UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: **JAMES A. WINKELMANN, SR. AND BLUE OCEAN PORTFOLIOS, LLC,** **Respondents.**	ADMINISTRATIVE PROCEEDING File No. 3-17253

RESPONDENTS' BRIEF IN RESPONSE TO THE DIVISION'S OPENING BRIEF AND IN SUPPORT OF RESPONDENTS' CROSS-PETITION FOR REVIEW

September 3, 2019

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I. INTRODUCTION

After six days of hearing and complete review following remand, the ALJ concluded that Respondents James Winkelmann and his investment advisory firm Blue Ocean Portfolios, LLC ("Blue Ocean") did not commit intentional fraud. The Commission should uphold that conclusion. As the ALJ found, the Division of Enforcement ("Division") failed to meet its burden of proving that the Respondents made materially misleading statements or omissions regarding the advertising factor or consultant Bryan Binkholder.

However, the ALJ's finding that Respondents were negligent in failing to disclose actual or potential conflicts of interest should be reversed. Respondents relied on experienced securities counsel to prepare offering documents that contained all necessary disclosures. The offerings at issue here, and the documents relating to those offerings, may not have been perfectly executed, but Respondents met or exceeded every legal standard that governs their conduct. Respondents' reliance on counsel defense should rebut any violation that may have been occurred relating to conflicts of interest.

Most importantly, no investor interest was protected by the investigation or this enforcement proceeding. In fact, at least one of the investors faults the instant proceedings as one of the reasons Blue Ocean was not performing as well as expected. As advisory client and royalty unit investor James Hipsky testified:[1]

[1] Tr. 1032-33 (James Hipsky)

5 If we weren't tied up in this court and
6 spending a lot of money on lawyers and growing --
7 you know, I know it's not good for you, but and
8 you -- we would be moving forward and growing Blue
9 Ocean Portfolios's business; thereby, I would be
10 getting my money back sooner than 10.66 years.
11 **Q So did you have an understanding that**
12 **the speed at which you would be repaid on your**
13 **Royalty Unit was somehow tied to the performance**
14 **of Blue Ocean Portfolios?**
15 A Well, yes.

The evidence shows that Respondents delivered on every promise they made to the investors regarding how the money would be used, and how, when and how much the investors would be paid. Thus, sanctioning the Respondents does not serve the public interest.

II. BACKGROUND

The Respondents in this matter are James Winkelmann and Blue Ocean Portfolios. Blue Ocean was an investment advisory firm that Mr. Winkelmann formed in 2009.[2] Blue Ocean provided its advisory clients - a mix of individuals and small-to-midsize institutional clients - with portfolio allocation services on a fee-only basis.[3] At all relevant times, Mr. Winkelmann was Blue Ocean's CEO and CCO.[4]

A. The Royalty Unit Offerings

Blue Ocean's mission as an investment advisory firm was to provide its clients with an alternative to the commission-driven client/advisor relationship.[5] Instead of focusing on individual

[2] Tr. 412:17-23; 413: 6-14 (Winkelmann).

[3] RX-001, pp. 7-9; Stip. No. 3. The Parties' Factual Stipulations were filed November 14, 2016 and are referred to herein as "Stip. No.___").

[4] Stip No. 5.

[5] RX-001 pp. 6-7.

stocks and bonds, and speculating on their future performance, Blue Ocean focused on portfolio allocation. It chose investments in low-cost index funds, establishing the allocation based on client-specific factors. Blue Ocean did not chase individual investment performance.[6] The Firm advertised its approach in print and radio ads throughout the St. Louis region.

In 2010, Blue Ocean began experimenting with targeted advertising, that is, using a combination of radio, online, direct mail, and print advertising to spread awareness of its investment approach and attract new customers to the Firm.[7] While advertising in the industry is common, Blue Ocean did not merely flood the airwaves with advertisements and hope for the best. Instead, each advertisement and advertising vendor was closely monitored. The cost of the advertisement was measured against its success in actually bringing in new clients.[8] Only those advertising venues which were successful were pursued.[9] Those with poor performance were discontinued.[10]

In 2011, the Firm decided to expand the scope of its campaign to attempt to attract more clients and grow its assets under management ("AUM").[11] To fund the campaign, the Firm contemplated a capital raise. Mr. Winkelmann met with Michael Morgan, an attorney at the law firm of Greensfelder Hemker & Gale, P.C. ("Greensfelder") in St. Louis, to discuss the possibility.[12] Mr. Morgan specialized in advising clients in all aspects of securities law and

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[6] *Id.*

[7] RX-003, pp. 7-8.

[8] Tr. 1252:10-19; Tr. 1298:13-1299:9; (Winkelmann); Tr. 861: 12-23 (Juris).

[9] *Id;* Tr. 463: 23-464:12; Tr. 1292: 5-19 (Winkelmann).

[10] Tr. 1252:10-19; Tr. 1298:13-1299:9; Tr. 1317: 4-22 (Winkelmann); Tr. 861: 12-23 (Juris).

[11] Tr. 439: 16-440:4.

[12] Stip. No. 51; Tr. 1318:24-1319: 15 (Winkelmann).

regulatory compliance.[13] Together, Mr. Morgan and Mr. Winkelmann settled on the royalty unit structure for each of the four offerings at issue here (the "Offerings").[14] While each Offering varies in its specific terms, the structure of each is the same.[15]

1. Royalty Unit Structure: Mandatory Percentage Payments

Under the terms of the Offerings, purchasers of royalty units would contribute capital to Blue Ocean in exchange for the right to receive a certain minimum percentage of the Firm's cash gross receipts on a monthly or quarterly basis, regardless of whether the Firm managed to achieve a profit during the same time period ("mandatory percentage payment").[16] There was no obligation for Mr. Winkelmann or the Firm to pay anything above the mandatory percentage payment, but the Firm could, in its sole discretion, make additional payments once the Firm "achieved profitability."[17]

Until profitability was reached, investors were explicitly cautioned to expect to receive only the mandatory percentage payments,[18] which would continue in perpetuity until the investor was paid back his or her principal investment plus some stated multiple of the investment.[19] These payments were always made from the Firm's cash receipts – i.e., revenue – and not profits,

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[13] *Id;* Tr. 1326: 17-23 (Winkelmann).

[14] Tr. 1246:10-1248:8; Tr. 1249:11-1250:16. At all times relevant, Mr. Morgan was an attorney at Greensfelder.

[15] There were four Royalty Unit Offerings at issue here: Round 1(March 2011), Round 2 (February 2012), Round 3 (September 2012) and Round 4 (February 2013). Each is discussed further herein. Together, they are referred to as the "Offerings."

[16] Tr. 1274:19-25-1275:1-4 (Winkelmann); Tr. 277:2-7 (Laby).

[17] Each offering projected "profitability" would occur at $124 million (except for Round 1 which projected $150 million). RX-001 p. 13; RX-002, p. 6; RX-003 p. 4, 16; RX-004 p. 14. Mr. Winkelmann testified to the same at hearing. Tr. 1515:24-1516:24. The investors called to testify likewise understood that the repayment was dependent on the Company achieving stability. Tr. 1056:8-19 (Mr. Swift).

[18] RX-002 p. 16 (emphasis added). Similar disclosures appear in Rounds 3 and 4. The language of Round 1 projects a different threshold. (RX-001 pp. 11-12).

[19] The multiple changed slightly from offering to offering. In Round 1, it was 3; in Round 2, it was 2.5; in Round 3, it was 2.25; and, in Round 4, it was 2.5 . FOF 7,9,11,13, respectively.

meaning investors were paid first, before any expenses were factored in and regardless of whether the Firm was profitable for the period.[20]

Further, the explicit terms of each Offering Memorandum stated that there was no established timeframe within, or deadline by, which investors would be repaid.[21] Rather, the Offerings stated that the percentage payments would simply continue for as long as necessary for investors to receive their promised returns:[22]

> The Subscriber acknowledges that the Royalty...may never be paid in full by the Company and the Royalty is not required to be paid in full before any scheduled date.

2. The Source of the Mandatory Percentage Payments

It is important to note when considering the mandatory percentage payments that they were to be paid from gross cash receipts and gross revenue, not profits. Thus, regardless of the Firm's expenses, as long as it generated revenue, the royalty unit holders received a stated percentage of that amount.[23] The structure ensured that even if the Firm's expenses greatly exceeded revenue, royalty unit holders nevertheless received their mandatory percentage payment.[24] It was only after royalty unit holders were paid that remaining revenue could be used to cover the Firm's expenses,

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[20] Tr. 45:3-10 (Swardson); Tr. 188: 1-9 (Collins); Tr. 189:17-190:1 (Collins); Tr. 1273: 5-9 (Winkelmann); Tr. 1273:15-25 (Winkelmann); Tr. 277:2-7 (Laby).

[21] RX-001 p. 98 (paragraph (r)); CX-124 (paragraph (p)); RX-003 p. 132 (paragraph (p); RX-004 p. 146 (paragraph (p)).

[22] RX-001 p. 98, paragraph (r). Similar language for Offerings 2-4 appears at CX-124 (paragraph (p)); RX-003 p. 132 (paragraph (p); RX-004 p. 146 (paragraph (p)).

[23] Tr. 277:2-7; Tr. 300:3-17 (Division's Expert Witness); Tr. 188: 25-25, 189:1-4 (SEC Examiner Collins). Tr. 1274:19-25 -1275:1-4 (Winkelmann); Tr. 1402:25- 1403:1-8 (Winkelmann).

[24] *Id.*

including salaries.[25] The risk that expenses would rise – and dwarf the Firm's revenue – was borne only by Blue Ocean and Mr. Winkelmann; the royalty unit holders carried no expense risk at all.[26]

3. Royalty Unit Structure: Discretionary Additional Payments

The Offering Memoranda allowed the Firm to make additional payments to investors at its "sole and absolute discretion".[27] Those additional payments, if made, would mean an investor would be repaid his principal-plus-multiple more quickly.[28] The Offering Memoranda made clear, however, that there was no promise that investors would be repaid in any particular time frame.[29] Nor was there any promise that the additional payments would occur *at all*.[30] Investors specifically warranted, in the Subscription Agreement, that they understood these facets of the Offering and accepted them.[31]

To the contrary, the offering documents expressly disclosed that the Firm's ability to make additional payments was entirely conditioned on its ability to reach and maintain lower advertising factors and sustained profitability.[32]

4. The Interest of Investors and the Firm are Aligned: Both want to increase the Firm's Revenue

[25] This includes Mr. Winkelmann's salary, which the Division contends gives rise to a conflict.

[26] Tr. 1273:15-25 (Winkelmann)

[27] RX-001 p. 82; Tr. 558:13-23 (Winkelmann); Tr. 272:20-23 (Laby); CX-124; RX-003 p. 132; RX-004 p. 146. Profitability is a defined term under the offering documents.

[2828] It is worth reflecting upon the purpose of the additional payments. Mr. Winkelmann hoped to pay investors more than he was obligated to. He wanted the Firm to be successful.

[29] *Id.*

[30] RX-001 p. 82; Tr. 558:13-23 (Winkelmann); Tr. 272:20-23 (Laby); CX-124; RX-003 p. 132; RX-004 p. 146.

[31] *Id.*

[32] Mr. Winkelmann testified to the same at hearing. Tr. 1515:24-1516:24. The investors called to testify likewise understood that the repayment was dependent on the Company achieving this level of stability. Tr. 1056:8-19 (Mr. Swift).

A primary feature of the Offerings, and the reason the royalty unit structure was selected, was that it "aligned" the financial interest of the Company and the royalty unit holders.[33] That is, because the investors were entitled to a percentage of cash receipts, both investors and Blue Ocean were interested in increased revenues.[34] Higher revenues for the Firm meant the Firm was growing (its stated objective). Which in fact it did, growing from approximately $40 million in AUM in early 2011 to over $120 million in AUM in 2014. These higher revenues for the Firm also meant the investors received higher royalty payments, even if only the minimum percentage was applied. The higher their payments, the more quickly they would be repaid their principal plus the promised multiple (which varied by offering).[35]

This "alignment" was one of the primary reasons that Mr. Winkelmann and Mr. Morgan chose the royalty unit structure. The success of growing the Firm's recurring revenue depended on its ability to successfully convert advertising spends into new advisory clients, and, thus, higher AUM, and higher recurring advisory fee revenues.[36] Since investors in the Offerings were entitled to be paid purely out of gross revenue, the higher the Firm's AUM grew, the higher the Firm's revenue grew, and the more quickly investors would be repaid.[37] The following charts demonstrate that the Firm's AUM increased steadily over time, producing corresponding increases in revenue for the benefit of investors: [38]

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[33] RX-001 p. 11 ("The overall objective is keep the interest of the investors, employees, customers, and owners of Blue Ocean Portfolios aligned at all times.") RX-002 p. 15 ("The interests of the owners, employees and royalty holders are aligned to create the fastest growth."); RX-003 p. 13 (same language as RX-002); RX-004 p. 13 (same language as RX-002).

[34] *Id.* Tr. 1248:20 1249:10; Tr. 1248:20-25; 1249: 1-10 (Winkelmann).

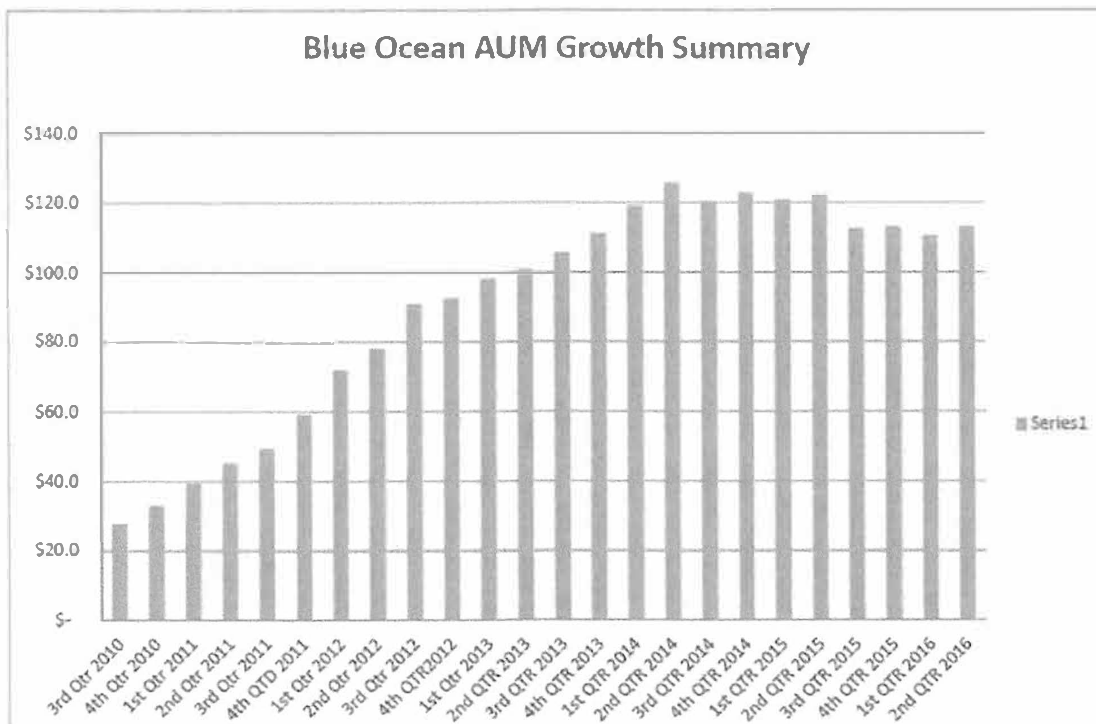
[35] RX-001 p. 11; RX-002 p. 15; RX-003 p. 13; RX-004 p. 13.

[36] RX-001 p. 9; Tr. 45:20-23 (Swardson); Tr. 1248:20-25; 1249: 1-10 (Winkelmann).

[37] *Id.*

[38] RX-076.

Blue Ocean Portfolios Business Growth Summary								
End of	Ending AUM AUM Millions	Quarterly Increase Millions	Quarterly Growth Rate	Annual Increase Millions	Annual Growth Rate	Quarterly Qtrly Rev	Quarterly Revenue Increases	Quarterly Revenue Growth Rate
	$ 24.4							
3rd Qtr 2010	$ 27.8	$ 3.4	13.9%			$ 44,298	$ 1,792	4.22%
4th Qtr 2010	$ 32.9	$ 5.1	18.3%			$ 49,555	$ 5,257	11.87%
1st Qtr 2011	$ 39.4	$ 6.5	19.8%			$ 70,211	$ 11,291	22.79%
2nd Qtr 2011	$ 45.1	$ 5.7	14.5%	$ 20.70	84.8%	$ 85,820	$ 17,309	28.45%
3rd Qtr 2011	$ 49.4	$ 4.3	9.5%	$ 21.60	77.7%	$ 98,341	$ 12,521	14.59%
4th QTD 2011	$ 59.1	$ 9.7	19.6%	$ 26.20	179.6%	$ 111,741	$ 13,400	13.63%
1st Qtr 2012	$ 72.0	$ 12.9	21.8%	$ 32.60	82.7%	$ 140,000	$ 28,259	25.29%
2nd Qtr 2012	$ 78.0	$ 6.0	8.3%	$ 32.90	72.9%	$ 154,050	$ 14,050	10.04%
3rd Qtr 2012	$ 91.0	$ 13.0	16.7%	$ 41.60	84.2%	$ 166,383	$ 12,333	8.01%
4th QTR2012	$ 92.7	$ 1.7	1.9%	$ 33.60	56.9%	$ 176,023	$ 9,640	5.79%
1st Qtr 2013	$ 98.2	$ 5.5	5.9%	$ 26.20	36.4%	$ 183,016	$ 6,993	3.97%
2nd QTR 2013	$ 100.8	$ 2.6	2.6%	$ 22.30	29.2%	$ 187,389	$ 4,373	2.39%
3rd QTR 2013	$ 105.6	$ 4.8	4.8%	$ 14.60	16.0%	$ 189,755	$ 2,366	1.26%
4th QTR 2013	$ 111.1	$ 5.5	5.2%	$ 18.40	19.8%	$ 196,313	$ 6,558	3.46%
1st QTR 2014	$ 118.9	$ 7.8	7.0%	$ 20.70	21.1%	$ 208,993	$ 12,680	6.46%
2nd QTR 2014	$ 125.7	$ 6.3	5.7%	$ 24.90	24.7%	$ 224,254	$ 15,261	7.30%
3rd QTR 2014 2	$ 120.3	$ (5.4)	-4.3%	$ 14.70	13.9%	$ 210,883	$ (13,371)	-5.96%
4th QTR 2014 2	$ 122.8	$ 2.5	2.1%	$ 11.70	10.5%	$ 213,920	$ 3,037	1.44%
1st QTR 2015 2	$ 120.7	$ (2.1)	-1.7%	$ 1.30	1.5%	$ 208,210	$ (5,710)	-2.67%
2nd QTR 2015	$ 122.4	$ 1.7	1.4%	$ (3.30)	-2.6%	$ 208,134	$ (76) 2	-0.04%
3rd QTR 2015 2	$ 112.6	$ (9.3)	-8.0%	$ (7.70)	-6.4%	$ 196,608	$ (11,526)	-5.54%
4th QTR 2015	$ 113.0	$ 0.4	0.4%	$ (9.78)	-8.0%	$ 189,836	$ (6,772)	-3.44%
1st QTR 2016	$ 110.5	$ (2.5)	-2.2%	$ (10.20)	-8.5%	$ 183,874	$ (5,962)	-3.14%
2nd QTR 2016	$ 113.1	$ 2.6	2.3%	$ (9.33)	-7.6%	$ 190,070	$ 6,196	3.37%
Average		$ 5.5	9.6%	Average	37.1%	Average	$ 9,097	9.17%



5. Greensfelder Retained to Prepare Offering Documents

As stated above, Michael Morgan, an attorney at Greensfelder, was retained to (and did) assist Respondents with each of the four Offerings.[39] Each offering was made pursuant to a written Offering Memorandum, which Mr. Morgan reviewed.[40] Further, Mr. Morgan was intimately involved with the offerings from their inception. Not only did Mr. Morgan participate in the preparation and review of the Offering Memoranda, Mr. Morgan and Mr. Winkelmann, together, came up with the royalty unit structure.[41]

III. ARGUMENT IN RESPONSE TO DIVISION'S BRIEF

With regard to each alleged violation set forth in the OIP,[42] the Division carries the burden of proof. To carry this burden, it is required to prove by a preponderance of the evidence each element of each and every claim.[43] As a matter of law, if the Division fails to carry its burden, Respondents are entitled to judgment in their favor.[44]

A. Respondents did not Violate Section 10(b) of the Exchange Act, Section 17(a)(1) of the Securities Act or Section 206(1) of the Advisers Act Because They Did Not Make any Material Misrepresentations or Omissions to Potential Investors.

Section 206(1)[45] of the Advisers Act, Section 17(a)(1) of the Securities Act[46] and Section 10(b) of the Exchange Act and SEC Rule 10b-5[47] essentially prohibit the same type of conduct.

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[39] Stip. Nos. 51-55.

[40] *Id.*

[41] Tr. 439:16-24 (Winkelmann).

[42] Order Instituting Proceedings dated May 19, 2016 ("OIP").

[43] *Steadman v. SEC*, 450 U.S. 91, 95–96 (1981).

[44] *Id.*

[45] 15 U.S.C. §§ 80b-6(1).

[46] 15 U.S.C. §77q(a).

[47] 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5.

To prove a violation of Section 17(a) or Section 10(b), the Division must establish that Respondents: (1) made misrepresentations or omissions of material fact; (2) in connection with the offer, sale, or purchase of securities; and (3) that they acted with scienter.[48] To prove a Section 206(1) violation, the Division must show that Respondents (1) engaged in fraudulent activities; and (2) breached their fiduciary duty to their clients by making false or misleading statements or omissions of material fact.[49]

The Division has failed to carry its burden of proving each of the above elements.

1. The ALJ Correctly Found that Respondents Did Not Misrepresent the Advertising Factor.

The ALJ correctly found in the Initial Decision Following Remand that the Division "failed to meet its burden" of proving that the "various advertising factors and lack of disclosure were materially misleading."[50] The OIP sets forth several purported misrepresentations in the offering documents relating to the advertising factor.[51] Each alleged misrepresentation is addressed separately below.

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[48] *In the Matter of Warren Lammert*, 2008 SEC LEXIS 937, *54 (April 28, 2008).

[49] *SEC v. Merrill Scott*, 505 F. Supp. 2d 1193 (D. Utah 2007).

[50] Initial Decision Following Remand, p. 65.

[51] OIP ¶¶ 7-10, 12-15.

a. Respondents Always Calculated the Advertising Factor Using the Most Accurate Information Available.

i. The Current Advertising Factor in the Round 1 Offering Memo (Paragraph 7 of the OIP).

The Division alleges in Paragraph 7 of the OIP that the Round 1 Offering Memorandum[52] misrepresented the advertising conversion rate[53] when it stated that "each $10,000 in new recurring revenue will cost [Blue Ocean] $2,200 in advertising – a 22/100 ratio." The Division alleged that "[i]n reality each $10,000 in new recurring revenue cost Blue Ocean $4,548 in advertising – a 45/100 ratio."[54] The Division failed to carry its burden of proving that the factor Respondents used in the Offering Memorandum was either incorrect or misleading.[55] The Division also failed to prove that the "real" or "actual" factor was 0.45, as alleged.

Winkelmann and Morgan began exchanging drafts of the Round 1 offering documents in February 2011.[56] The final Offering Memorandum for Round 1 was dated March 31, 2011.[57] It included a detailed overview of the Firm's sales and marketing plan.[58] The Offering Memorandum also included a list of the Firm's "business drivers," and identified as and "*the* key business driver" the Firm's "client acquisition cost," i.e., how much advertising spending was needed to bring in

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[52] RX-001.

[53] The offering documents use the term "advertising conversion rate," while the term "advertising factor" was more commonly used during testimony. Moreover, at times, the term "ratio" or "ad ratio" was also utilized. All these terms mean the same thing and are used interchangeably in this submission.

[54] OIP ¶ 7.

[55] The Division not only pled in the OIP that the advertising factors identified in the various Offering Memoranda that Respondents distributed were inaccurate, but it also alleged what the supposed "correct" advertising factors were. Thus, to prevail, the Division must prove that Respondents' advertising factors were not correct, *and* that the Division's computations of the advertising factors were correct. This issue is addressed fully in Section 3.A.2., below.

[56] RX-106, p. 30-31. Morgan's role in the preparation of the offering documents is discussed in Section III.C., below. Additionally, the parties have stipulated to his involvement (along with his colleagues at Greensfelder). FOF 51-54.

[57] RX-001, p. 1.

[58] RX-001, p. 8.

new clients. To inform potential investors about that acquisition cost, the Offering Memorandum discussed how the Firm's current advertising spending was translating into new revenue at the time of the Offering, and how the Firm anticipated that trend would fare going forward.[59]

That language – and the purported misrepresentation identified in paragraph 7 of the OIP – appears on page 9 of the 116-page offering memorandum:[60]

> Currently Blue Ocean Portfolios 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 into 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 Blue Ocean Portfolios $2,200 in advertising – a 22/100 ratio. No assurance can be given that business will continue to experience growth at this conversion ratio of 22/100.

The Division has alleged that this information is inaccurate because "in reality" the Firm's advertising conversion ratio was actually 45/100.[61] As set forth in Section III.A.2., below, the Division introduced no evidence that the "real" advertising conversion rate was 45/100.

Beyond that, the evidence adduced at the hearing showed that the Firm's stated ratio of 22/100 was accurate and, therefore, not misleading. When calculating the 22/100 conversion ratio, Winkelmann looked back to the start of the new advertising campaign – June 2010 – and calculated the *average* amount the Firm was spending on advertising each month. [62] Around that date, the Firm started a master advertising spreadsheet[63] that tracked the source of potential leads (i.e., potential clients).[64] This spreadsheet began the source-tracking advertising strategy and contained

[59] RX-001 p. 9.

[60] RX-001, p. 9.

[61] OIP ¶ 7.

[62] FOF 52, 53; Tr. 506: 23-507:2 (Winkelmann).

[63] RX-006; Tr. 871:5-872:1; Tr. 870:19-871:4.

[64] RX-006.

the most complete data matching clients with advertising sources.[65] The master advertising spreadsheet also tracked the total assets each new client deposited.[66] Multiplying those new assets by the Firm's advisory fee, the Firm was able to estimate the annually recurring revenue those new assets would generate. Winkelmann selected June 2010 as the start date in computing the advertising factor because that was the first data the Firm had collected on the spreadsheet.[67]

Winkelmann used this data when preparing the initial draft of the Round 1 Offering Memorandum. At that time, the Firm's most current revenue data was for February 2011.[68] As of then, the Firm's advertisements were bringing in about $2.6 million in new assets.[69] Assuming a 1.0% annual advisory fee, those assets would generate $26,000 in recurring annual revenue. The first Offering Memorandum[70] "approximated" those figures at $2.5 million and $25,000, respectively.

To determine the advertising spending, the Firm looked to its QuickBooks, which reflected all advertising expenses.[71] From June 1, 2010 through the end of February 2011,[72] the Firm incurred approximately $45,000 in advertising expenses.[73] Winkelmann "approximated" these expenses at about $5,500 per month. Dividing the average monthly spend by the newly recurring revenue produces the 22/100 ratio set forth in the Offering Memorandum.

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[65] *Id.*

[66] *Id.*

[67] Tr. 1465:25-1466:9; Tr. 525:15-19; Tr. 1179:3-8; Tr. 1227:16-1228:13 (Winkelmann).

[68] Tr. 518:7-19 (Winkelmann).

[69] Tr. 518:23-519:10 (Winkelmann).

[70] RX-001, p. 9.

[71] RX-008.

[72] While the first Offering Memorandum is dated March 31, 2011, the evidence shows the drafting process began in the beginning of March and was finalized in the next few weeks. RX-106, p. 30.

[73] RX-008; RX-022 & 23.

Winkelmann's calculation of the 0.22 advertising factor is supported by the Firm's own internal data. In January 2011, the Firm received new AUM totaling $1,351,432.[74] At that time, the Firm's revenue estimates assumed that clients paid an annual fee of 1.0% of their AUM.[75] Applying that assumption here, 1.0% of $1,351,432 is $13,514.[76] The Firm's advertising spending for January 2011 came to $3,024.[77] When the advertising spend ($3,024) is divided by the estimated annual recurring revenue ($13,514),[78] the quotient equals 0.22 – the exact number that appears in the Offering Memorandum. This verifies that Winkelmann's calculations – and the representation – were correct. Accordingly, there is no misrepresentation, and the Division's claim necessarily fails.

ii. The Current Advertising Factor in the Round 2 Offering Memorandum (Paragraph 8 of the OIP).

The Division alleges in Paragraph 8 of the OIP that the Round 2 Offering Memorandum, dated March 15, 2012,[79] misrepresented the current advertising conversion rate when it stated that "each $10,000 in new recurring revenue is currently costing [Blue Ocean] $6,200 in advertising – a 62/100 ratio or an 'advertising conversion factor' of 0.62." The Division further alleged that "[i]n reality the current advertising conversion factor was 1.11, not 0.62."[80] As was the case with Round 1, the Division failed to submit any evidence that the "real" advertising conversion factor

[74] DX-159; Tr. 923:23-924:1; Tr. 924:14-23 (Juris).

[75] Tr. 923:23-924:1; Tr. 924:14-23 (Juris).

[76] Tr. 923:23-924:1; Tr. 924:14-23; Tr. 920:16-923:22 (Juris).

[77] DX-159; *See* Section III.A.2., discussing the data contained in DX-159.

[78] Tr. 878:2-14. Tr. 924:14-925:4 (Juris).

[79] RX-002.

[80] OIP ¶8.

at the time of the Round 2 offering was 1.11.[81] More importantly, the Division likewise failed to prove that the figures the Firm used in the Round 2 Offering Memorandum were incorrect.

When the Firm was preparing the Round 2 offering in March 2012, it had recently (January 2012) implemented monthly advertising reports to track the advertising data (amount spent, clients acquired, assets acquired and projected new revenue).[82] The reports were generated in the first week after the month ended.[83] So, for example, the January 2012 report would have been available after the first week of February 2012.[84] Because the monthly advertising reports were printed off and maintained, they are contemporaneous evidence reflecting the Firm's calculations at a particular time. Those reports were relied upon in the Round 2, 3 and 4 Offering Memoranda.[85]

Round 2 was issued March 10, 2012.[86] When Winkelmann was working with Morgan at Greensfelder[87] to prepare the Round 2 Offering Memorandum, the most current advertising report was the February 2012 report.[88] According to that report, the Firm's current advertising costs were $14,804 and its estimated first year revenues were $22,000.[89] To calculate the advertising factor, the costs ($14,804) are divided by the new revenue ($22,000), which equals 0.67[90]:

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[81] *See*. Section III.A.2.

[82] RX-0054; RX-0036, RX-0037; Tr. 871:5-872:1 (Juris).

[83] Tr. 872:25-873:7 (Juris).

[84] *Id.*

[85] But not Round 1, since they were implemented after the first offering.

[86] RX-002.

[87] FOF 51, 53, 54, and 55.

[88] Tr. 872:25-873:7. Tr. 912:2-912:14. The February report would have been available the first week of March. Tr. 871:9-18 (Juris).

[89] RX-036; Tr. 879:11-15. This number is just slightly less than the $24,200 that appears in the Round 2 Offering Memorandum.

[90] RX-036; Tr. 879:11-880:5 (Juris)

Years	Advertising Cost	# Leads	# Appts Set from Month's Leads	# Clients from Month's Leads	Percentage of Appts Set	Percentage of Clients Set	New Aum from Month's Leads
November 2011	*$24,386.20*	170	22	12	13%	7%	$1,650,500
December 2011	*$18,881.49*	106	16	3	15%	3%	$575,000
January 2012	*$25,004.00*	152	13	5	9%	3%	$458,000
February 2012	*$14,804.00*	99	15	5	15%	5%	$840,000
March 2012		9	0	0	0%	0%	
2012 Total							

Years	Cost per Lead	Cost per Client	Estimated First Year Revenues 2012	Factor
November 2011	$143.45	$1,108	$16,850	1.45
December 2011	$178.13	$1,180	$18,425	1.02
January 2012	$164.50	$1,923	$34,005	0.74
February 2012	[illegible]	$987	$22,000	0.67
March 2012				
2012 Total				

The information in the February report appears, with only modest variations, in the Round 2 Offering Memorandum:

> Currently, Blue Ocean Portfolios is spending approximately $15,000 per month on advertising which generates leads for the sales staff to follow up on. This $15,000 advertising spend is converting to approximately $2.42 million in new assets that are generating $24,200 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,200 in advertising – a 62/100 ratio or an "advertising conversion factor" of .62.

The February advertising factor of 0.67 is just above the factor included in the Offering Memorandum (0.62). When Winkelmann prepared the Offering Memorandum in March, he was able to access the master spreadsheet,[91] and thus he could use the most up-to-date data reflecting the annual recurring revenue, which had increased slightly (to $24,200)[92] since the February 2012

[91] Tr. 909:19-910:2. Winkelmann had the ability to access the spreadsheet in between monthly meetings and view the most current calculation advertising factor. Tr. 912:15-23 (Juris).

[92] RX-002 p. 13.

report (to 0.67).[93] Accordingly, there is no misrepresentation, and the Division's claim necessarily fails.

iii. The 2011 Advertising Factor in the Round 2 Offering Memorandum (Paragraph 8 of the OIP).

Paragraph 8 also alleges that the Offering Memorandum represents the advertising factor for 2011 as 0.78 when "in reality" the advertising factor for 2011 was 1.28. The statement at issue reads:[94]

> In 2011, Blue Ocean Portfolios invested approximately $328,000 in advertising. The result was that AUM increased by $25 million to $57 million and recurring annual revenues increased from approximately $200,000 at the end of 2010 to $404,000 at the end of 2011...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, Blue Ocean Portfolios spent $0.79 in advertising to buy $1.00 in new recurring revenue.

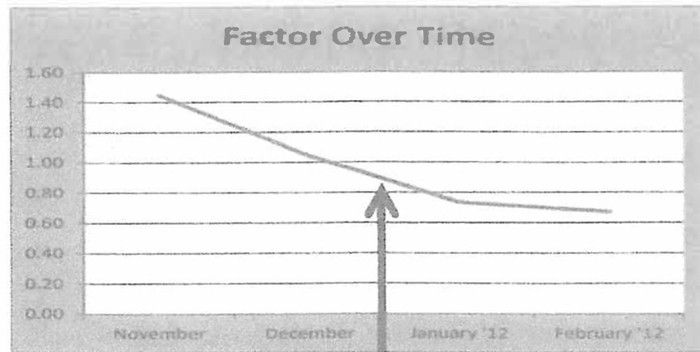
To calculate this advertising factor, the Firm turned again to its master advertising data. While there was no report generated at the time the Offering Memorandum was created, the contemporaneous advertising reports evidence the advertising factor before and after the offering.

The advertising reports included a graph that tracked the advertising factor over time. In the February advertising report, the graph appeared as follows:[95]

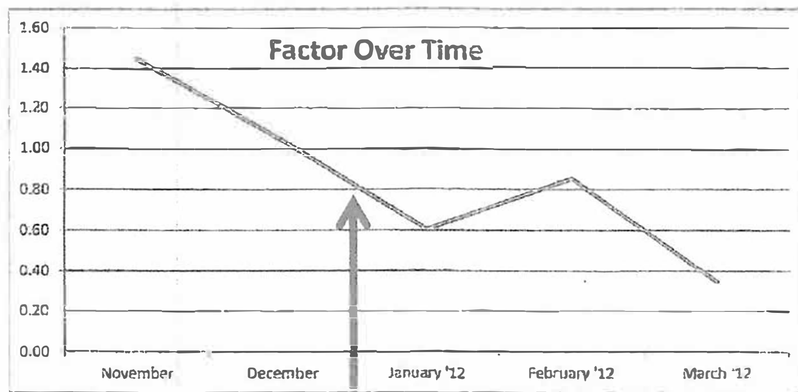
[93] Indeed, by the time the March report was generated in April 2012 (after the second offering), the Firm's estimated first year revenues had increased to $53,540 and the advertising factor had dropped to 0.35. RX-037, p. 1.

[94] RX-002, p. 5.

[95] RX-036; Tr. 872:25-7 (Juris).



A month later, the March 2012 advertising report showed the following:



On each report, the advertising factor as of December 31, 2011 hovered around 0.80 – corroborating Winkelmann's calculation of 0.79.

In addition, the data provided in the Offering Memorandum supports the calculation. The quotation above states that in 2011, the Firm invested "approximately $328,000" in advertising, resulting in recurring annual revenues of $404,000.[96] Dividing the stated advertising spend ($328,000) by the stated annual recurring revenue ($404,000) produces an advertising factor of 0.81. This computation (which is based on the "approximated" advertising costs) is within two decimal points of the ratio contained in the Offering Memorandum. The Division's staff accountant admitted that a single decimal point difference was not material.[97]

[96] RX-002, p. 5.

[97] Tr. 91:15-18 (Collins).

iv. The Current Advertising Factor in the Round 3 Offering Memorandum (Paragraph 9 of the OIP).

Paragraph 9 of the OIP alleges that the Round 3 Offering Memorandum, dated September 1, 2012,[98] misrepresented the advertising conversion rate by stating that "each $10,000 in new recurring revenue is currently costing [Blue Ocean] $6,700 in advertising – a 67/100 ratio or an 'advertising conversion factor' of 0.67." The Division alleged that "[i]n reality the current advertising conversion factor was 1.03, not 0.67."[99]

As with the prior offerings, the Division failed to submit any evidence that the "real" advertising conversion factor at the time of the Round 3 offering was 1.03.[100] The Division likewise failed to prove that the figures the Firm used were incorrect.

When the Firm and Morgan prepared the offering documents for the Round 3 Offering Memorandum in August 2012, the August advertising report was not available.[101] The July report was the most recent available.[102] The reports had evolved since the last Royalty Unit offering in March 2012, and now included a six-month trailing factor.[103] The Firm found that the six-month trailing factor better represented the data because it considered an extended period of time.[104] The July 2012 advertising report computed a trailing six-month average advertising factor of 0.71[105]:

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[98] RX-002.

[99] OIP ¶9.

[100] *See also* Section III.A.2., below.

[101] The August monthly advertising report would have been generated in the first week of September – after the Round 3 offering. Tr. 913:5-23 (Juris).

[102] RX-54. p. 62; Tr. 913:5-23 (Juris).

[103] Compare RX-054 pp. 1-3 and RX-054 p. 63.

[104] Tr. 901:12-25 (Juris).

[105] RX-054, p. 63.

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

At the time of drafting, the six-month average factor had dipped slightly, to 0.67. Therefore, when Winkelmann provided Morgan with the financial data for the Round 3 Offering Memorandum, he provided him with the following information:[106]

> So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising – a 67/100 ratio or an "advertising conversion factor" of 0.67.

Because the factor provided was correct, there was no misrepresentation with regard to this statement. The allegations contained in paragraph 9 should be dismissed.

v. The 2011 Advertising Factor in the Third Offering Memorandum (Paragraph 9 of the OIP).

For the same reasons set forth in Section II.A.1.a.i, above, the 2011 advertising factor is accurate and is not misleading. Accordingly, the allegation in paragraph 9 that the 2011 advertising conversion rate constituted a material misrepresentation is wrong.

vi. The Current Advertising Factor in the Round 4 Offering Memorandum (Paragraph 10 of the OIP).

For the Round 4 Offering, the Division alleges that the Firm "misrepresented the advertising conversion rate by approximately 15%" when it "incorrectly stated that Blue Ocean's 2012 conversion rate was 0.89."[107] The Division further alleged that the "actual" conversion rate for 2012 was 1.02.[108]

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[106] RX-003, p. 11; FOF 51, 53, 54, 55; Tr. 692:11-22 (Winkelmann).

[107] RX-4, p. 4.

[108] OIP ¶10.

As above, the Division failed to introduce any evidence that the "actual" conversion rate was 1.02. Respondents, while they carry no burden to *disprove* the allegations, were easily able to do so.[109] Round 4 was offered on February 15, 2013.[110] As of the time the Offering Memorandum was prepared, in early February/late January of 2013, the Firm's data showed that the advertising conversion factor for the year 2012 was 0.89.

While it is not possible to view the Firm's master spreadsheet as of the date the Round 4 Offering Memorandum was created, the contemporaneous monthly reports reflect the numbers that then available. In late January/early February 2013, when the Round 4 Offering Memorandum was being prepared, the December advertising report was available.[111] That report calculated the 12-month trailing advertising factor (i.e., the factor for calendar year 2012) to be 0.89 – the exact number that appears in the Round 4 Offering Memorandum[112]:

(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

Accordingly, there is no misrepresentation, and the Division's claims set forth in Paragraph 10 of the OIP fail.

[109] *See*, Section III.A.2.

[110] RX-004, p. 1.

[111] RX-120.

[112] *Id.*

b. Enforcement failed to prove its calculations as to the "real" advertising factors were accurate.

As shown above, Enforcement failed to prove that the Offering Memoranda contained false or misleading advertising conversion factors. Moreover, the Division failed to prove that its own calculations of the "real" conversion factors were accurate.

i. Collins' calculations assume the wrong management fee.

Collins, the SEC Staff Accountant,[113] performed the only calculations the Division offered in support of the "real" conversion factors. His calculations have a serious defect: they are based on faulty mathematical assumptions. As Juris testified, in all of 2011 and in January, February and March of 2012, the Firm calculated its estimated revenues assuming a 1.0% advisory fee on its AUM.[114] In April 2012, however, the Firm changed its fee assumption from 1.0% to 0.77%, to better reflect the fees that the Firm was actually earning, which were less than 1.0% (due to instances in which clients negotiated a lower fee and instances where the fee charged was reduced due to the amount of assets deposited).[115]

When the Firm changed its advisory fee assumption, it updated the master advertising spreadsheet accordingly. This meant that when the Firm used the spreadsheet to generate advertising reports, the calculations reflected a 0.77% fee. This change also applied to calculations based on *past* numbers. Thus, if the Firm generated a report after April 2012 showing the 12 months prior, those calculations would reflect a 0.77% management fee – even though the Firm had employed a 1.0% fee during that prior time period.

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[113] Tr. 55:4-5 (Collins).

[114] Tr. 986:15-987:1; 926:25-928:1 (Juris).

[115] *Compare* RX-54, p. 29 (April) *with* RX-54, p. 17 (March).

This change to the fee assumption led to Collins' first error in computing the Round 1 and Round 2 advertising factors. In June 2012, the Firm's monthly advertising report included a chart calculating the advertising factor on a monthly basis from January 2011 onward.[116] Every monthly revenue figure on that chart[117] calculates the annual revenue using a 0.77% fee assumption *even though* the Firm did not implement a 0.77% assumption until April 2012. This time period includes both the Round 1 and 2 Offerings.[118] Collins used this chart exclusively to calculate the purportedly "correct" factors the Division relies upon in the OIP.[119]

For example, the chart's February 2012 row shows annual revenue of $17,697, which is 0.77% of the New AUM for the same month ($2,296,000)[120]:

	New AUM	Annual Revenue	Advertising Spend	Factor
January	$1,351,432	$10,406	$3,024	0.29
February	$2,131,408	$16,412	$10,054	0.61
March	$1,980,798	$15,252	$5,607	0.37
April	$3,391,131	$26,112	$11,264	0.43
May	$ 68,500	$527	$18,720	35.49
June	$ 892,233	$6,870	$36,670	5.34
July	$3,047,956	$23,469	$30,970	1.32
August	$3,719,674	$28,641	$18,962	0.66
September	$1,817,346	$13,994	$26,467	1.89
October	$1,539,823	$11,857	$25,952	2.19
November	$1,685,000	$12,975	$24,386	1.88
December	$1,842,500	$14,187	$18,881	1.33
January '12	$3,485,500	$26,838	$20,989	0.78
February '12	$2,296,000	$17,679	$19,562	1.11
March '12	$5,354,000	$41,226	$19,028	0.46

[116] RX-54, pp. 51-61.

[117] DX-159.

[118] RX-54, pp. 51-61. Tr. 919:22-920:9 (Juris); Tr. 928: 17-22 (Juris).

[119] DX-440, 442, 443; Tr. 92:6-15 (Collins).

[120] DX-159.

Using this chart, Collins calculated the conversion factor to be 1.11.[121] In February 2012, however, the Firm actually used a 1.0% fee assumption.[122] Thus, for AUM of $2,296,000, the Firm *would have calculated* annual revenue of $22,960. Dividing that revenue ($22,960) by the stated advertising spend ($19,562) would yield a factor of 0.85. Yet, this factor would still be incorrect, because of Collins' second erroneous assumption (discussed below).

ii. Collins' data differed from the data the Firm actually possessed real-time (Rounds 1 and 2).

Collins' second error was using data from June 2012 and *assuming* that it was identical to data from February 2012. It was not.

Even though Collins' chart (DX-159) contains a line item for February 2012, that line item represents February data *as of June 2012.* This is different than the February data *as of February 2012.* As Juris testified, the Firm often made adjustments to its data after a particular months' end.[123] Juris explained that the Firm was meticulous in tracking how its advertising spending translated into client acquisition and, then, revenue.[124] The Firm determined the source of each potential client and then, once engaged by the client, attributed the resultant revenue to a particular advertisement.[125] For example, if a prospective client called the Firm in July and reported he had heard the Firm's commercial on the *Charlie Brennan Show* in January, once that prospect became an advisory client, the Firm would update its records to attribute that client's assets to the January

[121] DX-159. Collins' advertising spend amount is also different than what the Firm actually used (knew) in February 2012. That error is discussed below.

[122] RX-54, p. 10; Tr. 879:2-15; Tr. 886:25-887:8.

[123] Tr. 896:1-13 (Juris).

[124] Tr. 874:25-875:9 (Juris).

[125] Tr. 865:7-866:1 (Juris).

spend on the *Charlie Brennan Show*.[126] Because clients often called weeks or months after hearing an advertisement, the advertising data for a particular month continued to change even after the calendar month ended.[127]

The addition of new revenue, however, was not the only reason a month's totals could be updated. Often times the Firm would receive late or erroneous invoices from a radio station and would then update its spreadsheet to properly allocate the dollars spent.[128] Thus, the advertising spend for a particular month could be updated even after the month ended.

Yet, all of Collins' calculations are based off of the Firm's data as of June 2012.[129] By June 2012, the data for January through April had already been updated, as needed, to reflect changes like those discussed above. The June 2012 data which Collins relied on thus differed substantially from the real-time data the Firm possessed when the Offering Memoranda for Rounds 1 and 2 were prepared:[130]

	June 2012 Data [DX-159]			**Blue Ocean Month End Data [RX-54]**		
Month	New AUM	Est. Annual Revenue	Advertising Spend	New AUM	Est. Annual Revenue	Advertising Cost
2/2012	$2,296,000	$17,679	$19,562	$2,200,000	$22,000	$24,386
3/2012	$5,354,000	$41,226	$19,028	$5,354,000	$53,540	$18,472
4/2012	$6,604,000	$50,851	$32,966	$6,449,000	$41,225	$26,575
5/2012	$3,025,000	$23,547	$16,333	$3,058,000	$23,547	$10,179

[126] Tr. 896:1-13 (Juris).

[127] Tr. 897:9-22 (Juris).

[128] Tr. 874:4-24; Tr. 892:17-894:53; Tr. 896:19-897:3.

[129] DX-159 was generated as part of the Firm's June 2012 monthly advertising report.

[130] Source: DX-159 and RX-54.

As the above chart demonstrates, the data Collins relied on to "replicate" the Firm's calculations constituted information that the Firm did not possess before June 2012. Returning to the example above regarding Collins' calculation of the February 2012 advertising factor, it is incorrect both because of the change in the fee assumption and because the Firm's real-time February 2012 data showed an AUM of $2,200,000 (translating into $22,000 in annually recurring revenue) and $14,804 in advertising costs:

Years	Advertising Cost	# Leads	# Appts Set from Month's Leads	# Clients from Month's Leads	Percentage of Appts Set	Percentage of Clients Set	New Aum from Month's Leads
November 2011	$24,386.20	170	22	12	13%	7%	$1,650,500
December 2011	$18,881.49	106	16	3	15%	3%	$575,000
January 2012	$25,004.00	152	13	5	9%	3%	$458,000
February 2012	$14,804.00	99	15	5	15%	5%	$840,000
March 2012		9	0	0	0%	0%	
2012 Total							

Years	# Appts Came in During Month	Appointments Closed	Closing Percentage	# Clients Signed During Month	New AUM from Clients Signed During Month
November 2011	26	10	38%	11	$1,685,000
December 2011	26	11	42%	9	$1,842,500
January 2012	30	11	37%	24	$3,400,500
February 2012	28	10	36%	11	$2,200,000
March 2012	2	0		1	$20,000
2012 Total					

Years	Cost per Lead	Cost per Client	Estimated First Year Revenues 2012	Factor
November 2011	$143.45	$1,108	$16,850	1.45
December 2011	$178.13	$1,180	$18,425	1.02
January 2012	$164.50	$1,923	$34,005	0.74
February 2012 [illegible]	[illegible]	$987	$22,000	0.67
March 2012				
2012 Total				

When these advertising costs are divided by the estimated revenues, the factor is 0.67.

The February 2012 example highlights how Collins' calculations can be mathematically correct (in that his division is accurate), but nonetheless fail to recreate the calculations that the Firm made with the information presently available. Accordingly, Collins' calculations do not

support the Division's allegations that the advertising factors expressed in the Offering Memoranda were inaccurate.[131]

iii. Collins' calculations were based on data not yet available to the Firm (Round 3).

When calculating the Round 3 factor, Collins made a new error. The Round 3 Offering Memorandum is dated September 1, 2012.[132] When the Firm and Morgan prepared the documents for the Round 3 Offering Memorandum in August 2012,[133] the July report was the most recent available.[134] The most recent data in the master spreadsheet (which Winkelmann had access to) would have included only a part of August. Collins, however, calculated the purportedly correct factor by using the *final* August 2012 numbers. Accordingly, Collins' calculations do not support the Division's allegations that the advertising factors expressed in the Offering Memorandum for Round 3 were inaccurate

iv. There are many ways to compute advertising efficacy.

The Division's allegations regarding the advertising factor fail to take into account what the ALJ acknowledged: "there are different ways to capture this factor, there are different ways to calculate it, and there are different ways then to report it." [135] The result is that the Offering

[131] The Division was given leave by the Court to introduce additional evidence on this point, specifically, to recall Collins to replicate Respondents' computation of the advertising factors and to show they were not accurate. The Division declined this opportunity. As a result, the record contains no evidence to support the Division's calculations in the OIP.

[132] RX0003.

[133] Tr.1356:5-7; Tr. 1356:14-22 (Winkelmann); RX-106 p. 1209; FOF 51, 53, 54, 55.

[134] The August advertising report was generated the first week of September – after the Round 3 offering. Tr. 913:5-23. Thus, the July report was the most recent complete data set. RX-54, p. 62; Tr. 913:5-23. Tellingly, Collins' chart in DX-443 shows the July month-end factor as being 0.63 – just slightly less than the factor disclosed in the Round 3 offering memorandum.

[135] Tr. 1078:7-1081:9 (Judge Patil).

Memoranda's stated advertising factors are not incorrect – and, therefore, not misleading – even if the Division's computations yield different results.

c. The sole misrepresentations at issue with regard to the advertising factors are those alleged in paragraphs 7-10 of the OIP.

The Division did not merely allege that the Offering Memoranda's advertising factors were materially inaccurate. It expressly alleged that the advertising factors were inaccurate because they were materially different from the "real" advertising factors that the Division calculated. Thus, to prove its case, the Division must show that its computations of the "real" advertising factors were correct.

Yet, the Division introduced no evidence to support its allegations regarding the "real" advertising factors. In fact, the Division stipulated that the one witness it presented to testify about the advertising factor, Collins, "did not perform the ad ratio calculations that went that form the basis of the allegations in the OIP."[136] The end result is that there is no evidence in the record that the "real" advertising factors alleged in the OIP were accurate.

Indeed, the ALJ acknowledged this during the arguments on Respondents' Motion for Partial Summary Disposition, made at the close of the Division's case-in-chief under SEC Rule of Practice 250: "It's not an allegation that [at] this point has been supported by any evidence."[137] Although the ALJ ultimately denied the motion, it again concluded that "some of the facts alleged

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[136] Tr. 175:16-20 (stipulation on the record). The Division's expert, Laby, also acknowledged that he was merely relying on Collins' computations. Tr. 212:9-24; 215:12-216:16 and 216:25-218:17. Thus, if Collins' calculations are wrong, then so is Laby. Tr. at 223:17-21.

[137] Tr., 843:13-19 (Judge Patil).

in the OIP aren't directly supported by evidence."[138] The ALJ's observation is correct, and requires the dismissal of the Division's claims.

At hearing, the Division suggested that notwithstanding the allegations made in paragraphs 7-9 of the OIP, it should be free to pursue *any* misrepresentation under paragraph 6 of the OIP.[139] But Paragraph 6 is not a "general" allegation of misrepresentation. It makes no allegations on its own, instead introducing the specific allegations regarding the advertising factor included in paragraphs 7-9. The Division's late attempt to manufacture new claims out of paragraph 6 because it could not prove paragraphs 7-9 should not be allowed.

Indeed, the ALJ previously ruled on the specificity with which the Division must plead its case. Judge Foleak, on July 20, 2016, entered an Order requiring the Division to specifically identify the alleged "other misrepresentations" it hinted at (but did not identify) in paragraph 15 of the OIP.[140] The Division's attempt to pursue modified claims should be rejected because it is prejudicial to Respondents and inconsistent with the ALJ's prior order.

d. Respondents demonstrated there are multiple acceptable ways to calculate an advertising factor. The Division failed to prove that the Respondents' method deviated from an acceptable standard.

The hearing evidence showed that there are multiple methods of calculating the efficiency of an advertising program. Respondents chose to divide their advertising spend into the newly recurring revenue produced by that spend. As Respondents' expert, Palubiak, testified, this method was both "reasonable" and "conservative"[141] in its calculation. In addition, Palubiak

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[138] Tr. 847:2-8 (Judge Patil).

[139] Tr. 1038:7-1081:20 (Swift).

[140] Order granting Respondents Motion for More Definite Statement. July 20, 2016.

[141] Palubiak concluded that the Firm was conservative because it assumed only one year of revenue from its new accounts, even though the Firm had an excellent client retention rate. RX-125, p. 8.

testified that Respondents' advertising campaign and its calculation of the advertising conversion factor were in line with industry standards.[142] In fact, Palubiak testified that "[t]his practice was as good as I have ever seen" and, "if anything . . . understates how effective the Firm truly was."[143]

The Division, conversely, despite carrying the burden of proof, did not introduce any evidence to show that the Firm's methodology was *unreasonable* or deviated from recognized industry standards.

2. Respondents did not fail to disclose or misrepresent material conflicts of interest, and if they did, they reasonably relied upon the advice of counsel.

The Initial Decision on Remand concluded that Respondents made material misrepresentations and omissions regarding conflicts of interest, but further concluded that Respondents acted without scienter due to their good faith reliance on the advice of counsel.[144]

The Commission should reconsider the ALJ's conclusions because respondents did not owe a fiduciary duty in the context of the Royalty Unit offerings and because no conflicts existed. However, even if the Commission finds that a violation should occurred, it should conclude that Respondents' reliance on the advice of counsel means that Respondents acted without scienter and without negligence.

a. Respondents Did Not Owe a Fiduciary Duty.

The duty to make this type of disclosure flows from the existence of an investment advisory relationship, which is fiduciary in nature. Investment advisers have an obligation to avoid conflicts and, when they cannot be avoided, to disclose all material conflicts pending between them and

[142] RX-125, p. 6.

[143] RX-125, p. 6.

[144] Initial Decision on Remand, p. 70-71.

their clients.[145] This obligation attaches when investment advisers are soliciting new investment advisory clients, acting as advisers and making recommendations, or, again, acting as advisers and giving investment advice.[146]

In the context of the Royalty Unit offerings, however, Respondents were not soliciting new investment advisory clients, making recommendations or giving investment advice – they were offering securities as part of a capital raise.[147] Outside of the investment adviser/client relationship, there does not exist a similar obligation to disclose conflicts of interest. Further, when communicating with potential investors that happened to be investment advisory clients of Blue Ocean, Winkelmann was careful to tell them that he could not recommend they purchase the investment.[148] Even the investor witnesses called by the Division admitted that Winkelmann so informed them.[149] Indeed, in the very first representation in the Subscription Agreement, the investor acknowledged that Blue Ocean had not provided any investment advice.[150]

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[145] *Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-92 ("The existence of a conflict of interest is a material fact which an investment adviser must disclose ***to its clients*** because a conflict of interest "might incline an ***investment adviser*** -- consciously or unconsciously -- ***to render advice*** that was not disinterested.") (Emphasis supplied).

[146] *See* Instructions to Part 2 of Form ADV:

> Disclosure Obligations as a Fiduciary. Under federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts ***relating to the advisory relationship***. As a fiduciary, you also must seek to avoid conflicts of interest ***with your clients***, and, at a minimum, make full disclosure of all material conflicts of interest between ***you and your clients*** that could affect ***the advisory relationship***....

[147] Tr. 1255:10-24; Tr. 1256:2-16 (Winkelmann).

[148] *Id.*

[149]Tr. 37:12-25; 38: Tr. 46:5-10; (Swardson); 783:20-784:2 (Winkelmann).

[150] RX-003, p. 129. The Division argued this particular representation should be interpreted to mean that Blue Ocean had *never* provided any investment advice, in any context, to the particular investor. Given the context of the paragraph, however, in a document accepting the purchase of a particular investment, it is more properly read to speak only to the specific investment that is contemplated.

The Division also suggested this single sentence proved that Greensfelder was unaware that Winkelmann intended to (and did) sell Royalty Units to Firm clients. This extrapolation is contradicted by Winkelmann's unrebutted testimony was that he and Morgan discussed this issue and that Morgan advised him he could sell it to Firm clients. Tr. 1251:5-23 (Winkelmann). Moreover, Winkelmann's testimony is supported by his written email communications with Morgan. Winkelmann had two email exchanges with Morgan before the first Royalty Unit offering that make clear he

Where, as here, the investment was discussed outside of the investment advisory relationship and without any recommendation, the Respondents had no legal obligation to disclose alleged conflicts. Because there was no duty to disclose, even were the Division able to establish the existence of some conflict, there necessarily was no omission. Accordingly, the claims cannot succeed.

b. No Conflict Existed.

Even were Respondents found to be operating as investment advisers at the time of the sale of the units, and even were the Division able to prove a recommendation (which they are not), their allegation that the Respondents failed to disclose a material conflict nonetheless fails.

In paragraph 12 of the OIP, the Division alleges that Respondents failed to disclose a supposed "material conflict of interest" that existed between themselves and the investors in the Offerings. Specifically, the Division alleges that Respondents had a "financial interest in their advisory clients' decision regarding whether to purchase Royalty Units," but did not disclose this. Stated differently, as amplified in paragraph 13 of the OIP, the Division essentially posits that there was a conflict between the investors' right to a minimum percentage of monthly cash receipts, on the one hand, and Winkelmann's decision to compensate himself, on the other. In fact, the evidence established that there was no conflict, thus obviating any need to disclose its supposed existence.

The problem with the Division's argument is that it ignores the unique nature of the Royalty Unit. A typical equity or debt investment requires the issuer to make ongoing interest or dividend

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was aware of, and approved of, Winkelmann's intent to offer Royalty Units to advisory clients. *See* Section III(A)(2)(c).

payments for a stated length of time, followed by the return of the investors' principal. The risk investors take is that the issuer will not earn enough profits to make the promised payments.

By comparison, the Royalty Units' Offering Memoranda state two facts that make the investment different. The first is the source of funds for investors' payments: Blue Ocean's cash receipts (not its profits). As a result, investors are paid before any expenses – including Winkelmann's compensation – and regardless of whether profits were realized.[151] The unrebutted hearing testimony confirmed that none of Blue Ocean's expenses, including Winkelmann's compensation, had any impact on investors receipts.[152]

Second, the Offering Memoranda make clear that there was no fixed timeframe for investors to receive their money. The Subscription Agreement that each investor signed included an acknowledgement from the investor "that the Royalty . . . may never be paid in full by the Company *and the Royalty is not required to be paid in full before any scheduled date*."[153] If those words were not clear enough, the Offering Memoranda each contained a table showing varying payout schedules based on different assumptions of the monthly percentage paid. They all depict a scenario where only the minimum percentage is paid, revealing a wide range of possible "payback" dates, none of which was promised.

While Blue Ocean *aspired* to be able to pay more than the minimum monthly percentage of cash receipts to its investors,[154] it is undisputed that Blue Ocean had no *obligation* to do so.

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[151] Even Collins, the SEC Staff Accountant, conceded this. Tr. 188: 1-9 (Collins). Laby also agreed that Blue Ocean had no obligation to share any profits with the investors. Tr. 277:2-7 (Laby).

[152] Collins agreed with this, too. Tr. 189:17-190:1 (Collins).

[153] RX 1, p. 98. In addition, each investor that testified, including those the Division called (Tr. 41:20-42:4 (Swardson); Tr. 365: 1-9 (Buckowitz); Tr. 647: 12-23 (Grau)) acknowledged awareness of this fact.

[154] The Division's expert, Laby, agreed that something "aspirational" is not a "duty." Tr. 262:19-263:6 (Laby).

Any decision to pay more than the minimum was in Blue Ocean's "sole and absolute discretion,"[155] and there were no circumstances under which Blue Ocean *had* to pay more than the minimum.

Because Winkelmann's compensation did not affect Blue Ocean's duty under the Offerings, the Offering Memoranda statements quoted in paragraph 13 of the OIP regarding the "alignment" of the investors' interests and Winkelmann's interest were accurate and there was no conflict of interest to disclose. Accordingly, the Division's claims based on that alleged omission must be dismissed.

c. Respondents Relied in Good Faith on the Advice of Their Counsel.

After reviewing the additional evidence[156] entered into the record by Order of the Commission,[157] the ALJ correctly found that Respondents' counsel (Greensfelder) was fully aware that the offering was to be made to the Respondents' advisory clients and approved of that course of action. Specifically, the ALJ found, "[b]ased on Winkelmann's testimony and the corroborating documentation," that "Greensfelder was aware that Winkelmann and Blue Ocean wanted to sell royalty units to advisory clients and that Morgan advised Winkelmann that there was no impermissible conflict of interest with such a plan."[158]

The ALJ's finding of fact on this point deserves deference. As Justice Kagan wrote in the recent U.S. Supreme Court decision *Lucia v. SEC*: "[t]he Commission has repeatedly stated, as it did below, that its ALJs are in the 'best position to make findings of fact' and 'resolve any conflicts

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[155] RX-1, p. 82; Tr. 558: 13-23 (Winkelmann). Laby also acknowledged this to be true. Tr. 272: 20-23 (Laby).

[156] RX 126-127

[157] Commission Order Granting Leave to Adduce Additional Evidence; June 15, 2017.

[158] Initial Decision Following Remand, p. 42.

in the evidence.' [159] Furthermore, "when factfinding derives from credibility judgments, as it frequently does, acceptance is near automatic. Recognizing ALJs' 'personal experience with the witnesses,' the Commission adopts their 'credibility finding[s] absent overwhelming evidence to the contrary.'"[160] The ALJ found that Winkelmann was credible when testifying that Greensfelder advised him there were no conflicts and that he relied on Greensfelder's advice. The ALJ also found that "Winkelmann appears to hold a sincere belief that the royalty unit offerings and associated representations posed no conflicts of interest."[161] There is no overwhelming evidence to the contrary, so the Commission should accept these findings of fact.

There is also corroborating documentary evidence that supports Winkelmann's testimony. This evidence includes the email exchange between Winkelmann and Morgan that was admitted into the record following remand, which show "that Greensfelder was aware of the plan to sell royalty units to clients even before the first offering."[162] The evidence also includes the email exchange between Winkelmann and Morgan that Respondents asked the Commission to admit after it granted the petitions for review.[163] In that email, which was sent just before the First Round offering, Morgan discusses Blue Ocean issuing securities to clients and tells Winkelmann that "the risks here are small."[164] This email further shows that Winkelmann relied on the advice of his counsel when offering the Royalty Units to advisory clients and was not negligent in doing so.

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[159] *Lucia v. SEC*, 138 S. Ct. 2044, 2054 (2018).

[160] *Id.*

[161] Initial Decision Following Remand, p. 73.

[162] Initial Decision Following Remand, p. 42, footnote 23.

[163] Motion for Leave to Adduce Additional Evidence; July 15, 2019.

[164] Exhibit A to Motion for Leave to Adduce Additional Evidence; July 15, 2019.

3. The ALJ correctly found Respondents made no material misrepresentations regarding Bryan Binkholder.

In the Initial Decision Following Remand, the ALJ correctly found that "the Division failed to prove materiality" with respect to the Division's allegations that Respondents made misrepresentations or omissions regarding Bryan Binkholder.[165]. The Commission should uphold this finding.

The Division alleges that Respondents should have informed investors that in December 2011, Binkholder was barred him from acting "as an agent or investment adviser representative in the State of Missouri." According to the Division, this disclosure was necessary due to "the prominence of [Binkholder] and his radio show in the offering memoranda."

In truth, Binkholder had limited involvement with Blue Ocean as of the date of the Offering. He was ***not*** registered as an investment adviser representative.[166] Accordingly, the fact that he was barred from acting in that capacity had no impact on the tasks he performed for Blue Ocean.[167] What Binkholder was doing for Blue Ocean was acting as a lead generator[168] through his radio show and website. Prospective customers that heard about Blue Ocean on Binkholder's radio show would, ideally, then contact the Firm.[169]

It is also undisputed that following his Missouri bar, Binkholder continued to perform the same functions for Blue Ocean as he had prior to the bar. He continued to host his radio show, and he continued to drive customers to Blue Ocean.[170] That did not change until *after* Rounds 2

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[165] Initial Decision Following Remand, p. 69.

[166] Tr. 1371:18-20 (Winkelmann).

[167] Laby conceded this fact. Tr. 292:14-20 (Laby).

[168] Tr. 1371:18-24 (Winkelmann).

[169] Tr. 1306:25-1907:18; Tr. 1378:20-22 (Winkelmann).

[170] Tr. 1382:2-1383:14 (Winkelmann).

and 3. Accordingly, there was no reason to disclose to investors in those two rounds that Binkholder was barred by Missouri, as that Order did not affect in the slightest Binkholder's described role at Blue Ocean.[171]

The Division insists that despite these undisputed facts, Binkholder was somehow more important to Blue Ocean – and therefore to potential investors – than Respondents admit. Yet, the Division's argument requires one to ignore these facts:

- None of the four Offering Memoranda included Binkholder among Blue Ocean's list of "Key People."[172]
- None of the four Offering Memoranda included Binkholder or his dba (The Financial Coach) among Blue Ocean's "Key Vendors & Relationships."[173]
- Binkholder's radio show was merely one piece of a larger advertising strategy. The Offering Memoranda gave equal attention to Charlie Brennan, the host of another radio show that Blue Ocean sponsored.
- No evidence shows that Binkholder was particularly successful in generating business for Blue Ocean.[174]

On balance, there was nothing about Binkholder's Missouri bar that investors needed to know. He was engaged by Blue Ocean exclusively to generate leads[175] by hosting a radio program.

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[171] Winkelmann testified that he told at least three investors about Binkholder's bar when it occurred. Tr. 1384:6-13. At least one investor witness (called by the Division) corroborated that. Tr. at 340:11-341:6.

[172] RX-001-004.

[173] RX-001-004.

[174] While evidence reflects that Blue Ocean's biggest source of leads was radio advertising, the data does not distinguish between leads from Binkholder's radio program and leads from ads run at other times on the same radio station. RX-013 and RX-014.

[175] *See* RX-001, p. 27, which outlines the entirety of Binkholder's "obligations" under the Marketing Agreement: "to prominently and exclusively display and promote Blue Ocean services . . . ."

And that is precisely what he did. Had the Missouri bar somehow prevented Binkholder from doing that, the Division might have a leg to stand on; but, since the bar created no impediment to Binkholder's ability to do his show, it was immaterial to Blue Ocean and its investors. As Winkelmann testified, it simply did not matter that Binkholder was barred from functioning as an investment advisor because Binkholder "wasn't being retained or compensated in that capacity of being an investment advisor representative."[176]

4. The ALJ correctly found Respondents' email communications were not a violation.

The Initial Decision Following Remand did not make specific conclusions of law regarding the Respondents' email communications with investors but did not find them to be a violation. The Commission should not find differently.

Similar to the above allegations, the Division has failed to prove that any of the information contained in the emails discussing the adverting factors were incorrect.[177] Winkelmann testified that he obtained the information by accessing the Firm's records and the contents of the emails reflected what he had reviewed. Further, some of these emails repeat the advertising factors already addressed above, none of which was incorrect or misleading.

The emails in Paragraphs 1-3[178] set forth the same advertising data addressed above with regard to Round 1. The first email, sent over a month before the offering, stated that the Firm was spending $2,200 to generate $9,000 in revenue, or a 0.24 factor. This is almost the same as the factor of 0.22 that would be later disclosed in the Offering Memorandum, suggesting it was retrieved directly from the Firm's data. The second email, sent after the offering, provides a

[176] Tr. 1381:14-1382:17 (Winkelmann).

[177] Paragraphs 1-6 of the Additional Misstatements filed by the Division on July 22, 2016.

[178] Of the Division's Additional Misstatements filed July 22, 2016.

$22,000 to $100,000 ratio – or 0.22 (identical to the offering memorandum). The third email equates to a 0.31 factor (but was based on post-offering information, given it was sent in May)[179]. The data in each email, like the data in the Offering Memoranda, was calculated using the Firm's then-existing data. For the same reason the Offering Memoranda are not misleading, the emails are likewise not misleading.

Paragraph 7 fails to state a claim for relief, since the statement was not made "in connection with" the purchase or sale of any security. On August 1, 2012, there was no open offering.[180] Because the statement, even if incorrect, was not made in connection with the purchase or sale of a security, it cannot form the basis for the Division's Section 10(b) or 17(a) claims.[181]

With regard to paragraphs 8-11, all sent within days of one another,[182] Winkelmann testified that he believed each of those statements, regarding the current status of the Round 3 raise, to be true when he made them based on the commitments he had received and that he "had every reason to believe" were firm.[183] These statements were not false or misleading because Winkelmann believed them to be true and accurate.[184]

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[179] Recall the month end factor for March 2012 was 0.35. RX-037.

[180] Tr. 1364:1-15 (Winkelmann).

[181] 17 C.F.R. § 240.10b–5(b); *U.S. v. Harris*, 919 F. Supp. 2d 702, 709 (E.D. Va. 2013); *Harris*, 919 F. Supp. at 709 ([Section 17(a)] is still limited to actions taken in the offer or sale of a security ***and does not include post-sale conduct*** . . . [a]ccordingly, where fraud in the sale of a security is alleged, the fraud must ***facilitate*** the sale of that security. Under this logic, any acts occurring post-sale would fall outside the scope of [the Section].") (emphasis added); *Bosio v. Norbay Sec., Inc.*, 599 F. Supp. 1563, 1566 (E.D.N.Y. 1985) ("This principle has been reiterated in numerous district and circuit court cases in this circuit. The fraud practiced must have been *prior to or contemporaneous with* the sale of securities.") (internal citations omitted, emphasis added).

[182] Paragraphs 8-10 reflect emails all sent on the same day.

[183] Tr. 710:7-18; Tr. 1365:9-1366:1 (Winkelmann). Mr. Swift's testimony corroborates Winkelmann's belief. Tr. 1064:2-18 (Swift).

[184] With regard to Paragraph 12, Winkelmann denied ever having told him that. Tr. 1364:16-25.

Moreover, for each of the emails sent immediately prior to or contemporaneous with an offering, even were the statements deemed misrepresentations (which they are not), the distribution of the Offering Memoranda provided the investor with information needed to make the prior statement not misleading.[185] Additionally, each subscription agreement required each investor to affirm the following statement to be true[186]:

> The subscriber has not relied upon representations or other information (whether written or oral) other than documents or information provided by the Company under Section 2(K) above [referring to the Company's operating documents].

Each investor completed and signed a subscription agreement in connection with his or her purchase, representing that their investment decision was based entirely on the information contained in the offering memorandum (and not from any other source).

B. Respondents did not violate Section 10(b) of the Exchange Act, Section 17(a)(1) of the Securities Act or Section 206(1) of the Advisers Act because Enforcement failed to prove materiality.

1. Standard for materiality.

Section 206(1), Section 10(b) and Section 17(a)(1)-(3) all require that the alleged misrepresented or omitted fact be "material." "[T]o fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"[187] Further, whether a fact is material "depends on the significance the reasonable investor would place on the withheld or misrepresented information."[188] "Whether or not a

[185] RX-001 – RX-004.

[186] RX-001 p. 96, Paragraph (l); DX-124 p. 3; RX-003 p. 130; RX-004 p. 131.

[187] *Basic Inc. v. Levinson*, 485 U.S. 224, 239 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[188] *Basic*, 485 U.S. at 240.

particular description, representation, illustration, or other statement involving a material fact is misleading depends on evaluation of the context in which it is made."[189] Further, "if it is questionable whether a fact is material, or its material is marginal, that tends to undercut the argument that defendants acted with the requisite intent or extreme recklessness in not disclosing the fact."[190]

2. Enforcement failed to prove materiality.

Assuming *arguendo* that the advertising conversion factors that appeared in the Offering Memoranda were incorrect (which they were not), the Division's Section 10(b) and Section 17(a) claims nonetheless fail because the information was not material. To be material, there must be a "substantial likelihood" that the misrepresented fact would have "significantly altered" the "total mix of information" available.

The focus of the Offering was the Firm's advertising campaign and, specifically, the Firm's ability to spend its advertising dollars efficiently to bring in new clients. Thus, the Offering Memoranda focus heavily on the Firm's advertising plan, devoting pages to a detailed explanation of how it would use investor funds to spread its message to potential investors/new clients most efficiently.[191] The offering documents expressly identified the Firm's primary advertising venues (The Financial Coach and the Charlie Brennan Show), as well as its expansion plans going forward.[192] The offering documents also included a tremendous amount of financial data about the Firm, its historical, current and projected AUM, and charts that projected revenue based on the projected growth.

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[189] 17 C.F.R. § 230.156(b).

[190] *City of Dearborn Heights v. Waters Corp.*, 632 F. 3d 751 (1st Cir. 2011).

[191] RX-001, p. 8-9; RX-002 pp. 7-8; RX-003 pp. 7-8; RX-004 pp. 7-8.

[192] RX-3, p 7.

All of this information allowed investors to assess (1) Blue Ocean as a company; (2) Winkelmann as its manager; (3) the Firm's approach to investing (i.e., its advertising message); (4) the advertising expansion plan; (5) advertising partners; (6) revenue projections based on assumed growth and fees; and, importantly, (7) the attendant risks. This description included graphs and pie charts which explained visually what the above paragraphs communicated verbally.[193] Even transcripts of the radio advertisements was provided for investors to review.[194]

From this "total mix" of information, an investor could reasonably assess the Firm's advertising strategy and make a fully informed decision on whether to invest. There is no evidence that a single sentence of the Offering Memoranda containing the advertising factor, a short-hand arithmetic expression of what otherwise took pages to describe in words, "significantly altered" that analysis. To the contrary, the investors who testified at the hearing stated that they attributed no importance to the listed factor. Instead, they invested because they believed in the Firm's message, its strategy for achieving growth via efficient advertising, and Winkelmann himself.[195]

This is even more obvious with regard to the Round 3 Offering. In Round 3, the Firm included in the Offering Memorandum a full chart, produced out of the Firm's internal data, showing the advertising spend and revenues received on a monthly basis for the prior year. The chart also calculated the advertising factor on a monthly basis. Thus, in addition to the single sentence in the Offering Memorandum on which the Division focuses, investors also received the following[196]:

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[193] RX-3, pp. 8-9, 14-15.

[194] *See*, RX-002 pp. 50-54.

[195] Tr. 998:24-999:24 (King); Tr. 1032:9-19 (Hipsky); Tr. 1053:11-1054:15 (Swift).

[196] RX-003, p. 14.

	New AUM	Projected New Annual Recurring Revenue	Advertising Spend	Sales Rep Commission Paid	Administrative Bonus Payments	Total Acquisition Cost	Months to Payback	Advertising Factor
June-11	$ 892,234	$ 8,030	$ 42,921	$ 2,231	$ 833	$ 45,985	68.7	5.35
July-11	$ 3,047,957	$ 27,432	$ 27,884	$ 7,620	$ 1,100	$ 36,603	16.0	1.02
August-11	$ 3,719,673	$ 33,477	$ 17,763	$ 9,299	$ 1,100	$ 28,162	10.1	0.53
September-11	$ 1,817,347	$ 16,356	$ 18,626	$ 4,543	$ 1,100	$ 24,270	17.8	1.14
October-11	$ 1,539,823	$ 13,858	$ 32,447	$ 3,850	$ 1,320	$ 37,616	32.6	2.34
November-11	$ 1,887,106	$ 16,984	$ 24,386	$ 8,115	$ 1,320	$ 33,821	23.9	1.44
December-11	$ 1,928,116	$ 17,353	$ 18,881	$ 8,291	$ 1,320	$ 28,492	19.7	1.09
January-12	$ 3,379,121	$ 30,412	$ 25,004	$ 14,530	$ 1,890	$ 41,425	16.3	0.82
February-12	$ 1,925,153	$ 17,326	$ 15,636	$ 8,278	$ 1,890	$ 25,804	17.9	0.90
March-12	$ 5,235,951	$ 47,124	$ 22,112	$ 19,832	$ 1,890	$ 43,834	11.2	0.47
April-12	$ 5,183,446	$ 46,651	$ 32,966	$ 9,126	$ 1,283	$ 43,376	11.2	0.71
May-12	$ 2,860,477	$ 25,744	$ 16,462	$ 11,616	$ 1,283	$ 29,361	13.7	0.64
June-12	$ 1,677,033	$ 15,093	$ 7,689	$ 8,748	$ 1,283	$ 17,720	14.1	0.51
	$ 35,093,437	$ 315,841				$ 436,469	16.58	

Even if the "current" factor listed in the Round 3 memorandum was inaccurate, it would not be misleading or material in light of the full information provided. The above includes all relevant data regarding the Firm's past spending and performance – including a calculation of the advertising factor on a monthly basis. In light of the inclusion of the above data, even if the language at issue is incorrect, it did not alter the total mix and, therefore, is not material as a matter of law.

C. Respondents did not violate Section 10(b) of the Exchange Act, Section 17(a)(1) of the Securities Act or Section 206(1) of the Advisers Act because they did not act with scienter.

As noted above, reasonable reliance upon advice of counsel is a recognized defense to the *scienter* element that the Division must prove to establish the alleged violations.[197] The defense requires that Respondents establish four elements: (1) complete disclosure to counsel; (2) request for counsel's advice as to the legality of a contemplated action; (3) receipt of advice that the contemplated action was legal; and (4) good faith reliance on that advice.[198] Here, the record

[197] *S.E.C. v. Huff*, 758 F. Supp. 2d 1288, 1348-49 (S.D. Fla. 2010), *aff'd*, 455 F. App'x 882 (11th Cir. 2012).

[198] *S.E.C. v. Prince*, 942 F. Supp. 2d 108, 138, 143-44 (D.D.C. 2013).

supports the conclusion that Respondents relied on the legal advice that they obtained from their attorneys at Greensfelder.

Winkelmann principally worked with attorney Michael Morgan, whom he had known since the mid-1990s.[199] When Morgan later joined Greensfelder, Winkelmann looked to Greensfelder for legal advice regarding the Offerings.[200] Moreover, Greensfelder held itself out to the public as possessing expertise and experience in banking and financial services..[201]

Winkelmann engaged Greensfelder to provide legal services in connection with two separate matters – securities compliance and the Offering – which were related, given that the Offering triggered the need to make certain regulatory filings.[202] The securities compliance matter included "[a]ny kind of regulatory filing that would be needed to be reviewed, updated, filed with the appropriate regulatory agencies."[203] Regarding Greensfelder's work on the Offerings, "[a]ny kind of investor-facing or regulatory-facing document, they would have had at least a review role, if not a drafting role, on that document."[204] To that end, Greensfelder drafted the certificate that investors received, the subscription agreement (including the risk disclosures), the exclusive marketing agreement between Blue Ocean and Binkholder, the warrant that Round 1 investors received, the cover letter that was used to transmit the offering materials to investors, Blue Ocean's business plan that was included in the offering materials, and, most importantly. Greensfelder "reviewed and . . . proofed the PPM or the offering memo" for each round.[205]

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[199] Tr. 1318:24-1319: 15 (Winkelmann). FOF 51, 53, 54, 55.

[200] *Id.* FOF 51, 53, 54, 55.

[201] RX-114.

[202] RX-106. p. 1; RX-113; Tr. 1325:6-16 (Winkelmann).

[203] Tr. 1333:12-25 (Winkelmann).

[204] Tr. 1326:3-13 (Winkelmann).

[205] Tr. 1326: 17-23; 1344-1345; Tr. 1347:4-1348:18; Tr. 1356:5-22 (Winkelmann). FOF 50-55.

It was undisputed that Winkelmann frequently communicated with Greensfelder regarding the Offering Memoranda.[206] In fact, the Division stipulated that Winkelmann "consulted with Greensfelder for each of the offerings, and that Greensfelder did review all of the offering memoranda."[207] More specifically, it was undisputed that:

- Winkelmann had discussions with Greensfelder about the disclosures that are contained in the Offering Memoranda;[208]
- Greensfelder provided Winkelmann advice about the disclosures contained in the Offering Memoranda;[209]
- Winkelmann never declined to accept any advice he received from Greensfelder about the disclosures contained in the Offering Memoranda;[210]
- The Offering Memoranda include all the disclosures that Greensfelder advised Winkelmann to make; and[211]
- Winkelmann followed the advice that he received from Greensfelder in preparing the Offering Memorandum and related documents.[212]
- Greensfelder was aware that offerings were being made to advisory clients.[213]

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206 RX-106.

207 Tr. 1352:9-25 (Winkelmann); FOF 51, 53, 54, 55.

208 Tr. 506: 23-507:2; Tr. 508:15-19; Tr. 402:2-5; Tr. 508: 15-19; Tr. 378:5-12; Tr. 1325:6-16; Tr. 1347:4-12; Tr. 1347:13-24 (Winkelmann).

209 *Id.*

210 Tr. 1251:5-23 (Winkelmann).

211 Tr. 1347:4-12 (Winkelmann).

212 Tr. 1335:1-1337:4 (Winkelmann).

213 RX 126 and RX 127 (admitted through Order Granting Leave to Adduce Additional Evidence; June 15, 2017.

In light of the evidence that Respondents solicited and received advice on the above topics, and that Respondents reasonably relied upon the advice of their counsel, the Division's allegation that Respondents acted with *scienter* is rebutted.[214] As a result, the Divisions' *scienter*-based allegations must be dismissed.

For the same reason, Winkelmann did not aid and abet any violation of Section 10(b), 17(a)(1), or 206(1). In *Howard v. SEC*, the court held that the scienter requirement for aiding and abetting liability requires "knowledge or wrongdoing" or "extreme recklessness."[215] Here that standard is not met because Winkelmann reasonably relied upon Greensfelder's advice. Furthermore, Winkelmann's unrebutted testimony shows that he believed he did nothing wrong.[216] As discussed in *Howard*, the complexity of the securities laws makes engaging counsel a practical necessity for advisers who are attempting to comply with the law.[217] For the Commission to find the Respondents liable even though the Respondents retained experienced attorneys in good faith and relied upon their advice would create a disincentive for industry participants to spend money on legal counsel. The Commission should recognize that the Respondents' retention of counsel and constant communication with them regarding the Royalty Units is not consistent with *scienter* or negligence.

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[214] *S.E.C. v. Prince*, 942 F. Supp. 2d at 143-44 (quotation in fn. 87, *supra*); *In re Digi Int'l, Inc., Sec. Litig.*, 14 F. App'x 714, 717 (8th Cir. 2001). ("We fully agree with the district court that Coopers & Lybrand's changing posture about how to account for the Aether Works investments, coupled with the opinions of outside legal counsel rendered to Digi during the pertinent time frame, establishes that no reasonable jury could find the necessary element of scienter even if the accounting treatment was improper. As the district court correctly noted, '[t]he undisputable fact that the Defendants were in consultations with their outside accountants and legal counsel during the period in question is in itself evidence which tends to negate a finding of scienter.'").

[215] *Howard v. S.E.C.*, 376 F. 3d 1136, 1143-44 (D.C. Cir. 2004).

[216] Tr. at 828 (Winkelmann).

[217] *Howard*, 376 F.3d at 1147-48, footnote 20.

who is not familiar with securities laws or disclosure requirements in offering documents acts reasonably by obtaining and relying on the advice of experienced counsel.[221] In fact, it would be *un*reasonable to presume that a person unsophisticated in securities law would take it upon themselves to "independently examine" the applicable laws "after taking the reasonably prudent step of securing advice" from a qualified attorney.

Accordingly, because Respondents did not act negligently, the Division's allegations that Respondents violated Section 206(2) of the Advisers Act, and Section 17(a)(2) and (3) of the Securities Act fail as a matter of law.

IV. ARGUMENT IN SUPPORT OF RESPONDENT'S CROSS PETITION

A. Respondents Were Not Negligent.

1. Respondents Did Not Negligently Violate Sections 17(a)(2), 17(a)(3), or 206(2).

As explained above in Sections II, C & D, the ALJ's conclusion that Respondents negligently violated Sections 17(a)(2), 17(a)(3), and 206(2) should be reversed because no violation occurred. Even if the Commission does find that a violation occurred, Respondents were not negligent because they relied in good faith on the advice of their counsel.

2. Respondents did not Violate Section 207.

The ALJ found that Respondents violated Section 207 of the Act.[222] That section states:

> It shall be unlawful for any person ***willfully*** to make any untrue statement of a material fact in any registration application or report filed with the Commission

[221] *In re E.F. Hutton Sw. Properties II, Ltd.*, 953 F.2d 963, 973 (5th Cir. 1992) ("Reliance on advice of counsel to resolve an open question of law is not negligence."); *Streber v. C.I.R.*, 138 F.3d 216, 219–20 (5th Cir. 1998) (denying Tax Court's imposition of a negligence penalty holding the respondent was not required to "independently examine their tax liabilities after taking the reasonably prudent step of securing advice from a tax attorney."); *Estate of Stetson*, 463 Pa. 64, 80 (1975). ("While reliance on the advice of counsel does not provide a fiduciary with a blanket immunity in all circumstances it persuasively rebuts a claim of breach of duty when the decision concerns a matter so dependent on legal expertise.") (internal citations omitted).

[222] 15 U.S.C. § 80b-7.

> under section 80b-3 or 80b-4 of this title, or ***willfully*** to omit to state in any such application or report any material fact which is required to be stated therein.

Specifically, the ALJ found that that Respondents filed an inaccurate Form ADV because they stated that the Firm did not have custody of client assets.[223] However, the ALJ also found that "[i]n early 2014, Winkelmann completely disclosed the custody issue to Greensfelder and requested advice about whether to continue to take the position that Blue Ocean did not have custody of royalty unit holders' funds."[224] Furthermore, "Greensfelder expressly counseled Respondents that they did not have custody of client funds" and "Winkelmann relied on that advice."[225] The ALJ's finding that Respondents relied on Greensfelder's advice should be upheld. The finding that Respondents willfully violated Section 207 before 2014 should be reversed because even then Respondents were relying on Greensfelder's advice, and Respondents did not act willfully.

The Division must show that Respondents "willfully" omitted material facts from Form ADV. The record establishes that the Division failed to meet this burden. Winkelmann's unrebutted testimony was that (1) he sought and obtained advice from Greensfelder on whether Blue Ocean had custody of customer funds, (2) Greensfelder advised that the Firm did not maintain custody, (3) he relied on that advice, and (4) he had no "reason to believe the advice was not correct."[226]

The email exchange that Respondents have asked the Commission to add to the record[227] shows that Greensfelder was always aware that Blue Ocean was going to offer securities to investment advisory clients and therefore could be in possession of client funds. The email from Morgan to Winkelmann discusses Blue Ocean issuing securities to clients and how that impacts

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[223] Initial Decision Following Remand, p. 77.

[224] Initial Decision Following Remand, p. 78.

[225] *Id.*

[226] Tr. at 1388-1392 (Winkelmann).

[227] Exhibit A to Respondent's Motion for Leave to Adduce Additional Evidence; July 15, 2019.

the Form ADV, but Morgan did not advise Winkelmann that Blue Ocean needed to indicate that it had custody of client funds. Respondents acted reasonably by relying on Greensfelder's advice.

> **From: Michael Morgan [mm@greensfelder.com]**
> **Sent: Thursday, March 24, 2011 2:47 PM**
> **To: Jim**
> **Subject: Re: ADV - more**
>
> **OK my last comment on the ADV.**
>
> **I guess that arguably for BOP to issue a security to a client is a principal cross-transaction, which your ADV says you don't do.**
>
> **The obvious solution is to amend the ADV to cover this BUT that means a reference in the ADV to this offering, which I think is a bad idea.**
>
> **I think we stick where we are, but I have not researched the no-action letters or other materials that might address this or any other aspects of an offering by an IA to its customers of its securities. I did spend some time with the CCH reporter and saw nothing. But the risks here are small - the customers with whom you engage in these transactions will, after all, certainly will know your status as "principal."**
>
> **Just to let you know my thinking on this.**
>
> **MM**

Furthermore, in 2014, when the SEC exam team (headed by Collins) expressed its opinion that the Firm was in custody of customer funds, Greensfelder held firm to its contrary view and advised Winkelmann to do the same. For example, Winkelmann asked his attorneys in an email:

> Our annual ADV filing is due on Monday. I am concerned about this custody issues that the examiners bring up. Are we clear that we are taking the position that we are not in custody with respect to both our response to the SEC and the ADV?

Greensfelder responded:

> We need to be consistent. If we take the position, as I think we should, in the SEC exam deficiency response that we don't have custody we should be taking the same position in the ADV filing. Giles' email from yesterday (attached) was focused on making sure we are consistently saying we do not have custody.[228]

[228] RX-106, pp. 2409-2410. Because the State of Missouri was focused on the custody issue, Winkelmann and his attorneys discussed its several times. *See* RX-106, pp. 2400; 2404-2405; 2407-2408; 2415.

Winkelmann followed Greenfelder's adamant advice. On April 7, 2014, the Firm responded to Collins' deficiency letter (in a letter prepared by Greensfelder[229]), stating[230]:

> Blue Ocean Portfolios does not share the staff's conclusion that it is in custody of client assets as defined by Rule 206(4)-2 of the Advisors Act....Blue Ocean Portfolios' royalty units do not meet the definition of custody or any of the examples set forth in Rule 206(4)-2. Blue Ocean Portfolios does not hold, directly or indirectly, client monies or the certificates or have any authority to obtain possession of them. Investors hold their own certificates, not Blue Ocean Portfolios. Blue Ocean does not have any authority to obtain possession of the certificates. Royalty unit investors purchased the royalty units pursuant to a subscription agreement and Blue Ocean Portfolios does not have the ability to transfer or redeem the royalty units without their consent. Lastly, Blue Ocean Portfolios does not hold or have access to the certificates or the Royalty unit investor's monies as part of the royalty units offering. Royalty unit investors exchanged their funds for royalty units at which point those funds belong to Blue Ocean Portfolios, not the Royalty unit investors.

This evidence of Winkelmann's mindset when he filed the Forms ADV – specifically his good faith compliance with his attorney's advice – shows that his conduct with regard to the custody disclosure was not "willful."

Winkelmann's situation is similar to that of the respondent in *SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144, 181-82 (D.R.I. 2004). In that case, despite concluding that the respondent did, in fact, fail to make a necessary disclosure in its Form ADV, the Court nonetheless held that it did *not* violate Section 207 because the Division failed to prove the failure was "willful":

> Gordon, who prepared the ADV Form for SG & C, testified that he believed SG & C's account structure was in compliance with the SEC at the time. This assumption was supported by both the two previous SEC examinations, which failed to note SG & C's account structure as a problem, and the firm's annual surprise examination by independent auditors Deloitte & Touche, which also failed to identify SG & C's account structure as a questionable practice. . . .

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[229] RX-105, pp. 1215-121; Tr. 1392:21-5 (Winkelmann).

[230] DX-298.

> In light of the foregoing, the Court is not persuaded that Gordon knew that the SG & C account structure in place at the time violated federal securities laws. Thus, the Court cannot conclude that he intentionally failed to disclose or willfully omitted this information from the firm's filings.

Id. at 181-82 (internal citations omitted). Here, as in *Slocum,* the Division did not rebut Winkelmann's sworn testimony that he relied on Greensfelder's advice and had no "reason to believe the advice was not correct."[231]

Additionally, in *Robare Group, Ltd. v. SEC*, the court held that Section 207 requires a finding that the person accused of a violation must have "subjectively intended to omit material information."[232] There is no evidence that Respondents knew they were omitting material information from the Forms ADV. Thus, like in *Slocum* and *Robare*, the § 207 claim should be dismissed for lack of willfulness.

B. Because the Division has Failed to Prove a Violation, Sanctions are not Warranted.

The Division failed to carry its burden of proof and establish that Respondents violated Section 17(a)(1)-(3) of the Securities Act, Section 10(b) of the Exchange Act, Sections 206(1) or (2) of the Advisers Act, or Section 207 of the Advisers Act.[233] As a result, Respondents request that each of those allegations be dismissed in its entirety and that no sanctions be assessed.

C. Even if There is a Violation, no Sanction is Warranted.

Even if unintentional violations are found, no sanction is warranted. The appropriateness of any sanction is guided by the public interest factors set forth in *Steadman.*[234] The Commission

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[231] Tr. at 1388-1392 (Winkelmann).

[232] 922 F.3d 468, 479 (D.C. Cir. 2019).

[233] Or any aiding and abetting liability thereunder.

[234] *Steadman v. SEC,* 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds,* 450 U.S. 92 (1981) ("Steadman factors").

should weigh these factors in light of the entire record. No one factor is dispositive:[235] (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction;(3) the degree of scienter involved;(4) the sincerity of the respondent's assurances against future violations; (5) respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. Other factors that have been considered include: (7) the age of the violation;[236] (8) the degree of harm to investors and the marketplace resulting from the violation;[237] (9) the extent to which the sanction will have a deterrent effect;[238] and (10) whether there is a reasonable likelihood of violations in the future.[239]

Here, assuming a violation exists, the Steadman factors show that sanctions are not in the public interest. The Division's sole argument for the imposition of sanctions is based on two allegations: (1) that Winkelmann intentionally "manipulated" the advertising factor and (2) that he "diverted" funds that "could have" been paid to investors for his own benefit. Neither of these allegations was supported by the evidence. As addressed in great detail, above, Winkelmann did not manipulate – intentionally or otherwise – the Firm's advertising data.[240] Instead, he attempted to be as detailed as possible in his description of the program and its efficiency. As for the "diversion" of funds, the Division has failed to show that Winkelmann failed to pay any amounts

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[235] *Id.*

[236] *Marshall Melton*, 56 S.E.C. 695, 698 (2003).

[237] *Id.*

[238] *Schield Mgmt. Co.*, Exchange Act Release No 53201 (Jan 31, 2006), 87 SEC Docket 848, 862.

[239] *KPMG*, 54 S.E.C. 1135, 1191 (2001).

[240] *See* Section III.A. above.

he owed to investors or that he used funds for a purpose not expressly permitted in the offering documents.[241]

Beyond that, there is no evidence that Respondents acted with *scienter*. To the contrary, at all times they strove to comply with the applicable rules and requirements. To do so, they employed experienced legal counsel and relied upon their advice as to the propriety of the offering documents and Form ADV filings – actions indicative of persons acting in good faith.

Moreover, in this case, there is no customer harm. To the contrary, it is undisputed that Royalty Unit holders continue to receive their regular payment of a percentage of the Firm's cash receipts as promised.

Finally, were the Commission to contemplate civil penalties,[242] the Division was unable to set forth *any* evidence that *anything* over a first-tier penalty is even conceivable in this case. Second- and third-tier penalties are only awarded where the Division establishes the respondent acted with "fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement.[243] Third-tier penalties are only awarded where the Division establishes that the acts or omissions at issue resulted in substantial losses (or created a significant risk of substantial losses) or resulted in "substantial" pecuniary gain.

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[241] *See*, Section III.A.7. above.

[242] Six factors are considered when determining the propriety of civil penalties:

(1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. 15 U.S.C. §§ 78u-2(c), 80b-3(i)(3); *Anthony Fields, CPA*, Exchange Act Release No. 74344, 2015 WL 728005, at *24 (Feb. 20, 2015).

[243] 15 U.S.C. §78u-2(c); *S.E.C. v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144, 186–87 (D.R.I. 2004) ("However, because no losses were demonstrated, and because this Court concludes that Defendants' actions were not intentional or deliberate, second and third tier penalties are inappropriate. Rather, the Court will impose a civil penalty under the first tier only."); *In the Matter of J.P. Turner & Co., LLC*, Release No. 395 (May 19, 2010).

Neither occurred here, and those penalties are unwarranted. To the contrary, the evidence showed that Respondents made every attempt to comply with the applicable laws.[244]

D. **In the case of the Custody Charge, No Cease and Desist is Warranted and the Sanction should be as Minor as Permitted under the Circumstances.**

Prior to May 2012, the Firm made monthly payments to investors pursuant to the terms of the Offering, reflecting their respective percentage of revenues, no matter how modest.[245] In May 2012, the Firm determined that monthly payments required a lot of work for a small check.[246] After consulting with Greensfelder, the Firm decided to change to a quarterly payment schedule. Greensfelder assured Winkelmann that the change was proper so long as he informed the investors it would occur.[247] Winkelmann so informed them.[248] Despite Greensfelder's review of the change, its advice that the change was proper, and Winkelmann and the Firm's ongoing good faith reliance on its counsel's determination, the Firm accepted the SEC's conclusion that it may have inadvertently tripped the "Custody Rule."

Custody, in this situation, however. was far more nuanced then a traditional situation. Normally, it is open and obvious to the adviser that he or she has taken custody of client funds or assets. That is, (1) an asset exists; (2) it is delivered to the IA; and (3) the IA must ensure it is properly handled. Here, the clients never tendered anything to the Firm – nor did the Firm take possession from third party. Instead, its own cash receipts were accrued at month end to an "accrued royalty account" payable to investors, some of whom were also advisory clients. Indeed,

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[244] *In the Matter of Ireeco, LLC, & Ireeco Ltd.*, Release No. 986 (Mar. 24, 2016) (declining to award civil penalties where no evidence of "fraud" or "manipulation" or customer harm).

[245] Tr. 1385:2-5 (Winkelmann).

[246] *Id.*

[247] RX-104; Tr. 1385:2-5; Tr. 1387:7-21; Tr. 1388:6-1389:5 (Winkelmann).

[248] *Id.*

this nuance eluded even Greensfelder which, as set forth in Section III.C., above, held firm on its belief that the SEC was wrong, that the funds were *not* custodied. Respondents, in turn, relied on that belief at all times relevant.

In light of these facts, the Commission should impose a remedy similar to that rendered in a proceeding involving a similarly unusual accounting procedure and a similar lack of willful conduct. In *SEC v. Slocum, Gordon, & Co.*, 334 F. Supp. 2d 144, 185-86 (D.R.I. 2004), the court found a technical violation of the Custody Rule and, when presented with the Division's demand for third-tier penalties, opined:

> Here, after evaluating these factors, the Court opines that a permanent injunction against Defendants is unnecessary. Their only securities violations were non-scienter based, technical violations. The SEC was unable to demonstrate that Defendants were aware that their account structure was improper before the Commission brought it to their attention in 2000. When they were informed of a potential violation, however, [Defendants] took every step possible to rectify the situation as quickly as possible. ... With the account structure at [Defendant Firm] fundamentally restructured through Fidelity, the Court concludes that the possibility for future commingling violations are nonexistent or slim at the very worst.
>
> ***
>
> The Commission argues that the Court should apply the third tier to Defendants' respective violations, arguing that their actions were both deliberate and resulted in substantial losses to their clients. However, because no losses were demonstrated, and because this Court concludes that Defendants' actions were not intentional or deliberate, second and third tier penalties are inappropriate. Rather, the Court will impose a civil penalty under the first tier only.
>
> ***
>
> In light of the evidence presented, the Court imposes a civil penalty of $ 1,000 against [Defendants] for each respective violation.... Because Defendants' violations were not willful, and as no actual loss to clients resulted, the Court finds that this nominal penalty is appropriate.

Id. at 186-187; (internal citations omitted).

Here, as in *Slocum,* the Commission should award, at most, a Tier 1 penalty for the custody violation. Further, because the violation at issue was the result of a single misinterpretation – and not a series of repeated acts – the Commission should consider the conduct at issue to be a single actor omission.

The Division has sought disgorgement of the amounts invested in the four Offerings at issue. Because the Firm acted properly and the Division was unable to prove any violation occurred, disgorgement is unwarranted and should be denied.

Moreover, even were some technical violation found, disgorgement would be solely punitive and would not serve any deterrent value.[249] First, for the reasons set forth above, there are no "ill-gotten gains" or "wrongfully obtained profits."[250] Respondents did everything right in this case: (1) they hired experienced legal counsel to advise and assist in the drafting and preparation of the offering documents; (2) they hired experienced legal counsel to advise and assist in the drafting and preparation of the Form ADV; (3) they objectively believed that the information contained in the offering documents was truthful, accurate and compliant with the securities laws; and (4) most importantly, Respondents advanced the interests of its investors by growing the recurring revenues of the firm consistent with the business plan described in the offering memos. In sum, this is not a fact pattern that preaches a message of deterrence to the industry and no sanctions should be awarded based on the Division's assertions.

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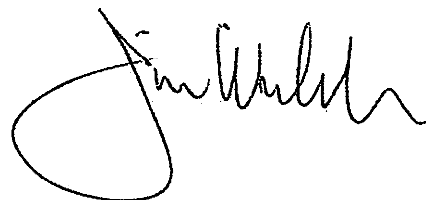
[249] *S.E.C. v. Wyly*, 71 F. Supp. 3d 399, 405–06 (S.D.N.Y. 2014).

[250] *S.E.C. v. Jones*, 476 F. Supp. 2d 374, 386 (S.D.N.Y. 2007); *United States Sec. & Exch. Comm'n v. Markusen*, 143 F. Supp. 3d 877, 893 (D. Minn. 2015).

V. CONCLUSION

For the reasons stated herein, Respondents respectfully request that the Commission dismiss the allegations against them their entirety, or alternatively, find that the evidence supporting their advice of counsel defense negates liability for any violations.



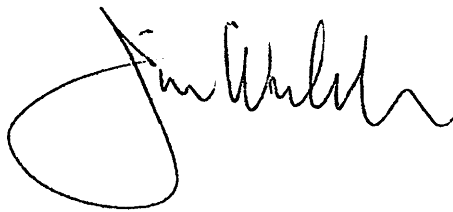
Dated: September 3, 2019

James A. Winkelmann, Sr.

CERTIFICATE OF SERVICE

I, James A. Winkelmann, Sr. hereby certify that on September 3, 2019, I served a copy of the foregoing. **RESPONDENTS' BRIEF IN RESPONSE TO THE DIVISION'S OPENING BRIEF AND IN SUPPORT OF RESPONDENTS' CROSS-PETITION FOR REVIEW**, as follows:

Original and three copies to: Via Facsimile transmission and Registered Mail	Office of the Secretary US Securities & Exchange Commission 100 F. Street, N.E. Washington, DC 20549 Fax (202)772-9324
One Copy to: Via Email	David F. Benson Benjamin J. Hanauer Division of Enforcement US Securities & Exchange Commission 175 W. Jackson Blvd., St. 900 Chicago, IL 60604 bensond@sec.gov hanauerb@sec.gov



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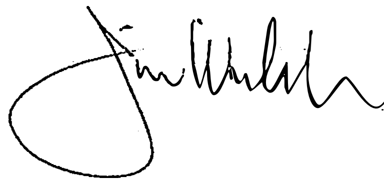
CERTFICATE OF COMPLIANCE

In accordance with Rule450(d) of the Rules of Practice, I certify this brief, exclusive of the cover page, table of contents, tables of authorities, and signature block is in compliance with the 16,000-word limit. The brief contains 15,891 words according the word processing system used to the prepare the brief.



James A. Winkelmann, Sr.