure were materially misleading.

The Division failed to prove its assertion that "Respondents made false statements by representing to investors [advertising] ratios that were not supported by BOP's internal financial figures." Div. Br. at 36. In the OIP, the Division alleged that the advertising ratios for each offering were incorrect, and, for each offering, specified the purportedly accurate ratio. However, at the hearing, the Division presented the testimony and summary exhibits of

Commission employee Collins, who calculated multiple advertising factors to compare to each statement in the four offering memoranda. Collins' calculations differ from what the Division alleges to be the correct factors in the OIP. The OIP's allegations and Collins' testimony are illustrative of the point that there can be reasonable disagreements in the calculation of the advertising ratios. Here, the Division, after the investigative phase, sought to provide various potential advertising factor calculations.

Although Winkelmann generally selected and reported the advertising ratios favorable to BOP based on recent firm performance, each ratio in the offering memoranda is generally attributable either to one in the financial data or exceedingly close to one in the data. While Juris did not work at BOP before or during the first offering, she was able to verify, persuasively, the advertising factor of 0.22 used in the first offering, using similar records and methods she later utilized throughout her tenure. Tr. 891, 924-28. For the second, third, and fourth offerings, an advertising ratio in the latest monthly report available preceding each offering is quite close, or the same, to the principal ratio reported in the respective offering. Resp. Reply Br. at 15 (summary chart) (citing RX 2-4; RX 36; RX 54 at 63; RX 120). In addition, the consistent testimony of Juris and Winkelmann was that the ratio, which was the result of more than one Excel equation, was revised over time as data points were added or corrected, so it is probable that Winkelmann had ratios available to him, at any given time, that do not necessarily appear in printed documents. *See* Tr. 456, 459-60, 692, 909-10, 912. However, one would nonetheless expect that the ratios used in the offering documents were at least close to the ratio captured in the monthly reports that preceded them. This is not a case of Winkelmann making up numbers, but instead one of Winkelmann choosing to report a ratio that was both favorable to BOP and supported by the data compilation continuously updated by Juris.

While Collins' summary of BOP's data available after the fact reflects that it is probable that the reported advertising ratios appeared more favorable than other ratio calculations, the ratios reported were part of a credible, evolving effort to improve how advertising expenditures were made and tracked. For example, in a purported effort to calculate the advertising factor for the first round offering, Collins used data that was compiled in June 2012 that reflected different numbers for earlier months than the data used by BOP at the time the offering was drafted. While Collins' summary, with different data, indeed presents a different picture of the advertising ratio, it is not one that shows BOP's reported ratio, at that time, was incorrect. Indeed, Collins' summary did not take into account how Juris collected, maintained, and utilized data to track advertising ratio, so his findings do not discredit the contemporaneous ratios that BOP had available. Tr. 1078-81.

The Division also failed to provide any "false statement" with respect to reports of the advertising ratio that "excluded the Chicago office's significant advertising expenditures." Div. Br. at 36. The plain language of the pertinent offering documents clearly expressed to investors that the figures for the Chicago office were not included, and were different from St. Louis. *See* RX 3 at 11 ("This conversion factor experience will be different in the Chicago market."). While that language, without more, should defeat the Division's allegation concerning Chicago, the advertising expert, Palubiak, testified that industry practice supported how Winkelmann handled the newly opened Chicago office's data in the context of the advertising ratio – excluding it from the St. Louis figures and then waiting for sufficient time and experience to elapse. Tr. 1196-97.

Furthermore, with respect to the only persons who invested in the fourth round offering, Winkelmann candidly discussed with them the difficulties of the Chicago office. Tr. 1313-14. Thus, in addition to them knowing the reported ratios in the offering document did not reflect on Chicago, those investors knew, from Winkelmann's own words, that the Chicago office was faring poorly.

The Division also contends that the advertising ratio appears more favorable than it should because a monthly sum paid to Binkholder was not included in the numerator of the advertising ratio. BOP did not treat the payments it made to Binkholder under the agreement to be advertising expenses. What is lacking, however, is evidence from the Division that BOP was required either by rule or industry standard to include the payments to Binkholder as advertising spending. Collins admitted that as far as he was aware, there is nothing in GAAP that supports characterizing the payments to Binkholder under his agreement with BOP as advertising expenses. Tr. 168. Winkelmann's CPA advised him that it was not inappropriate to classify the payments to Binkholder as consulting fees rather than advertising expenses. Tr. 1308-09. Binkholder provided a host of advertising and marketing consulting services to BOP. Tr. 1371; *see* RX 101. The advertising expert, Palubiak, analyzed this host of services and confidently concluded that they should not be included in advertising expenses. RX 125 at 9; Tr. 1199-1200, 1204-05, 1207-08, 1210-11. In the marketing agreement itself, the payments to Binkholder were explicitly deemed by the parties to be "over and beyond the direct expenses of advertising." DX 5 at 2. By contrast, payments that BOP made to the radio station on which Binkholder's show aired *were* treated as advertising expenses. Although the Division's position is not unreasonable – for one could imagine a world where the payments were factored into the advertising ratio – here neither law nor practice requires it, and, as such, it was not problematic to exclude them from the advertising ratio calculation.

With respect to the Division's pejorative characterization of Winkelmann's selection of favorable ratios as "cherry pick[ing]," the Division has failed to establish that selecting favorable ratios was inappropriate. Div. Br. at 36. Although the Division surely could have presented an expert on the advertising ratio, for unknown reason(s) it elected not to do so. Palubiak explained that there is not a specific industry standard for how to calculate and report the advertising ratio, and that, in comparison to small and even large companies, BOP had one of the best methods to track and improve the calculation and tracking of its advertising ratio. In addition, any assessment of the reasonability of BOP's advertising ratio must be informed by Palubiak's opinion that it used a "very conservative" approach in how it discussed the ratio. Tr. 1161. Because BOP only compared advertising expenditure with respect to a year's worth of resulting revenue, it created the impression that if one dollar spent on advertising did not yield more than one dollar of annual revenue it was not a good investment. However, as Palubiak explained, BOP was likely to receive substantial, long-term revenue for years from any new investment. In that vein, one dollar spent on advertising, even if the new business it returned resulted in less than one dollar of revenue that year, may nonetheless be positive for investors as it returned revenue for several years thereafter. Indeed, the present posture of BOP, which continues to be profitable in the absence of any continuing or further advertising, has validated Palubiak's opinion.

Similarly, the Division's assertion that Winkelmann "switched methodologies" is not an indicia of fraud, but simply Winkelmann's decision to report actual data reflecting success of the business. Div. Br. at 37. BOP's documents never described the methodology other than in relatively basic terms, i.e., that for BOP, revenue resulting from advertising expenses should be greater than those expenses, and its evolving method, according to Juris, Palubiak, and Winkelmann, was oriented toward improving the efficacy of advertising spending in order to improve that ratio. As Palubiak explains, the desirable industry practice is for businesses to pursue vigorous efforts internally to identify how to improve both its promotional mix and track its ratio. There is no evidence that this evolving internal approach need be relayed to investors. No investors here asked for information on methodology. Although some testified that they would have wanted to know if the advertising ratio was stated incorrectly, the gravamen of the testimony was of course that they would have wanted to know if the overall approach was not cost effective. I note that the Division, in bringing public allegations against Respondents, claimed that they committed fraud by not stating accurate ratios, which the Division did not specify the methodology for, and later abandoned its allegations of the correct figures. By contrast, Respondents' overarching method is at least reasonable.

The Division is correct that there were areas for improvement in select offering documents, but these were mitigated, or were not established to be meaningful problems. For example, in the second offering, BOP assumed that all "revenues were 1% of AUM," but because for investments over a certain size, BOP charged less than 1%, in April 2012, BOP changed its fee assumption from 1.0% to 0.77%, to better reflect the fees that BOP was actually earning.[30] Winkelmann, on his own, oversaw the refinement of this method to more accurately reflect the revenue stream. Had Winkelmann been engaged in an effort to falsify the advertising ratio, he would surely not have made the refinements to revenue calculations that decreased revenue projections, and, in general, adopted a "very conservative" approach to how he characterized the ratio. Although the offerings flagged the advertising ratio as a "key driver" of BOP's model, I do not find that BOP materially misrepresented the advertising ratios here. While, on the one hand, the data could have been used to report a less favorable ratio, Winkelmann's decision to take a conservative approach in comparing it to the amounts of future revenue establishes that imperfections, on the whole, did not disadvantage investors. Furthermore, as Palubiak attests, Winkelmann and BOP took ongoing, praiseworthy efforts to use its promotion mix to hone the efficacy of advertising expenditures, which, to the extent successful, was of direct benefit to investors.

2. Representations and Omissions Regarding Binkholder

I also find that the Division failed to prove materiality with respect to the Division's allegations that Respondents' second and third round offering documents misleadingly failed to disclose that the Missouri Division of Securities had barred Binkholder from acting "as an agent

[30] *Compare* RX 54 at 29 (April) (new AUM of $6,449,000 times 0.77% equals estimated new revenues of $49,657), *with id.* at 17 (March) (new AUM of $5,354,000 times 1.0% equals $53,540 in estimated first-year revenues).

or investment adviser representative in the State of Missouri" in 2011. OIP ¶ 14.[31] Binkholder was not acting as an investment adviser for BOP. Tr. 1371. The Division's expert, Arthur Laby, conceded the bar had no impact on the tasks performed by Binkholder. Tr. 292. Binkholder consulted on BOP's advertising and marketing efforts, and generated leads through the radio and internet. Although the Division intimates that Binkholder was so important to the offerings that the bar should have been disclosed, that argument is undercut by a number of factors: (1) Binkholder is never included in the list of BOP's "key people" – although there are eight such individuals listed in the second round and nine in the third round, *see* RX 2 at 19-22; RX 3 at 17-20; (2) neither Binkholder nor his radio show name, *The Financial Coach*, is included in the list of BOP's "key vendors and relationships" – although six are mentioned in the second round and seven are mentioned in the third round, *see* RX 2 at 17; RX 3 at 11-12; and (3) the evidence establishes that Binkholder's radio show, which aired only one hour per week, had at least a modest, positive impact on advertising, but it is not clear what its impact was in comparison to BOP's daily promotion mix on all media, including radio advertisements. Tr. 427-31; RX 13-14. More important, however, Binkholder's bar did not preclude him from providing the services he did to BOP, and as Winkelmann testified, it did not matter that Binkholder was barred from functioning as an investment adviser because Binkholder "wasn't being retained or compensated in that capacity of being an investment advisor representative." Tr. 1381-82.

3. Conflicts of Interest

I find that Respondents failed to disclose actual and potential conflicts of interest while making positive assertions regarding a lack of conflicts, and as a result, violated Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1) and 206(2). *See Edgar R. Page*, Advisers Act Release No. 4400, 2016 SEC LEXIS 1925, at *14 (May 27, 2016) ("Advisers are required as a matter of law to disclose 'economic conflicts of interests' to their clients." (quoting *IMS/CPAs & Assocs.*, Securities Act Release No. 8031, 2001 WL 1359521, at *8 & n.33 (Nov. 5, 2001), *aff'd sub nom. Vernazza v. SEC*, 327 F.3d 851 (9th Cir. 2003))); *Dennis J. Malouf*, 2016 SEC LEXIS 2644, at *61 ("By failing to correct UASNM's multiple representations that he did *not* have a conflict, Malouf breached his fiduciary duties as an investment adviser."); *Larry C. Grossman*, Securities Act Release No. 10227, 2016 SEC LEXIS 3768, at *24 (Sept. 30, 2016) (failure to disclose conflicts violated Sections 206(1) and 206(2)). As discussed in more detail below, Respondents' statements and omissions were material, Respondents acted with scienter, and Respondents violated their fiduciary duties to their investment advisory clients.[32]

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[31] This Binkholder issue post-dates the first round offering, and the fourth round offering contains disclosures about Binkholder based on additional revelations about Binkholder following the bar.

[32] I address Respondents' advice of counsel defense *infra*. While I find that Respondents relied on counsel with respect to the conflict of interest disclosures made to non-advisory client investors, I do not find similarly with respect to Respondents' advisory client investors. Thus, scienter is negated with respect to the non-advisory clients only, and Respondents' violations apply only to the advisory client investors.

Winkelmann was reckless, at the very least, in repeatedly asserting to royalty unit investors that his approach eliminated conflicts of interest, aligned their respective interests, and that he always acted in their best interests when in fact their interests were adverse in two critical respects. First, as investments came in, although Winkelmann represented that those proceeds would be spent to generate revenue, Winkelmann did not disclose that as a result of that increased revenue, he could and did increase his and Binkholder's compensation. Although the fact that they received compensation from BOP, in general, was either disclosed in some form or could be safely assumed, investors could not reasonably have known that they were being courted, in part, to hand over funds that could go directly into Winkelmann's pocket, or that of his entities. Although the offering documents contained language regarding general and administrative expenses, *e.g.*, RX 2 at 6-7, they did not contain express language regarding Winkelmann's compensation, or any language to address the tension between Winkelmann's self-interest and the investors.

The aforementioned creditable efforts of Winkelmann and BOP to use advertising expenditures as effectively as possible to increase revenue would of course be undercut to the extent that rather than directing new investments into the promotion mix, Winkelmann instead paid himself or one of his companies. While Respondents contend that an undisclosed conflict of interest is not actionable if there is no fiduciary obligation to the purchaser, that is incorrect where, as here, it is not a mere case of an undisclosed conflict of interest, but a case where Respondents repeatedly misrepresented that there were no conflicts of interest, and indeed, that conflicts had been eliminated by a structure that always aligned the interests of the royalty unit holders and Winkelmann.

Second, as revenue resulting from advertising came in, while there was no conflict of interest with respect to the minimum payment royalty unit holders would receive, with respect to any return above that, there was an actual, continuing conflict between their interests, and Winkelmann's, who could always elect to increase his compensation rather than returning more than the minimum to investors.[33] This conflict is highlighted by Respondents' contention that "[w]hile each offering contemplated additional payments that could be made to investors, such payments were to be made at Mr. Winkelmann's sole discretion, and were never obligatory." Resp. Reply Br. at 4.

Although Respondents point to ten separate disclosures, including the variable repayment schedules, concerning the "conditional" nature of additional payments, what is conspicuously absent from all those disclosures is the inherent conflict between Winkelmann's ability to take, for himself, both the initial investments, and revenues after the investors' guaranteed minimum. *See* Resp. Reply Br. at 5-6. Either action by Winkelmann would decrease funds available to grow the business through advertising or pay investors a higher rate of return. Indeed, Respondents themselves agree that the express terms of the offering described "what investors' funds *were* to be used for: funding the Firm's advertising campaign. *The sole objective of the*

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[33] Although it would have been relatively easy to create a system where their interests were actually aligned – e.g. tying what Winkelmann received to a percentage of what he paid each royalty unit holder, and disclosing it up front – that is not what took place. Instead, other than a minute guaranteed payment, everything beyond that was fair game for Winkelmann.

offerings was to grow Blue Ocean's customer base through selective advertising. On this point, the documents are clear and unequivocal . . . ." Resp. Reply Br. at 10 (second emphasis added) (footnote omitted). Although the timeline to repay investors "was extremely variable," *id.* at 6, and subject to various disclosed risks, *id.* at 7-8, neither the existence nor impact of the above-described conflicts were ever mentioned, and because the offerings represented that conflicts had been eliminated, Respondents' argument, by inference, that the other disclosures somehow cure these conflicts is unpersuasive.

Respondents contend that the Division's position is that "*every single dollar* held in the Firm's operating account or available to the Firm was somehow owed to the investors." Resp. Reply Br. at 8 (emphasis in original). This appears to be a red herring, because nowhere in the Division's filings is this contention made, and seems to miss the point that the conflict of interest is not an all or nothing proposition (it does not have to be "every" dollar to cause a conflict), but simply that a conflict existed, and investors should have been made aware of it.

While Winkelmann appears to hold a sincere belief that the royalty unit offerings and associated representations pose no conflicts of interest, that view is nonetheless extremely reckless. Yet, Winkelmann did not just fail to disclose the actual and potential conflicts, but instead affirmatively misrepresented that he had "eliminated" them. As CCO and a licensed securities professional with more than thirty years of experience, Winkelmann's belief that he had somehow eliminated conflicts of interest was extremely reckless. *See Larry C. Grossman*, 2016 SEC LEXIS 3768, at *18-19 (investment adviser acted with scienter when he knew he was receiving compensation by virtue of client investments but failed to disclose conflict). Though Winkelmann recalls that one attorney told him he could do so, the subscription agreements drafted by the same attorney required investors to represent and warrant that they had not received investment advice from BOP. Because Winkelmann reviewed and approved the subscription agreements, he was reckless in knowing all his BOP clients who purchased royalty units made false representations in order to invest. The reckless misrepresentations by Winkelmann and BOP regarding the elimination of conflicts of interest represent violations of Exchange Act Section 10(b) and Rule 10b-5 and Securities Act Section 17(a). As CEO and manager of BOP and in his role as the main actor in raising funds for BOP and preparing the offering memoranda, Winkelmann caused and willfully aided and abetted BOP's violations.

For the same reasons, Winkelmann and BOP willfully violated Advisers Act Section 206 and Winkelmann caused and willfully aided and abetted BOP's violations. *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007) ("Facts showing a violation of Section 17(a) or 10(b) by an investment adviser will also support a showing of a Section 206 violation."). Additionally, Winkelmann and BOP violated Section 206 by breaching the fiduciary duties owed to their advisory clients who purchased royalty units. Winkelmann and BOP breached the duties of loyalty, due care, and honesty owed to their clients. By failing to disclose the conflicts attendant to the royalty unit offerings, whereby Winkelmann faced the recurring choice of whether to increase payments to investors or to increase his own compensation, Winkelmann breached his duty to recognize and fully disclose all conflicts of interest.

Winkelmann's recklessly misleading statements with respect to eliminating conflicts of interest are particularly troubling in light of the fact that the majority of royalty unit holders were advisory clients to whom Winkelmann and BOP owed fiduciary obligations to disclose all material facts – including all conflicts of interest, which are always material in that context. *See Vernazza*, 327 F.3d at 859 ("It is indisputable that potential conflicts of interest are 'material' facts with respect to clients and the Commission."). I am unpersuaded by Respondents' contention that "[i]n the context of the Royalty Unit offerings, however, Mr. Winkelmann and Blue Ocean were not . . . making recommendations or giving investment advice . . . ." Resp. Br. at 32. By the very language of the Advisers Act, which prohibits certain conduct by an investment adviser with respect to "any client or prospective client," an investment adviser cannot take off his fiduciary hat in exchange for a non-fiduciary hat when it suits him. 15 U.S.C. § 80b-6. It would be inconsistent with the purposes of the Advisers Act to permit an adviser to disown his fiduciary obligations especially with respect to an investment he is intimately involved with, as Winkelmann was here. Winkelmann repeatedly went to his advisory clients, told them about the opportunity, and, in effect, attempted to persuade them to invest, typically by using funds in their advisory accounts. While Winkelmann caveated his overtures with the assertion that he was not giving advice or making a recommendation, he nonetheless had a fiduciary obligation to each client in presenting them the investment opportunity to purchase with their BOP-managed advisory account, to disclose conflicts. To find otherwise would mean that all investment advisers, simply by telling a client it is not advice or a recommendation, can now present any other investment opportunity to them, fail to disclose conflicts of interest, and empty the advisory clients' accounts into such investments. And by routinely choosing to pay himself or his entities while keeping investor payments at near-minimum levels, Winkelmann violated the duty of loyalty to always act in his clients' best interest. The Division presented unrebutted expert testimony from Professor Arthur Laby that Winkelmann violated applicable industry standards of conduct with respect to the preceding disclosure and fiduciary obligations. DX 363 at 3, 20, 22-24, 26-28.

The Division makes two additional arguments regarding Respondents' conflicts of interest and how Respondents used BOP's funds, to which I give no weight. The Division contends that Respondents should have disclosed a four-day collateral pledge BOP made to Blue Ocean ATM to secure a bank loan to stock ATMs. Div. Br. at 23, 44; *see* Tr. 809-10. No specific disclosure was required for two reasons. First, the pledge was not of money that Respondents could have then paid royalty unit holders, because it was earmarked for future advertisements. Tr. 1396. Thus, there was no conflict created by the pledge. Second, the offering documents advised royalty unit holders that "[p]roceeds could also be used to fund other revenue-producing activities that are directly or indirectly related to Blue Ocean Portfolio's business activities." *E.g.*, RX 2 at 6-7. Prominently featuring "Blue Ocean" ATMs at an event attended by several thousand people – which include the "Blue Ocean" name and logo, albeit without the word portfolios, produced a great advertising benefit to BOP. Tr. 815, 1397. Thus the offering documents, which generally contemplated such promotional activities, contained a sufficient disclosure. Although Blue Ocean ATM realized $4,000 from the festival and never paid BOP or the royalty unit investors for the use of the funds as collateral, Respondents later credited royalty unit holders' accounts with their share of these funds, which amounted to about twenty dollars (the royalty unit holders did not receive additional funds, but had previously been paid more than the required minimum percentage payments). *See* DX 375.

The Division also contends that Winkelmann failed to disclose to royalty unit holders a $50,000 settlement and that by "using BOP funds to settle personal debts . . . Winkelmann violated the duty of loyalty to always act in his clients' best interest." Div. Br. at 23, 44. Although Winkelmann personally consented to the judgment, the lawsuit was against both him and BOP, and his settlement ended the claims against both of them. DX 170 at 8895-96, 8921; Tr. 800-01. While the manner of the settlement means the payment can properly be parsed as satisfying Winkelmann's personal debt, the benefit to BOP was the same, or more, given that it did not have to consent to end the suit. Winkelmann viewed the lawsuit as an effort to hold BOP "hostage" and ultimately deemed it a "good business decision for Blue Ocean" to get out of the litigation. Tr. 800-01. Thus Winkelmann's understanding from his attorney that the $50,000 was owed by both him and BOP, though technically incorrect, was reasonable. Tr. 801-02. The use of BOP's funds to end the lawsuit against Respondents was in the royalty unit holder's best interest, and although Winkelmann personally consented to the settlement, the expenditure to end the lawsuit against BOP can be construed in these specific circumstances as an appropriate, general expense of BOP.

B. Custody and Compliance Rules and Advisers Act Section 207 Violations

Respondents are also charged with violating the Advisers Act's custody, compliance, and reporting provisions. OIP ¶¶ 19-25, 31-33. Specifically, the Division alleges that BOP willfully violated, and Winkelmann caused BOP's violation of, Advisers Act Section 206(4) and Rules 206(4)-2 and 206(4)-7, and Respondents willfully violated Advisers Act Section 207. OIP ¶¶ 31-33.

Advisers Act Section 206(4) prohibits an investment adviser from "engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative" and authorizes the Commission to promulgate rules to further prevent violative behavior. 15 U.S.C. § 80b-6(4). Rule 206(4)-2, the custody rule, governs the required procedures for investment advisers who have custody of their clients' funds or securities. 17 C.F.R. § 275.206(4)-2. Rule 206(4)-2 is designed to "provide for a more robust set of controls over client assets designed to prevent those assets from being lost, misused, misappropriated or subject to advisers' financial reverses." Custody of Funds or Securities of Clients by Investment Advisers, 75 Fed. Reg. 1456, 1457 (Jan. 11, 2010). The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent the 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: (a) 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; (b) notify each client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained; (c) have a reasonable basis, after due inquiry, for believing that the custodian sends account statements directly to each client at least quarterly; and (d) 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.* § 275.206(4)-2(a)(1)-(4). "Lack of intent is no defense" to a custody rule violation. *Abraham &*

Sons Capital, Inc., Advisers Act Release No. 1956, 2001 SEC LEXIS 2773, at *27 & n.28 (July 31, 2001).

BOP willfully violated Section 206(4) and the custody rule by accruing in BOP's lone operating bank account the percentage of BOP cash receipts owed to the royalty unit investors who were BOP advisory clients. Winkelmann knew about the custody rule and understood that all accrued amounts belonged to the investors. Winkelmann further understood that these accrued amounts owed to the investors were held as cash in BOP's lone bank account for months at a time, and were commingled with BOP's operating cash. Prior to 2015, BOP failed to take the measures required for advisers with custody of client funds. Winkelmann caused BOP's custody rule violations. As BOP's CEO and CCO, Winkelmann determined BOP's process for when investors would be paid, how the amounts owed to investors would be commingled with other funds in BOP's operating account, and whether or not to have BOP comply with the requirements of the custody rule.

Rule 206(4)-7 requires investment advisers to (1) "[a]dopt and implement written policies and procedures reasonably designed to prevent violation[s] . . . of the Act and the rules . . . adopted under the Act"; (2) review annually the adequacy and effectiveness of these policies and procedures; and (3) designate a CCO responsible for administering the adopted policies and procedures. 17 C.F.R. § 275.206(4)-7. An adviser violates Rule 206(4)-7 when it fails to adhere to its own written compliance policies. *See J.S. Oliver Capital Mgmt., L.P.*, 2016 SEC LEXIS 2157, at *35; *Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *77-78 (May 16, 2014), *pet. granted in part on other grounds*, 793 F.3d 147 (D.C. Cir. 2015).

BOP willfully violated Section 206(4) and Rule 206(4)-7 because its compliance policies and procedures manuals falsely stated that BOP did not have custody of client assets, and that client funds would be maintained by custodians other than BOP. As CCO, Winkelmann was tasked, in writing, with implementing BOP's custody policies and procedures. Accordingly, Winkelmann caused BOP's violation of Rule 206(4)-7.

Advisers Act Section 207 prohibits the willful making of any untrue statement of a material fact or omission of any material fact in a Form ADV. 15 U.S.C. § 80b-7. "Scienter is not required for violations of Section 207," such that there is "no requirement that the respondent 'also be aware' that he 'violat[ed] one of the Rules or Acts.'" *J.S. Oliver Capital Mgmt., L.P.*, 2016 SEC LEXIS 2157, at *32 (alteration in original) (quoting *Wonsover*, 205 F.3d at 414 (D.C. Cir. 2000)).

During the relevant period, BOP filed at least twenty Forms ADV that inaccurately represented that BOP did not have custody of client funds. Winkelmann was a "maker" of the statements within the meaning of Section 207 because he had ultimate authority over and controlled the contents of those forms and caused the forms to be filed with the Commission. Thus, both he and BOP willfully violated Section 207. *Larry C. Grossman*, 2016 SEC LEXIS 3768, at *25-27 (misstated custody arrangements in adviser's Forms ADV were material and violated Section 207).

C. Reliance on Counsel Defense

Respondents have raised reliance on counsel as an affirmative defense, premised on their consultations with the Greensfelder attorneys. Resp. Br. at 50-53; Resp. Reply Br. at 38-41. Reasonable reliance upon advice of counsel is a recognized defense to the *scienter* element of the alleged violations, meaning that the defense has no effect on non-scienter-based violations, such as Advisers Act Section 207. *SEC v. Huff*, 758 F. Supp. 2d 1288, 1348-49 (S.D. Fla. 2010), *aff'd*, 455 F. App'x 882 (11th Cir. 2012). The advice of counsel defense requires that Winkelmann and BOP satisfy the following four elements: (1) complete disclosure to counsel; (2) request for counsel's advice as to the legality of a contemplated action; (3) receipt of advice that the contemplated action was legal; and (4) good faith reliance on that advice. *SEC v. Prince*, 942 F. Supp. 2d 108, 138 (D.D.C. 2013). For the reasons that follow, Respondents have satisfied the reliance on counsel defense with respect to certain aspects of the Division's claims, but not with respect to others. The three areas in which Respondents assert the defense are: (1) custody and Forms ADV; (2) conflicts of interest; and (3) the Binkholder bar. Each is discussed in turn.

1. Custody/Forms ADV

In early 2014, Winkelmann completely disclosed the custody issue to Greensfelder and requested advice about whether to continue to take the position that BOP did not have custody of royalty unit holder's funds. At that time, Greensfelder expressly counseled Respondents that they did not have custody of client funds and expressly advised them not to revise their Form ADV otherwise. RX 106 at 2404-05, 2407-08; *see* DX 298 at 1, 5. Winkelmann relied on that advice. Thus, I find that for the period from when Winkelmann received that advice, up until when Respondents changed their custody position and practice to comply with the Commission's request, the elements of the advice of counsel defense are satisfied. Meaning that during that period, Respondents acted neither with scienter, nor negligence, with respect to custody and their custody disclosures on Forms ADV. Before 2014, there is no direct, or indirect evidence that Winkelmann satisfied the four elements of the advice of counsel defense with respect to custody issues or Forms ADV, and because of that, Respondents have failed to satisfy the requirements of the defense for the period before 2014. In any event, Respondents' reliance on counsel does not negate their liability for the Advisers Act Sections 206(4) and 207 and Rule 206(4)-2 violations because as discussed *supra*, scienter is not an element of these provisions.

2. Conflicts of interest

Although Winkelmann initially drafted language concerning conflicts of interest in the offering documents, he submitted those drafts to Greensfelder for review and revision. FOF 53, 55. The language regarding the elimination of all conflicts of interest, and the alignment of interests, repeatedly appears in each of those documents. RX 1-4. While it is difficult to appreciate how someone who understood the royalty unit offering could understand that such representations were true, Greensfelder expended considerable time discussing, reviewing, and revising the offering documents that were used by Winkelmann in the offerings. Despite other changes to the draft offering documents, and despite changes to the disclosures between the various offerings, the conflict of interest language was never amended or updated. Winkelmann followed Greensfelder's advice with respect to the offering documents. Thus, with respect to the inclusion of the language in the offering materials reviewed and approved by Greensfelder, Respondents have satisfied the elements of the advice of counsel defense, and, as such have established a defense to *scienter* regarding those representations with respect to royalty units sold to non-advisory clients.[34]

A related, but more difficult issue for Respondents is the sale of royalty unit offerings to advisory clients, to whom they owed fiduciary obligations. Respondents argue that the Greensfelder attorneys were aware of the sales to BOP advisory clients. Resp. Br. at 32 n.132. Respondents contend that the subscription agreement Greensfelder drafted, in which the subscriber warrants that BOP "has not provided any investment advice to Subscriber," *e.g.*, RX 3 at 129, represents:

> [R]elatively standard language [that] is not reasonably interpreted to mean that Blue Ocean had *never* provided any investment advice, in any context, to the particular investor at any point in the history of the world. Given the context of the paragraph, however, in a document accepting the purchase of a particular investment, it is more properly read to state only that the Blue Ocean did not advise the Subscriber as to whether or not this particular investment was proper for them.

Resp. Reply Br. at 37-38 (emphasis added).

Setting aside the reference to "the history of the world," Respondents' interpretation is unpersuasive for a number of reasons. The quoted language from the subscription agreement more reasonably suggests that the Greensfelder attorneys drafted it at the time with the view that Respondents would not be making these sales to advisory clients. First, the plain language of the representation is clear, and not limited to advice to the "Subscriber as to whether or not this particular investment was proper for them." *Id.* at 38. Greensfelder selected language that BOP had "not provided *any* investment advice to Subscriber." RX 3 at 129 (emphasis added). "Any" means "some, or even the smallest amount (of)" a thing,[35] and it appears in a sentence concerning "investment advice" where that advice is not limited as to whether the royalty unit was proper for them (nor subject to another limitation). If Respondents are correct as to the intent and purpose of the representation, then Greensfelder could have easily drafted plain language to that effect, either by using language similar to the Respondents' interpretation, or by stating that "neither Blue Ocean nor Winkelmann provided investment advice or a recommendation to the Subscriber in relation to this royalty unit offering" (or recommended or advised that the Subscriber purchase this offering).[36] But, in the absence of any such limitation,

[34] Thirteen royalty units were sold to five non-advisory clients over the course of the four offerings. DX 455.

[35] *Any*, CAMBRIDGE DICTIONARY, http://dictionary.cambridge.org/us/dictionary/english/any (last visited Mar. 15, 2017).

[36] This example merely illustrates the ease with which plain language could represent the meaning urged by Respondents, but does not intend to address the overarching issue of whether

plain language is a principal canon of construction that governs here. *Hallwood Plaza, Inc. v. United States*, 84 Fed. Cl. 804, 811 (2008) (stating that where the plain language of a contract is unambiguous, "the court's inquiry is at an end, and the plain language of the agreement controls").

Second, given Respondents' assertion that Greensfelder used "relatively standard language," Resp. Reply at 37, meaning what Respondents profess it does, then it stands to reason that there should be ample interpretive precedent that confirms Respondents' position. Yet Respondents cite no precedent(s) or persuasive authority whatsoever to support that position, presumably because there is none. Instead of arguing from the agreement's language, or any interpretive authority, Respondents instead seek to support their position by inference based on the testimony – or rather, lack of testimony – from investor witnesses, arguing "[t]his reading of the document is supported by the fact that none of the investment clients who executed a subscription agreement raised any concerns with the document or otherwise indicated the provision was 'ambiguous.'" *Id.* at 38 (citing Tr. 32, 35, 360, 644). But none of the cited testimony reflects that any witness held the view of the agreement that Respondent is now urging. While one may take the subscribers' views and actions at the time they signed the agreement into account, it is well established that such contemporaneous considerations cannot alter an agreement's plain meaning. *See Brawley v. United States*, 96 U.S. 168, 173-74 (1877). They would come into play, productively, only insofar as the agreement's language was unclear. *Cf. id.*

Third, quite unlike the advice from Greensfelder on the offering documents, for which there is a considerable quantity of documentation and correspondence, there is a perplexing dearth of documentation as to Greensfelder's consideration and advice, if any, on the issue of whether Winkelmann could sell royalty units to advisory clients without violating his fiduciary duties. Winkelmann presented the offerings as a way for advisory clients, among a few others, to buy into his investment advisory business. BOP's clients often paid for those royalty units by having Winkelmann effectuate transfers out of their advisory accounts, and into the operational accounts of BOP from where Winkelmann could spend monies at his discretion. Given Winkelmann's legal duties to advisory clients, and the language of the subscription agreements, this was, at the least, an area fraught with legal risk. While Winkelmann recalls that upon asking orally, Morgan orally advised him that there was "no problem" selling royalty units to existing advisory clients, it is inconceivable that there would not have been some underlying research, analysis, and discussion within Greensfelder before rendering such bold advice. All agree that Morgan was an experienced securities practitioner, and it is not conceivable that he would have blessed this scheme in the absence of any documentation or correspondence to show how he arrived at the advice that Winkelmann recalls receiving. Yet there is nothing at all in writing.

Furthermore, despite Morgan's unfortunate passing, there were still at least two other attorneys at Greensfelder who were available to testify, but not called by Respondents, notwithstanding Respondents' contention that they advised Respondents could sell royalty units to advisory clients, Resp. Reply Br. at 37 (citing RX 106 at 2400-02), and were not "surprise[d]"

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investment advisers are permitted bypass their fiduciary obligations to their clients in the sale of securities so long as they have each client sign such a warrant.

that Winkelmann had been selling them to advisory clients, *id.* at 37 & n.173. The support for the foregoing assertion is the following email exchange. On March 4, 2014, BOP's accounting and compliance manager, Kelly Hennessy, emailed two questions to Walsh, copying Winkelmann. RX 106 at 2402. One question was whether "royalty units qualify as 'securities' for the purposes of" Form ADV Part 1 Item 8(A). *Id.*[37] On March 13, 2014, Hennessy emailed Winkelmann only – not even copying Walsh – and conveyed that she just spoke to Walsh "regarding the ADV updates." *Id.* at 2401. Hennessy's email conveys that if Winkelmann is "'recommending' to current advisory clients that they purchase royalty units than this[[38]] should be answered YES. I assume we would also need to enter a disclosure on Part 2. He said this will definitely raise some interest from regulators." *Id.* On March 13, 2014, Winkelmann responded to Hennessy's email, writing to Walsh, Hennessy, and Wendy Menghini (another Greensfelder attorney) as follows:

> We never "recommended" Royalty Units to clients. In my interview with [the Missouri Division of Securities] last year during their investigation, I said that I made clients aware of the offering and never "recommended" to any client that they subscribe. Some clients that I informed subscribed others did not. So I think it should stay NO. Plus at this point we have no plans for follow on offerings.

Id. Winkelmann's email did not request any action or response from Walsh or Menghini. Unremarkably, neither attorney responded to that email, so it is difficult to infer anything about what their reaction was (or lack of "surprise"). The asserted lack of "shock and surprise" by the two Greensfelder counsel, given that they were not asked in the email for advice, is insufficient evidence to substantiate their reaction.[39] Resp. Reply Br. at 37. For Winkelmann to have to volunteer the above information to them suggests that they did not know the history of his activities selling the royalty units. For him to have posed, for the first time in 2014, questions to Greensfelder about how the royalty units must be addressed on Forms ADV, indicates he had not previously made complete disclosures and sought the advice of Greensfelder on this issue.

If, as Respondents contend, both of these two attorneys would have corroborated the reliance on counsel defense with regard to selling securities to advisory clients, then it was at their peril that they elected not to call either one of them. Notably, neither Hennessy's summary

[37] That fact that such a basic question – whether the royalty units were securities – was being posed to counsel, apparently for the first time – three years after the first round offering, underscores the preceding finding that Respondents failed to establish a reliance on counsel for the Form ADVs prior to 2014.

[38] Form ADV Part 1 Item 8.A.(3) asks "Do you or any related person: recommend securities (or other investment products) to advisory clients in which you or any related person has some other proprietary (ownership) interest (other than those mentioned in Items 8.A.(1) or (2))?" *E.g.*, DX 295 at 23.

[39] Furthermore, Winkelmann noted in the email that BOP had "no plans for follow on offerings," suggesting to Walsh and Menghini that they were not being asked for any advice. RX 106 at 2401.

of her discussion with Walsh, nor any of the Greensfelder material in RX 106, reflect Walsh's consideration of the relationship between the subscription agreements and the above email exchange, which took place years after the initial subscription agreement. There is no discussion with Walsh as to how the subscription agreements would bear on the appropriateness of Winkelmann selling royalty units to advisory clients. Just as Morgan would have been expected to engage in thoughtful consideration of this issue, the same can be said for Walsh and Menghini. Again, there is nothing in the substantial documentary production from Greensfelder that reflects that Winkelmann ever asked them for advice on whether or not he could sell royalty to units to clients or that Greensfelder advised he could. There is no evidence that Winkelmann ever asked Greensfelder attorneys whether he could successfully sidestep his fiduciary duties to advisory clients by caveating his presentations of investment opportunities (where his interests would conflict with theirs) simply by saying he was not advising or recommending that they invest. Had he done so, one would expect evidence that Greensfelder considered it before advising him. The practice that Winkelmann contends Greensfelder approved would allow any investment adviser to sell investments to advisory clients, in which the adviser has interests in conflict with clients, just so long as each time a new, conflict-laden investment is being offered, the adviser says he's not advising or recommending that the client invest, but just alerting them to another excellent opportunity. Yet, an investment adviser's duties to his advisory clients are not so easily circumvented and Respondents have failed to carry their burden of proof that they relied on Greensfelder's advice before selling royalty units to advisory clients. Because Respondents were unable to meet their burden of proof on the reliance defense with respect to the sale of royalty units to BOP advisory clients, scienter is not negated with respect to the conflict-of-interest related antifraud violations. Although the Greensfelder attorneys provided advice regarding the conflict of interest disclosures (and lack thereof), this advice was uninformed with respect to the fact that Respondents would be offering the units to their advisory clients. Greensfelder was unable to fully contemplate the actual and potential conflicts of interest that could, and did, arise when advisory clients were offered and invested in the royalty unit offerings.

3. Binkholder Bar[40]

Because Winkelmann's representations concerning Binkholder were not misleading, Respondents need not establish their reliance defense with respect to those disclosures. Notably, however, Greensfelder drafted the exclusive marketing agreement regarding Binkholder, revised the various offering documents that related to him in some way, and had fulsome disclosures from Winkelmann about Binkholder's relationship with BOP. Greensfelder was aware of Binkholder bar's earlier than the Division maintains, and that the bar was not disclosed in certain of the offering memoranda. Tr. 573-77, 656-57, 1494-95. Greensfelder never indicated that this was a required disclosure after it first saw the order. Based on those facts, even if Respondents' statements as they related to Binkholder had been problematic, they nonetheless would have established a defense to *scienter* given reliance on counsel.

[40] Respondents do not contend that they ever asked Greensfelder for advice about whether to include Binkholder's consultation fees in the calculation of the advertising ratio.

IV. SANCTIONS

The Division seeks a cease-and-desist order, disgorgement and prejudgment interest, civil penalties, and industry bars. Div. Br. at 49-55.

A. Industry Bars

Section 203(e) of the Advisers Act authorizes the Commission to censure, place limitations on, suspend, or revoke the registration of any investment adviser if it is in the public interest and the investment adviser has willfully made a materially false or misleading statement or omitted a material fact in a filing with the Commission or violated any provision of the Securities Act, Exchange Act, or Advisers Act, among others, or the rules thereunder. 15 U.S.C. § 80b-3(e)(1), (5). Under Section 203(f) of the Advisers Act, the Commission may censure, place limitations on, suspend, or bar any person from being associated with an investment adviser or other segments of the securities industry if it is in the public interest and the person willfully caused a materially false or misleading statement to be made or omitted from a Commission filing or willfully violated or aided and abetted a violation of the Securities Act, Exchange Act, or Advisers Act, among others, or the rules thereunder.[41] 15 U.S.C. § 80b-3(e)(1), (5), (6), (f); *Larry C. Grossman*, 2016 SEC LEXIS 3768, at *53. BOP is an investment adviser and Winkelmann is associated with BOP (and he acted as an adviser) and thus both are subject to Advisers Act Section 203. As discussed above, I found that BOP and Winkelmann willfully violated, and Winkelmann caused and willfully aided and abetted violations of, certain provisions of the Securities Act, Exchange Act, and Advisers Act and the rules thereunder.

In determining whether it is in the public interest to impose sanctions on Winkelmann or BOP, the Commission considers the *Steadman* factors: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Larry C. Grossman*, 2016 SEC LEXIS 3768, at *81-84; *see Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). In assessing the *Steadman* factors, "the 'degree of risk [that the respondent] poses to the public' and the extent of the respondent's 'unfitness to serve the investing public' are central considerations." *Larry C. Grossman*, 2016 SEC LEXIS 3768, at *83-84 (alteration in original) (quoting *Meadows v. SEC*, 119 F.3d 1219, 1228 & n.20 (5th Cir. 1997)). This inquiry is flexible, and no one factor is dispositive. *Id.* at 83; *see Marshall*

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[41] This proceeding was also instituted pursuant to Section 9(b) of the Investment Company Act of 1940. OIP at 1. Section 9(b) allows the Commission to prohibit a person 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. 15 U.S.C. § 80a-9(b). The Investment Company Act also authorizes disgorgement and civil penalties in proceedings brought pursuant to Section 9(b). 15 U.S.C. § 80a-9(d), (e). Because the Division did not request sanctions pursuant to Section 9(b), I consider this claim abandoned. *See* Div. Br. at 48-55.

E. Melton, Advisers Act Release No. 2151, 2003 SEC LEXIS 1767, at *4 (July 25, 2003) ("The Commission's determination that a remedial, disciplinary sanction is in the public interest is based on the particular circumstances and entire record of the case."). Other factors to be considered include: (7) the age of the violation, *Marshall E. Melton*, 2003 SEC LEXIS 1767, at *5; (8) the degree of harm to investors and the marketplace resulting from the violation, *id.*; (9) the extent to which the sanction will have a deterrent effect, *Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 SEC LEXIS 195, at *35 (Jan. 31, 2006); and (10) whether there is a reasonable likelihood of violations in the future, *see KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *116.

With regard to Winkelmann, his sale of royalty units to advisory clients was egregious. As previously discussed, such activities attempt to sidestep the fiduciary duty of an adviser to his client and cannot be tolerated.[42] *See Larry C. Grossman*, 2016 SEC LEXIS 3768, at *84 (finding respondent's conduct egregious because he "was acting in a fiduciary capacity in which he had a duty to disclose material facts and not benefit himself"). His activities persisted for years, over four offerings, and he sold royalty units to nineteen of his own advisory clients on twenty-three occasions. DX 455. Winkelmann's activities were at least extremely reckless. Winkelmann has not acknowledged the wrongful nature of his conduct and has not offered meaningfully sincere assurances against future violations, which is troubling given his desire to remain in the advisory business until retirement.[43] The violations are relatively recent, having all taken place from early to the middle of the current decade. Royalty unit investors were harmed by handing over substantial sums of money to purchase royalty units that will only provide the full return on the investment over ten or more years. The degree of harm is not as great as it could be because, though slower than reasonably expected, the royalty units should be paid provided BOP remains in business. Barring Winkelmann should have the deterrent effect on investment advisers from trying to make side-deals with their advisory clients where the parties' financial interests conflict. In the absence of a bar, there is at least some likelihood that Winkelmann would recidivate, though presumably the cease-and-desist order against him, *see infra*, would have some salutary effect. The Division points out that two of Winkelmann's past partners in the financial services business are convicted felons. Div. Br. at 55. While Winkelmann's judgment of who to work with may be imperfect, because he was not convicted of similarly bad acts, and no evidence shows he knew of their crimes until after the fact, I do not hold their criminal activities and records against him. However, based on all the foregoing factors, full industry and associational bars will be imposed as to Winkelmann.

Although the Division requested that I revoke BOP's registration as an investment adviser, Div. Br. at 53-54, in the alternative, it has recommended that only Winkelmann be barred so that BOP can remain in business and may, over time, repay the royalty unit holders:

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[42] This case does not present the issue of what other disclosures may permit the sale of side investments by an investment adviser to his or her clients; it simply decides that proceeding in the manner as Winkelmann did here is unacceptable.

[43] I am unpersuaded by the Division's argument that an unrelated contempt order against Winkelmann bears meaningfully on this analysis because Winkelmann chose not to oppose the contempt request. *See* Div. Br. at 49 n.19; *supra* pt. II.A.1.

> To the extent the Court is concerned that barring Respondents would result in BOP being unable to repay the royalty unit investors, the Court should consider barring Winkelmann but allowing BOP to stay in business. Given Winkelmann's testimony that BOP could succeed without his day-to-day management of the company, it appears that BOP could continue to operate under its current ownership by Winkelmann's family company (23 Glen Abbey Partners) or if Winkelmann sells BOP to a third-party. Further, Respondents have not asserted an "inability to pay" defense, and Winkelmann testified that he has resources other than BOP to pay personal obligations.

Id. at 55 n.23 (citations omitted). Respondents do not dispute the Division's factual contentions that establish the preceding alternative is feasible. *See* Div. PFOF ¶¶ 199-204 (section titled "If Winkelmann, But Not BOP, Is Barred, the Royalty Unit Investors Can be Repaid"); Resp. Response to Div. PFOF ¶¶ 199-204. Given that the bar against Winkelmann will have a sufficient deterrent effect, and, with Winkelmann gone, as he was the force behind selling the royalty units to advisory clients unlawfully, there is little likelihood of such further violations by BOP. Given the disastrous results BOP's investors would suffer if I were to revoke BOP's registration, I find that it would not be in the public interest to do so.

B. Cease-and Desist Orders

Section 21C of the Exchange Act, Section 8A of the Securities Act, and Section 203(k) of the Advisers Act authorize the Commission to issue a cease-and-desist order against any person who "has violated," as well as any person who caused such violation "due to an act or omission the person knew or should have known would contribute to such violation" of, each respective statute or related rules. 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k). In determining whether to issue a cease-and-desist order, the Commission considers the public interest factors described above and the remedial function a cease-and-desist order would serve in the overall context of any other sanctions sought in the same proceeding. *ZPR Inv. Mgmt., Inc.*, Advisers Act Release No. 4249, 2015 SEC LEXIS 4474, at *115-16 (Oct. 30, 2015). "[A]bsent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violations." *Rodney R. Schoemann*, Securities Act Release No. 9076, 2009 SEC LEXIS 3939, at *48 (Oct. 23, 2009), *aff'd per curiam*, 398 F. App'x 603 (D.C. Cir. 2010). Although "'some' risk is necessary, it need not be very great to warrant issuing a cease-and-desist order." *ZPR Inv. Mgmt., Inc.*, 2015 SEC LEXIS 4474, at *116.

Custody. Respondents previously accepted responsibility for this non-scienter based violation. Resp. Br. at 62 ("[T]he Firm has since accepted the SEC's conclusion that it inadvertently tripped the 'Custody Rule.'"). Since that acceptance, for the past two years Respondents changed how they custody royalty unit holders' funds and it is undisputed that since then they have complied fully with the custody rule. Hence, a cease-and-desist order is not justified as to Advisers Act Sections 206(4) and 207 and Rules 206(4)-2 and 206(4)-7. *See SEC v. Slocum, Gordon, & Co.*, 334 F. Supp. 2d 144, 185 (D.R.I. 2004) ("With the account structure at [Defendant Firm] fundamentally restructured . . . the Court concludes that the possibility for future commingling violations are nonexistent or slim at the very worst.").

Conflicts. Respondents argue that a cease-and-desist order is not needed because "[t]he Offerings are closed" as of three years ago. Resp. Br. at 64. However, unlike for the custody rule, Respondents did not effect a structural change to ensure that sales of securities to advisory clients in violation of their fiduciary duties. It appears that Respondents did not pursue additional offerings because they were under investigation by the Commission and State of Missouri. While the lapse of time since the last offering is some evidence indicating less risk of future violations, the risk remains sufficient to satisfy the relatively modest burden for a cease-and-desist order. Thus, Respondents are ordered to cease and desist from committing or causing violations of the antifraud provisions they violated or caused to be violated by this misconduct – Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1) and 206(2).

C. Disgorgement and Prejudgment Interest

Sections 21B(e) and 21C(e) of the Exchange Act, Section 8A(e) of the Securities Act, and Section 203(k)(5) of the Advisers Act authorize disgorgement in this proceeding, including reasonable prejudgment interest. 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e), 80b-3(k)(5). In enforcement actions, "disgorgement restores the *status quo ante* by depriving violators of ill-gotten profits." *Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009). The disgorgement award "need only be a reasonable approximation of the profits causally connected to the violation," and "the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that uncertainty." *Id.* at 473.

Courts may order issuers, as well as people who participate in an issuer's offering, to disgorge the proceeds received from an unlawful offering. *See, e.g.*, *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1192 (9th Cir. 1998); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972); *SEC v. Capital Solutions Monthly Income Fund*, 28 F. Supp. 3d 887, 897-99 (D. Minn. 2014), *aff'd*, 818 F.3d 346 (8th Cir. 2016). Here, BOP's proceeds from the offerings (net of repayments to investors) are $874,327.49 ($1.4 million raised[44] minus the $525,672.71 returned to investors). FOF 1, 14.

This case, however, does not present appropriate circumstances for disgorging the proceeds of the entire offering. Ordering BOP to disgorge that amount would ruin the company to insolvency. *See* DX 366. I agree with Respondents' cautionary view that "[o]rdering disgorgement, and unwinding this investment, would deprive investors of their bargained for benefit, and for the first time during the relevant time period, pose a threat to the safety of their investment." Resp. Br. at 65. While the Division contends the foregoing statement is unsupported, it is clear that such an order against BOP would bankrupt the company. Div. Reply Br. at 43-44. For example, in 2015, BOP's annual gross income was less than the amount the Division seeks in disgorgement, and BOP's net profit for the entire year was only slightly more

[44] Because the reliance on counsel defense negates scienter with regard to non-advisory client subscribers, only $1.075 million of the offerings is at issue, or, stated a different way, approximately 75% of the total value of all royalty units sold were purchased by advisory clients. *See* DX 455. While disgorgement is not imposed on BOP, any reasonable approximation would have to discount proceeds from non-advisory clients.

than $200,000. DX 366. In addition, one of the alternatives that the Division posed that could keep BOP running and protect the royalty unit investors was sale to a third party. Div. Br. at 55 n.23. Given the financials of BOP, the addition of the comparatively large-scale disgorgement order liability would severely challenge that alternative.

To the Division's credit, it provides a much more reasonable measure of disgorgement with respect to Winkelmann alone:

> [T]he Court should order Winkelmann to disgorge at least the $678,757 he personally benefitted from the royalty unit offerings. This figure includes the $125,000, $189,200, and $227,557 yearly sums BOP paid to compensate Winkelmann, respectively, in 2012, 2013, and 2014. It also includes the additional $41,000 BOP paid Longrow Insurance Agency to compensate Winkelmann for his services to BOP, the $46,000 BOP paid Blue Ocean ATM, and the $50,000 BOP paid to extinguish Winkelmann's personal settlement obligation in a lawsuit against him.

Div. Br. at 51 (citations omitted). Because the $50,000 settlement benefitted BOP and its clients, it will not be disgorged. The other amounts are not a reasonable measure of how much Winkelmann benefited from the royalty unit offerings specifically, but are instead his entire direct and indirect compensation from BOP, which in sum make a substantial figure, to date. Thus, the $2,000 monthly salary Winkelmann was taking before he contemplated a second round offering, in part to increase his salary, should not be disgorged for this three-year period. *Cf.* Div. Br. at 52 n.20. In addition, because approximately 25% of the proceeds of the offerings came from non-advisory clients, DX 455, Winkelmann's disgorgement amount should be discounted accordingly. After adjusting the Division's request by those factors, I find that $415,000, plus prejudgment interest, represents a reasonable approximation of his ill-gotten profits, and will order it disgorged.[45]

Although the Division urges finding BOP and Winkelmann jointly and severally liable for disgorgement, Div. Br. at 50-51, disgorgement is an equitable form of relief, and the preceding determinations with respect to disgorgement render subjecting the Respondents jointly and severally liable inappropriate in these circumstances.

D. Civil Penalties

Securities Act Section 8A(g), Exchange Act Section 21B(a)(2), and Advisers Act Section 203(i)(1)(B) authorize civil penalties in a cease-and-desist proceeding where a respondent is violating, has violated, or is the cause of a violation of any provision of the Securities Act, Exchange Act, or Advisers Act, respectively, or their rules or regulations. 15 U.S.C. §§ 77h-1(g), 78u-2(a)(2), 80b-3(i)(1)(B). The statutes set out a three-tier system identifying the

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[45] I calculate this number as follows: $678,757 requested by the Division less the $50,000 settlement payment and three years' salary of $72,000 ($2,000 a month for thirty-six months) is $556,757. I then discount this number by 25% for the non-advisory client investors for a total of $417,567.75.

maximum amount of civil penalties, depending on the severity of the respondent's conduct. 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b), 80b-3(i)(2). First-tier penalties may be imposed for each act or omission. 15 U.S.C. §§ 77h-1(g)(2)(A), 78u-2(b)(1), 80b-3(i)(2)(A). Second-tier penalties may be imposed for each act or omission in cases involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. 15 U.S.C. §§ 77h-1(g)(2)(B), 78u-2(b)(2), 80b-3(i)(2)(B). Third-tier penalties may be imposed for each act or omission in cases involving fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement and where the conduct in question directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons, or resulted in substantial pecuniary gain to the person who committed the act or omission. 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3), 80b-3(i)(2)(C). The maximum amounts of civil penalty for a violation after March 3, 2009, to March 5, 2013, at the first tier are $7,500 (for a natural person) and $75,000 (for entities), at the second tier are $75,000 (for a natural person) and $375,000 (for entities), and at the third tier are $150,000 (for a natural person) and $725,000 (for entities). 17 C.F.R. § 201.1001 tbl. I.

Penalties must be in the public interest. Factors relevant to the public interest consideration include: (1) whether the violations involved fraud, deceit, manipulation, or reckless disregard of a regulatory requirement; (2) the harm caused to others; (3) the extent to which any person was unjustly enriched; (4) prior violations by the respondent; (5) the need for deterrence; and (6) such other matters as justice may require. 15 U.S.C. §§ 78u-2(c), 80b-3(i)(3); *see Francis V Lorenzo*, Securities Act Release No. 9762, 2015 SEC LEXIS 1650, at *58-59 (Apr. 29, 2015); *Jay T. Comeaux*, Securities Act Release No. 9633, 2014 SEC LEXIS 3001, at *22 n.39 (Aug. 21, 2014).

Taking the last factor first, it would contravene the interests of justice to penalize BOP, because any such penalty would primarily punish BOP's royalty unit holders, who were the direct victims of Winkelmann's misconduct. In addition, the need for deterrence is already satisfied by the cease-and-desist order against BOP, and full industry and associational bars, disgorgement, and penalties against Winkelmann, discussed here.

Custody. Because Respondents' technical violation of the custody rule did not result in in investor losses, and was not intentional – it simply arose from the mistaken understanding, since corrected, that Respondents did not have custody of royalty unit holder's funds – only a first-tier penalty is justified. *SEC v. Slocum*, 334 F. Supp. 2d at 186 ("[B]ecause no losses were demonstrated, and because this Court concludes that Defendants' actions were not intentional or deliberate, second and third tier penalties are inappropriate. Rather, the Court will impose a civil penalty under the first tier only."). The appropriateness of first-tier penalties is confirmed by advice from Greensfelder that Respondents did not have custody. I order that Winkelmann pay one first-tier penalty of $7,500 for causing BOP's violation of the custody rule and his violation of Advisers Act Section 207 that arose from his misunderstanding of whether Respondents had custody of BOP funds.

Conflicts. Winkelmann sold royalty units to advisory clients without sufficient disclosures in reckless disregard of his fiduciary obligations. Those clients were harmed as Winkelmann kept their royalty unit payments at near-minimal levels. While they fared poorly, Winkelmann benefited. To his credit, Winkelmann does not have a prior history of securities law violations. However, this case presents an important area for deterrence, because it implicates the efficacy of core protections for advisory clients. For these reasons, the amount of any civil penalty assessed against Winkelmann should be sufficient to deter him and others from engaging in the type of conduct at issue in this proceeding.

Second-tier penalties are appropriate because, in selling royalty units to his advisory clients, Winkelmann acted with at least "reckless disregard of a regulatory requirement." 15 U.S.C. §§ 77h-1(g)(2)(B), 78u-2(b)(2), 80b-3(i)(2)(B). Third-tier penalties are only awarded where the Division establishes that the acts or omissions at issue resulted in substantial losses (or created a significant risk of substantial losses) or resulted in "substantial" pecuniary gain. Because Winkelmann sold royalty units to his advisory clients in reckless disregard of the securities laws on twenty-three occasions, DX 455, I find twenty-three violative acts that could be penalized. The Division has not sought to establish that any of these twenty-three transactions, on their own, caused a substantial loss or risk of loss, or gain for Winkelmann, so it has not established that a third-tier penalty is warranted. Within the second-tier penalty range, there are two significant mitigating factors – his lack of past violations, and although his acts were reckless, his misapprehension that he could sell royalty units to advisory clients may have been tainted by advice he received from counsel regarding their sale to non-advisory clients. For those reasons, I order that Winkelmann pay a second-tier penalty of only $10,000 per violation. Five of these purchases occurred outside the limitations period. Although an argument could be made that the violations themselves continued after the purchase date, out of an abundance of caution, I will only order penalties as to the eighteen violations within the limitations period, for a total of $180,000 for these violations.

In sum, I order a total civil penalty of $187,500 on Winkelmann.

V. RECORD CERTIFICATION

Pursuant to 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the revised record index issued by the Commission's Office of the Secretary on January 27, 2017.

ORDER

I ORDER that, pursuant to 17 C.F.R. § 201.322, DX 170 be placed UNDER SEAL and removed from the public record.

I FURTHER ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940, James A. Winkelmann, Sr., is PERMANENTLY BARRED from being associated with an investment adviser, broker, dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

I FURTHER ORDER that, pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 203(k) of the Investment Advisers Act of 1940, James A. Winkelmann, Sr., and Blue Ocean Portfolios, LLP, shall CEASE AND DESIST from committing or causing violations, and any future violations of, Section 17(a) of the

Securities Act of 1933, Section 10(b) of the Securities Exchange Act and Rule 10b-5, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940.

I FURTHER ORDER that, pursuant to Section 8A(e) of the Securities Act of 1933, Sections 21B(e) and 21C(e) of the Securities Exchange Act of 1934, and Section 203(k)(5) of the Investment Advisers Act of 1940, James A. Winkelmann, Sr., shall PAY DISGORGEMENT in the amount of $415,000 plus prejudgment interest.

Prejudgment interest shall be calculated from January 1, 2015, to the last day of the month preceding the month in which payment of disgorgement is made, consistent with 17 C.F.R. § 201.600. Prejudgment interest shall be calculated at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), and shall be compounded quarterly. 17 C.F.R. § 201.600. Interest shall continue to accrue on all funds owed until they are paid.

I FURTHER ORDER that, pursuant to Section 8A(g) of the Securities Act of 1933, Section 21B(a)(2) of the Securities Exchange Act of 1934, and Section 203(i) of the Investment Advisers Act of 1940 James A. Winkelmann, Sr., shall PAY A CIVIL MONEY PENALTY in the amount of $187,500.

Payment of civil penalties, disgorgement, and prejudgment interest shall be made no later than twenty-one days following the day this initial decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) by certified check, bank cashier's check, bank money order, or United States postal money order made payable to the Securities and Exchange Commission and hand-delivered or mailed to the following address alongside a cover letter identifying Respondent and Administrative Proceeding No. 3-17253: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This initial decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that rule, a party may file a petition for review of this initial decision within twenty-one days after service of the initial decision. A party may also file a motion to correct a manifest error of fact within ten days of the initial decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The initial decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the initial decision as to a party. If any of these events occur, the initial decision shall not become final as to that party.

Jason S. Patil
Administrative Law Judge