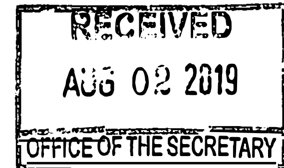

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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 BRIEF IN SUPPORT OF ITS PETITION FOR REVIEW

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I. INTRODUCTION

Respondent James Winkelmann was an experienced investment adviser who systematically touted the fiduciary duties he owed his clients. Nevertheless, Winkelmann repeatedly made misstatements and omissions, and breached his fiduciary duties, when offering investments in his own advisory firm, Respondent Blue Ocean Portfolios, LLC ("BOP"). Despite the inherent conflicts, Winkelmann targeted BOP clients as investors.

Winkelmann portrayed BOP as a successful adviser. In reality BOP was unable to achieve profitability or even obtain a bank loan, and faced a regulatory investigation into BOP's co-owner, Bryan Binkholder. Winkelmann chose to keep BOP afloat, and steadily increase his compensation, by selling $1.4 million worth of BOP securities called "royalty units" ("Units").

During four offerings spanning two years, Winkelmann marketed the Units by promoting BOP as a conflict-free adviser that always acted in clients' best interest, and falsely represented his interests being "aligned" with investors' interests. Despite these affirmative statements, Winkelmann never disclosed that each month he faced the conflict-riddled decision of whether to increase payments to investors or to increase his own compensation. And he concealed that this conflict manifested itself, to investors' detriment, when Winkelmann routinely paid himself more while keeping investor payments at the minimum-allowable levels.

Winkelmann additionally concealed that Binkholder – Winkelmann's partner, BOP's co-founder, and the centerpiece of BOP's advertising campaign – was under investigation and ultimately barred by Missouri securities regulators. Winkelmann's failure to disclose Binkholder's bar was even more egregious because Winkelmann was engaging in the same conduct underpinning Binkholder's bar: selling his clients securities in his own advisory business, without disclosing the attendant conflicts. Yet, given the importance of Binkholder to BOP, Winkelmann hid the bar and its findings from BOP's attorneys, clients, and investors.

Winkelmann also made false and misleading statements about BOP's "advertising ratio," a metric quantifying the efficiency of BOP's advertising that Winkelmann considered the "key driver" to BOP's business. Winkelmann chose what ratios to present to investors, selecting the ratios from a variety of available figures contained in BOP internal reports. BOP calculated those disparate ratios using evolving methodologies that resulted in sharply different outcomes, depending on the methodology chosen by Winkelmann. However, Winkelmann never disclosed the changing methodologies, or that he cherry-picked from multiple options and chose the ratio that made BOP look best. Winkelmann also repeatedly misrepresented BOP's 2011 annual ratio, making it appear BOP's advertisements were much more effective than they actually were.

Beyond the offering materials, Winkelmann lied about the Units in one-on-one correspondence with clients and other investors. To sell more Units, he materially overstated the amounts BOP had paid to earlier investors and BOP's success in raising funds.

Following a six-day hearing, the ALJ issued an initial decision (a) finding that Respondents violated the antifraud provisions of the Securities Act, Exchange Act, and Advisers Act by failing to disclose conflicts to their clients who purchased Units; and (b) imposing an industry bar, cease-and-desist orders, significant disgorgement, and third-tier penalties against Winkelmann. (Initial Decision No. 1116). Following a remand and introduction of limited evidence following *Lucia v. SEC*, the ALJ issued a revised initial decision (the "R.I.D."). (Initial Decision No. 1261). The R.I.D. again found that Respondents defrauded their clients and violated the negligence-based antifraud provisions, and left the original disgorgement award unchanged. However, the R.I.D. reversed the prior findings that Winkelmann violated the scienter-based antifraud provisions,

reduced Winkelmann's penalty from $187,500 to $25,000, and shortened his permanent bar to a six-month suspension. (*Id.*).[1]

The Division now appeals the findings that Respondents did *not* violate the antifraud provisions, including those requiring scienter, by: (a) failing to disclose Binkholder's adviser bar; (b) misrepresenting the amount of money BOP had repaid investors and raised in the Unit offerings; (c) failing to disclose conflicts, misrepresenting a lack of conflicts, and breaching fiduciary duties owed to clients who purchased Units; (d) misrepresenting the "alignment" and purported absence of conflicts between Winkelmann's and investors' interests; and (e) making misrepresentations and omissions regarding BOP's advertising ratio. The Division also appeals the reduced sanctions imposed by the R.I.D.

II. STANDARD OF REVIEW

The Commission's *de novo* review employs an "independent review of the record." *Robare Grp., Ltd.*, Advisers Act Release 4566, 2016 SEC LEXIS 4179, *2, *18 (Nov. 7, 2016). The Commission thus determines, by a preponderance of the evidence, whether Respondents violated the securities laws. *Steadman v. SEC*, 450 U.S. 91 (1981).

III. FACTS

A. Winkelmann's Background

Winkelmann has worked in the securities industry since 1981. (Parties' Stipulations, Nov. 14, 2016 ("Stip.") ¶17).[2] He has extensive experience in financial services sales, management, administration, compliance, and regulatory relations. (Stip. ¶18). Before forming

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[1] The R.I.D. also found various Advisers Act violations related to BOP's failure to comply with the Custody Rule. For those violations, the R.I.D. imposed a $7,500 first-tier penalty against Winkelmann. Respondents have not challenged those findings.

[2] The ALJ adopted the stipulations and ordered them binding on the parties. (Order, Nov. 15, 2016).

BOP, Winkelmann owned brokerage and advisory firms for more than 20 years. (Stip. ¶19). Winkelmann previously was chairman of the Missouri Securities Association, treasurer of a mutual fund, and an expert consultant on securities disputes involving sales practices and disclosures. (Stip. ¶¶20-22). He has passed multiple FINRA examinations. (Stip. ¶23). Winkelmann claims to understand the importance of compliance and ethical selling practices. (Stip. ¶24).

Winkelmann's longtime business partner was Don Weir. They co-owned the financial services firm Winkelmann operated before forming BOP. (Stip. ¶25). In 2008, after learning that Weir had misappropriated millions of dollars' worth of clients' gold, Winkelmann closed their firm. (Stip. ¶26, ¶29). Weir pled guilty to mail fraud and received a 78-month prison sentence. (Stip. ¶27).

Beyond his long securities career, Winkelmann owned Longrow Insurance Agency ("Longrow") and an automatic teller machine ("ATM") company. (Stip. ¶30). Winkelmann also managed his son's clothing business. (Hearing Transcript ("Tr.") 1440:7-15). In 2012, after Winkelmann and his son's company were sued for trademark infringement, Winkelmann was held in contempt for violating an injunction entered against him in the lawsuit. (Tr. 1440:16-1442:5; Division Exhibit ("DX") 205).

B. Binkholder's Securities Violations and the Formation of BOP

Winkelmann first met Binkholder after listening to Binkholder's radio show. (Stip. ¶32). By August 2009, Winkelmann and Binkholder became partners and formed BOP. (*Id.*). Each was an advisory representative and owned 50% of BOP. (Stip. ¶¶ 32-34, 43).

In early 2010, BOP began advising clients. (Stip. ¶38). Winkelmann's and Binkholder's legacy clients from their prior independent firms became BOP clients. (Stip. ¶39). In January 2010, BOP started sponsoring Binkholder's radio show. (Stip. ¶40).

Later in 2010, Winkelmann learned Binkholder was being investigated by Missouri securities regulators. (Stip. ¶41). The investigation involved the advisory firm Binkholder owned prior to BOP. (DX-84, ¶12-¶13; Stip. ¶39). Just as Winkelmann would soon begin offering BOP securities to BOP clients, Binkholder had been selling securities in his own businesses to his pre-BOP clients. (DX-84, ¶15(c)). The investigation culminated in December 2011, when Missouri barred Binkholder from being an investment adviser. (DX-84). The bar order: (a) was premised on Binkholder selling securities in his businesses to advisory clients; and (b) found "Binkholder did not disclose to investors ... the potential conflict of interest that could affect the advisory relationship between Binkholder and the investors." (*Id.*, ¶15(c), ¶16). As discussed below, Winkelmann failed to disclose Binkholder's bar, or the reasons for the bar, to clients and investors.

When Winkelmann learned of Binkholder's investigation he told Binkholder that until the investigation ended, Binkholder needed to rescind his membership in BOP, and no longer talk to clients or "have anything to do with" BOP. (Stip. ¶41, ¶56). Despite this admonishment, Winkelmann allowed Binkholder to remain intimately involved with BOP. They continued to share office space and employees, and Binkholder remained a BOP owner and adviser representative until March 2011. (Tr. 415:25-417:11). After that, Binkholder nevertheless continued to work in BOP's offices and stayed involved in BOP's financial decision-making. (Respondents' Exhibit ("RX") 4, p. 16; DX-70; DX-83). Binkholder's legacy clients remained BOP clients, and Winkelmann became their adviser representative. (Stip. ¶43).

In February 2011, BOP and Binkholder entered a "Solicitor's Agreement" for Binkholder to serve as BOP's "paid spokesman" and "introduce and assist [prospective clients] in establishing a relationship with [BOP]." (DX-456, §§ 3, 2).

The following month, BOP and Binkholder entered a separate "Marketing & Sponsorship" agreement, which obligated BOP to sponsor the production of Binkholder's radio show and other media. (DX-5, §1.01). The agreement required BOP to pay Binkholder monthly compensation at least equal to Winkelmann's compensation, and to purchase a $2 million insurance policy on Binkholder's life, with Binkholder choosing a 50% beneficiary. (*Id.*, §1.02, §1.04(b)(ii)). In return, Binkholder was required to: (a) "prominently and exclusively display and promote [BOP] services on all [his] web based, radio and television shows, productions and social media"; and (b) "exclusively enable [BOP] to generate leads from [Binkholder's] websites, social media sites, radio shows, television shows, speaking engagements and book publications." (*Id.*, §1.03). BOP's Form ADV brochure disclosed its marketing agreement with Binkholder and sponsorship of his show. (DX-13, PDF p. 11).

BOP promoted Binkholder's radio show in the signature block on Winkelmann's and his employees' emails. (*See, e.g.*, DX-99, DX-129; DX-130; DX-131; RX-106, pp. 492-493, 525, 1089, 1097-98, 1099, 1189-90, 1195-96, 1197-98, 1199-1200). Winkelmann also frequently co-hosted Binkholder's show to promote BOP. (RX-4, p. 16). Binkholder proved key to BOP's advertising efforts, generating 70 to 100 weekly leads for BOP. (Tr. 425:25-427:9).

C. Winkelmann Controlled BOP and Determined His Compensation Increases

As BOP's CEO, Winkelmann had ultimate decision-making authority and "the buck stopped" with him. (Stip.¶¶ 34-35; Tr. 437:11-21). He reviewed, at least monthly, BOP's financial statements; and "constantly" monitored BOP's revenues and expenses. (Stip. ¶37; Tr. 438:18-439:15). Also serving as Chief Compliance Officer, Winkelmann was responsible for BOP's compliance program and compliance manuals. (Stip. ¶¶34, 36).

In early 2011, Winkelmann conveyed his ownership interest in BOP to 23 Glen Abbey Partners ("23GAP"), a company owned by Winkelmann's family but managed by Winkelmann.

(Stip. ¶31, ¶42). Once Winkelmann removed Binkholder as BOP's co-owner, 23GAP fully owned BOP. (Stip. ¶42).

Controlling BOP, Winkelmann decided when and how much BOP would pay him. (Stip. ¶60). In 2012, BOP paid $125,000 to 23GAP as compensation for Winkelmann's services. (Stip. ¶64). In 2013, Winkelmann increased his compensation by having BOP pay 23GAP $182,000 and an extra $7,200 directly to Winkelmann. (*Id.*). In 2014, Winkelmann upped his pay to $227,557. (*Id.*). As discussed below, Winkelmann needed the Unit offerings to fund his pay increases.

Beyond the compensation Winkelmann received either directly or through 23GAP, he also funneled BOP money to other companies he owned. Between August 2011 and March 2012, BOP paid $41,000 in "management fees" to Longrow, which Winkelmann admitted were to compensate him for his services to BOP. (DX-457; Tr. 774:6-777:15, 1486:1-17). Between October 2011 and September 2012, BOP also paid more than $46,000 to Winkelmann's ATM company. (DX-457; Tr. 111:21-112:25). And in July 2012, BOP paid $50,000 to settle Winkelmann's personal debt – Winkelmann's settlement obligation in a lawsuit filed by a Weir victim. (DX-170, §3.1(c); Tr. 800:10-23, 802:19-24, 804:20-23).

D. Winkelmann Understood and Touted His Fiduciary Obligations

Winkelmann understood the fiduciary obligations he owed his clients. He admitted owing duties of honesty, good faith, loyalty, and disclosure of all material facts, including conflicts of interest. (Tr. 373:18-376:23). He recognized that conflicts can negatively impact investor returns. (DX-423; Tr. 380:16-381:10).

Winkelmann's fiduciary obligations were also documented in BOP's internal policy manuals which Winkelmann was charged with enforcing. (Stip. ¶36). Those manuals repeatedly: (a) note BOP's fiduciary relationship with its clients; and (b) state that BOP must

"always" place its clients' interests "first and foremost." (DX-3, BO10065; DX-4, BO10166, BO10188, BO10207, BO10209).

Consistent with these policies, BOP's clients received a "Conflicts of Interest Disclosure" that purported to disclose situations where BOP acted, or did not act, in a fiduciary capacity. (DX-228, p. 1; Tr. 391:16-23). That form identified three scenarios, each with a box for BOP to check when applicable:

Fiduciary Role

☒ Advisor and/or Firm ***always*** acts in a fiduciary role for the client and only offers options and recommendations in the clients' best interest. This would include all products (mutual funds, stocks, variable annuities, etc) plus advisory services.

☐ Advisor and/or firm ***occasionally*** acts as a fiduciary when providing some services. Please list or explain:

☐ Advisor and/or Firm ***do not*** operate under a fiduciary duty. As such, our recommendations are not necessarily in the clients' best interests but are instead "suitable" based on their needs.

(DX-228, p. 1). Winkelmann testified that clients received forms with the box checked for the first paragraph, where BOP represents that it ***always*** acts, for "all products," in a fiduciary capacity. (Tr. 391:20-392:10).

Winkelmann admitted he frequently reminded clients of his fiduciary obligations. (Tr. 396:13-17). For instance, a September 2011 press release stated that BOP puts "at all times...clients' interest first." (DX-67, p. 2). Similarly, Winkelmann often wrote directly to clients that he was required to "always" or "at all times" put their interests first. (DX-90, p. 2; DX-127, p. 2; DX-462, p. 1; Tr. 397:23-399:9). Winkelmann also routinely sent clients emails with a signature block describing Winkelmann as a "Registered Fiduciary." (*See, e.g.*, DX 129-132; DX-167, DX-172, DX-197).

BOP's website touted Winkelmann's commitment "to always acting in the best interest of clients." (DX-310, p. 2). Winkelmann similarly represented on BOP's website: "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." (Tr. 1523:12-1525:9).

E. BOP's Financial Distress Led Winkelmann to Offer Units

BOP's first year was unprofitable. For 2010, despite receiving more than $120,000 in management fees, BOP's expenses exceeded $198,000 and its net losses exceeded $36,000. (Stip. ¶44). BOP began 2011 precariously, with only $164 in the bank, $3,264 in total assets, and over $43,600 in liabilities. (Stip. ¶45). By March 31, 2011 – as it started offering Units – BOP only had $240 in the bank, was past due on its rent, and had recurring expenses including pay for between six and ten employees. (Stip. ¶46; DX-27; RX-1; DX-15, p. 6).

Winkelmann wanted to grow BOP's revenues, its management fees based on assets under management ("AUM"), through increased advertising. (Tr. 440:10-18). But BOP couldn't afford an advertising campaign, and no bank would loan it money. (Stip. ¶46; Tr. 445:15-446:5). Consulting with Binkholder, Winkelmann devised the Units, believing they were "critical" to funding BOP's business plan and advertising campaign. (Tr. 439:16-440:9, 446:6-447:3; RX-3, p. 12). Winkelmann targeted his clients to be investors. Indeed, ten of the initial fourteen investors were BOP clients, as were eighteen of the 24 total investors. (Stip. ¶¶5-6).

Winkelmann authored the initial drafts of the offering memoranda, reviewed and approved the final versions, and controlled their content. (Stip. ¶53, ¶55). Each Unit cost $25,000, and granted the buyer a minimum percentage of BOP's monthly gross revenues until the investor

received a fixed amount, ranging from 2.25 to 3.0 times the original investment amount.[3] (Stip. ¶7, ¶9, ¶11, ¶13). Below are the terms of each offering:

	Unit Price	Promised Returns Per Unit	Minimum Monthly Returns Per Unit (as Percentage of BOP's Monthly Revenues)
Offering 1	$25,000	$75,000	0.25%
Offering 2	$25,000	$62,500	0.25%
Offering 3	$25,000	$56,250	0.10%
Offering 4	$5,000	$12,500	0.05%

The offering memoranda represented BOP could pay more than the monthly minimum and that doing so was BOP's goal. (RX-1, pp. 11, 111; RX-2, pp. 6, 16; RX-3, pp. 4, 14). The memoranda also contained tables showing a range of monthly payout percentages, up to six times the minimum amounts, and how those percentages impacted the speed of investors' returns. (RX-1, p. 11; RX-2, pp. 6, 17; RX-3, pp. 4, 15; RX-4, pp. 4, 15). Those tables indicated that the higher the monthly payout percentage, the faster investors got paid. (*Id.*).

BOP ultimately raised $1.4 million by issuing Units. (Stip. ¶1). BOP required each investor to complete a Subscription Agreement – written by Greensfelder law firm attorneys, and reviewed and approved by Winkelmann – and thereby "represent" and "warrant" that BOP "has not provided any investment advice" to the investor. (Stip. ¶54; Tr. 535:23-536:6; RX-1, p. 95; DX-2, PDF p. 2; DX-29, BOP8772; DX-33, BOP8892; DX-119, BOP9667; DX-124, BOP9375; DX-192, BOP9738; DX-347, BOP9782; DX-242, BOP9851; DX-246, BOP9865). Thus,

[3] For the first offering only, investors also received a warrant providing an option to purchase 1% of BOP for $100,000. (Stip. ¶7). BOP offered the fourth round Units in $5,000 increments, but required a minimum five-Unit purchase. (Stip. ¶13).

Winkelmann was forcing his clients, who undisputedly received BOP's investment advice, to provide false representations when purchasing Units.

F. The First Offering

In April 2011, Winkelmann began circulating the first offering memorandum to prospective investors, including non-accredited investors. (Stip. ¶50; Tr. 506:10-18, 510:15-25). The memorandum does not disclose *any* actual or potential conflicts of interest. (RX-1; Tr. 551:9-12). Rather, the memorandum repeatedly and affirmatively represents the *absence* of conflicts:

- "...the [Unit] concept...appears to be a compelling way for the investors, owners and employees to align their interest." (RX-1, p. 5).
- BOP "creates value for its clients by eliminating conflicts of interest..." (*Id.*, p. 7).
- "The expansion capital in the form of [Units] is a way to fund growth, provide immediate cash flow stream to the [Unit] holders, and align all interests for returns at relatively low risk." (*Id.*, p. 15).
- 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." (*Id.*, p. 6).
- "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." (*Id.*, p. 8).

The memorandum describes how BOP's sponsorship of Binkholder's radio show drives potential clients to BOP. (RX-1, p. 8). BOP represents that it "will use a substantial portion of the proceeds of this offering and future cash flows to fund media buys for both [BOP] and [Binkholder's] Show." (*Id.*). The memorandum further discloses that Binkholder had been providing financing to BOP and anticipated receiving BOP membership units. (*Id.*, p. 10). The memorandum additionally promotes a book Winkelmann and Binkholder co-authored, "The

401(k) Conspiracy." (*Id.*, p. 9). Binkholder's Marketing/Sponsorship agreement is an exhibit to the memorandum. (*Id.*, p. 26).

The memorandum describes BOP's advertising ratio as an important business metric:

> A key business driver for [BOP] is the client acquisition cost. Currently [BOP] is spending approximately $5,500 per month on advertising that generates leads for the sales staff to follow up on. This $5,500 advertising spend is currently converting to approximately $2.5 million in new assets that are generating $25,000 in new annually recurring revenue. So, if this trend continues, each $10,000 in new recurring revenue will cost [BOP] $2,200 in advertising - a 22/100 ratio.

(RX-1, p. 9).

The memorandum further represents: "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, p. 13).

The memorandum states: "the investor will receive *no less than* 0.25% of the cash receipts of [BOP] on a monthly basis" until the investor receives $75,000. (RX-1, p. 10) (emphasis added). The memorandum contains charts showing anticipated payback times based on the monthly percentage of revenues paid per Unit (ranging from 0.25% to 1.5%). (RX-1, p. 11). The charts show higher percentages causing significantly shorter payout timeframes. (*Id.*).

The memorandum included a BOP PowerPoint presentation (RX-1, p. 109; Tr. 532:17-24), which stated:

- "Growth Attributed to Advertising and Radio Show" (RX-1, p. 109)
- "Goal – Maintain Advertising Yield Conversion $25/$100." (*Id.*, p. 110)
- "Royalty Units Summary...Right to at Least 0.25% of Monthly Cash Receipts. Plan is to be higher! Investors get repaid first!" (*Id.*, p. 111).
- "Payback Time Depends on...Advertising & Lead Conversion Efficacy." (*Id.*)

- "[BOP]: Conflict Free Wealth Management…Eliminates Conflicts." (*Id.*, p. 115)

On May 17, 2011, Winkelmann offered Units to client Mike King, writing: "So far we have raised about $650,000 we are going to close the offering at the end of May." (DX-50). This statement was false. BOP had only raised $425,000 at the time, and the offering would continue until the last Unit was sold on July 13, 2011. (Stip. ¶4, ¶6; DX-455). When the offering closed, BOP had raised $650,000 from fourteen investors, ten being advisory clients. (Stip. ¶6). As discussed below, Winkelmann would continue lying to clients about the success of BOP and its Unit offerings.

G. Despite Raising $650,000, BOP's Financial Situation Worsened

Raising $650,000 could not solve BOP's financial problems. By October 18, 2011, Winkelmann realized BOP's expenses were higher, and its revenues lower, than anticipated. (DX-70; Tr. 560:20-561:13). Winkelmann emailed Binkholder BOP's financial statements, writing: "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 did not share this negative information with investors. Only two days later, Winkelmann emailed his client and Unit investor, Jason Grau, and touted BOP's performance while withholding the negative information Winkelmann shared with Binkholder. (DX-71; Tr. 563:3-564:15).

On December 20, 2011, Winkelmann reminded Binkholder BOP was performing much worse than expected, and warned BOP was heavily undercapitalized and running out of money. (DX-83). Winkelmann's email presented Binkholder with two options, the first being reducing monthly expenses by $18,000: "This 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 [receive from BOP]…..more pain and suffering!" (*Id.*; Tr. 584:6-584:9).

Winkelmann's second option was: "Raise additional $1.8 - $2.0 million...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..." (*Id.*; Tr. 586:3-19). Winkelmann concluded by recommending BOP "be bold" and initiate a second offering. (DX-83). Winkelmann contemporaneously created an "Action plan" to: (a) reduce monthly advertising spending by $7,000; and (b) raise his and Binkholder's monthly compensation from $2,000 to $10,000. (DX-395, BO5317; Tr. 587:19-23, 589:19-23, 590:3-6, 591:20-592:4).

On February 27, 2012, Grau raised concerns about the performance of his Units. (DX-104, BO971). Winkelmann responded by acknowledging that BOP's "payments/revenue growth are a little behind projections but we are not worried." (*Id.*). Winkelmann withheld from Grau the negative financial information – including BOP being undercapitalized and running out of money – Winkelmann had previously shared with Binkholder. (*Id.*). Winkelmann also withheld from Grau his "plan" of reducing BOP's advertising spending to increase Winkelmann's and Binkholder's compensation. (*Id.*).

H. Winkelmann Conceals, Including from his Attorneys, Binkholder's Adviser Bar

Compounding BOP's deteriorating finances, in late December 2011 Winkelmann first saw the order barring Binkholder from being an investment adviser. (Stip. ¶56). The order found that Binkholder had offered securities in Binkholder's prior companies to advisory clients without disclosing "the potential conflict of interest that could affect the advisory relationship." (DX-84, p. 3, ¶16). Winkelmann testified that upon learning of the order: (a) he alerted Greensfelder attorney Michael Morgan; (b) Morgan and his partner, Wendy Menghini, scrutinized the 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 order) or January 2012, and that Menghini first billed time to BOP in **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 only after learning of a separate *criminal* investigation into Binkholder. (DX-220; Stip. ¶57). Winkelmann agreed this 2013 email, sent over a year after Winkelmann learned of Binkholder's bar, is the only record of him apprising Greensfelder of the order. (Tr. 580:25-581:7, 1492:25-1493:9).

While the Greensfelder invoices provide compelling evidence, common sense alone refutes the notion that Winkelmann apprised Greensfelder of Binkholder's bar 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.[4] It further strains credulity to suggest that an attorney would give such advice without first devoting thorough attention to the matter. As the invoices demonstrate, Greensfelder performed *no legal services whatsoever* for BOP between June 2011 and January 2012, the period in which Winkelmann claims Greensfelder analyzed, discussed, and provided him with advice about Binkholder's bar. (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.

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[4] Prior to the first offering, and before Binkholder was barred, Morgan specifically advised Winkelmann that he had to disclose to investors "all material facts regarding any legal or disciplinary events that are material to your evaluation of [BOP] or the integrity of [BOP's] management." (RX-106, p. 295).

As discussed below, Winkelmann concealed Binkholder's bar from investors as well as his attorneys. Winkelmann also doubled-down on his relationship with Binkholder by entering an amended Marketing/Sponsorship Agreement in February 2012. (DX-106). That agreement not only allowed the now-barred Binkholder to continue acting as BOP's spokesman, but more than tripled Binkholder's salary to $7,000 per month. (DX-106; §1.01, §1.02, §1.03).

I. The Second Offering

Needing cash to support his and Binkholder's pay raises, in March 2012 Winkelmann initiated the second Unit offering. (DX-83; Tr. 659:19-660:2).

Like the first memorandum, the second memorandum failed to disclose any actual or potential conflicts and contained numerous statements touting the offering's lack of conflicts. (RX-2 pp. 6, 9, 22 (the "Royalty [Unit] method would appear to be the most compelling way for the Investors, owners, and employees to align their interests"; BOP "creates value for its clients by eliminating conflicts of interest..."; and "The expansion capital in the form of [Units] is the optimal way to fund growth...and align all interests for the highest potential return at the least risk.")).

The memorandum also represented: "the fewer number of [Units] issued, the better for owners and employees" and 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-2, pp. 6-7, 16). Despite these representations, the memorandum concealed that investor proceeds would fund increases to Winkelmann's and Binkholder's compensation. (Tr. 668:24-669:3, 671:8-19).

The memorandum continued to tout Binkholder's radio show and book, and included BOP's amended agreement with Binkholder as an exhibit. (RX-2, pp. 10-13, 34). Consistent with Winkelmann's *modus operandi* of concealing bad news, the memorandum did not disclose Binkholder's bar.

The second memorandum stated: "The key driver to the [BOP] model is the efficacy or yield of the money spent on advertising...The key indicator on the advertising efficacy is to determine how much advertising is needed to generate one additional dollar in new recurring revenue. In 2011, this 'factor' was 0.79. Or in other words, [BOP] spent $0.79 in advertising to buy $1.00 in new recurring annual revenue." (RX-2, p. 5). The memorandum later represents: "**Advertising Yield Factor;** this is the key driver of the [BOP] model. This advertising factor for 2011 was 0.78. So far in 2012, this factor has dropped to 0.62." (*Id.*, p. 16).

The memorandum further represents: "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." (*Id.*, p. 17). BOP does not disclose that it previously told investors its key business driver was a ratio *below 0.4*. (Tr. 676:16-677:15).[5]

The second memorandum contained multiple representations that BOP intended to pay investors more than the monthly minimum 0.25% of its revenues. (RX-2, p. 6 ("Once recurring sustainable profitability is achieved, larger and larger portions of the cash receipts will be used to pay back [investors]"), p. 16 ("Once [BOP] achieves profitability, the current plan (although not required) is to pay at least 50% of the profits, which we expect will exceed 0.25% of revenue...")). Reinforcing investors' expectations of receiving more than the minimum payments, the memorandum contained tables showing payout ranges from less than four years (for monthly payouts at 1.5%) to more than ten years (if payments were kept at a minimum):

[5] A lower ratio was better for BOP and investors. A lower ratio indicated more revenues, less advertising expenses, and a faster payment of investor returns. (RX-1, p. 13; Tr. 595:25-596:18, 939:18-20, 960:14-17, 964:25-965:8, 982:4-9, 983:5-8, 987:6-17, 1141:15-17).

Royalty Rate Per Unit	Internal Rate of Return/Unit	Months to Payback
0.25%	13%	128
0.50%	20%	87
0.75%	26%	68
1.00%	31%	57
1.25%	36%	49
1.50%	40%	44

(RX-2, p. 6; *see also* RX-2, p. 17)

The second offering continued through May 2012, cumulatively raising $350,000 from ten investors, seven being BOP clients. (Stip. ¶8). Even before that offering ended, Winkelmann invited investors to participate in an upcoming third offering. (DX 129-132; Tr. 677:16-678:11). Winkelmann's email – which promoted Binkholder's show and book – noted that BOP "should again exceed our projections." (*Id.*).

On August 1, 2012, Winkelmann promoted the upcoming third offering to client Mark Funfsinn by representing that first round investors had been repaid $4,961 to date. (DX-167; Tr. 546:15-18). Winkelmann conceded that statement was false: BOP had paid only $2,671 per Unit. (Tr. 682:3-22; DX-454).

J. The Third Offering

In August 2012, as BOP was preparing the third offering memorandum, BOP employee Jennifer Juris alerted Winkelmann the current draft disclosed inconsistent advertising ratios, writing: "We just need to be consistent on whatever number we use in the document." (DX-169; Tr. 683:14-22).

On August 24, 2012, Winkelmann emailed each Unit investor about the third offering. (DX-172; Tr. 685:14-21, 686:5-10). Winkelmann again promoted Binkholder's book and radio show, and encouraged investors to let him know "right away" if they were interested because "we

have many prospective investors and will give preference to the current royalty holders." (DX-172). But BOP did not have "many" prospective investors lined up. Rather, only four investors ultimately purchased third round Units. (Stip. ¶10; Tr. 688:21-24). Demonstrating his pressing need for cash, Winkelmann initiated the third offering despite having serious health issues at the time. (Tr. 689:6-691:22).

The third memorandum repeats many misstatements contained in the second memorandum about: (a) lack of conflicts; (b) the alignment of Winkelmann's and investors' interests; (c) BOP issuing fewer Units being better for Winkelmann; and (d) investor proceeds only being spent on activities that would cause higher revenues for BOP and better returns for investors. (RX-3, pp. 4-6, 13, 20-21). The memorandum again promotes Binkholder's radio show and book, and attaches Binkholder's marketing agreement, but fails to disclose Binkholder's bar. (RX-3, pp. 8, 10, 32; Tr. 701:6-13). The memorandum also fails to disclose any conflicts or investor proceeds being used to increase Winkelmann's compensation. (RX-3; Tr. 699:25-701:3).

The third memorandum represents: "The key driver to the [BOP] model is the efficacy, or yield, of the money spent on advertising... currently this 'factor' is 0.67. Or in other words, [BOP] spends $0.67 in advertising to buy $1.00 in new recurring annual revenue." (RX-3, p. 3). The memorandum repeats the second memorandum's representation that BOP's 2011 advertising ratio was 0.78. (RX-3, p. 13).

The third memorandum contains multiple statements indicating investors should expect more than the 0.10% minimum monthly payment percentage, including the representation: "Investors should expect the bulk of their return in years 3-5." (RX-3, pp. 4, 14). The memorandum contains charts reflecting that, to pay back investors in five years, BOP would have

to pay, *every single month*, more than twice the minimum monthly payout percentage. (*Id.*, pp. 4, 14, 15; Tr. 708:11-24).

Months to Payback

		Better		Advertising Yield Factor			Worse			
	[illegible]	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.85	0.90
Royalty per Unit	0.10%	127	129	131	133	135	136	138	139	140
	0.25%	79	80	82	83	84	85	86	87	87
	0.40%	51	52	53	54	54	55	55	56	56
	0.55%	36	37	37	38	38	39	39	39	40
	0.70%	27	28	28	28	29	29	29	29	29
	0.85%	21	22	22	22	22	22	23	23	23

(RX-3, p. 15). BOP does not disclose that it never paid such heightened returns. (RX-3).

On October 2, 2012, Winkelmann again promoted the third offering to each Unit investor. (DX 197-199; Tr. 711:12-712:6). Winkelmann's emails falsely represented that the offering had raised $325,000. (*Id.*). In reality, BOP only had raised $250,000 and would ultimately raise $275,000 during the entire third round. (DX-455; Stip. ¶4, ¶10). In an October 9, 2012 letter to a prospective investor, Winkelmann continued lying about the third offering's success, this time boasting BOP had raised $400,000. (DX-203; Tr. 713:15-714:6).

K. Binkholder's Criminal Investigation, Another Missouri Regulatory Investigation, and BOP's Failing Finances Lead to the Fourth Offering

By November 2012, the third offering was floundering. Only four investors, two of whom were BOP employees, bought Units. (DX-455; Stip. ¶4; Tr. 1005:2-6, 1059:8-12). Making matters worse, that month Winkelmann learned Binkholder was under federal criminal investigation. (Stip. ¶57; DX-206; Tr. 715:7-18). Winkelmann severed Binkholder's relationship with BOP, and Binkholder later pled guilty to wire fraud and was sentenced to 108 months imprisonment. (Stip. ¶58).

On December 12, 2012, Winkelmann emailed his close friend, Bryan Swift, financial projections showing BOP running out of money by February. (DX-211, BO54; Tr. 727:16-728:14,

1058:22-24). Winkelmann did not want other investors to learn about BOP's failing finances, writing: "I need to come up with a deal – I am hesitate (sic) to go back to some of the investor/clients with this bad news – need to be careful not to start any rumors." (DX-211, BO52; Tr. 725:22-726:2). The bad news compounded itself when, on December 21, Winkelmann learned he was under investigation by the same Missouri regulators that had barred Binkholder. (DX-212).

Meanwhile, on December 1, 2012, client Ed Mahoney asked about the performance of his first round Unit, which had only paid $3,778.54 on Mahoney's $25,000 investment. (DX-210; Tr. 716:24-718:15). Mahoney wanted to unload his poorly performing Unit, prompting Winkelmann to offer to attempt finding a buyer. (DX-210; Tr. 718:24-719:23). Even though Mahoney's first round Unit had better payout terms (3x payout and a warrant) than the 2.5x payout of the fourth offering, Winkelmann did not inform the fourth round investors – both clients – that Mahoney had asked about selling his Unit. (Tr. 721:16-725:2; DX-455).

On January 25, 2013, Winkelmann wrote Morgan "we need to raise money," and proposed draft disclosures for an upcoming offering. (DX-225, BO3140-41). Those disclosures, which Winkelmann devised, addressed Binkholder's criminal investigation and the regulatory investigation into Winkelmann and BOP. (*Id.*; Tr. 735:23-736:8). Three days later, Winkelmann asked Morgan if BOP, only a month from being out of money, could raise $500,000 over the next two months. (DX-229; Tr. 737:22-738:20). Winkelmann wrote: "I think the odds are that the state will fine us but not shut us down. If we stop growing we start [dying]." (DX-229).

In February 2013, Winkelmann started the fourth offering, hoping to raise $375,000. (Stip. ¶12; RX-4, p. 3; Tr. 766:25-767:18). However, Winkelmann only provided a memorandum to three clients, all earlier round investors. (Stip. ¶59; DX-455). Thus, only three investors received the memorandum's disclosures that: (a) Binkholder had been barred for not disclosing conflicts to

clients; (b) Binkholder was under criminal investigation; and (c) without additional capital BOP would run out of money by March 1, 2013. (RX-4, pp. 5, 16)

The fourth memorandum again fails to disclose any conflicts or Winkelmann's use of investor proceeds to increase his compensation. (RX-4). Likewise, the memorandum repeats many misrepresentations from the earlier memoranda concerning: (a) lack of conflicts; (b) the alignment of Winkelmann's and investors' interests; and (c) the fact that issuing fewer Units would be better for Winkelmann. (RX-4, pp. 4, 7, 13, 21).

The fourth memorandum represents that BOP's "current" advertising ratio is 0.89, and repeats the prior memoranda's representation that BOP's 2011 ratio was 0.78. (RX-4, pp. 11, 13). Like the third memorandum, the fourth memorandum represents: "Investors should expect the bulk of their returns in years 3-5." (RX-4, p. 14). The fourth memorandum also 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).

Royalty Rate Per Unit	Internal Rate of Return	Months to Payback
0.05%	5%	176
0.10%	19%	114
0.15%	25%	86
0.20%	31%	70
0.25%	37%	59
0.30%	43%	51

Chart assumes an Advertising Conversion Factor of 0.90

(RX-4, p. 4).

BOP's fourth offering only raised $125,000, from two clients (Stip. ¶12), before Missouri regulators asked BOP to stop issuing Units. (Tr. 767:25-768:15, 770:22-771:13).

On May 20, 2014, client Mahoney again complained to Winkelmann about his investment. (DX-302, BO934). The 74-year-old Mahoney observed his Unit's pace of return was so slow he would not be paid in full for another 30 years. (*Id.*).

By Respondents' October 2016 trial, BOP had only paid investors a combined $525,672.51 on their cumulative $1.4 million investment, while owing them more than $3.3 million. (Stip. ¶¶14-15).

L. Winkelmann's Conflicts of Interest

As discussed, Winkelmann relied on Unit investor proceeds to increase his own compensation, funnel BOP money to his other companies, and use BOP money for personal expenditures. While routinely determining to pay himself more, he also decided whether to pay investors more than the minimum monthly percentage of BOP's revenues. (Stip. ¶62).

BOP received nearly all of its revenue on a quarterly basis (when management fees were deducted), and Winkelmann took advantage of that fact when deciding when to pay investors more than the minimum. (DX-448; DX-315; Tr. 117:9-118:9). Using that discretion, until August 2014 Winkelmann generally had BOP pay the investors the minimum monthly percentages. (*Id.*). From April 2011 to June 2012, Winkelmann did increase the payout percentages two months per quarter, *but only for the months when BOP's revenues were negligible*. (DX-448). For the every third month when BOP received nearly all of its revenues (its quarterly management fees), Winkelmann always paid the minimum percentage. (*Id.*).

Winkelmann recognizes that an adviser selling its own securities to clients could create a conflict of interest. (Tr. 778:20-779:14). Nevertheless, the offering memoranda never disclosed actual or potential conflicts, and Winkelmann never discussed such conflicts with investors. (Tr. 780:1-8, 782:22-783:8). As the ALJ observed, these circumstances resulted in "an actual, continuing conflict between [investors'] interests and Winkelmann's, who could always elect to

increase his compensation rather than returning more than the minimum to investors." (R.I.D. at 71-72). The ALJ also correctly noted that the Division "presented unrebutted expert testimony from Professor Arthur Laby that Winkelmann violated applicable industry standards of conduct with respect to...disclosure and fiduciary obligations." (R.I.D. at 74).

M. The Advertising Ratios

The offering memoranda emphasized the importance of BOP's advertising ratio or "factor," describing the metric as the "key driver" for BOP's business. (Tr. 448:18-449:2; RX-1, p. 9; RX-2, p. 16; RX-3, p. 13; RX-4, p. 13). The lower the ratio, the better. (Tr. 983:5-8, 987:6-17). Winkelmann personally selected what ratio to represent to investors. (Tr. 972:2-14, 981:8-13, 982:10-22). BOP never disclosed: (a) its methodology for calculating the ratio, (b) that BOP changed its methodologies from offering to offering, or (c) that Winkelmann cherry-picked from multiple available ratios. (Tr. 484:18-485:15, 517:9-518:12, 663:5-664:21, 695:8-697:20, 705:25-706:15, 756:7-14). Moreover, Winkelmann's shifting accounts for how BOP calculated the ratio, coupled with his inability to explain how he arrived at certain ratios touted to investors, belie his claim BOP fully and accurately represented the ratio to investors.

1. Winkelmann's Changing and Conflicting Story

At his investigative testimony, Winkelmann testified BOP calculated the ratio by dividing (a) total advertising spending for a given period by (b) the amount of new recurring revenue BOP generated during that same period. (Tr. 449:16-450:12, 1450:9-19). However, Winkelmann could not explain the discrepancies between the ratios disclosed to investors and the ratios the Division calculated using BOP's financial records and the methodology Winkelmann described. (Tr. 1447:2-20). Even though Winkelmann recognized these inconsistencies, his subsequent Wells submission offered no explanation for how BOP calculated the ratios. (Tr. 477:14-478:15, 1451:12-16; DX-346).

When confronted at trial with his investigative testimony concerning the ratios, Winkelmann claimed his investigative testimony was inaccurate and "wrong." (Tr. 453:3-454:19, 471:10-472:22, 476:8-477:8, 1457:23-1458:4). At trial, Winkelmann initially testified the numerator component of the ratio was revenue, but later reversed himself and testified revenue composed the ratio's denominator. (Tr. 455:9-13, 458:1-8). Winkelmann eventually settled on a methodology he only recently embraced in his prehearing brief and expert's report: advertising spending for a period divided by new revenues that *resulted* from the period of advertising, as opposed to new revenues generated *during* the advertising period. (Tr. 471:10-472:22, 476:8-477:8, 1457:23-1458:4, 1459:6-1460:24).

Juris was BOP's employee responsible for tracking the advertising ratio. (Tr. 863:12-864:10, 865:7-866:11; 873:8-17, 876:24-877:18, 942:21-945:11, RX-6; RX-36). Even though Winkelmann called Juris to testify, she refuted the new methodology described in Winkelmann's trial testimony, prehearing brief, and expert report. (Tr. 872:25-879:15, 948:2-21, 950:23-952:8, 900:4-903:1). Namely, Juris testified BOP calculated the ratio using new revenues generated *during* the period of advertising at issue. (*Id.*). Juris was unaware how Winkelmann selected the ratios cited in the offering memoranda. (Tr. 967:10-16, 982:10-22). Winkelmann later admitted that Juris's account of how BOP calculated the ratio was more accurate. (Tr. 1461:25-1462:6).

Winkelmann testified that BOP's sponsorship of a radio show constitutes an advertising expense. (Tr. 491:17-23). However, Winkelmann chose to exclude payments to Binkholder from the advertising expense component of the ratio, and agreed that had BOP included those payments, the ratio would have increased. (Stip. ¶48, ¶49; Tr. 493:15-494:1). Winkelmann's accounting treatment of the Binkholder payments differed from his treatment for payments to another BOP paid spokesman, radio host Charlie Brennan, which Winkelmann classified as advertising expenses

when calculating the ratios. (DX-86; RX-1, p. 8). Winkelmann made these determinations without consulting an accountant or accounting guidance. (Tr. 494:2-495:11).

2. Even Assuming Winkelmann's Explanations Are Correct, He Changed Methodologies and Cherry-Picked to Arrive at Better Ratios

a. The First Memorandum

The first memorandum does not disclose how BOP calculated the 0.22 ratio represented to investors. (RX-1; Tr. 517:9-15). Winkelmann now contends BOP calculated the 0.22 ratio by dividing (a) BOP's advertising expenses going back to June 2010, by (b) recurring revenues generated *during* February 2011. (Tr. 519:25-520:8, 521:6-10, 525:15-526:7; Resp. Post-Hearing Br. at 8-9). Winkelmann failed to introduce *any* contemporaneous document, or elicit testimony from any other percipient witness, supporting this purported methodology. Moreover, Winkelmann's testimony and post-hearing brief conflict with his pre-hearing brief, which claims BOP arrived at the 0.22 ratio by: (a) averaging BOP's advertising spending from June 2010 to "the middle of" March 2011, which purportedly equaled $5,300 per month; and (b) dividing that $5,300 by $25,000, the amount BOP purportedly generated, "as of mid-March 2011," *as a result* of that advertising. (Prehearing Br. at 8). Both accounts contradict Winkelmann's investigative testimony, that he calculated the 0.22 ratio using data going back as far as BOP had it, which was January 2010. (Tr. 523:23-525:14; DX-327, 167:22-168:1).

b. The Second Memorandum

Winkelmann claims he based the second memorandum's 0.62 "current" ratio off a February 2012 advertising report, RX-36, which shows a ratio of 0.67. No contemporaneous document shows BOP with a 0.62 ratio in March 2012.

Winkelmann testified he arrived at this number by using a different methodology than for the first memorandum's "current" ratio. Winkelmann testified the first memorandum divided

advertising expenses for a 9-month period by revenues for a single month (February 2011), but that beginning with the second memorandum, BOP divided advertising expenses for a period by revenues *resulting from* the period of advertising. (Tr. 661:4-20, 662:11-663:3).

The second memorandum does not disclose any change in methodology. (Tr. 663:5-11). Winkelmann admitted the investors who invested in the first two offerings could not ascertain BOP had changed its methodology between these two offerings. (DX-455; Tr. 663:12-664:21).

Winkelmann attempted to explain the 0.62 ratio through Juris's testimony. Juris discussed RX-36, a February 2012 advertising report. (Tr. 872:25-873:7, 878:2-20, 879:2-15, 912:2-14). Per RX-36, BOP's ratio for February 2012 was 0.67, not 0.62.[6] (Tr. 945:23-946:8). Juris refuted Winkelmann by testifying that, when the second memorandum was issued, BOP calculated the ratio by dividing advertising expenses for a month by recurring revenues generated *during* that month. (Tr. 872:25-873:7, 878:2-20, 879:2-15, 912:2-14).

The February 2012 report does contain data allowing one to calculate the ratio in the manner described by Winkelmann: $14,804 in advertising expenses for February 2012, and $840,000 in new AUM *resulting from* that advertising that produces $8,400 in revenues.[7] (RX-036; *see also* Juris's testimony that RX-36's top chart shows revenues *resulting from* advertising (Tr. 943:2-7, 944:24-945:11)). Juris testified that calculating the ratio for February 2012 according to Winkelmann's trial testimony and the data on RX-36 results in a ratio of 1.76 ($14,804 ÷ $8,400) – nearly 3 times worse than the reported 0.62 ratio. (Tr. 948:2-21).

[6] The February 2012 report also showed worse, higher ratios for November 2011 (1.45), December 2011 (1.02), and January 2012 (0.74), none of which are disclosed in the second memorandum. (RX-36).

[7] Juris testified that, at the time, BOP calculated the ratio by assuming it earned 1% revenues off its AUM. (Tr. 879:2-15, 912:2-14, 937:20-24). $840,000 x 0.01 = $8,400.

c. The Third Memorandum

Winkelmann claims he based the third memorandum's 0.67 "current" ratio off BOP's July 2012 advertising report (RX-54, p. 63). (Tr. 898:6-18, 913:16-23). The July report shows monthly advertising factors (ratios) for November 2011 through July 2012, with the most recent being July 2012's 3.00 ratio. (RX-54, p. 63, bottom row of table). Juris testified the July 2012 report calculated the monthly factor in the same way the February report did: advertising spending for a month divided by new annual revenues generated *during* that month. (*Id.*; Tr. 901:3-11). The July report also showed two "Trailing 6-Month Factor[s]," an "Average Factor" of 0.71 and a "Geometric Mean Factor" of 0.69, both being significantly better than the 3.00 July monthly factor:

Trailing 6-Month Factor	
Average Factor	0.71
Geometric Mean Factor	0.69
(Jan-June)	

(RX-54, p. 63).

Juris testified the trailing 6-month factors were calculated using the same formula as the monthly factors – advertising expenses for a period divided by new revenues generated *during* that period – but with a six-month (rather than one-month) look-back period. (Tr. 901:12-903:1).

Winkelmann asserts that for the third memorandum's 0.67 "current" ratio, BOP switched methodologies and relied on the trailing 6-month factors from the July 2012 report, the lower of which is 0.69. However, this contradicts Winkelmann's trial testimony that, for the third memorandum, BOP continued to use the revenues *resulting from* advertising methodology. (Tr. 692:11-693:3).

Even assuming the 0.67 "current" ratio came from the July 2012 report's "trailing six-month factor" (RX-54, p. 63), there is no disclosure that BOP changed methodologies from using one month of advertising expenses/revenues, as BOP did for the second memorandum, to using six months. There is also no disclosure that using the July report's six-month ratios results in a much better figure (lower ratio) than relying on the most recent month's ratio (3.00 for July 2012). (*Id.*).

d. The Fourth Memorandum

The fourth memorandum represents BOP's "current" ratio is 0.89. (RX-4, p. 11). Winkelmann claims he selected that ratio based off BOP's December 2012 advertising report (RX-120, p.1), which shows a 0.89 trailing 12-month ratio for BOP's St. Louis office. That report, *which only includes data for BOP's St. Louis office yet excludes data from BOP's failing Chicago office*, computes three different "trailing" ratios using three different look-back periods: 6-month (ranging from 1.02 to 2.00), 9-month (ranging from 0.85 to 2.01), and 12-month (0.89).[8]

(Advertising Cost/Estimated Revenue)	Trailing 6mo.	Trailing 9mo.	Trailing 12mo.
Trailing Factor	2.00	2.01	
Trailing Factor	1.22	0.91	
Trailing Factor	1.02	0.85	0.89

(RX-120, p.1.; Tr. 904:12-905:25)

To the extent Winkelmann actually relied on the trailing 12-month ratio, there is no disclosure that: (a) BOP again changed look-back periods, from the six-month period purportedly used in the third memorandum; (b) doing so resulted in a better ratio; or (c) a wide variety of ratios existed and Winkelmann excluded the worst options.

Moreover, if Winkelmann truly used the December 2012 report's 0.89 ratio as the basis for the fourth memorandum, it demonstrates he intentionally presented misleading information to

[8] The report also shows December 2012 monthly factors of 0.79 and 3.65. (RX-120, p. 1).

investors. This is because the December report, on a separate page, contained advertising data for BOP's unsuccessful Chicago office. (RX-120, p. 2; Tr. 972:25-975:2). The Chicago data was so poor that it resulted in monthly ratios between 7.17 and 20.18, magnitudes higher than what BOP ever represented to investors:

Chicago		Sep-12	Oct-12	Nov-12	Dec-12
	Advertising Cost	$ 14,165	$ 35,455	$ 15,010	$ 5,030
From THIS Month's Leads	# Leads	43	202	117	28
	# Appts Set from Month's Leads	3	10	6	0
	# Clients from Month's Leads	1	2	0	0
	% of Appts Set	7.0%	5.0%	5.1%	0.0%
	% of Clients Set	2.3%	1.0%	0.0%	0.0%
	New AUM from Month's Leads	$ 90,000	$ 240,000	$ -	$ -
	Estimated First Year Revenues	$ 702	$ 1,872	$ -	$ -
	Factor (1)	20.18	18.94	#DIV/0!	#DIV/0!
From ANY Month's Leads	# of Appts Came in During Month	0	8	7	5
	# of Appts Closed	0	0	1	0
	Closing %	#DIV/0!	0.0%	14.3%	0.0%
	# of Clients Signed During Month	0	0	1	1
	New AUM from Clients Signed in Month	$ -	$ -	$ 140,000	$ 90,000
	Estimated First Year Revenues	$ -	$ -	$ 1,092	$ 702
	Factor (2)	#DIV/0!	#DIV/0!	13.75	7.17

(RX-120, p. 2).[9]

Juris confirmed that had BOP included the Chicago data, BOP's company-wide trailing 12-month ratio would have been higher than the 0.89 St. Louis-only ratio. (Tr. 975:12-976:1, 976:24-977:4). There is no disclosure that BOP excluded the much poorer Chicago data and that doing so allowed BOP to present a lower ratio.

3. Respondents Repeatedly Misrepresented BOP's 2011 Annual Ratio

Respondents presented *no evidence whatsoever* showing how BOP calculated the 0.78/0.79 annual ratio for 2011 cited in the second, third, and fourth memoranda. (RX-2, pp. 5, 16; RX-3, p.

[9] In other words, BOP's Chicago office spent between $7.17 and $20.18 on advertising for every new dollar that the advertising brought in.

13; RX-4, p. 13).[10] Indeed, the ALJ noted the record is completely devoid of any (a) document showing BOP's 2011 annual ratio to be 0.78/0.79; or (b) testimony explaining how BOP arrived at that figure. (R.I.D. at 32 ("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 posthearing brief.")).

While Winkelmann offered no explanation for the 2011 annual ratio, OCIE accountant Michael Collins calculated that ratio using the same methodology described by Winkelmann during his investigative testimony and Juris during her trial testimony: BOP's advertising expenses for 2011 divided by its new recurring revenues generated that year. (Tr. 55:19-23, 71:9-13, 72:23-73:3, 73:24-77:11; 92:16-93:24; DX-441). Collins calculated that, based on BOP's internal data and the methodology Juris described, BOP's advertising ratio for 2011 was 1.28, not 0.78. (DX-441; Tr. 91:19-92:5).

IV. LEGAL ANALYSIS

A. Respondents Violated the Antifraud Provisions

Respondents repeatedly violated the antifraud provisions of the Securities Act of 1933 ("Securities Act"), Securities Exchange Act of 1934 ("Exchange Act"), and the Investment Advisers Act of 1940 ("Advisers Act"). They did so by failing to disclose Binkholder's bar and making numerous false and misleading statements about BOP's advertising ratios, the success of the Unit offerings, the use of investor proceeds, and the alignment of Winkelmann's and investors' interests. They also lured clients with claims that BOP was conflict-free and always acted in

[10] Winkelmann additionally represented BOP's 2011 ratio being 0.78 in emails to investors Mahoney and Zenner. (DX-97, BO877; DX-102, BO423; Tr. 599:12-14, 602:21-603:6).

clients' best interests, and then sold those same clients BOP securities without disclosing the significant conflicts attendant to the offerings.

1. Legal Standards

Exchange Act Section 10(b) and Rule 10b-5 prohibit in connection with the sale of securities: (1) employing any device, scheme or artifice to defraud; (2) making material misstatements of fact or omitting material facts; or (3) engaging in any act, practice or course of business which operates as a fraud or deceit. Securities Act Section 17(a) contains similar prohibitions in the "offer or sale of any securities." A respondent violates Sections 10(b) and 17(a) by engaging "in conduct that produces a false impression." *Dennis Malouf*, Advisers Act Release 4463, 2016 SEC LEXIS 2644, *20 (July 27, 2016).

Investment advisers, such as Respondents (Stip. ¶2), violate Sections 10(b) and 17(a) by "failing to correct a material misstatement in violation of a fiduciary duty to do so." *Malouf*, 2016 SEC LEXIS 2644, *30, *47. The Commission has long held that a "breach of duty of disclosure" can violate "all three subdivisions" of Section 17(a) and Rule 10b-5. *Cady, Roberts & Co.*, Exchange Act Release 6668, 1961 SEC LEXIS 385, *14 (Nov. 8, 1961). The dissemination of false or misleading statements similarly violates all three subsections. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1099 (2019).

For a misstatement or omission to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by [a] reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc. v. Northway*, 426 U.S. 438, 449 (1976). One "who discloses material facts in connection with securities transactions assume[s] a duty to speak fully and truthfully on those subjects" and "provide complete and non-misleading information with respect to the subjects on which he undertakes to speak." *In re K-Tel Sec. Litig.*, 300 F.3d 881, 898 (8th Cir. 2002) (quotations omitted)).

To prove a violation of Sections 17(a)(1) and 10(b), and Rule 10b-5, the Division must establish scienter, which can be shown through recklessness. *Bernerd Young,* Exchange Act Release 774421, 2016 SEC LEXIS 1123, *64 (Mar. 24, 2016). Violations of Sections 17(a)(2) and 17(a)(3) require only a showing of negligence. *Malouf,* 2016 SEC LEXIS 2644, *53.

Similarly, Advisers Act Sections 206(1) and 206(2) prohibit "advisers from misstating material facts or omitting facts necessary to make a prior statement non-misleading in promotional literature and other communications to clients or prospective clients." *Anthony Fields, CPA,* Exchange Act Release 74344, 2015 SEC LEXIS 662, *58 (Feb. 20, 2015). Section 206 "prohibits failures to disclose material information, not just affirmative frauds." *SEC v. Wash. Inv. Network,* 475 F.3d 392, 395 (D.C. Cir. 2007)). Section 206(2) further establishes a fiduciary relationship between the adviser and clients, and imposes "duties of 'utmost good faith, and full and fair disclosure of all material facts' and 'to employ reasonable care to avoid misleading [advisory] clients.'" *Young,* 2016 SEC LEXIS 1123, *38-39 (quoting *SEC v. Capital Gains Research Bureau,* 375 U.S. 180, 194 (1963)).

The Commission consistently holds that an adviser violates Section 206 by failing to disclose conflicts. *See, e.g., Robare,* 2016 SEC LEXIS 4179, *17 ("'[f]ailure by an investment adviser to disclose potential conflicts of interest to its clients constitutes fraud within the meaning of Sections 206(1) and (2).'") (citations omitted); *Malouf,* 2016 SEC LEXIS 2644, *61 ("By failing to correct UASNM's multiple representations that he did *not* have a conflict, Malouf breached his fiduciary duties...."); *Larry Grossman,* Advisers Act Release 4543, 2016 SEC LEXIS 3768, *16 (Sept. 30, 2016); *J.S. Oliver Capital Mgmt., L.P.,* Advisers Act Release 4431, 2016 SEC LEXIS 2157, *29 (June 17, 2016) ("It is indisputable that potential conflicts of interest are 'material' facts with respect to clients and the Commission.") (citations omitted).

Section 206(1) requires a showing of scienter, while negligence establishes a Section 206(2) violation. *Malouf*, 2016 SEC LEXIS 2644, *54. "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." *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007).

2. Respondents' Failure to Disclose Binkholder's Adviser Bar

Given Binkholder's central role in BOP's advertising campaign, his key position at BOP, and the prominence given to Binkholder in the offering memoranda, concealing Binkholder's bar was material. In *SEC v. Bolla*, the court faced strikingly similar facts: one of two co-founders of an advisory firm was barred shortly after the firm's formation and then removed as an owner. 401 F. Supp. 2d 43, 48, 50 (D.D.C. 2005). Like Winkelmann, the remaining founder failed to disclose to clients that his co-founder had been barred, which the court found violated Sections 206(1) and 206(2). *Id.* at 56-57.

The court determined the co-founder's bar was "clearly" material, reasoning: "once [the remaining co-founder] began discussing the whereabouts of [the barred co-founder] with [the firm's] clients and prospective clients, he triggered an affirmative obligation to truthfully and accurately represent why [the barred co-founder] had 'left' [the firm]." *Id.* at 68, 70. Using language particularly apt in this case, the court explained:

> The mere fact that Mr. Bolla was no longer with [the adviser] is significant, but not complete. Mr. Bolla left because the SEC obtained an anti-fraud injunction and bar against him. *There is a substantial difference between telling an investor that a principal had "left the firm" and notifying them that the principal "has been barred," even if the bar originated out of an unrelated matter*. Confronted with the fact that his/her investment adviser had been barred, the reasonable investor would likely question the firm, wondering whether the other investment advisers could also be trusted to fulfill their ethical obligations...

Id. at 72 (emphasis added).

The D.C. Circuit affirmed, finding the adviser's fiduciary "duty included disclosing Bolla's bar" and that when "such a critical player in an investment advisory firm is barred from the business on account of misconduct, the firm has a fiduciary duty to disclose that fact to its clients." *Wash. Inv. Network*, 475 F.3d at 404-405.[11]

Here, the first three memoranda prominently discuss Binkholder, his radio show, how the show provides leads to potential clients, and the show's role in BOP's advertising campaign. (RX-1, p. 8; RX-2, pp. 10-11; RX-3, pp. 7-8). Winkelmann's decision to pay Binkholder the same compensation Winkelmann himself received, and have BOP purchase a $2 million policy on Binkholder's life, further evidences Binkholder's importance to BOP. The fact that BOP's Form ADV brochure disclosed BOP's relationship with Binkholder further shows that Winkelmann considered the relationship to be material. (DX-13, PDF p. 11).

Additionally establishing the value BOP placed on Binkholder, the signature block on Winkelmann's emails expressly referenced Binkholder's radio show. (DX129-131; RX-106, pp. 492-493, 525, 1089, 1097-99, 1189-90, 1195-1200). As in *Bolla*, once Winkelmann chose to make disclosures regarding Binkholder, "he triggered an affirmative obligation to truthfully and accurately represent why" Binkholder had "left" BOP. 401 F. Supp. 2d at 70. Confirming the bar's materiality, investors Grau and Swardson testified they would have wanted to know about Binkholder's regulatory issues when they invested. (Tr. 23:10-24:7, 626:20-627:13).

Not only was Binkholder's bar material to investors, so too was the basis for the bar: Binkholder defrauding his advisory clients by selling them securities in his own businesses without disclosing the attendant conflicts. Any reasonable investor would want to know that

[11] Despite the factual similarities to Winkelmann's non-disclosure of Binkholder's bar, the R.I.D. did not address the Division's citations to *Bolla* and *Wash. Inv. Network*.

Winkelmann, BOP's CEO and principal, could also be barred for selling Units to clients. To that end, client Grau asked Winkelmann before investing whether the Units were permissible from a conflicts perspective. (Tr. 621:25-622:22; 654:13-655:4).

3. Respondents Failed to Disclose Conflicts to Clients

Winkelmann faced the recurring conflict of whether to use BOP funds in ways that would (a) benefit investors, such as by increasing their monthly payments or by deploying BOP's resources to increase BOP's revenues; or (b) increase his own compensation. Winkelmann never disclosed this conflict or that the conflict manifested itself through Winkelmann continuously raising his compensation at investors' expense. As in the above-cited decisions, Winkelmann's failure to disclose conflicts to his clients who purchased Units violates the Advisers Act, Securities Act, and Exchange Act's antifraud provisions. *J.S. Oliver,* 2016 SEC LEXIS 2157, *27, n.27.

4. Respondents' Misrepresented Their "Alignment" and Lack of Conflicts with Investors

The offering memoranda repeatedly represent that Winkelmann's interests were aligned with investors and that BOP eliminates conflicts of interest. The memoranda also falsely represent that it would be better for Winkelmann to sell less Units and that BOP would only use investor proceeds on expenditures that would generate revenues for BOP. Beyond the memoranda, Winkelmann on numerous occasions falsely told investors he would always act in their best interests.

These statements were false and misleading because the interests of Winkelmann and the investors, at times, directly conflicted. Winkelmann routinely used BOP money – that could have been used to repay or otherwise benefit investors through deployment in advertising or other revenue-generating activities – to increase his compensation, pay personal debts, or fund his other companies. A prime example is Winkelmann's "Action Plan" that reduced BOP's advertising

spending by $7,000 per month while increasing his and Binkholder's pay by $8,000 per month. (DX-395, BO5317; Tr. 590:3-6, 591:20-592:4). Winkelmann's decision to sharply cut advertising (which would presumably lower BOP's revenues) while simultaneously raising his compensation demonstrates that his and the investors' interests were not always "aligned."

As for materiality, any reasonable investor would want to know excess funds available to them were being used to increase Winkelmann's pay. Investors Grau, Buckowitz, and Swardson confirmed that knowing Winkelmann would use investment proceeds to increase his compensation would have impacted their investment decision. (Tr. 22:4-12, 348:19-349:9, 622:23-623:16).

5. Winkelmann's Misstatements About Investor Returns and the Success of the Offerings

An adviser violates the antifraud provisions by misstating its performance or success in procuring investments. *See, e.g., Bennett Grp. Fin. Servs.*, Advisers Act Release 4676, 2017 SEC LEXIS 1003, *11-12 (Mar. 30, 2017) (adviser misstated assets under management); *SEC v. Nadel*, 97 F. Supp. 3d 117, 123-126 (E.D.N.Y. 2015) (same); *Seaboard Inv. Advisers*, Advisers Act Release 1918, 2001 SEC LEXIS 2780, *13-19 (Jan. 10, 2001) (adviser misrepresented performance of client accounts); *Haligiannis*, 470 F. Supp. 2d at 381 (same); *see also Lorenzo*, 139 S. Ct. at 1099 (sending two false emails violates antifraud provisions).

Trying to sell more Units, Winkelmann falsely represented in one-on-one correspondence with potential investors how much money BOP had raised and the amount of investor repayments. Examples include representations that: (a) BOP had raised $650,000 in the first offering when, at the time, BOP had only raised $425,000 (DX-50; DX-455); (b) BOP raised $325,000 to $400,000 in the third offering when, at the time, BOP had only raised $250,000 (DX-199, p. 2; Tr. 711:12-712:6; DX-203; DX-455); and (c) in August 2012 first round investors had been repaid $4,961.95,

when they had only been repaid $2,671.98 (DX-167; DX-454; Tr. 682:3-22). While the R.I.D. acknowledged each of these misrepresentations, it did not address them in its legal analysis section.

6. Respondents' Misstatements and Omissions About the Advertising Ratios

The offering memoranda contain false statements and material omissions about BOP's advertising ratios. In the second, third, and fourth memoranda, BOP represented that BOP's 2011 annual ratio was 0.78, when BOP's internal data showed that BOP's ratio for that year was 1.28. These misstatements were, at the very least, reckless given that Respondents offered no support whatsoever for the 0.78 annual ratio. They were also material, given that a ratio above 1.0 indicated BOP was spending more on advertising than it was generating from that advertising. Indeed, investors Buckowitz and Swardson testified it was important to them that BOP's ratio was below 1.0. (Tr. 18:2-23; 19:6-17; 346:9-347:5).

Regarding the other ratios represented in the offering memoranda, those representations are misleading and omit material information, even assuming Winkelmann based those ratios on BOP's internal reports. The below chart shows how Respondents' purported methodology for calculating BOP's "current" ratio changed from memorandum to memorandum:

Offering Memo	Purported Supporting Report	Respondents' Purported Methodology (per post-hearing brief)	"Current" ratio cited in memo	Ratios listed on Advertising Report
1	n/a	June 2010 through February 2011 advertising expenses, divided by February 2011 new revenues	0.22	n/a
2	RX-36	February 2012 advertising expenses divided by February 2012 new revenues	0.62	1.45 (Nov. 2011) 1.02 (Dec. 2011) 0.74 (Jan. 2012) 0.67 (Feb. 2012)
3	RX-54, p. 63	Trailing six months (February-July, 2012) advertising expenses divided by trailing six months new revenue	0.67	3.00 (July 2012) 0.71 (trailing 6-month "average" factor) 0.69 (trailing 6-month "geometric mean" factor)
4	RX-120	2012 advertising expenses divided by 2012 new revenues	0.89	1.02, 1.22, 2.00 (trailing 6 months) 2.01, 0.91, 0.85 (trailing 9 months) 0.89 (trailing 12 months)

Despite the changing methodologies, BOP never disclosed: (a) the methodology, month at issue, or look-back period used for the ratios presented in the memoranda; (b) the continuing change in computation method; or (c) that Winkelmann had many methods to choose from and consistently chose the one that made BOP look best. Given Winkelmann's failure to disclose BOP's changing methodologies and the materially different results they produced, even if Winkelmann relied on BOP's data when representing the ratios to investors, those representations are misleading and omit material information. *In re BP p.l.c. Secs. Litig.*, 2016 WL 3090779, *15 (S.D. Tex. May 31, 2016) ("If... Suttles merely cherry-picked the more favorable of the two [estimates], then the omission of the higher estimate would be misleading to a reasonable investor. Moreover, it would suggest that Suttles acted with 'intent to deceive.'"); *Von Hoffman v. Prudential Ins. Co.*, 202 F. Supp. 2d 252, 255, 261 (S.D.N.Y. 2002) (insurer changing its methodology for calculating dividends material to reasonable investor).

Winkelmann's misrepresentations and omissions regarding the ratios, which Winkelmann touted as the "key driver" of BOP's success and ability to repay investors, were material. Investors Grau, Buckowitz, and Swardson testified the ratio was important to their investment decision and they would have wanted to know if the ratios were misstated. (Tr. 18:2-23, 19:6-17, 346:9-347:5, 628:20-629:15).

7. Winkelmann Acted with Scienter

A variety of evidence demonstrates Winkelmann's scienter.

First, Winkelmann knew Binkholder was barred for selling securities in his own companies to advisory clients. Yet Winkelmann concealed the order from investors, failed to follow the order's guidance that selling BOP securities to clients without disclosing conflicts was illegal, and ignored his attorney's advice to disclose to investors "all material facts regarding any legal or disciplinary events that are material to your evaluation of [BOP] or the integrity of

[BOP's] management." (RX-106, p. 295). Winkelmann did so because the overwhelming majority of investors were his clients, and Winkelmann knew that excluding clients would mean less money for him and BOP. Indeed, Winkelmann recognized that BOP's solvency and his own compensation were dependent on selling Units. (*See, e.g.*, DX-83; Tr. 587:19-23; DX-225; Tr. 735:23-736:8; RX-004, p. 5).[12]

By not disclosing conflicts, misrepresenting his "alignment" and lack of conflicts with investors, and concealing that he routinely paid himself more at investors' expense, Winkelmann also acted with scienter. As BOP's CCO with over 30 years of industry experience, Winkelmann either knew or was reckless in not realizing the offering materials misstated and omitted material information. *See, e.g., Malouf*, 2016 SEC LEXIS 2644, *67 (finding scienter when respondent, "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.").

Similarly, Winkelmann acted either knowingly or recklessly when, in one-on-one communications with investors, he repeatedly misstated BOP's success in raising funds and repaying investors. A simple review of BOP's financial records would have shown that Winkelmann's claims were misstated by material amounts. *See, e.g., Elam v. Neidorff*, 544 F.3d 921, 929 (8th Cir. 2008) ("materially misleading statements, while in possession of conflicting information, support a strong inference of scienter"); *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 665 (8th Cir. 2001) ("classic" fact pattern showing scienter where

[12] The fact that Winkelmann did not disclose the bar to his attorneys until 2013 (DX-220), when Binkholder became the subject of a criminal investigation, and then lied at trial that he told this attorneys about the bar a full year earlier, is additional evidence of Winkelmann's scienter.

"defendants published statements when they knew facts or had access to information suggesting that their public statements were materially inaccurate.").

Winkelmann likewise acted at least recklessly when repeatedly representing BOP's 2011 advertising ratio was 0.78, when no contemporaneous record supported this figure and, to the contrary, BOP's financial data resulted in a much worse 2011 ratio of 1.28. He also acted knowingly or recklessly by failing to disclose his cherry-picking from methodologies and look-back periods to select a more favorable ratio. Additional evidence of Winkelmann's scienter and/or recklessness is his shifting explanation for BOP's ratios and the fact that Juris, who Winkelmann called to testify, contradicted the explanations offered in Winkelmann's trial testimony, prehearing brief, and expert report.

Also evidencing Winkelmann's scienter is his repeated concealment from investors that BOP's finances were failing and that he needed the Unit proceeds to increase his own compensation and settle personal debts. One such example is Winkelmann's December 2012 email to his friend Bryan Swift where he admitted not wanting to share the "bad news" of BOP's poor finances with the other investors. (DX-211; Tr. 725:22-726:2, 727:16-728:14). Winkelmann further limited disclosure of BOP's problems by only providing the fourth memorandum (which actually disclosed BOP's dire financial condition) to three prospective investors, including Swift, each of whom had previously purchased Units. (Stip. ¶59; RX-4, p. 5).

Winkelmann again showed his scienter in late 2012, when Mahoney requested that Winkelmann find a buyer for his poorly performing first round Unit. Rather than match Mahoney with a prospective fourth round investor – creating a win-win situation for investors whereby Mahoney would sell his Unit and the prospective investor would buy one that paid higher returns

than the fourth round unit – Winkelmann simply proceeded with the fourth offering in order to raise additional funds and increase his own compensation. (Tr. 721:16-723:10, 724:14-725:2).[13]

Winkelmann's pattern and practice of only disclosing good news to investors while hiding the bad – Winkelmann's conflicts, Binkholder's bar, BOP's financial problems, and that Winkelmann needed to cherry-pick and change methodologies to present more favorable ratios to investors – demonstrate that Winkelmann intended to deceive his clients and investors.

B. Respondents' Reliance Defense Fails

Respondents premise their reliance-on-counsel defense on their consultations with Greensfelder attorneys. To invoke the defense, a respondent must demonstrate "that he made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith." *Robare*, 2016 SEC LEXIS 4179, *33-34 (quoting *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994)).

In the first instance, the reliance defense fails for issues where Winkelmann did not consult an attorney. Winkelmann does not claim that he sought or received legal advice relating to the advertising ratios or before sending investors emails that misrepresented BOP's success in selling Units and repaying investors. And, as discussed above, Winkelmann's testimony that he sought advice on Binkholder's bar prior to the second and third offerings is a lie.

As for the subjects where Winkelmann claims he sought legal advice, the best evidence of Winkelmann's consultations with Greensfelder are: (a) Greensfelder's detailed billing invoices (DX-277); and (b) the 2,443 pages of email correspondence between Greensfelder and Winkelmann (RX-106). Those documents show Winkelmann *never* sought advice on fiduciary duties and conflicts of interest or, prior to the fourth offering, disclosure of Binkholder's bar.

[13] Winkelmann's failure to follow his attorneys' advice, discussed below, further confirms his scienter.

Regarding Winkelmann's failure to disclose conflicts and misrepresentations about the alignment of and lack of conflicts between Winkelmann's and the investors' interests, the ALJ concluded that Respondents established reliance on counsel. The ALJ based this finding on Winkelmann asking Greensfelder to review the offering memoranda Winkelmann drafted, and Greensfelder not making edits to the language regarding alignment and lack of conflicts. (R.I.D. at 39-40).

The ALJ erred in this determination, *inter alia*, because Winkelmann did not make full disclosure to Greensfelder of the facts necessary to advise on the issue of Winkelmann's alignment and lack of conflicts with investors. *See, e.g., U.S. v. Parker*, 839 F.2d 1473, 1482 & n. 6 (11th Cir. 1988) (defendant precluded from asserting reliance when he failed to tell attorney the investments at issue were under-collateralized).

There is no evidence that Winkelmann apprised attorneys he would keep investor payments at minimum levels while steadily increasing his own compensation. To the contrary, the offering memoranda Greensfelder reviewed contained representations and charts indicating that investors would receive well above the minimum allowable returns. Further, rather than disclose that Winkelmann would use the offering proceeds to increase his compensation, he 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).

Moreover, Winkelmann disregarded Greensfelder's written advice not to offer Units to clients who received investment advice from BOP. Indeed, the Subscription Agreements

constitute the most precise advice Winkelmann received from Greensfelder on the issue of offering 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")).

Winkelmann also expressly disregarded Greensfelder's advice on the subject of the alignment of his and investors' interests. He did so after Greensfelder edited the first memorandum to remove Winkelmann's false representation that issuing *fewer* Units was "better for [BOP's] owners and employees." (RX-106, p. 121). Despite receiving this advice, Winkelmann reinserted such language in subsequent memoranda. (RX-2, p. 16; RX-3, p. 13; RX-4, p. 13). After discovering what Winkelmann had done, Morgan's associate lamented that Winkelmann had either "rejected all of our changes" on, or simply did not use, offering materials containing Greensfelder's edits. (DX-114). And by not disclosing Binkholder's bar, Winkelmann refused to follow Morgan's earlier advice to disclose "all material facts regarding any legal or disciplinary events that are material to your evaluation of [BOP] or the integrity of [BOP's] management." (RX-106, p. 295).

Respondents' reliance defense likewise fails because Winkelmann did not seek specific advice on the relevant representations in the offering memoranda. Rather, he simply provided Greensfelder with an entire memorandum and asked for Greensfelder's general review. (RX-106, p. 30). *See, e.g., SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981) ("Compliance with federal securities laws cannot be avoided simply by retaining outside counsel to prepare required documents."); *SEC v. Snyder*, 2006 U.S. Dist. LEXIS 45185, *23-24 (S.D. Tex. June 29, 2006) (rejecting reliance defense, even where auditors reviewed Form 10-Q, when auditor was never asked to provide opinion regarding specific adjustments at issue); *Timothy Dembski*, Advisers Act Release 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) (defendant "never sought specific advice from counsel with respect to disclosure...reliance on the advice of counsel means more than simply supplying counsel with information.").

Finally, to the extent Winkelmann actually received relevant legal advice, any reliance by Winkelmann was "objectively unreasonable." *Robare Grp., Ltd. v. SEC*, 922 F.3d 468, 478 (D.C. Cir. 2019). As an experienced securities professional who understood and routinely touted his fiduciary obligations, Winkelmann did not need advice that it was illegal to lie to clients, omit important information, misrepresent a lack of conflicts, or prioritize his personal interests. *See, e.g., id.* (reliance defense failed where respondents "knew of their fiduciary duty to fully and fairly disclose the potential conflicts"); *Mohammed Riad*, Advisers Act Release 4420A, 2016 SEC LEXIS 2396 (July 7, 2016), *135-136 (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..."); *Rockies Fund, Inc.*, Exchange Act Release 48590, 2003 SEC LEXIS 2361, *71 (Oct. 2, 2003) ("Given the recklessness with which the relevant [periodic reports] were prepared by Respondents, they can take no comfort now that the Fund's auditor failed to spot their mistakes.")

V. THE ALJ ERRED IN REDUCING WINKELMANN'S SANCTIONS

The R.I.D. reduced the original sanctions imposed by: (a) shortening Winkelmann's permanent bar to a six-month suspension, (b) reducing Winkelmann's penalty from $187,500 to $25,000, and (c) rescinding the cease-and-desist orders regarding the scienter-based antifraud

provisions.[14] The ALJ erred because these reduced sanctions are insufficient remedies for Winkelmann's fraud.

In determining sanctions, the Commission considers: the egregiousness of the actions; the isolated or recurrent nature of the infractions; the degree of scienter involved; the sincerity of respondent's assurances against future violations; a respondent's recognition of the wrongful nature of his conduct; and the likelihood that a respondent's occupation will present opportunities for future violations. *Riad*, 2016 SEC LEXIS 2396, *151-52 (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979)). The Commission stresses flexibility in its analysis, such that "no one factor is dispositive." *Riad* at *152. The Commission also considers a sanction's deterrence effect. *Schield Mgmt. Co.*, Exchange Act Release 53201, 58 S.E.C. 1197, 1217-18 (Jan. 31, 2006).

Winkelmann acted egregiously and with scienter by failing to disclose conflicts, breaching his fiduciary duties, and otherwise making misstatements and omissions to clients. *See, e.g., James Tagliaferri*, Advisers Act Release 4650, 2017 SEC LEXIS 481, *22 (Feb. 15, 2017) ("We 'consistently view[] misconduct involving a breach of fiduciary duty . . . as egregious.'") (citations omitted); *Grossman*, 2016 SEC LEXIS 3768, *84-85) ("Grossman's conduct [repeatedly failing to disclose conflicts] was egregious...").

The other *Steadman* factors likewise support strong sanctions. Winkelmann's fraud continued over the course of two years and four separate offerings. Winkelmann offers no assurances against future violations and refuses to acknowledge his misconduct. To the contrary,

[14] The Division does not appeal the sanctions imposed for conduct related to BOP's violation of the Custody Rule. (R.I.D. at 90). Because Respondents appealed the R.I.D.'s disgorgement award, the Division will address disgorgement in response to Respondents' opening brief.

he testified he has done nothing wrong, and instead blames his attorneys, the Commission, and Missouri regulators. (Tr. 600:7-16; 827:7-828:24).[15] Winkelmann went so far as testifying his investors have received "everything they deserve" and have been made "whole." (Tr. 832:10-18). Given Winkelmann's lengthy securities industry career, without appropriate sanctions he will have ample opportunity to commit future violations.

A. The Commission Should Enter Cease-and-Desist Orders

Exchange Act Section 21C, Securities Act Section 8A, and Advisers Act Section 203(k) authorize the Commission to issue cease-and-desist orders against any person who "has violated" the securities laws. "The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction...a single past violation ordinarily suffices to raise a sufficient risk of future violations." *Rodney Schoemann*, Securities Act Release 9076, 2009 SEC LEXIS 3939, *48 (Oct. 23, 2009). Given Winkelmann's repeated violations of the antifraud provisions, and his failure to recognize the wrongful nature of his conduct, the Commission should impose cease-and-desist orders.

B. The Commission Should Order Third-Tier Penalties

Winkelmann should pay significant civil penalties for his misconduct. Relevant factors 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

[15] Further evidencing Winkelmann's refusal to accept responsibility, shortly before trial Winkelmann drafted an email for his assistant to send to Unit investors, including multiple trial witnesses. (DX-464; Tr. 828:25-830:23). Winkelmann's email presents investors with quotes from his attorneys, including: (a) "This is a classic case of prosecutorial overreach," (b) "Not only did [BOP] and Winkelmann do nothing wrong, to the contrary, they objectively strove to do everything right," and (c) "If anyone is guilty of harming the investors, it is the Division itself, and its wholly predictable decision to plead this case as 'fraud.'" (DX-464; Tr. 830:24-832:9). Winkelmann was shown DX-464 and discussed the email during his testimony, but the exhibit was not moved into evidence. So that the Commission may consider the document in its full context, the Division attaches DX-464 hereto as Exhibit 1.

unjustly enriched; (4) prior violations by the respondent; (5) the need for deterrence; and (6) such other matters as justice may require. Exchange Act § 21B(a)(2); Securities Act § 8A(g); Advisers Act § 203(i). Third-tier penalties are properly imposed for "each act or omission involving fraud or deceit that additionally resulted in (or created a significant risk) of substantial losses to other persons or that resulted in substantial gains to the wrongdoer." *Fields*, 2015 SEC LEXIS 662, *102-104.

Employing these standards, 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.*, Advisers Act Release 3829, 2014 SEC LEXIS 1529, *102-103 (May 2, 2014) (third-tier penalties); *J.S. Oliver*, 2016, SEC LEXIS 2157, *70-71 ($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 securities to clients.

Third-tier penalties are also justified for Winkelmann's additional fraudulent conduct, including his: (a) failure to disclose Binkholder's bar; (b) misrepresenting his alignment and lack of conflicts with investors; and (c) false statements and omissions regarding BOP's advertising ratio and success in raising funds and repaying investors. Winkelmann's misconduct involved fraud, deceit, and reckless disregard of the statutorily imposed fiduciary duties owed to his clients. *ZPR Inv. Mgmt. v. SEC*, 861 F.3d 1239, 1247 (11th Cir. 2017) ("The Advisers Act sets 'federal fiduciary standards for investment advisers.'") (citation omitted). Winkelmann harmed his clients by keeping their payments at near-minimal levels that are not commensurate with the returns suggested by the offering memoranda. Winkelmann further harmed investors by diverting to himself significant sums – that could have been used to repay investors – resulting in Winkelmann

receiving substantial gains.[16] Accordingly, any penalty should be sufficient to deter Winkelmann and others from engaging in fraud at the expense of advisory clients.

The ALJ's penalty analysis utilized a "per violation" framework, considering each occasion Winkelmann illegally sold Units to an investor a single violation. (R.I.D. at 90-91). The ALJ thus imposed 18 first-tier penalties of $1,000 each, representing the 18 of the 23 total Unit sales to BOP clients the ALJ determined fell within the five-year limitations period. (*Id.*). In other words, the ALJ excluded (a) non-client sales, and (b) five client sales prior to May 20, 2011. (*Id.*)

To the extent the Commission adopts a similar "per violation" analysis, the Division submits that the framework should result in increased penalties. First, Winkelmann defrauded both clients and non-clients alike. Thus, there were 30 "occasions" where Winkelmann sold Units to investors in violation of the antifraud provisions. (DX-455). Next, because Winkelmann and BOP executed tolling agreements (DX-357; DX-358), there is no reason to exclude sales based on statute of limitations grounds.

The ALJ further erred by holding that "without scienter, only first-tier penalties *may* be imposed." (R.I.D. at 90 (emphasis added)). However, the relevant penalty statutes do not contain the term "scienter." Rather they use the same "fraud" and "deceit" terminology found in Sections 17(a)(3) and 206(2), neither of which contain a scienter element. *See Robare,* 2016 SEC LEXIS 4179, *43-44 (imposing second-tier penalties despite finding no scienter). Thus, even if the Commission sustains the ALJ's findings of no scienter, which it should not, the ALJ's "per violation" framework supports multiple second-tier penalties.

[16] BOP also realized substantial gains by selling Units, raising $1.4 million that was "critical" to allowing BOP to stay above water and implement its business plan. (RX-3, p. 12; Stip. ¶ 1).

C. The Commission Should Bar Winkelmann

Under Advisers Act Section 203(f), the Commission may bar persons from being associated with an investment adviser or other types of registrants. *Grossman*, 2016 SEC LEXIS 3768, *53. To bar Winkelmann or BOP, the Commission must find: (1) they willfully violated the Advisers Act or its rules; and (2) based on the *Steadman* factors, a bar is in the public interest. *Grossman* at *81-84. An industry bar necessarily serves the public interest where respondent's degree of scienter is "at least reckless." *Edgar Page*, Advisers Act Release 4400, 2016 SEC LEXIS 1925, *23 (May 27, 2016) (citation omitted).

Applying these factors, the Commission routinely bars professionals who make fraudulent representations or omissions to investors. *See, e.g., Lorenzo*, 139 St. Ct. at 1099 (bar for sending two fraudulent emails); *Bennett Grp.*, 2017 SEC LEXIS 1003, *11-12, *17-18 (bar for adviser fraud "which spanned more than a year and involved repeated, knowing misstatements" regarding AUM and investment returns), *Dembski*, 2017 SEC LEXIS 959, *46 (bar where adviser "lied repeatedly to multiple clients for close to two years"); *Riad*, 2016 SEC LEXIS 2369, *153-154 (bar for misleading statements and omissions in two periodic reports); *Young*, 2016 SEC LEXIS 1123, *90-91 (bar for CCO who approved "false and misleading" disclosures); *Fields,* 2015 SEC LEXIS 662, *61, *92 (bar for "numerous material misrepresentations to potential investment adviser clients"). Under this precedent, Winkelmann's concealment of Binkholder's bar and his misrepresentations regarding his lack of conflicts, the advertising ratios, and the Unit offerings' success all warrant an industry bar.

The Commission also regularly bars advisers for failing to disclose conflicts to clients, finding such conduct to be "egregious." *See, e.g., Tagliaferri*, 2017 SEC LEXIS 481, *21-22; *Grossman*, 2016 SEC LEXIS 3768, *84-85; *Malouf*, 2016 SEC LEXIS 2644, *94-96; *J.S. Oliver*, 2016 SEC LEXIS 2157, *40-41; *Page*, 2016 SEC LEXIS 1925, *14-15; *Montford*, 2014

SEC LEXIS 1529, *78-80. Winkelmann's conduct in not disclosing conflicts was similarly egregious and committed with scienter, and independently justifies a bar. Given his lengthy career in the securities industry, his understanding of fiduciary obligations, his knowledge of the reasons for Binkholder's bar, and the fact that he systematically touted his fiduciary duties, there is no excuse for Winkelmann's failure to disclose conflicts.

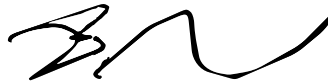
Providing additional context for the Commission's bar determination, both of Winkelmann's previous two advisory partners, in unrelated cases, were criminally convicted and imprisoned for defrauding clients. (Stip. ¶¶ 27, 58). Moreover, during the period at issue in these proceedings, Winkelmann was held in contempt for violating an injunction. (DX-205). Winkelmann's history of associating with crooked advisers and ignoring an injunction provides still more reason, beyond his violations and recalcitrance in this matter, why he should not be entrusted with the fiduciary responsibilities of an investment adviser.

VI. CONCLUSION

Respondents defrauded their advisory clients and other investors. Accordingly, the Commission should find that Respondents' conduct violated the federal securities laws' antifraud provisions and impose commensurate sanctions in the public interest.

Dated: August 1, 2019

Respectfully submitted:



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Rule 450(d) Certification

The undersigned counsel for the Division of Enforcement hereby certifies that this brief is 13,946 words, exclusive of the tables of contents and authorities.

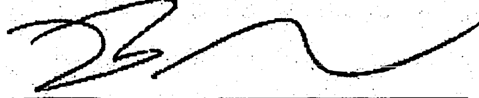

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EXHIBIT 1

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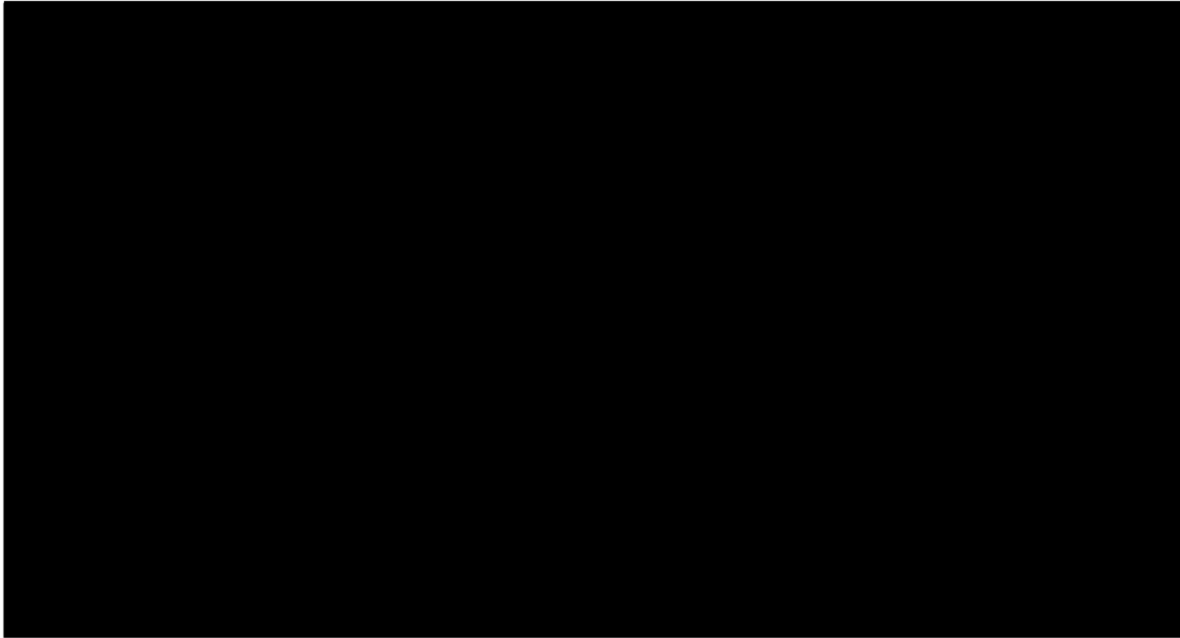
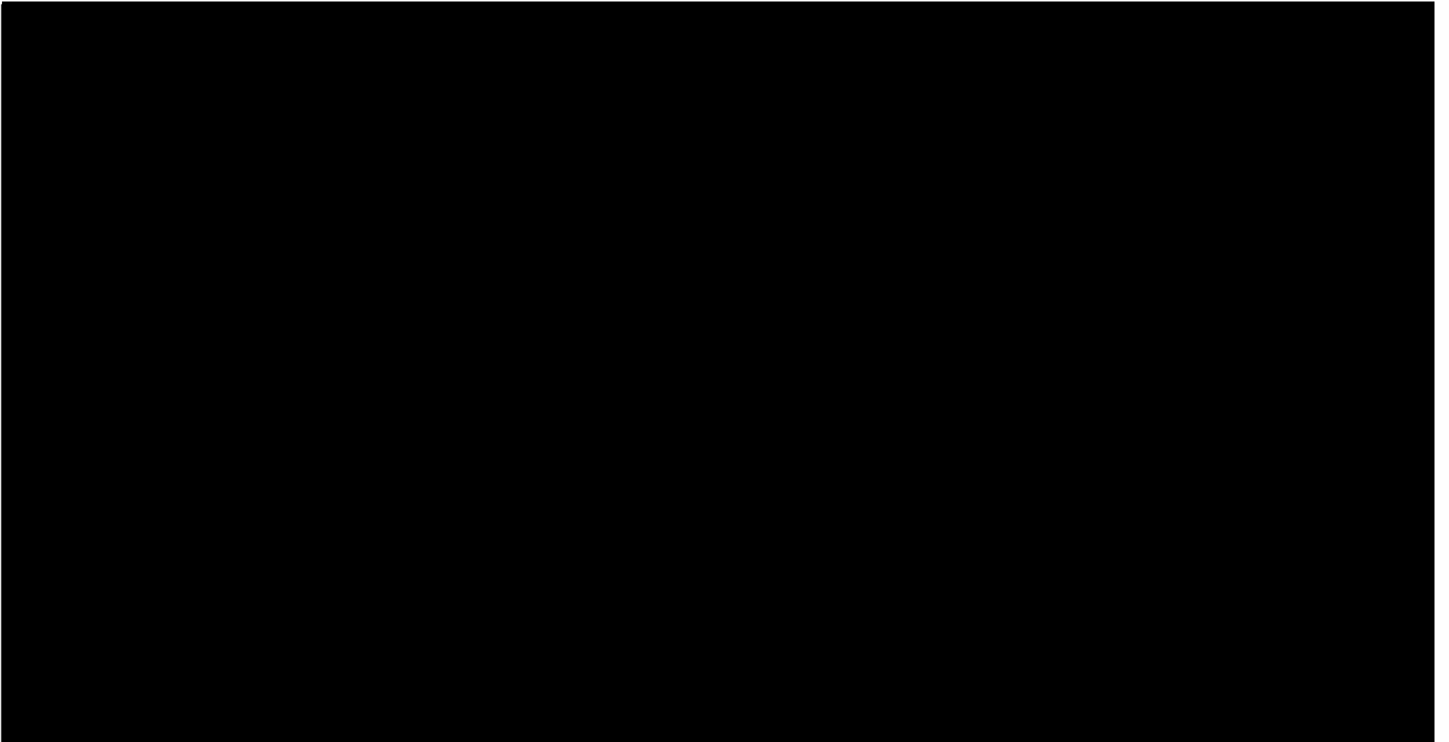
464





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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 August 1, 2019, he caused a true and correct copy of The Division of Enforcement's Brief in Support of its Petition for Review to be served on the following:

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