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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17253

In the Matter of

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

Respondents.

THE DIVISION OF ENFORCEMENT'S
<u>RESPONSE TO RESPONDENTS' SUBMISSION OF NEW EVIDENCE</u>

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A. Introduction

The trial in this matter demonstrated that Winkelmann systematically violated a basic and fundamental obligation he owed his investment advisory clients: identifying and disclosing conflicts of interest. He violated these duties while targeting his clients to invest in "royalty unit" securities offered by his own advisory business, Respondent Blue Ocean Portfolios, LLC ("BOP"). The structure of the offerings presented Winkelmann with a stark and persistent conflict. He faced the recurring choice of whether to use available BOP funds to: (a) increase his own compensation; or (b) benefit investors, such as by increasing their investment returns or by using the money to increase BOP's revenues, which would also lead to increased investor payments. The conflict was not hypothetical. Rather, it repeatedly manifested itself as Winkelmann consistently chose to pay himself more while keeping investor payments low and reducing BOP's expenditures on revenue-producing activities such as advertising.

Compounding the egregiousness of Winkelmann's conduct, and confirming his scienter, was Winkelmann's deep understanding of his fiduciary obligations and his first-hand knowledge of the conflicts that exist when an adviser sells securities to its clients. Winkelmann gained that understanding through a 30-year career as an adviser and by obtaining a "Registered Fiduciary" certification. He constantly reminded investors of his fiduciary duties, emphasized BOP's "conflict-free" services, and touted acting "always" or at "all times" in his clients' best interest. Moreover, Winkelmann knew the severe consequences of failing to disclose conflicts to clients. Winkelmann's own business partner, Brian Binkholder, was barred for selling securities in his businesses to advisory clients without disclosing the attendant conflicts. Nevertheless, in order to increase his own compensation, Winkelmann continued to sell royalty units to clients without disclosing conflicts or that Binkholder had been barred for doing the same thing.

Based on these facts, the Initial Decision was well justified in its findings that Winkelmann violated the antifraud provisions. So too were the sanctions imposed, which are eminently consistent with Commission precedent for cases where advisers defraud their clients by failing to disclose conflicts.

While styled as a submission of "new evidence," Respondents' brief is really a motion for reconsideration. Indeed, Respondents concede that the "new" evidence they ask the Court to consider is already part of the record (the collection of emails contained in RX-106) the Court reviewed to arrive at its Initial Decision. (Resp. Br. at 2). To that end, rather than basing their submission on evidence that was not introduced at trial, Respondents simply ask the Court to perform a "re-examination" of the same evidence the Court previously analyzed in reaching its decision that Winkelmann engaged in fraud at the expense of his advisory clients. (*Id.*).

Just as the evidence the Court initially reviewed supports its findings that Winkelmann defrauded his clients and should be sanctioned accordingly, that same evidence reviewed anew properly confirms those findings. That evidence shows that Winkelmann cannot establish a reliance on counsel defense. Even focusing on the evidence discussed in Respondents' submission, a reliance defense does not hinge on whether a lawyer was aware Winkelmann could offer royalty units to a limited number of clients. Rather, the defense fails, in the first instance, because Winkelmann never sought nor received advice on the violation which sustained the Initial Decision's fraud finding: Winkelmann's failure to adequately disclose the conflicts attendant to the royalty unit offerings.

Any reliance defense additionally fails because Winkelmann concealed key facts from his lawyers. Even if a lawyer saw a couple of documents reflecting that certain BOP clients would be offered royalty units, Winkelmann never disclosed the extent to which he would target and depend on his clients to raise funds for BOP. Winkelmann also never told his attorneys he would use offering proceeds to steadily increase his salary, or that he would concurrently suppress investor payments to the minimum allowable levels. Perhaps most importantly, Winkelmann hid from his attorneys, and investors, that Binkholder had been barred for failing to disclose conflicts to clients.[1]

Based on the record, including the "new" evidence cited by Respondents, the Court correctly determined that Winkelmann's fraud warrants significant sanctions. That determination is consistent with longstanding Commission precedent barring advisers who fail to disclose conflicts or otherwise violate their fiduciary obligations. Because Winkelmann repeatedly placed his interests before clients' interests and benefited himself at his clients' expense, the Court's sanctions determinations, like its liability findings, should not be disturbed.

B. Winkelmann's Reliance Defense Fails

Winkelmann asks the Court to reconsider its holding that he failed to establish a reliance on counsel defense. Winkelmann premises that defense on his claim that he orally asked his attorney – Michael Morgan of the Greensfelder firm – whether he could offer royalty units to clients and that Morgan responded in the affirmative. (Br. at 4-5). Even assuming this is true, Winkelmann

[1] The Court did not accept the Division's fraud theory premised on Winkelmann's failure to disclose Binkholder's bar to investors, finding the nondisclosure to be immaterial. (Initial Decision at 52-53). The Division petitioned the Commission to review that finding, noting that the D.C. Circuit, in an analogous fact pattern, affirmed Section 206(1) violations based on an adviser's failure to disclose to clients that his partner (and advisory firm co-founder) had been barred. *SEC v. Wash. Inv. Network*, 475 F.3d 392, 404-405 (D.C. Cir. 2007). While the Division is not asking the Court to reconsider that finding at this ratification stage, the Division submits that Winkelmann's failure to apprise his attorneys of Binkholder's bar is relevant to the reliance issues raised in Respondents' submission.

cannot satisfy the requisite elements to invoke a reliance defense.[2] In particular, and as demonstrated by the evidence cited in Respondents' submission, Winkelmann *did not seek or receive specific advice from Morgan on the issue of whether conflicts were adequately disclosed.*

At best, any limited advice Winkelmann received was conflicting, given that Greensfelder prepared Subscription Agreements, which Winkelmann approved, that precluded clients from purchasing royalty units. Winkelmann also failed to disclose, and in fact concealed, key information from Morgan that would be necessary for Morgan to render informed advice. For instance, Winkelmann never told Morgan the extent to which he would target advisory clients, or that he would keep investor payments at minimal levels while steadily increasing his own salary. Perhaps most importantly, when Winkelmann learned that Binkholder had been barred for selling securities in Binkholder's businesses to Binkholder's advisory clients without disclosure of conflicts, *a fact that would necessarily call into question any advice that such conduct was permissible*, Winkelmann concealed the bar order from Morgan. Accordingly, and for the reasons discussed below, Winkelmann's reliance defense fails.

1. Legal Standards

To invoke a reliance defense, and disprove they acted with scienter, Respondents must show: "(1) that they made complete disclosure to counsel; (2) that they sought advice on the legality of the intended conduct; (3) that they received advice that the intended conduct was legal; and (4) that they relied in good faith on counsel's advice." *William Scholander*, Exchange Act Rel. 77492, 2016 SEC LEXIS 1209, *25-26 and nn.37-38 (Mar. 31, 2016). To assert good faith reliance to rebut the Division's negligence-based charges, the same elements must be satisfied.

[2] Respondents argue that, because Morgan is dead, the Court must accept as true Winkelmann's version of the events. As the Division noted in its post-hearing briefing, Winkelmann was not a credible witness. (*See,* Div. Post-hearing Br. at 47-48; Div. Response Br. at 3-7, 35-37). To that end, and as discussed below, the documentary evidence contradicts Winkelmann on key issues relevant to his reliance defense.

Robare Group, Advisers Act Rel. No. 4566, 2016 SEC LEXIS 4179 (Nov. 7, 2016), *33-35 (Nov. 7, 2016). Simply retaining securities counsel is insufficient. *Id.* at *33-35.

2. Winkelmann Neither Sought Nor Received Advice that Failing to Disclose Conflicts was Permissible

Winkelmann claims he establishes a reliance defense because Morgan purportedly gave permission for BOP to offer royalty units to clients. (Br. at 4-5). Winkelmann asserts he asked for and received this advice orally, and then asked Morgan to review draft letters which would indicate BOP intended to offer royalty units to certain clients. (*Id.* at 3-5). However, even crediting these interactions with Morgan, there is no evidence that Winkelmann sought or received specific advice on the finding Winkelmann now asks the Court to reconsider: that Winkelmann failed to disclose conflicts when offering royalty units to clients.

Winkelmann claims that Morgan – who is deceased and can neither corroborate nor rebut Winkelmann's testimony – orally advised him that it "would be no problem" to offer royalty units to clients. (Br. at 5). Winkelmann posits that, consistent with that advice, on February 15, 2011, he asked Morgan to review a draft letter Winkelmann wanted to send to "clients that are suspects for participation" in the royalty offering. (RX-106, p. 2 (2/15/11 email)). Notably, the draft letter was not part of the record, and Respondents have declined to submit that letter as new evidence for the Court to consider.[3] Nor is there any evidence in the 2,443 pages of Winkelmann-Greensfelder email correspondence that Morgan responded to Winkelmann's February 15 email. (RX-106).

As noted in Respondents' brief, the record does show that six weeks later, on March 28, 2011, Winkelmann sent Morgan an email titled "what about our accredited investors," in which

[3] Respondents' brief incorrectly cites RX-128 as evidence of that email and attachment. (Br. at 3). However, RX-128 is limited to Greensfelder's billing invoices for March 2011. (RX-128). Moreover, RX-128 is not "new" evidence, as identical portions of the Greensfelder invoices are contained in DX-277 (at pages GHG5993-95 (pages 4-7 of PDF)).

Winkelmann asked Morgan to review a draft letter to send "to a handful of accredited investors." (Br. at 3-4 (citing RX-106, p. 399)). That draft letter, which Morgan edited and sent back to Winkelmann on March 29, indicated that at least one BOP client could be offered a royalty unit. (*Id.* at 399-401).[4] However, there is no evidence that Winkelmann asked Morgan whether such an arrangement required any tailored disclosures addressing actual or potential conflicts of interest.

Despite being availed of the opportunity to submit new evidence, the draft letter and related emails already in the record, sent in the context of Winkelmann seeking advice on the tangential issue of offerings involving "accredited investors," are the only documentary evidence supporting the argument that Morgan advised Winkelmann he could offer royalty units to clients prior to the start of the offerings. Notably absent from this evidence is: (a) any inquiry from Winkelmann whether the offering materials adequately disclosed conflicts of interest, or (b) advice that any conflicts disclosures were adequate. This lack of inquiry is consistent with Winkelmann's testimony that he himself believed no conflict existed. (Tr. 551:5-8). Given his belief there was no conflict, there would be no reason for Winkelmann to seek guidance on whether conflicts were adequately disclosed. Instead, Winkelmann simply sent Morgan a draft of the first offering memorandum and generally asked for Morgan's review, without seeking advice on any particular topic, such as whether the memorandum adequately disclosed conflicts. (RX-106, p. 30).[5]

Such failure to seek or receive advice on a specific topic precludes a reliance defense. *See, e.g., SEC v. Snyder*, 2006 U.S. Dist. LEXIS 45185, *23-24 (S.D. Tex. June 29, 2006) (rejecting

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[4] Rather than being "new" evidence, Morgan's edits to Winkelmann's letter were already part of the record. (RX-106, pp. 399-401).

[5] Notably, Morgan provided Winkelmann his comments on the offering memorandum on March 15, 2011 (RX-106, p. 112), *two weeks before* Winkelmann sent Morgan, and Morgan edited, the draft letter indicating Winkelmann might offer royalty units to at least one client. (RX-106, pp. 399-401).

reliance defense, even where auditors reviewed Form 10-Q at issue, when auditor was never asked to provide opinion regarding specific adjustments at issue); *Timothy Dembski*, Advisers Act Rel. 4671, 2017 SEC LEXIS 959, *6-9, *37-38 (Mar. 24, 2017) (rejecting defense even where attorneys reviewed entire PPM, because client never asked for or received advice about specific PPM section at issue); *SEC v. Enters. Solutions, Inc.*, 142 F. Supp. 2d 561, 576 (S.D.N.Y. 2001) (defense failed where defendant "never sought specific advice from counsel with respect to disclosure of the bankruptcy, nor did he receive specific advice that ESI was not required to disclose the bankruptcy. Good faith reliance on the advice of counsel means more than simply supplying counsel with information . . . 'Compliance with federal securities laws cannot be avoided by simply retaining outside counsel to prepare required documents.'" (quoting *SEC v. Savoy Indus., Inc.* 665 F.2d 1310, 1315 n. 28 (D.C. Cir. 1981)); *SEC v. AIC, Inc.*, 2013 U.S. Dist. LEXIS 130249, *24 (E.D. Tenn. Sept. 12, 2013) (rejecting reliance defense, reasoning: "whether Troutman Sanders's attorneys prepared each form is immaterial... as the drafting of documents does not constitute rendering legal advice on a specific transaction.").

Moreover, to the extent Winkelmann sought to disclose conflicts via the draft letter he sent Morgan in March 2011, as opposed to the offering memoranda, his own testimony shows that Winkelmann believed any such disclosure would be insufficient. Specifically, Winkelmann testified that, based on his 30 years in the securities industry, he understood that investors could only rely on disclosures contained in the offering documents, as opposed to extraneous materials. (DX-327 (Winkelmann investigative testimony) at 97:2-14). In fact, Winkelmann conceded that Morgan specifically advised him that the only representations investors could rely on where those contained in the offering memoranda. (*Id.* at 99:4-21).

Consistent with that advice, Greensfelder prepared a Subscription Agreement that royalty investors were required to complete, which mandated investors to "represent" and "warrant" that they did not rely on any representations or disclosures beyond those contained in the offering memoranda. (RX-106, p. 96 (¶ 2(l)); Stip. ¶ 54; RX-1, p. 96 ¶ 2(l)). Winkelmann admitted he reviewed and approved that Subscription Agreement before it was sent to investors. (Tr. 535:23-536:6). Those Subscription Agreements constitute the most precise advice Winkelmann received from Greensfelder on the issue of offering royalty units to clients, *and expressly prohibited the practice*. (*See, e.g.,* RX-106, p. 95 (requiring investor representation that BOP "has not provided any investment advice")). For these reasons, Winkelmann cannot credibly claim that he believed disclosures not contained in the offering documents but instead in draft letters to clients, whether approved by lawyers or not, were sufficient to advise clients of any conflicts of interest.[6]

Thus, even assuming Greensfelder advised Winkelmann he could offer royalty units to clients, in the face of Greensfelder's conflicting advice through the Subscription Agreements, Winkelmann was obliged to do more. Such measures would include following-up with Greensfelder, discussing the inconsistency, and obtaining confirmation he could proceed with an offering that required clients to falsely represent that they had not received any investment advice from BOP. *See, e.g., Jones v. SEC*, 115 F.3d 1173, 1184 (4th Cir. 1997) (no reliance defense where client "chose to disregard the terms of the offering materials" prepared by counsel); *SEC v. Scott*, 565 F. Supp. 1513, 1535 (S.D.N.Y. 1983) ("The reliance-on-counsel defense, however, does not mean that one can totally abdicate responsibility by consulting counsel...[the] defense requires

[6] Even if Winkelmann believed investors could rely on extraneous disclosures, there is no evidence in the record, or included with Winkelmann's submission of "new" evidence, of any client who purchased royalty units actually receiving a letter disclosing a conflict of interest. Indeed, the draft letter Winkelmann references in his brief (RX-106, p. 401) was not addressed to a client who purchased any royalty units (DX-455).

more than such a complacent attitude."); *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 276 (2d Cir. 1986) ("The proper exercise of due care by a director in informing himself of material information and in overseeing the outside advice on which he might appropriately rely is, of necessity, a pre-condition to performing his ultimate duty of acting in good faith").

For the same reasons, once Winkelmann saw the Binkholder bar order prior to the second offering (Stip. ¶ 56), and learned that Binkholder had been barred for failing to disclose the conflicts attendant to selling his advisory clients securities in his businesses, Winkelmann was on notice that offering royalty units to clients without disclosing conflicts was illegal. At that point, regardless of any advice he had previously received, it was incumbent on Winkelmann to consult Greensfelder, apprise Greensfelder of the order, and specifically seek guidance on whether Winkelmann could continue to engage in conduct that had caused his business partner to be barred.[7] Winkelmann did none of this.

While Winkelmann claims that he immediately notified Greensfelder of the bar order, as detailed below, the evidence proves otherwise. Indeed, it is hard to imagine that any experienced securities lawyer such as Morgan would review Binkholder's bar order and then advise Winkelmann he need not disclose conflicts to clients being offered royalty units. To that end, it is telling that only after Winkelmann finally disclosed Binkholder's bar order to Greensfelder in late 2012 and consulted with Greensfelder on the issue, did Winkelmann disclose to investors Binkholder's bar and the reasons for the bar, albeit only to the three investors who received the fourth offering memorandum. (Stip. ¶ 59; RX-4, p. 16).

[7] Winkelmann should additionally have reached out to Greensfelder even earlier, at the start of the first offering, when a client and one of the first investors, Jason Grau, asked Winkelmann whether the royalty units were "legal" and presented any conflicts-related issues. (DX-455; Tr. 621:25-622:22, 654:6-655:4).

3. Any Reliance Defense Fails Because Winkelmann Concealed Key Information from Greensfelder

Winkelmann's reliance defense additionally fails because Winkelmann did not apprise his attorneys of the facts necessary to provide advice regarding whether Winkelmann adequately disclosed conflicts of interest to investors. *See, e.g.*, *U.S. v. Parker*, 839 F.2d 1473, 1482 & n.6 (11th Cir. 1988) (defendant precluded from asserting reliance on counsel when he failed to tell attorney the investments at issue were under-collateralized); *U.S. v. Kenney*, 911 F.2d 315, 322 (9th Cir. 1990) (same result where "appellant never advised counsel that the $ 10,000 was intended to be a kickback or bribe; if he had it is highly unlikely that counsel would have advised him that the payment would be legal."); *Liss v. U.S.*, 915 F.2d 287, 291 (7th Cir. 1990) ("Liss' failure to inform counsel not only of his intention to use false information to acquire a passport but also his intention to assume the identity of Gerald Lew Drazin were material facts which would necessarily have been relevant to counsel's formulation of a legal opinion. Thus, the defendant is not entitled to rely on his counsel's general advice."); *SEC v. Scott*, 565 F. Supp. 1513, 1534 (S.D.N.Y. 1983) ("by not informing his counsel about the purchases until after the closing, Dirks failed to apprise his counsel of all the material facts and therefore cannot rely on his counsel's advice to shield him from culpability.")

To begin, Winkelmann never disclosed to Morgan the extent to which he relied on clients to purchase royalty units, and that the overwhelming majority of investors were clients. Instead, immediately prior to the first and second offerings, Winkelmann emailed Morgan draft Forms ADV to review, in which Winkelmann falsely represented that BOP does *not* "sell products...to [its] advisory clients." (RX-106, pp. 163, 195 (Item 6.B), pp. 525, 603 (Item 6.B)). Similarly, in the course of the second offering, Winkelmann emailed Morgan another draft Form ADV which falsely indicated that the only product BOP sold to clients was, "from time to time...life insurance products." (RX-106, pp. 1099, 1115). Thus, Winkelmann failed to provide Morgan the information needed to advise on whether BOP's conflicts disclosures, *in an offering targeting clients*, were adequate.

Winkelmann also kept from Morgan the facts necessary to inform him of the full scope of the conflict created by the royalty offering structure. Indeed, Winkelmann never told his attorneys that he would keep investor payments at minimum levels. Rather, the offering materials Winkelmann asked Greensfelder to review contained representations and charts indicating that investors would receive well above minimum returns. In the first round offering materials, BOP represented: "Royalty Units Summary...Right to at Least 0.25% of Monthly Cash Receipts. Plan is to be higher! Investors get repaid first!" (RX-1, p. 111). By the third offering, BOP was representing: "Investors should expect the bulk of their return in years 3-5." (RX-3, pp. 4, 14). The third memorandum contains charts reflecting that, to pay back investors in five years, BOP would have to pay, *every single month*, more than *triple* the minimum percentage. (*Id.*, pp. 4, 14, 15; Tr. 708:11-24). The fourth memorandum repeats the representation about investors receiving their returns in 3-5 years (RX-4, p. 14), and contains charts reflecting that BOP would need to pay, *every single month*, at least *four times* the minimum payout percentage in order to provide the promised returns in five years. (*Id.*, pp. 4, 15; Tr. 748:1-13, 763:8-19).

Nor did Winkelmann tell Greensfelder that he would use royalty unit proceeds to steadily increase his compensation. (Stip., ¶ 65). Winkelmann also never told Greensfelder that he would drastically reduce BOP's advertising budget (which would lower BOP's revenues and royalty investor returns) and instead devote BOP's resources to even greater increases in his and Binkholder's compensation. (DX-395, BO5317 (*see* "Action Plan"); Tr. 590:3-6, 591:20-592:4).

Rather than disclosing these facts, Winkelmann provided Greensfelder with memoranda representing: (a) the "proceeds of this offering will be used to increase the advertising budgets and to make needed additions to the sales and administration staff," (b) the offering proceeds "will be used exclusively for operations of [BOP]," and (c) BOP's use of the offering proceeds "would need to result in the potential for recurring revenues inuring to [BOP] and to investor returns." (RX-1, p. 5, 12; RX-2, pp. 6-7, 16). Thus, the offering memoranda Winkelmann prepared gave Greensfelder the same false impression that investors received: that BOP would pay more than minimal payments, and that investment proceeds would not be used to fund Winkelmann's salary increases.

But the key fact Winkelmann concealed from Greensfelder was that Binkholder had been barred for engaging in the same conduct as Winkelmann: selling securities in his own businesses to advisory clients. (DX-84, ¶ 16). Binkholder's bar, issued by the same Missouri securities regulators with jurisdiction over BOP, would be of paramount importance to any attorney advising whether Winkelmann was adequately disclosing conflicts to clients. Winkelmann admittedly had seen the bar order by late December 2011. (Stip. ¶ 56). Despite Winkelmann's protestations that he immediately advised Greensfelder of Binkholder's bar, the evidence proves Winkelmann would wait nearly a year to bring the bar to Greensfelder's attention.

Winkelmann testified that upon learning of Binkholder's bar in late 2011: (a) he alerted Morgan; (b) Morgan and his partner, Wendy Menghini, scrutinized the bar order; and (c) Winkelmann, Morgan and Menghini spoke "extensively" and "in-depth" about the order and its ramifications. (Tr. 573:20-574:9, 575:24-576:2, 577:4-18, 656:21-657:13, 1494:25-1495:13). Contrary to Winkelmann's testimony, Greensfelder's invoices show BOP was not billed for any services in December 2011 (when Winkelmann admits first seeing the bar order) or January

2012, and that Menghini did not bill *any* time to BOP until *August 2012*. (Stip. ¶56; Tr. 574:22-575:19; DX-277, GHG005998-6000; RX-113, p. 25). The evidence shows that only in 2013 did Winkelmann email a copy of Binkholder's bar order to Greensfelder, and he did so only after learning of a separate *criminal* investigation into Binkholder. (DX-220; Stip. ¶57).

Moreover, common sense refutes the notion that Winkelmann apprised Greensfelder of Binkholder's bar order prior to late 2012. Indeed, upon learning that Winkelmann's partner had been barred for selling his businesses' securities to clients without disclosing conflicts, no law-abiding securities lawyer would advise Winkelmann that it was appropriate to engage in the same conduct. It further strains credulity to suggest that an attorney would give such advice without first devoting thorough attention to the matter. As the Greensfelder invoices demonstrate, the firm performed *no legal services whatsoever* for BOP between June 2011 and January 2012. (RX-113, p. 11-13). Those invoices prove that Winkelmann's testimony, that he advised Greenfelder of the bar prior to the second and third offerings, is a lie.

4. The 2013 Emails Cited By Respondents Do Not Support a Reliance Defense

Most of the communications with Morgan that Winkelmann cites in support of his reliance argument are from 2013, and none are new evidence that was not part of the record. (Br. at 7-15). Those communications cannot sustain a reliance defense for the first three offerings, the last of which had concluded by October 2012. (DX-455). Moreover, those communications took place *after* Winkelmann belatedly disclosed Binkholder's bar order to Morgan (DX-220) and *after* Greensfelder began advising Winkelmann how to respond to a Missouri Securities Division investigation into him and BOP. (DX-212; RX-113, p. 47 (billing entries re "Binkholder Termination Agreement" and "research case law re: disclosures of proceedings") and p. 49 (billing entries re "state investigation")).

While Respondents claim that Greensfelder's activities in 2013 confirm Morgan's previous awareness that the royalty offerings heavily depended on sales to BOP clients, the evidence supports the opposite conclusion. Indeed, only in February 2013 did Greensfelder attorneys begin researching the "limits on clients investing in investment adviser." (RX-113, p. 53). On the other hand, the Greensfelder bills from March 2011, which Respondents submit as "new" evidence, indicate that Greensfelder did no work relating to conflicts issues prior to the first offering. (RX-128). Moreover, the flurry of activity related to Binkholder reflected in the November 2012 to February 2013 Greensfelder invoices indicates that until that time, Winkelmann had not apprised Greensfelder of Binkholder's regulatory issues or the extent of Winkelmann's reliance on clients for the royalty unit offerings. (RX-113, pp. 38-53).

In discussing these 2013 communications, Respondents falsely claim that for the subsequent fourth offering, Greensfelder "made no changes...to the disclosures in the offering documents." (Br. at 15). Respondents ignore that the fourth memorandum, unlike the previous versions, expressly discloses Binkholder's bar and the reasons for the bar. (RX-4, p. 16). This indicates that had Greensfelder actually known about Binkholder's bar at the time of the second and third offerings, it would have insisted that Winkelmann disclose the bar, and the reasons for the bar, to investors.

5. Any Reliance By Winkelmann Was Not Reasonable or in Good Faith

Regardless of his consultations with Greensfelder, any reliance defense fails because, as an experienced securities professional who understood and routinely touted his fiduciary obligations, Winkelmann did not need to be told that he couldn't omit important information, misrepresent a lack of conflicts, or prioritize his personal interests. Indeed, the Commission routinely rejects the defense in similar circumstances. *See, e.g., Mohammed Riad*, Exchange Act Rel. 78049A, 2016 SEC LEXIS 2396, *135-136 (July 7, 2016) ("These were not technical, compliance-related or legal judgments that respondents could reasonably have believed others were independently evaluating. In short, [respondents] could not in good faith have relied on any advice that purported to excuse them from the duty to speak the truth to investors…"); *Robare,* 2016 SEC LEXIS 4179, *36 (respondents "could not reasonably rely on any advice that the disclosures were adequate because they knew their obligations as investment advisers, that they were required to disclose potential conflicts of interest, and that the Arrangement presented such a conflict but was not disclosed."); *Dennis J. Malouf*, Advisers Act Rel. No. 4463, 2016 SEC LEXIS 2644, *67 (July 27, 2016) ("*regardless of what others may have thought*, Malouf, an experienced securities professional, had an independent obligation to disclose his conflict, understood that obligation, and must have known that clients would be misled by his failure to correct the representation that no conflict existed") (emphasis added); *Rockies Fund, Inc.*, Exchange Act Rel. No. 48590, 2003 SEC LEXIS 2361, *71 (Oct. 2, 2003) ("We see no reason that the auditor's review of the Fund's reports should mitigate our view of Respondents' culpability. Given the recklessness with which the relevant Forms 10-Q and 10-K were prepared by Respondents, they can take no comfort now that the Fund's auditor failed to spot their mistakes.").

Moreover, when Winkelmann saw that his partner, Binkholder, was barred for engaging in identical conduct, Winkelmann knew that failing to disclose conflicts while offering securities to clients was illegal. Reliance on any advice to the contrary would be patently unreasonable or in bad faith. *WHX Corp.*, Exchange Act Rel. No. 47980, 2003 SEC LEXIS 1350, *44-45 (June 4, 2003) (corporation could not claim good faith reliance, even where attorney approved tender offer, when firm's "sophisticated and experienced chairman" was aware that the Commission staff had informed the attorney that the tender offer was illegal).

C. Winkelmann Acted Willfully and With Scienter

In failing to disclose conflicts and otherwise breaching his fiduciary duties, Winkelmann acted with scienter. Prime evidence of Winkelmann's scienter is that after learning of Binkholder's bar, Winkelmann hid that bar from his attorneys while continuing to offer BOP securities to clients without any disclosure of conflicts or that Binkholder had been barred for engaging in similar conduct. Beyond the Binkholder bar, the record is replete with evidence demonstrating Winkelmann's intent to deceive:

- Winkelmann steadily raised his own salary at investors' expense, when he could have spent the money on increased investor payments or on other activities, such as advertising, which would increase BOP's revenues and investor returns. (Stip., ¶ 65)

- Winkelmann initiated the second offering so that he could sharply increase his and Binkholder's compensation. (DX-83). Yet he falsely told investors that BOP would use the offering proceeds to "expand its advertising reach" and fund "revenue-producing activities [that] would need to result in the potential for recurring revenues inuring to [BOP] and to investor returns." (RX-2, p. 6)

- Winkelmann concealed from investors and clients that BOP's finances were failing and that he needed the proceeds from the royalty units to increase his own compensation and settle personal debts. (DX-211; Tr. 725:22-726:2, 727:16-728:14).

- Winkelmann required clients who purchased royalty units to falsely "represent" and "warrant" that BOP had not provided them any investment advice. (RX-1, p. 95).

- Winkelmann used BOP money to fill the ATMs belonging to one of Winkelmann's other companies, and attempted to structure the transaction to avoid "regulatory scrutiny by the SEC" during an ongoing OCIE examination. (Tr. 809:14-813:11; DX-274, EBT000910).

- All the while, Winkelmann consistently touted his fiduciary obligations to his clients, such as by routinely telling them he would always act in their best interests or put their interests above his.

These repeated instances of Winkelmann's breaches of his fiduciary duties – including the duties of loyalty, honesty, and full disclosure of material facts – readily establish Winkelmann's scienter. *See, e.g. J.S. Oliver Cap. Mgmt., L.P.*, Exchange Act Rel. No. 78098, 2016 SEC LEXIS 2157, *40 (June 17, 2016) (adviser acted with a "high degree of scienter" when he "persistently and systematically failed to act in the best interests of [his] clients"); *Larry C. Grossman*, Advisers Act Rel. No. 4543, 2016 SEC LEXIS 3768, *18-19 (Sept, 30, 2016) (adviser "knew both that he was receiving [undisclosed compensation] and that he did not disclose this fact to his clients. In light of that knowledge, he acted with scienter."); *Malouf*, 2016 SEC LEXIS 2644, *64 ("Given this awareness and his admitted periodic reviews of the disclosures, we find that Malouf must have been aware that his conflict had not been disclosed to UASNM's clients.").

In addition to showing Winkelmann's intent to deceive, the above facts demonstrate that Winkelmann acted, at best, recklessly. As the Court correctly observed:

> 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.

(Initial Decision, p. 55).

While Winkelmann's intent is irrelevant to the Advisers Act Section 206(2) and Securities Act Section 17(a)(2) and (3) claims, *J.S. Oliver*, 2016 SEC LEXIS 2157, *12, the Division established that Winkelman acted not only intentionally, but negligently. The Division did so by presenting unrebutted expert testimony from Professor Arthur Laby that Winkelmann violated applicable industry standards of conduct with respect to disclosure and fiduciary obligations. (Ex. 363, pp. 3, 20-28). On the other hand, Winkelmann presented no testimony, expert or otherwise, that his conduct satisfied the standards or norms of the asset management industry.[8]

[8] Winkelmann's expert witness, Palubiak, conceded that he lacked qualifications to opine on the fiduciary obligations of investment advisers or whether Winkelmann's conduct satisfied industry standards. (Tr. 1106:21-1110:11).

Even though the "new" evidence submitted by Respondents is wholly unrelated to the custody issues which form the basis for the Section 206(4) and 207 violations found in the Initial Decision, Respondents seek to revisit those findings as well. However, Winkelmann's sole basis for challenging the custody-related findings is his claim that because of Greensfelder's involvement, he did not act "willfully." (Br. at 19-20). But Winkelmann ignores that a respondent "acts willfully when he intends to commit the act which constitutes a violation; willfulness does not require that the actor 'also be aware that he is violating one of the Rules or Acts.'" *Timothy Dembski*, 2017 SEC LEXIS 959, *45 (quoting *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)). Moreover, Respondents' new contention that they did not violate Sections 206(4) and 207 is belied by their concession, to this Court, that custody-related violations occurred and that sanctions are appropriate. (Resp. Post-hearing Br. at 62-63 (Respondents admit having "accepted the SEC's conclusion that [BOP] inadvertently tripped the 'Custody Rule'" and suggest that the Court "should award, at most, a Tier 1 penalty for the custody violation.")).

D. The Sanctions Imposed by the Initial Decision Are Well Justified

Respondents claim that, having established a reliance defense, the sanctions imposed in the Initial Decision are unwarranted. For the reasons discussed above, Respondents acted with scienter and cannot sustain a reliance defense. Accordingly, the Court's rationale for imposing heavy sanctions remains sound, and the "new" evidence submitted by Respondents does not merit a reduction in sanctions.

Regarding the industry bars imposed against Respondents, those bars are entirely consistent with Commission precedent. To that end, applying the *Steadman* factors, the Commission routinely bars advisers who fail to disclose conflicts of interest to clients, finding such conduct to be "egregious." *See, e.g., James S. Tagliaferri*, Advisers Act Rel. No. 4650, 2017 SEC LEXIS 481, *21-22 (Feb. 15, 2017); *Grossman*, 2016 SEC LEXIS 3768, *84-85;

Malouf, 2016 SEC LEXIS 2644, *94-96; *J.S. Oliver*, 2016 SEC LEXIS 2157, *40-41; *Edgar R. Page*, Advisers Act Rel. No. 400, 2016 SEC LEXIS 1925, *14-15 (May 27, 2016) ; *Timbervest, LLC*, Advisers Act Rel. No. 4197, 2015 SEC LEXIS 3854, *59-60 (Sept. 17, 2015); *Montford & Co., Inc.*, Advisers Act Rel. No. 3829, 2014 SEC LEXIS 1529, *78-80 (May 2, 2014).

Winkelmann's conduct in failing to disclose conflicts was similarly egregious and committed with scienter. Given his lengthy career in the securities industry, his understanding of fiduciary obligations, and the fact that he systematically touted his fiduciary duties, there is no excuse for Winkelmann's failure to disclose conflicts when offering royalty units to clients. As the Court correctly observed, "Winkelmann's activities were at least extremely reckless" and "such activities attempt to sidestep the fiduciary duty of an adviser to his client and cannot be tolerated." (Initial Decision at 65).[9] The fact that Winkelmann knew his partner Binkholder had been barred for failing to disclose conflicts in extremely similar circumstances only compounds the severity of Winkelmann's misconduct, and demonstrates that Winkelmann acted with scienter.

For the same reasons, Respondents' submission and "new" evidence should not change the Court's penalty analysis, which again is consistent with Commission precedent. The Commission routinely imposes significant penalties on advisers who fail to disclose conflicts to clients. *See, e.g., Malouf*, 2016 SEC LEXIS 2644, *108 (third-tier penalty); *Montford & Co.*, 2014 SEC LEXIS 1529, *102-103 (third-tier penalties); *J.S. Oliver*, 2016, SEC LEXIS 2157, *70-71

[9] The Court also correctly observed that the other *Steadman* factors supported an industry bar. Namely, the Initial Decision recognized that Winkelmann's misconduct was relatively recent, occurred for multiple years, over four offerings, and involved sales to clients on 23 occasions. (p. 65). The Court additionally found, correctly, that "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." (*Id.*). As evidenced by his latest submission, Winkelmann still does not accept any responsibility.

($1,325,000 in second-tier penalties); *Robare*, 2016 SEC LEXIS 4179, *42-44 (second-tier penalty for negligence based violations). As in these decisions, heavy penalties are warranted for Winkelmann's failure to disclose conflicts when offering royalty units to clients.

If anything, in re-reviewing the evidence, the Court should impose increased penalties, to account for the fact that the statute of limitations was extended when the parties executed tolling agreements. (DX-357; DX-358). In imposing 18 second-tier penalties of $10,000 each, the Court assessed a penalty for the 18 of the 23 total royalty unit sales to BOP clients which fell within five years of the filing of the OIP (prior to May 20, 2011). (Initial Decision at 70). Because the tolling agreements extend the limitations period to include the five investors who bought royalty units prior to May 20, 2011, there is no reason to exclude royalty unit sales based on statute of limitations concerns.

Moreover, the Court chose to impose second-tier, as opposed to third-tier, penalties based on its finding that no single "occasion" of royalty unit sales resulted in or created the risk of "substantial losses" or resulted in "substantial pecuniary gain" for Winkelmann. (Initial Decision at 70). However, many investors bought multiple royalty units via $100,000, $75,000, and $50,000 purchases. (DX-455). Through these sales of BOP securities to BOP clients, Winkelmann was engaging in conduct he knew could result in him being barred, just like his business partner Binkholder. Thus, each royalty unit sale created the risk of substantial loss, each a minimum of $25,000, to investors. Moreover, the royalty unit sales collectively resulted in Winkelmann receiving more than $650,000 in compensation, very much a substantial pecuniary gain for Winkelmann.

While Respondents claim that BOP no longer has advisory clients and that Winkelmann is out of work (Br. at 7), Respondents do not include any evidence to support these claims.[10] At trial, neither Winkelmann nor BOP asserted – rather they waived – an inability to pay defense. (Tr. 1417:8-12). And Winkelmann testified he has other available income sources to fund his personal obligations. (Tr. 750:12-751:9). For these reasons, Respondents have not presented evidence that should alter the Court's penalty analysis. Based on the record and "new" evidence, reduced penalties against Respondents are not warranted.[11]

E. Respondents' Constitutional Arguments Fail

Respondents are mistaken in their claim that the Commission's November 30, 2017 Order was ineffective and did not cure their alleged injury.

First, the Commission's November 30 Order itself forecloses Respondents' claim that the Commission failed to effectively ratify the appointment of its ALJs. It is undisputed that the Commission, acting in its capacity as head of a department, has the constitutional authority both to appoint ALJs as inferior officers and to ratify any such appointments after the fact. *See* 15 U.S.C. § 78d(b)(1); *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 512 (2010); *Wilkes-Barre Hospital Company, LLC v. National Labor Relations Board*, 857 F.3d 364, 370–71 (D.C. Cir. 2017). The Commission's order exercising that authority and ratifying the appointment of its ALJs is, moreover, binding on those ALJs. The scope of the inquiry before *this* Court is therefore limited to whether—having had its appointment ratified by the Commission—the Court should affirm or revise in any respect its prior actions in this proceeding.

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[10] If BOP is actually out of business, it is presumably no longer repaying the royalty unit investors. This would increase the investor losses suffered as a result of Winkelmann's fraud, and provide additional justification for substantial penalties.

[11] Respondents' submission does not address disgorgement or present new evidence that would alter the Court's disgorgement analysis. Thus, the Division rests on its disgorgement position from its post-hearing briefing.

What is more, even if the Court could consider the validity of the Commission's ratification of its ALJs' appointments, Respondents err in their claim that the ratification was invalid. Respondents contend that the Commission cannot ratify the initial "hir[ing]" of the ALJs (Resp. Br. 22)—but that argument misunderstands the nature of the ratification doctrine itself. Indeed, the claim that the Commission cannot retroactively remedy actions taken by its staff runs counter to the doctrine's very purpose: to allow a principal to subsequently authorize the actions taken by an agent acting outside the scope of his or her authority. Restatement (Third) Of Agency, ch. 4, intro. note (2006); id. § 4.01 cmt. b; *U.S. v. Heinszen & Co*, 206 U.S. 370, 382 (1907); 1 Floyd R. Mechem, Treatise on the Law of Public Offices and Officers § 536 (1890). This ratification "operates upon the act ratified in the same manner as though the authority of the agent to do the act existed originally." *Marsh v. Fulton County*, 77 U.S. (10 Wall.) 676, 684 (1871).

Here, agency staff approved the initial hiring of the Commission's ALJs. Even assuming that this action exceeded the scope of the hiring officials' authority, the defect was remedied by the Commission's November 30 ratification order. 1 Mechem § 533 (ratification of an act "render[s] it good from the beginning and the same as though he had originally authorized or made it"); *accord Heinszen & Co.*, at 382 (ratification "retroactively give[s]" an agent's acts "validity"). Any defect in the appointment process has therefore been cured, and Respondents' contrary arguments fail.

Finally, Respondents' removal-based challenge also misses the mark. The Commission's decision in *Timbervest, LLC*, 2015 WL 5472520, at *26-28, forecloses their claim that the manner of removing ALJs is unconstitutional. (Resp. Br. 23.) Any suggestion that the government's change of position in *Lucia v. SEC*, No. 17-130 (S. Ct.), compels a different result is also wrong. The Commission in *Timbervest* concluded that its ALJs were employees, but it also expressly stated that "*even if* the Commission's ALJs are considered officers," the method of their removal does not offend separation-of-powers principles because of the long-standing and circumscribed adjudicatory functions that ALJs exercise. *Id.* at *27 (emphasis added). Indeed, in *Free Enterprise Fund v. PCAOB*, the Court expressly declined to extend to ALJs its holding that the dual for-cause structure for removing Public Company Accounting Oversight Board members was unconstitutional, explaining that "unlike members of the Board, many administrative law judges of course perform adjudicative rather than enforcement or policymaking functions." 561 U.S. 477, 507 n.10 (2010).

Dated: February 8, 2018

Respectfully submitted:

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17253

In the Matter of

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

Respondents.

CERTIFICATE OF SERVICE

Benjamin J. Hanauer, an attorney, certifies that on February 8, 2018, he caused a true and correct copy of The Division of Enforcement's Response to Respondents' Submission of New Evidence to be served on the following by overnight delivery and email:

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