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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' PRE-HEARING BRIEF

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes and Regulations

Cases

I. INTRODUCTION

The Division has characterized this proceeding as a fraud case. This Honorable Court will have to struggle to remember this, however, in light of the evidence Respondents anticipate presenting. The allegations contained in the Order Instituting Proceedings ("OIP") would lead one to believe that Respondents – Mr. Winkelmann and Blue Ocean – slapped together an offering of securities with little analysis or effort. The OIP leads one to assume that Mr. Winkelmann and Blue Ocean made wild, unsupported calculations, paid irrational fees to themselves and affiliates, and otherwise intentionally set out to defraud their clients.

The facts will tell a very different story: the truth. The evidence will show that when it came to the offerings at issue, Mr. Winkelmann and Blue Ocean consistently strove to do everything right. Indeed, they hired one of the best law firms in the city to assist them in the offerings (and several other related areas). That law firm drafted and reviewed not only the offering documents at issue but the Firm's Form ADV, as well.

Respondents also developed a detailed and highly complex database of information, which they used continuously to monitor and assess the single data-point central to this dispute: the efficiency of the Firm's advertising expenditures. The evidence will also show that over time, this database became increasingly detailed, increasingly voluminous, and, most important, increasingly accurate. Utilizing this information, the Firm provided investors and potential investors with an incredibly detailed assessment of the Firm's current and potential growth through effective advertising spends. As the evidence will establish, the information contained in the offering documents on that issue was entirely accurate.

The Division, of course, has reached a different set of numbers that supposedly depict how wisely the Firm spent its advertising dollars. In fact, the Division has concluded that its numbers are not only accurate, but *better* than the Firm's. So much better, in fact, that it has alleged the Firm's calculations amount to a fraudulent, material misrepresentation, actionable under the federal securities laws. This Honorable Court will be well aware that the Division carries the burden of proving that fact, and that when it fails to do so, Respondents are entitled to judgment in their favor.

The rigidity with which the Division has approached the Firm's advertising calculations reveals its motivation in filing this proceeding and overcharging the OIP. To understand the Blue Ocean business model, one must understand its advertising campaign. The business model is based largely on the Firm's push for effective advertising, so it gains new clients – and the revenues they generate – for as little money as possible spent on ads. This required the Firm *constantly* to monitor not only revenues and expenses, but sources of leads, trends in advertisements, geographical strengths, source strengths, and client reactions thereto. To ensure it was maximizing efficiency, the Firm meticulously tracked this information so it could monitor with incredibly exactness not just whether its advertising strategy was working, overall, but which specific advertisement – a particular time slot on the radio, a particular internet banner, a particular written advertisement in a particular location – was responsible for attracting which client. Poor performers were cut; budgets for high performers were increased.

Also, the Division fails to understand the inherent fluidity of advertising. If an advertisement runs in January, the client reading (or hearing) the ad may not walk in the door until May. A less detailed analysis, i.e., the one the Division's accountant propounds, would credit May advertisements for the May business. Blue Ocean wanted to be more exact, so it made sure it knew the source of the customer, and properly credited the business to January advertising expenses. This attention to detail not only increased accuracy, it explains why the Firm's ad campaign was so successful.

The Division's failure to understand the Firm's business also caused it to imagine that undisclosed conflicts of interest existed between Mr. Winkelmann or Blue Ocean, on the one hand, and their advisory clients, on the other. As set forth herein, no such conflicts exist and, in turn, those claims fail as well.

In the end, the evidence will show that Mr. Winkelmann and Blue Ocean upheld the separate obligations they owed, respectively, to their advisory clients and to their investors. Not only will the Division be unable prove to establish the necessary element of *scienter*, it will be unable even to show negligence. In the absence of these requisite elements, the Division's charges should be denied and judgement should be entered in favor of Respondents.

Each allegation in the OIP is addressed, in full detail, below.

II. FACTS

A. James A. Winkelmann, Sr.

James A. Winkelmann, Sr. is the current CEO, CCO and Manager of Blue Ocean Portfolios ("Blue Ocean" or the "Firm"). He has been in the securities industry since 1981 and has worked as an investment adviser since 1995. In 2010, following a cancer diagnosis and upon the advice of his estate planning attorney, Mr. Winkelmann transferred his ownership of Blue Ocean into a limited family partnership, 23 Glenn Abbey Partners ("Glenn Abbey"), owned by his wife, Patty, and his three children. Mr. Winkelmann remained the Manager of Glenn Abbey at all times relevant to this proceeding.

B. Blue Ocean Portfolios

Blue Ocean Portfolios was founded by Mr. Winkelmann in 2009 and is a registered investment adviser. During the time period relevant to this proceeding, depending on its assets under management at the time, Blue Ocean was either a state-registered firm (with the States of Missouri and Illinois) or an SEC-registered firm.

Blue Ocean provides its advisory clients with portfolio allocation services on a fee-only basis. Its clients are a mix of individuals and small-to-midsize institutional clients. Currently, the Firm services approximately 265 households and 800 accounts.

Blue Ocean's investment approach focuses on the overall allocation of a portfolio – as opposed to chasing performance on individual investments. Blue Ocean developed a model portfolio that was comprised of a blend of equity index funds, commodity price index funds, treasuries, and certificates of deposit. Based on the particular client's investment and (if applicable) retirement needs, they are placed into the appropriate Blue Ocean model portfolio. The allocation of the individual models are closely monitored and rebalanced as necessary to best increase the odds of favorable returns to the advisory clients. Monitoring allocation – rather than chasing returns on specific investments – not only increased the statistical likelihood of success, it minimized the fees incurred along the way. This low-fee, high attention management style is unique to Blue Ocean and its clients select the Firm because they believe in its approach.

C. <u>The Royalty Offerings</u>

1. The Royalty Concept and First Offering

In 2010, Blue Ocean began experimenting with an aggressive marketing campaign. The Firm's low-fee approach been very well received and the Firm wanted to share it with a greater audience. In order to spread its message, however, the Firm would have to greatly increase its advertising, both in terms of cost and geographic scope.

To fund the campaign, Blue Ocean contemplated a capital raise. In late 2011, 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 options for such an endeavor. Mr. Morgan specialized in advising clients in all aspects of securities law and regulatory compliance.

Mr. Morgan, specifically, was highly experienced in the preparation of offering documents, like those at issue here.

Mr. Winkelmann and Mr. Morgan ultimately agreed on the Royalty Unit structure. Under this arrangement, investors would contribute capital to Blue Ocean in exchange for the right to receive a certain minimum percentage of the Firm's cash receipts each month, regardless of whether the Firm managed to achieve a profit that month. This right continues until the investor is eventually paid back some stated multiple of the investment, no matter how long that may take. Here, the multiple was between two and three times (depending on the offering). So, if an investor contributed $10,000 in an offering with a multiple of three, she was entitled to receive a set percentage of the Firm's cash receipts for as long as necessary until she received a total of $30,000.

After many meetings and discussions, Mr. Winkelmann and Mr. Morgan settled on the terms of the first offering. Blue Ocean would issue Royalty Units for $25,000. Each unit would entitle its holder to a minimum of 0.25% of cash receipts earned by Blue Ocean each month until paid back three times their initial investment (i.e., $75,000). Additionally, each Royalty Unit came with a warrant which the investor could exchange for a 1% equity stake in Blue Ocean. The warrant was only executable, however, after the principal had been repaid.

Mr. Morgan and his team at Greensfelder drafted the offering documents. Mr. Winkelmann and Mr. Morgan exchanged ideas, drafts, and comments until, on March 31, 2011, the final Offering Memoranda was finalized for distribution to investors ("Round 1" or the "First Offering").

Under the terms of Round 1, Blue Ocean raised $650,000. The Firm immediately put the funds to use implementing its advertising campaign. By the end of 2011, the results were in: the strategy was working and Blue Ocean's business was growing.

2. Subsequent Offerings

Blue Ocean, in reliance on Greenfelder's continued advice and counsel, conducted three additional rounds of Royalty Units to fund its expanding advertising campaign. The second round commenced on March 10, 2012 ("Round 2") and raised $350,000. The third round commenced on September 1, 2012 and raised $225,000 ("Round 3"). The fourth and final round took place in February 2013, and raised $125,000 ("Round 4"). To date, the Royalty Unit holders continue to receive their share of the Firm's cash receipts, as promised. This Firm has not received any complaints about the investments, nor has anyone sought to rescind.

D. Advertising Campaign and Calculation of the "Ad Factor"

1. The General Concept

The OIP focuses on the advertising factor ("ad factor") set forth in the offering documents prepared in connection with each of the four offerings. The Division has determined, based on unknown calculations, that the ad factors stated in the documents were somehow inaccurate or misleading. In fact, they have alleged the inclusion of the ad factor constitutes scienter-based fraud. This is nonsense.

The advertising factor used in the Offering Memorandum is the product of an incredibly complex and detailed assessment of the Firm's up-to-the-minute advertising efficiency. As the offering documents make clear, the Firm's business plan was not merely to dump thousands of dollars into new advertisements. To the contrary, the plan was to *selectively* advertise, by constantly re-evaluating whether a chosen advertising source was bringing in demonstrable business (i.e., revenue). If a particular advertisement was producing, it continued to receive funding. If it did not produce (or if it received little response), it was cut.

In order to track the efficiency of each individual advertisement, the Firm developed an elaborate tracking system. It was capable of determining, when a new client called, the specific source from which that client learned about the Firm. For example, the Firm would know that its client heard about Blue Ocean from a particular radio station, on a particular date and time. By meticulously tracking this information, the Firm ensured its advertising expenditures were justified and producing.

2. Computation

The Division has taken an incredibly simplified approach in its own calculations of the advertising factor. As the evidence in this case will reveal, this calculation was not a static formula with easily ascertained variables. To the contrary, the underlying data was *constantly* evolving. New customers were coming in every day, but it was common for there to be a considerable lag between the date an advertisement ran and the establishment of the new customer relationship. Sometimes, months would go by between an advertisement and a new engagement. The Firm's meticulous tracking system picked up and monitored these trends. Thus, the Firm did not view advertising on purely a monthly or calendar-year basis. Instead, advertising was tracked in terms of trends, comparing various periods of time in an attempt to best capture the efficacy of the advertising spends. This factor, which the Firm used to express its efficacy, was included in each offering document.

a. Round 1

The calculation of the ad factor used in Round 1 was the simplest of all the rounds. Round 1 occurred, obviously, at the very beginning of the Firm's advertising plan. In March

2011, that campaign had not truly begun. There had been some historical advertising, but, since no investor funds had yet been raised, the true campaign was yet to begin.

Nevertheless, the Firm did have historical advertising numbers to look to in determining its efficacy to that point. In the offerings that followed, the Firm would rely on its increasingly-detailed advertising source tracking. Round 1 pre-dated that sophisticated tracking, so, instead, it focused on historical data.

Specifically, when preparing the Round 1 offering document in March 2011, the Firm looked back to the beginning of its advertising plan – June 2010. Between June 2010 and the middle of March 2011, the Firm had spent just short of $50,000 in advertising. Spread out over approximately 9 months, it equated to around $5,300 per month in spending. Also as of mid-March 2011, the Firm had brought in approximately $25,000 in new revenue (i.e., new advisory fees paid by new customers) off of that 9 months of adverting.

Based on those figures, the Firm included the following description in its Offering Memorandum for Round 1:

> A key business driver for Blue Ocean Portfolios is the client acquisition cost. 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.

It is evident that the Division, based on some other calculations, came to a different efficacy ratio than the Firm did at the time the offering documents were being prepared. Regardless of the Division's calculations, however, the Firm's calculations were correct and accurate. The disclosure as to the ad factor was entirely proper.

b. Round 2

An entire year passed between the first and second rounds. During this time, the Firm had been constantly improving its advertising tracking and sourcing models. Its ability to identify and distinguish the profitable versus unprofitable advertisements was improving and the amount of data that went into calculating advertising efficiency had grown exponentially.

In the beginning of February 2012, the Firm and Greensfelder again sat down to design an offering to raise funds and prepare the written offering documents. Given the role of advertising efficacy in the Blue Ocean business model, the document again recited the Firm's then-existing spend-to-revenue ratio.

This time, the Firm had considerably more data from which to draw. It was able to look back over the prior six months to review the historical efficiency (i.e., the ad factor). Between November 2011 and February 2012, it had fallen from 1.45 to 0.67.[1] By the middle of March 2012, when the Firm was working with Greensfelder to finalize the offering documents, the cost had dropped even further, and the current advertising factor was 0.62. (By the end of March, it had dipped all the way to 0.35!)

Thus, using the up-to-the-minute mid-March figures, Blue Ocean and Mr. Winkelmann included the following discussion in the offering documents (emphasis supplied):

> The key business driver for Blue Ocean Portfolios is the client acquisition cost. *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.

[1] In November 2011, it cost the firm $1,108 to acquire a new client; in February 2012 that cost was down to $987 – and falling.

Once again, the numbers included in this section were entirely accurate and representative of the Firm's *current* advertising efficacy. The numbers are neither incorrect nor misleading.

c. Round 3

By Round 3 in September 2012, the Firm's data had grown and was further refined as it continuing to evolve and improve its advertising models. The Firm added new tracking metrics, such as a historical "trailing" factor designed to capture new business brought in long after the initial advertisement. For example, in the instance where a client saw an advertisement in January, but did not join the Firm as a client until May, the Firm was now capable of properly tracking and utilizing that information – better improving its ability to track successful advertising sources (and discontinue sources that did not produce).

Again with the advice and counsel of Greensfelder, in September 2012, the Firm prepared an Offering Memorandum for Round 3. It was mid-August when the Firm calculated the most up-to-date advertising figures for use in the offering documents. As of the end of July 2012, the six-month average advertising factor was 0.71. By mid-August, that number had declined just slightly, to 0.67. In order to use the most up-to-date information (given that the Offering Memorandum expressly references the "current" spending), the Firm presented the real-time mid-month numbers in the document. Hence the following disclosure:

> The key business driver for Blue Ocean Portfolios is the client acquisition cost. *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 $2.8 million in new assets that are generating $31,000 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising – a 67/100 ratio or an "advertising conversion factor" of 0.67.

As above, the Firm's calculations were accurate and designed to provide investors and prospective investors with the most accurate and timely information regarding the advertising to date. The numbers are neither false nor misleading.

d. Round 4

The Round 4 calculations used in the February 2013 offering followed a near-identical procedure. Once again, in preparing the offering documents, in February of 2013, the Firm reviewed its data, including the 2012 figures. The December 2012 month-end data showed a 12 month historical factor of 0.89 – the exact number reflected in the offering documents:

> The key business driver for Blue Ocean Portfolios is the client acquisition cost. Currently, Blue Ocean Portfolios is spending approximately $10,000 per month on advertising which generates leads for the sales staff to follow up on. This $10,000 advertising spend is converting to approximately $2.8 million in new assets that are generating $31,000 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising — an 89/100 ratio or an "advertising conversion factor" of 0.89. Advertising spend in other markets could be higher or lower. This conversion factor experience will be different in the Chicago market.

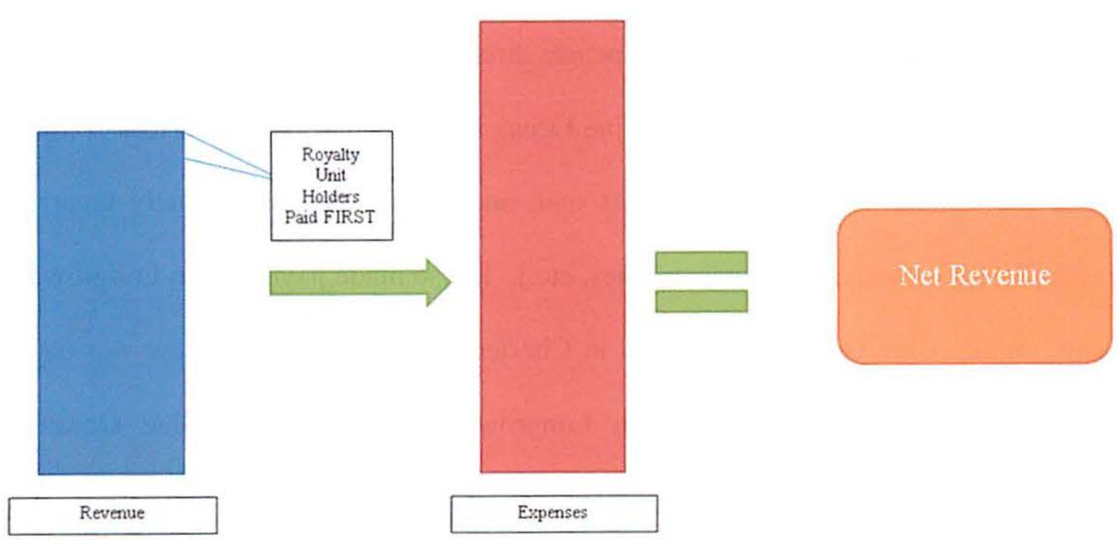
(RX-004). Simply put, there was no misrepresentation with regard to the numbers used.

The February 2013 offering raised $125,000 from two investors. As with the first three offerings, to date, Round 4 has met its obligations and paid investors the promised percentage of cash receipts without fail. There have been no customer complaints arising out of the Round 4 offering, nor has any investor asked to rescind.

E. <u>Blue Ocean Royalty Unit Payment Structure</u>

One of the most important aspect of the Royalty Units in this case is the manner in which investor payments were to be calculated and made. The Division has alleged that the ad factors stated in the offering memoranda (assuming the Division can show them to be somehow inaccurate) were *material* misrepresentations. Materiality, argues the Division, stems from the claim that a lower ad factor would cause investors to believe that they would be repaid more quickly (than were a higher ad factor included).

The Division's position, however, fundamentally misunderstands the structure of the offering. Under the terms of the memoranda, Royalty Unit holders were entitled to a certain percentage of the Firm's <u>cash receipts</u> – 0.05% - 0.25% – depending on the offering. That is, unlike a traditional equity investment – where an investor shares an interest in the issuer's potential *net* returns – Royalty Unit holders are paid out of revenues and other cash receipts. They receive a mandatory percentage of that revenue, regardless of Blue Ocean's bottom line. So, for example, if Blue Ocean earned $10,000 in revenue for a particular period, but the Firm incurred $20,000 in expenses, the Firm would be operating at a loss (which is very common in newly formed businesses). Royalty Unit holders, however, are not impacted by the loss or the fact that expenses outpaced returns. They receive their promised percentage payment regardless. See below:



Paying Royalty Unit holders out of revenue – not profits– had another important impact on the offering. Both Blue Ocean and investors benefited by high revenues. For Blue Ocean, higher revenues meant its advertising plan was working and that its business was growing. For investors, higher revenue meant they would receive a higher Royalty payment. In other words, the Firm and the investors shared a common goal of driving up revenue – aligning their interests exactly.

F. <u>Additional Facts Relevant to the SEC's allegations</u>

1. Management Fees

The Division has alleged that the offering documents for the four Rounds failed to disclose that Blue Ocean was paying "management fees" to other entities relating to Mr. Winkelmann. This is an entirely non-exceptional fact. At or around the time Blue Ocean was founded, Mr. Winkelman formed an umbrella company to manage Blue Ocean and three other entities. The plan was for the management company – named Blue Ocean Management ("BO Management") – to pay common costs (such as rent, salaries and supplies) and each entity would contribute its share.

This structure almost immediately proved overly complicated. By the end of 2011, Blue Ocean managed itself and paid its own expenses directly.

Nevertheless, throughout 2011, Blue Ocean made regular payments to BO Management to cover the salaries of its employees, its rent, and other expenses normally incurred by the business (health insurance, copiers, supplies, etc.). It also made payments to Longrow Insurance Agency. While Blue Ocean was located in Chesterfield, Missouri, Longrow was based out of Clayton, Missouri. Utilizing space in Longrow's offices allowed Blue Ocean to offer prospective advisory clients an alternative (and ideally more convenient) location to visit. Additionally, in 2011, Longrow maintained the email and file servers that Blue Ocean used to conduct business.

Thus, the payments made from Blue Ocean to Longrow over this period were to cover Blue Ocean's usage of both the servers and the office space. Contrary to the Division's insinuation, none of these expenses were unusual, improper, or required express disclosure in the offering documents.[2]

2. Bryan Binkholder

Beginning in 2011, Bryan Binkholder was a marketing and advertising consultant utilized by Blue Ocean. Mr. Binkholder advised the Firm on all aspects of its advertising and marketing strategy and, in other respects, its overall business plan. In exchange for his services, the Firm paid him pursuant to a written agreement that was fully disclosed to investors. In fact, the agreement was an exhibit to the offering memorandum.[3] In 2012, the Firm learned from one of its investors that Mr. Binkholder was under federal investigation. It immediately terminated the agreement and ceased using his consulting services.

The Division has alleged that prior to that, the Firm should have disclosed in the relevant Offering Memoranda that Mr. Binkholder had entered into a Consent Order with the State of Missouri that included a provision barring Mr. Binkholder from operating as an investment advisor, and that its failure to have made that disclosure serves as the basis for a securities fraud claim. There are two obvious defects in the Division's position. First, Mr. Binkholder was not functioning in an investment adviser capacity in his relationship with Blue Ocean; rather, he was acting as a marketing consultant. Second, the specific scope of Mr. Binkholder's role (and the fact that he would not have any involvement with Blue Ocean advisory clients) was expressly disclosed in the Offering Memoranda. The Firm informed investors:

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[2] There was also a payment to Longrow that reflected Mr. Winkelmann's salary payment.

[3] Mr. Binkholder's relationship with the Firm began after the first offering and terminated in 2012. His role is only relevant, therefore, to the second and third offerings.

> Blue Ocean Portfolios has entered into an exclusive marketing/sponsorship agreement with The Financial Coach Show. Hosted by Bryan Binkholder dba "The Financial Coach", - a Registered Investment Advisor - The Financial Coach Show is aired every Sunday at 6:00 PM on FM News Talk Radio 97.1 in the St. Louis market. According to Arbitron, the radio show has between 7,000 and 8,000 listeners every week. Blue Ocean Portfolios has been the sponsor of the show since January of 2010. It is planned that the radio show could be syndicated to other markets in the United States as well. The show gives up-beat analysis of the economic and political news while providing valuable insights on the traps and cons that typical Wall Street firms sell. The show drives listeners to The Financial Coach website (**www.FinancialCoachShow.com**) where they can request free information from Blue Ocean Portfolios on retirement, wealth management topics, life insurance, and other investment related topics. Under the exclusive marketing/sponsorship agreement, Bryan Binkholder receives a monthly retainer that is tied to the overall revenues of Blue Ocean Portfolios, LLC, regardless of where the leads come from. Overall Mr. Binkholder has no direct relationship or contact with his listeners who become prospective clients of Blue Ocean Portfolios; however from time to time Bryan Binkholder may have direct contact with clients and/or prospective clients of Blue Ocean Portfolios. In this event Mr. Binkholder will give the client an exclusive marketing agreement and the client will receive a copy of the ADV Form.
>
> Mr. Binkholder receives no direct compensation from any Blue Ocean Portfolio client for investment advisory services or insurance products or revenue of any kind. From time to time Mr. Binkholder could be directly compensated for speaking engagements or from other unrelated parties. If those other parties would also happen to be Blue Ocean Portfolio clients it would be purely coincidental and not linked to any relationship that the third party would have with Blue Ocean Portfolios.

Additionally, so there was no confusion, Exhibit 3 to the Offering Memoranda was a copy of the Firm's agreement with Mr. Binkholder. Therefore, all material information relating to Mr. Binkholder, his radio show, and his advertising expertise were fully and completely disclosed. Since he was not functioning as an investment advisor, the Missouri Consent Order was immaterial and irrelevant, and disclosure was not necessary.[4]

Further, at the time of the offerings, Mr. Winkelmann and Blue Ocean were very certain that the Consent Order was not something that needed to be disclosed. Prior to the issuance of Round 2, Mr. Winkelmann had discussed this issue with his counsel at Greensfelder and was told, with certainty, that it was not "material," given Mr. Binkholder's limited role as an advertising consultant, as opposed to a financial adviser. Mr. Winkelmann and Blue Ocean accepted the advice of their counsel, as they routinely did.

III. <u>AUTHORITY AND ARGUMENT</u>

With regard to each and every alleged violation set forth in the OIP, the Division carries the burden of proof. To carry this burden, it is required to show, by a preponderance of the evidence, each and every element of each and every claim. *See Steadman v. SEC,* 450 U.S. 91, 95–96 (1981). As a matter of law, if the Division fails to carry this burden, this Honorable Court must enter an order in the Respondents' favor. *Id.*

A. <u>Mr. Winkelmann and Blue Ocean did NOT violate Rule 206(1) of the Advisers Act, Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act.</u>

Rule 206(1)[5] of the Advisers Act, Section 17(a) of the Securities Act[6] and Section 10(b) of the Exchange Act and Rule 10b-5[7] essentially prohibit the same type of conduct. 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, or other fraudulent devices; (2) in

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[4] Although perhaps obvious, it is worth noting that neither Mr. Winkelmann nor Blue Ocean were parties to the Missouri Consent Order.

[5] 5 U.S.C. §§ 80b-6(1).

[6] 15 U.S.C. §77h(a).

[7] 15 U.S.C. §78j(b) and 17 C.F.R. §240,10b-5.

connection with the offer, sale, or purchase of securities; and (3) that they acted with scienter. *In the Matter of Warren Lammert*, 2008 SEC LEXIS 937, *54 (April 28, 2008). Similarly, Rule 206(1) prohibits employing "any device, scheme, or artifice to defraud any client or prospective client." To prove a Rule 206(1) violation, the Division must show, by a preponderance of the evidence, that Respondents (1) engaged in fraudulent activities; and (2) breached their fiduciary duty to its clients by making false or misleading statements or omissions of material fact. *SEC v. Merrill Scott*, 505 F. Supp. 2d 1193 (D. Utah 2007).

Rule 206(1) of the Advisers Act, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 all require that the misrepresentation or omission at issue be "material." "According to the United States Supreme Court, an omitted fact or misstatement in securities transactions is material if there is a substantial likelihood that a reasonable investor would consider it important in making his or her investment decision as to a particular security." *SEC v. Slocum, Gordon, & Co.*, 334 F. Supp. 2d 144, 171 (D.R.I. 2004). An investment advisor makes a material omission where it fails to make a "full and fair disclosure of all material facts." *In the Matter of Brandt, Kelly & Simmons, LLC, & Kenneth G. Brandt*, Release No. 289 (June 30, 2005) citing *Capital Gains Research Bureau, Inc.*, 375 U.S. at 191-192, 194, 201. Additionally, each of these provisions requires the Division prove Mr. Winkelmann and Blue Ocean acted with scienter: the intent to deceive manipulate or defraud (discussed fully, immediately below).

Because the Division will be unable to prove these requisite elements, the claims brought under these provisions must be dismissed.

1. No Scienter

In order to establish its claim that Mr. Winkelmann and Blue Ocean violated Section 10(b) of the Exchange Act, Section 206(1) of the Advisers Act, or Section 17(a)(1) of the

Securities Act, the Division must carry its burden of proving that Mr. Winkelmann and Blue Ocean acted with scienter, which is defined as a "mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 185 (1976); *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992); *SEC v. Moran*, 922 F. Supp. 867, 896 (S.D.N.Y. 1996). "Recklessness" can also satisfy the scienter requirement, but "recklessness" in this context "is not merely a heightened form of ordinary negligence; it is an ***extreme departure*** from standards of ordinary care, which presents a danger of misleading buyers or sellers." *See David Disner*, 52 S.E.C. 1217, 1222 & n. 20 (1997); *see also SEC v. Steadman*, 967 F.2d at 641-42; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990); *SEC v. Moran*, 922 F. Supp. 867, 897 (S.D.N.Y. 1996) citing *Steadman*, 967 F.2d 636 at 641-42; *In the Matter of Brandt, Kelly & Simmons, LLC, & Kenneth G. Brandt*, Release No. 289 (June 30, 2005) (emphasis added) *quoting Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978).

a. No evidence of any "intent to deceive, manipulate, or defraud"

In this case, the Division will be utterly unable to sustain its burden when it comes to scienter. To the contrary, the evidence will show that Mr. Winkelmann and Blue Ocean constantly strove to ensure that the structure of the offerings and the information contained in the documents was correct, truthful, and balanced, so that prospective investors could make informed, meaningful decisions.

To that end, as discussed immediately below, the Firm retained experienced legal counsel who specialized in securities offerings and filings to advise it on the very disclosures that the Division now contends were somehow incomplete or improper. Mr. Winkelmann and Blue Ocean relied upon that advice when it issued each offering memoranda and, more importantly, honestly and reasonably believed that the information contained therein, vetted by legal counsel, was in full compliance with the securities laws and the obligations owed to investors. This reliance upon the advice of counsel, made in good faith, overwhelmingly rebuts any insinuation of scienter.

b. Good faith reliance on legal counsel

As noted above, prior to any of the four Offerings, Mr. Winkelmann and Blue Ocean retained a very experienced and prestigious law firm to assist them in the process. Mr. Winkelmann is an experienced investment adviser, but he is not an expert in securities laws or regulation. So, to assist him, he retained counsel that did have that expertise and who, in fact, specialized in the area. The evidence will show that, for many of the issues the SEC has identified here, Mr. Winkelmann and Blue Ocean relied, in good faith, on the advice and counsel their attorneys provided.

To establish the advice-of-counsel defense, Respondents must demonstrate that they: "(1) made complete disclosure to counsel; (2) requested counsel's advice as to the legality of the contemplated action; (3) received advice that it was legal; and (4) relied in good faith on that advice." *SEC v. Prince,* 942 F. Supp. 2d 108, 138 (D.D.C. 2013) *citing* Zacharias v. SEC, 569 F.3d 458, 467 (2009). Reliance on counsel need not be a formal defense, as it is "simply evidence of good faith, a relevant consideration in evaluating a defendant's scienter." *Howard v. SEC,* 376 F.3d 1136, 1147, 363 U.S. App. D.C. 100 (D.C. Cir. 2004); *See also, SEC v. Prince*, 942 F. Supp. 2d 108, 138 (D.D.C. 2013). ("Thus, [respondent] has successfully established that Integral requested and received advice from [the attorney] after disclosing all relevant information and then relied on that advice in good faith when concluding that there was no need to file various reports with the SEC..."); *SEC v. Steadman*, 296 U.S. App. D.C. 269, 967 F.2d 636, 648 (1992) ("As we noted previously, there has been no suggestion that the appellants did not act in good faith when they ceased state registration and prepared their financial statements in reliance on the advice they received from [their attorney]."); *SEC v. Harwyn Indus. Corp.*, 326

F. Supp. 943, 955 (S.D.N.Y. 1971) ("The first of the facts which we deem relevant is that defendants at all times relied on the advice of counsel.")

As demonstrated herein, Mr. Winkelmann and Blue Ocean will have little difficulty establishing their good-faith reliance on counsel. The evidence of the specific advice they received – coupled with the evidence showing the totality of the attorney-client relationship – will leave no doubt that (1) Mr. Winkelmann requested his attorney's advice on the specific issue; (2) provided his counsel with all information necessary to render that advice; and (3) that he received and relied on the same.

In light of this reliance, the Division will be unable to show that Mr. Winkelmann acted with scienter – a fatal blow to the claims brought pursuant to Section 10(b) of the Exchange Act, Section 206(1) of the Advisers Act and or Section 17(a)(1) of the Securities Act.

2. No Material Misrepresentations or Omissions with regard to the Ad Factor calculations in the Offering Memoranda

In addition to being unable to prove scienter, the Division will likewise be unable to show that any misrepresentation or omission existed with regard to the ad factors utilized in the offering memoranda. As stated above in Section II.d., the Firm implemented and utilized an ever-evolving database in tracking advertising expenditures versus advertising returns. Having reviewed the Division's calculations – and alleged "correct" factor calculations – it is clear the Division fails to appreciate that calculating advertising efficacy is far more art than science.

a. The calculations contained in the offering documents are neither inaccurate nor misleading because they were correct.

It appears the Division has employed a straight month-over-month calculation in determining its advertising numbers. In other words, the Division simply takes the total revenue the Firm earned in a particular month and divides it by that month's particular expenses. The resultant quotient, the Division argues, is the proper ad factor for that month. This extremely simplistic approach is not necessarily incorrect, but it is a far less detailed and accurate computation compared to those done by Blue Ocean.

To understand why, one must consider the inherent fluidity of advertisements. For example, a company could install an advertisement in January. It could be in play for months without effect and then, suddenly, in July begin attracting clients. If one only compared the January revenues and expenses, he or she would fail to account for the advertisement's later success – thereby understating the advertisement's efficiency.

To avoid this type of inaccuracy, Blue Ocean came up with a system that would allow it to track the efficacy of an advertisement over that advertisement's *lifetime* and credit it for all revenue it brought in, no matter when it was received. To do this, the Firm employed a continuous look-back period when calculating advertising efficiency, both for individual advertisements and for its overall campaign. The database was updated constantly to credit new business to a particular source. Blue Ocean and Mr. Winkelmann made important decisions as to the spending levels, particular advertising venues and timing of the advertisements off of this continuum of information drawn from the system.

When Mr. Winkelmann and Blue Ocean calculated the ad factor for use in the offering memoranda, they did it by accessing and reviewing that database. The most current information, reflected therein, would be used to give investors an idea of the Firm's then-current efficacy rate. Attached hereto as Addenda 1-4 are summaries of how Mr. Winkelmann and Blue Ocean arrived at their final calculations for use in each Offering. As Mr. Winkelmann and Blue Ocean made clear in the offering documents, that rate was subject to change. Nevertheless, the numbers they included were accurate as of the stated dates. Because they were accurate, the advertising calculations were not misleading. As a result, the Division will be unable to prove a "false or misleading" statement with regard to these calculations. Each and every claim based on this alleged misrepresentation should be denied.[8]

3. No Material Misrepresentations or Omissions with Regard to Alleged Conflicts of Interest.[9]

Perhaps the most serious charge in the OIP is the allegation that Respondents failed to disclose purported conflicts that existed between Mr. Winkelmann and investors. To understand the Division's charge – and why it fails – one must understand the structure of the Royalty Units.

a. The only required payment was the monthly percentage of cash receipts.

As described in Section II. C above, the Royalty Unit holders were entitled to a certain percentage of the Firm's monthly cash receipts. All that Mr. Winkelmann and the Firm were obligated (i.e., had a duty) to tender was that promised percentage. There was no obligation for Mr. Winkelmann or the Firm to pay anything above and beyond that amount.

b. There was no date or time period with regard to repayment.

While the Division suggests otherwise, the offering documents are very clear that there is no time period by which Blue Ocean was required to repay investors. To the contrary, under the explicit terms of the offerings, Blue Ocean needed only to make the requisite percentage payments out of cash receipts until the particular investor had received two or three times his initial investment, whether that process took one year or ten. Despite the Division's suggestion to the contrary, Blue Ocean had no obligation to repay investors on any particular timetable.

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[8] Relevant allegations are contained in ¶ 7-11, 17-18, and 26-30 of the OIP.

[9] This includes the purported conflict of interest that the Division's expert notes in his report relating to a loan made to an ATM Company. As this event is not raised in the OIP, Respondents have no obligation to respond here. Nevertheless, Respondents disagree with the Division's expert's description and conclusions regarding the ATM loan.

c. Cash receipts are paid from revenue, not profits.

What sets these offerings apart from others is that investors were entitled to a percentage of the Firm's cash receipts – its revenue – and not from its profits. That means that regardless of the expenses incurred during any particular month, as long as the Firm generates any revenue (regardless of whether that revenue exceeded expenses), the Royalty Unit holders get paid. The remaining amounts, after the royalty payments are made, are used to cover the Firm's expenses, including salaries.[10] The risk that expenses will rise – and dwarf the Firm's revenue – is carried only by Blue Ocean and Mr. Winkelmann. The Royalty Unit holders carry no expense risk at all.

d. Under this structure, there are no conflicts of interest.

With these facts in mind, it is easy to see why the Division will be unable to establish one of the most basic elements of its claims: the existence of a conflict of interest. The Division contends that because Mr. Winkelmann had the discretion to set his salary, he had a potential incentive to increase that amount. That incentive, the Division argues, was in conflict with the interests of the investors because Mr. Winkelmann, instead of paying himself, could have made an *additional* payment to royalty holders above and beyond the minimum percentage owed. This "conflict," the Division reasons, mandated disclosure. The Division errs in its reasoning.

First and foremost, to the extent the Division's "misrepresentation" claims (under Section 17(a) or 10(b)) are based on the purported failure to disclose a conflict of interest, that claim fails as a matter of law. It is true that investment advisers have an obligation to disclose all material conflicts pending between them and their clients. Had Mr. Winkelmann been soliciting new investment advisory clients, his obligation to disclose conflicts would have existed.[11] Here,

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

[11] *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.")

however, Mr. Winkelmann and Blue Ocean were not soliciting new investment advisory clients or making recommendations or giving investment advice – they were offering securities as part of a capital raise. Outside of the investment adviser/client relationship, there does not exist a similar obligation to disclose conflicts of interest.[12] Therefore, when Blue Ocean issued the Offering Memoranda to potential *Royalty Unit* investors (not IA clients), it had no legal obligation to disclose such 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.

Second, putting aside the convoluted nature of the charges, the Division's claims likewise fail for a much more fundamental reason: there was no conflict of interest. As explained above, under the terms of the offerings, the Firm had the *obligation* to pay investors only a certain percentage of its revenue. The Firm has upheld that obligation since the date of each offering. Separate and apart from that, the Firm has the *ability* – but not the obligation – to pay investors more than the required minimum percentage. This provision is, effectively, a pre-payment option, giving the Firm the right to repay investors faster. In any event, the Firm is not – and never has been – obligated to make any payment to investors other than the stated monthly minimum percentage payment from revenues. Because there is no legal duty to make any

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

> <u>Disclosure Obligations as a Fiduciary.</u> 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. This obligation requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them. To satisfy this obligation, you therefore may have to disclose to clients information not specifically required by Part 2 of Form ADV or in more detail than the brochure items might otherwise require. You may disclose this additional information to clients in your brochure or by some other means.

payments above and beyond this amount, there likewise is no conflict of interest with regard to the same.[13]

Third, neither the fact nor the amount of an expense can create a conflict where the investors' only entitlement is the payment of revenue. Regardless of what expenses the Firm incurred (including Mr. Winkelmann's salary), it would have no impact on the investors' receipt of payment since the investors' payments were made based solely on revenue earned – not net profits. Expenses, therefore, were irrelevant and immaterial to investors or potential investors.

Fourth, but perhaps most fundamentally, the Firm's representation that its interests were "aligned" with that of its investors is entirely accurate. The investors' objective is to recoup their initial investment plus whatever multiple was promised under the terms of the particular offering (2-3x principal). The higher Blue Ocean's revenues, the higher the investors' periodic payment. The higher the periodic payment, the faster they are paid out. Thus, from an investor point of view, revenue was the most important metric.

Blue Ocean, likewise, had the same interest in increasing revenues. Blue Ocean used revenue to fund its business operations. The higher the revenue, the higher the likelihood it would be profitable. This joint objective is what Mr. Winkelmann and Blue Ocean referred to in the offering memoranda as "alignment" of interest.

Fifth, and finally, the language which the Division alleges to be misleading was prepared by the Firm's legal counsel, Greensfelder, whom it retained for the specific purpose of advising on and preparing the offering documents. In distributing the offering documents to investors

[13] The Division, through its expert, has essentially admitted to this fact. Its expert refers to the *ability* of the Firm to pay additional amounts (beyond the required revenue payments) as an "expectation." An "expectation" of course, is not an obligation or a legal duty and instead, as Webster defines it, is "a feeling or belief about how successful, good, etc., someone or something will be."

and potential investors, Mr. Winkelmann and Blue Ocean relied upon the advice of its counsel as to the propriety of the disclosures therein.

For each of these reasons, the Division will be unable to carry is burden of proving that the Firm made a material misrepresentation in connection with the purchase or sale of a security, or that it somehow "deceived" or "defrauded" investors. In the absence of such evidence, the charges should be denied in their entirety, and Respondents are entitled to judgment in their favor as a matter of law.

4. No Misleading Statements with Regard to Mr. Binkholder.

The Division also alleges that the Firm failed to disclose in the offering documents that Mr. Binkholder, the Firm's advertising consultant, had entered into a Consent Order with the State of Missouri and was barred as a result. As with the other alleged "misrepresentations," the Division carries the burden of proving that the omitted fact would be material to potential investors.

The OIP makes several insinuations about Mr. Binkholder's role and the relevance of the Missouri order. Insinuations, however, will not suffice at the hearing, where Enforcement must show the existence of a material fact by a preponderance of the evidence. As stated above, Mr. Binkholder was not an investment adviser. He was not investment advisor representative with Blue Ocean. At all times relevant to this dispute, he did not give financial advice or make recommendations to Blue Ocean clients. Instead, Mr. Binkholder had a show on the radio, where he discussed topics relating to tax planning, saving for retirement, and certain "traps" that he believed the public should avoid when it came to retirement planning. This role is explicitly spelled out in the offering memoranda and, were there any ambiguity left as to his role, the actual agreement between Mr. Winkelmann and Mr. Binkholder was attached to the offering memorandum as an exhibit.

The Offering Memorandum set forth very basic facts about who Mr. Binkholder was and what his role was. Those facts focused on the radio show and its expected audience. Mr. Winkelmann did not trumpet Mr. Binkholder's acumen as a financial adviser – which could have potentially given rise to the obligation to also disclose negative facts about that role – like the Consent Order.

The bar from the securities industry, however, has no relevance to Mr. Binkholder's success as an advertising consultant or radio host – the only two roles for which the Firm engaged his services. As a result, while information relating to his advertising proficiency may have been material, his work as a financial adviser was not.

Further, even were the Court to consider the materiality of the Consent Order, the Division will nonetheless be unable to prove the non-disclosure was made with scienter. Instead, the evidence will show that at the time of the offerings, Mr. Winkelmann and Blue Ocean acted in reliance on their attorney's well-reasoned conclusion that the Consent Order was not something that needed to be disclosed. Accordingly, this alleged "omission" cannot give rise to a violation of the securities laws, and the Division's charges based thereon should be denied.

5. No Material or Misleading Statements in the "Additional" Communications with Investors.

Subsequent to issuance of the OIP, the Division was required to, and did, provide Respondents with a list of the purported "additional" misstatements made by Mr. Winkelmann to potential investors. Those statements fall into two categories. First, many of the statements were, at the time they were made, true and accurate. Accordingly, those statements cannot give rise to a violation of the securities laws and the Division's claims, to the extent they are based on those accurate statements, should be dismissed.[14]

[14] Specifically, *see* paragraphs 1-6 of the Division's More Definite Statement.

The second class of alleged "misstatements" relate to Mr. Winkelmann's then-current understanding of where the capital raise stood.[15] Mr. Winkelmann believed the information to be true and accurate at the time. Some of the investors who had indicated they would invest, however, never ended up doing so.[16] Because the Division will be unable to show these statements to be either material or made with scienter, the allegations necessarily fail.

What is more, even were the information contained in these emails found to be an actionable statement, at first blush, the "misleading" nature was corrected when Mr. Winkelmann provided each investor or prospective investor with a copy of the Offering Memorandum that contained the most up-to-date information regarding the status of the respective offering. Accordingly, these alleged "misrepresentations" cannot give rise to a violation of the securities laws, and the Division's charges based thereon should be denied.

B. Mr. Winkelmann and Blue Ocean did NOT violate Rule 206(2) of the Advisers Act or Section 17(a)(2) or (3) of the Securities Act.

The required elements of a claim under 206(2) and 17(a)(2) and (3) are the same as those set forth in Section A above, except that 206(2) and 17(a)(2) do not require a finding of scienter. Instead, the Division must establish, by a preponderance of the evidence that Mr. Winkelmann and Blue Ocean acted negligently.

Each of the purportedly "false or misleading" statements has already been discussed, in detail, in Section III.A., immediately above. With regard to the elements already discussed in that section, except for scienter, Respondents incorporate them herein, by reference. Accordingly, for the reasons already set forth above, the Division will be unable to show that Mr.

[15] *See,* specifically, paragraphs 8-12 of the Division's More Definite Statement.

[16] Paragraph 6 does not fall into either category. That email was a simple typographical error however, which, like the others, was remedied by the delivery of a prospectus.

Winkelmann or Blue Ocean made any misrepresentations of a material fact. Having failed to establish this required element, the Division's claims necessarily fail.

Beyond that, the Division has failed to prove that Mr. Winkelmann or Blue Ocean acted negligently.

1. No Negligence

The alleged violations under Rule 206(2) and (4) of the Advisers Act, Rule 207 of the Advisers Act, and Section 17(a)(2) and (3) of the Securities Act require a showing of negligence, opposed to scienter. *See, e.g., In the Matter of David J. Montanino*, Release No. 773 (Apr. 16, 2015). Negligence is the failure to uphold a legal duty owned another. *Byron G. Borgardt*, 56 S.E.C. 999, 1021 (2003). In the context of an investment advisory relationship, the applicable duty arises out of the fiduciary relationship. *Id.* Respondents, therefore, held a duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" their clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194, 84 S. Ct. 275, 284 (1963).

For the same reasons set forth above, with regard to scienter, Respondents likewise did not act negligently. At all times, Respondents acted in good faith and acted reasonably to avoid misleading their advisory clients and investors. Further, Respondents reasonably believed that the disclosures set forth in the offering documents were proper, given that they retained experienced legal counsel to advise them on – and draft – those documents. Accordingly, because Respondents did not act negligently, the Division's allegations that Respondents violated Rule 206(2) and (4) of the Advisers Act, Rule 207 of the Advisers Act, and Section 17(a)(2) and (3) of the Securities Act fail as a matter of law.

C. Respondents did not Violate Section 207.

The final allegation made by the Division is that Respondents violated Section 207 of the Act, which 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 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.

15 U.S.C.A. § 80b-7. Although the OIP does not specify which "conduct" underlies its Section 207 claim (because the claim only applies to filings with the Commission), Respondents understand it to relate to the Forms ADV filed by Respondents stating that the Firm did not have custody of client assets.

In order to carry its burden on this claim, the Division must show, by a preponderance of the evidence that Mr. Winkelmann and Blue Ocean "willfully" omitted material facts when they caused the Forms ADV to be filed. Failure to establish "willfulness" is fatal to a § 207 claim. The fact that the Firm had custody of client assets after May 2012 does not inexorably lead to the conclusion that the Firm "willfully" violated Section 207. Instead, as with any of the charges, the Division carries the burden of proving this required element of its claim.

The Division will be unable to sustain this burden. The evidence will show that Mr. Winkelmann, at the time he submitted each ADV, honestly believed that the information contained therein was truthful and accurate.

What is more, the evidence will show that his attorneys believed the same after a careful review and revision of the document. Greensfelder was hired to draft *both* the offering documents and the Firm's Form ADV. Knowledgeable of all relevant facts, Greensfelder consistently advised Mr. Winkelmann that the ADV's language disclosing that the Firm did *not* have custody was accurate. To be sure, even after the SEC examination team expressed its opinion that the funds were, in fact, technically within the definition of "custody," Greensfelder steadfastly continued to hold firm to its interpretation, and advised Mr. Winkelmann to do the same. For example, Mr. Winkelmann asked his attorneys:

> 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.

RX-106, 2409-2410.

This evidence of Mr. Winkelmann's mindset in filing the Forms ADV shows that his conduct with regard to the custody disclosure was not "willful." Indeed, his situation is very 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, have custody of client assets, the Court nonetheless held that it did *not* violate Rule 207 when it filed an ADV failing to disclose the same:

> The third item the Commission suggests Defendants were required to disclose on their filings was their utilization of commingled bank accounts in their firm trades. Plaintiff argues that SG&C's disclosure elsewhere on the Form that it was engaging in short-term trading for the firm's benefit was inadequate, because it failed to reveal the fact that SG&C routed funds for both these firm trades and client trades through the same accounts. However, in so arguing, the Commission fails to establish that Defendants willfully or intentionally omitted the commingled account structure from their filings.
>
> The language in the ADV Form that the SEC argues compelled this disclosure referred not to bank accounts or to the process by which SG & C facilitated firm trades, but rather asked Defendants

> to disclose the procedures the firm employed to address conflicts of interest created by engaging in firm trading and client trading simultaneously. 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. Indeed, Gordon testified that he believed SG & C's account structure was based on the Gardner and Preston Moss No-Action Letter issued by the SEC in 1982. ... Gordon's testimony on these issues was unrebutted by the Commission, and the Court finds Gordon's reliance on these external evaluations reasonable.
>
> 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. Whether Gordon acted with the requisite mental state for his actions to constitute a violation of the Advisers Act is a question of fact. [] Here, the Court does not find that Gordon intentionally or willfully omitted material facts from his SEC filings. As willfulness is an element of a Section 207 violation... the Court concludes that the Commission failed to meet its burden on this claim, and rules in favor of the Defendants[.]

Id. at 181-82 (internal citations omitted).

Here, as in *Slocum*, even though the Firm may have had technical custody of client assets for a brief period of time, the Division will be unable to show that Respondents acted willfully in failing to disclose that fact. Here as in *Slocum*, Mr. Winkelmann "believed [the Firm's] account structure was in compliance with the SEC [rules] at the time." *Id.* Here, as in *Slocum,* Mr. Winkelmann's belief is supported by extraneous evidence – his attorneys' repeated recitation of their conclusion that the Firm did *not,* in fact, have custody. Here, as in *Slocum,* the Firm should find Mr. Winkelmann's reliance on "these external evaluations" reasonable.

Under such circumstances, the Division will be unable to meet its burden and establish Respondents acted "willfully." For these reasons, the § 207 claim should be dismissed.

IV. <u>SANCTIONS ARE NOT WARRANTED</u>

A. <u>Because the Division has Failed to Prove a Violation, Sanctions are not Warranted.</u>

The Division will be unable 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. As a result, Respondents therefore request that each of those allegations be dismissed in their entirety and that no sanctions be assessed.

B. <u>Even if There is a Violation, No Sanction is Warranted.</u>

That being said, in the remote circumstance that some unintentional violation is found to have occurred, Respondents feel compelled to set forth the following argument against the imposition of sanctions. The appropriateness of any sanction is guided by the public interest factors set forth in *Steadman.*

> (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.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds,* 450 U.S. 92 (1981) ("Steadman factors"). Other factors that have been considered include:

> (7) the age of the violation (*Marshall Melton,* 56 S.E.C. 695, 698 (2003));
>
> (8) the degree of harm to investors and the marketplace resulting from the violation (*Id.);*
>
> (9) the extent to which the sanction will have a deterrent effect (*Schield Mgmt. Co.,* Exchange Act Release No 53201 (Jan 31, 2006), 87 SEC Docket 848, 862);
>
> (10) whether there is a reasonable likelihood of violations in the future (*KPMG,* 54 S.E.C. 1135, 1191 (2001)).

The Court should weigh these factors in light of the entire record. No one factor is dispositive. *Id.*

Here, assuming a violation exists, the *Steadman* Factors mitigate against the imposition of sanctions. As stated above, there is no indication that Respondents acted with scienter, or with any evil intent whatsoever. To the contrary, at all times they strove to comply with the applicable rules and requirements. To do so, they employed extremely experienced and competent legal counsel and relied upon them to advise as to the propriety of the offering documents and their Form ADV filings – actions indicative of persons acting in good faith.

Moreover, in this case, there is no customer harm. To the contrary, Royalty Unit holders continue to receive their regular payment of the Firm's cash receipts – and will continue to receive it until they are fully repaid, as promised.

Finally, were the Court to contemplate civil penalties (which, again, it should not), the Division will be 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. (15 U.S.C. §78u-2(c)). 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. Neither occurred here, and those penalties are unwarranted.

C. <u>In the case of the Custody Charge, No Cease and Deist is Warranted and the Sanction should be as Minor as Permitted under the Circumstances.</u>

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. In May 2012, the Firm determined that monthly payments required a lot of work for a small check. After consulting with Greensfelder, the Firm decided to change to a quarterly payment schedule. Greensfelder assured Mr. Winkelmann that the change was proper so long as he informed the investors it would occur. Mr. Winkelman so informed them.

Despite Greensfelder's review of the change, its advice that the change was proper, and Mr. Winkelmann and the Firm's ongoing good faith reliance on its counsel's determination, the Firm has since accepted the SEC's conclusion that it 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 Firm and its legal counsel were presented with a unique business structure whereby potential client funds arose out of the revenues of the advisory firm. That is, the clients never tendered anything to the Firm – nor did the Firm take possession from third party. Instead, its own revenue was converted, at month end, into funds intended for clients.

Indeed, this issue 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. Mr. Winkelmann and Blue Ocean, in turn, relied on that belief at all times relevant.

In light of these facts, this Honorable Court should impose a remedy similar to that rendered in a similar 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.
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> ***
>
> 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 assigning the appropriate amount of a civil penalty under Section 209(e), the Court has discretion to arrive at a figure within the proscribed limitations "in light of the facts and circumstances" presented. Here, the Court has determined that [Defendants] violated Sections 206(2) and 206(4) of the Advisers' Act, and Rule 206(4) -2(a)(2) promulgated thereunder. ...Pursuant to the Act, civil penalties are to be assigned per violation.
>
> In light of the evidence presented, the Court imposes a civil penalty of $ 1,000 against [Defendants] for each respective violation. Although one course of conduct resulted in Defendants' violation of both Section 206(4) and Rule 206(4) -2(a)(2), this writer considers each provision violated, and imposes separate civil penalties. Thus, in light of the three independent violations by

> [Defendants], the Court imposes a $3,000 civil penalty on the firm for its infractions. 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 Court 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 Court should consider the conduct at issue to be a single actor omission.

D. <u>Cease and Desist Orders are Unnecessary.</u>

No cease and desist order is appropriate in this case. First, the evidence will show that Mr. Winkelmann and Blue Ocean, at all times relevant, acted in good faith and with the objective of compliance. Further, there is no likelihood that the issues raised in the OIP will manifest themselves again. The offerings are closed and, with regard to the custody issue, it has been remedied and the Firm, deferring to the SEC's interpretation, has implemented the required changes to comply with the custody rule.

In light of these facts, a cease and desist order is entirely unnecessary, and the Division's request should be denied.

E. <u>Disgorgement is not Warranted.</u>

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

Moreover, even were some technical violation found, disgorgement in this case would not serve any deterrent value. Mr. Winkelmann and Blue Ocean did everything right in this case: (1) they hired experienced legal counsel advise and assist in the drafting and preparation of the offering documents at issue; (2) they hired experienced legal counsel advise and assist in the drafting and preparation of the Form ADV; (3) they objectively believed that the information contained in those documents was entirely truthful and accurate and that it complied with the applicable securities laws; and (4) most importantly, Mr. Winkelmann and Blue Ocean strove to advance the interests of its investors and maximize revenue. 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.

Finally, the investors purchased their Royalty Units because they offered the chance to recoup their principal plus a multiple thereof. Ordering disgorgement, and unwinding this investment, would deprive investors of their bargained for benefit, and for the first time during the relevant time period, pose a threat to the safety of their investment.

Accordingly, any request for disgorgement should be denied.

V. CONCLUSION

For the reasons stated herein, Respondents respectfully request that the allegations against them be dismissed in their entirety. In the alternative, if some violation is found to have occurred, Respondents respectfully request that, in light of the absence of any aggravating factors and in light of the evidence of their good faith attempt to comply, no sanction be assessed against them for the conduct at issue in this dispute.

Dated: September 21, 2016

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CERTIFICATE OF COMPLIANCE

In accordance with Rule 450(d) of the Rules of Practice, I certify that this brief, exclusive of the cover page, table of contents, table of authorities, and signature block is in compliance with the 14,000-word limit. The brief contains 12,487 words, according to the word processing system used to prepare the brief.

Heidi VonderHeide

CERTIFICATE OF SERVICE

I hereby certify that on September 21, 2016, I served a copy of the foregoing **RESPONDENTS' PRE-HEARING BRIEF**, as follows:

Original and three copies to: Via facsimile transmission and overnight mail delivery	Brent J. Fields, Secretary Office of the Secretary Securities and Exchange Commission 100 F. Street, N.E. Washington, D.C. 20549 Fax: (202) 772-9324
One copy to: Via e-mail, facsimile transmission and overnight mail delivery	David F. Benson Benjamin J. Hanauer Division of Enforcement U.S. Securities and Exchange Commission 175 W. Jackson Blvd., St. 900 Chicago, IL 60604 Fax: (312) 353-7398 bensond@sec.gov hanauerb@sec.gov
One copy: Via e-mail and overnight mail delivery	Hon. Jason S. Patil Administrative Law Judge Securities and Exchange Commission 100 F Street, N.E. Washington, D.C. 20549-2557 ALJ@sec.gov

Heidi VonderHeide

ADDENDUM 1

Round 1 Offering: March 31, 2011

8:58 AM
02/09/15
Accrual Basis

Blue Ocean Portfolios, LLC
Transaction Detail By Account
January through December 2010

Type	Date	Num	Name
Advertising			
Advertising-Other			
Check			
Check			
Check			
Check			
Check			
Check			
Bill			
Bill			
Bill			
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8:58 AM
02/09/15
Accrual Basis

Blue Ocean Portfolios, LLC
Transaction Detail By Account
January through December 2010

	Memo	Class	Clr	Split	Amount
Advertising					
Advertising-Other					
	90 days Past Due Balance			US Bank Checking	1,0
	Past Due Balance			US Bank Checking	1,6
	Past Due Balance			US Bank Checking	2,6
	Updates to FCS.com			US Bank Checking	
	Past Due Balance			US Bank Checking	1,0
	50 FC booklets			US Bank Checking	
	Access US Marketing			Accounts Payable	
	Sears - Head Shot			Accounts Payable	
	Amazon			Accounts Payable	
	Amazon			Accounts Payable	
	KMOX Radio			Accounts Payable	4,3
	Requesting info - Wexford & James			US Bank Checking	
	Web CE Direct Marketing			US Bank Checking	48.95
	September Live Reads 9 @ $60			Accounts Payable	720.00
	radio show			US Bank Checking	2,600.00
				Accounts Payable	800.00
	October			Accounts Payable	1,000.00
	Dell Marketing			Accounts Payable	239.00
	Amazon			Accounts Payable	79.00
	Cadmus Article Works			Accounts Payable	45.00
	KMOX Radio			Accounts Payable	4,745.00
				US Bank Checking	19.00
	November			Accounts Payable	800.00
	November Live Reads (12 @$60)			Accounts Payable	720.00
				US Bank Checking	19.00
	KMOX			Accounts Payable	5,100.00
	December Brennan			Accounts Payable	4,015.00
Total Advertising-Other					32,092.41
Total Advertising					32,092.41
TOTAL					**32,092.41**

June—Dec 2010 Advertising Total = 32,092.41

2011 Jan and Feb Ad Total = $13,078

Advertising Expense Totals January	
dvertising - Other	$19.00
rennan	$840.00
acebook	
FTK	
IHT	
IHT-Radio Show	$1,800.00
LOU	
MOX	$365.00
SGF - Springfield	
TRS	
rospecting Fees	
TL Post Dispatch	
/XOS (101ESPN)	
otal	$3,024.00

Advertising Expense Totals February	
Advertising - Other	$3,254.00
Brennan	$60.00
Facebook	
KFTK	
KIHT	
KIHT-Radio Show	$2,000.00
KLOU	
KMOX	$4,740.00
KSGF - Springfield	
KTRS	
Prospecting Fees	
STL Post Dispatch	
WXOS (101ESPN)	
Total	$10,054.00

Blue Ocean Portfolios, LLC
Account QuickReport
March 2011

	Type	Date	Num	Name	Memo	Split	
Advertising							
Advertising-Other							
	Check	03/07/2011	EFT	AWeber Communications	Monthly Advertising	US Bank Ch	
	Credit Card Charge	03/24/2011		Constant Contact	Monthly CC	AMEX	
	Bill	03/30/2011	March	Drew Johnson	Production Fees:Lie Cheat Steal, Fin coach show S	Accounts Pa	
Total Advertising-Other							
Brennan							
	Bill	03/30/2011	March Reads	Charles Brennan	Mar Live Reads (9@$62.50)	Accounts Payable	56
Total Brennan							56
KIHT - Radio Show							
	Bill	03/31/2011	CC-A-	Emmis St. Louis	4 Spots (4 @ $600)	Accounts Payable	2
Total KIHT - Radio Show							2
KMOX							
	Credit Card Charge	03/04/2011		CBS Radio - KMOX	Mar Spots	AMEX	2,140.00
	Credit Card Charge	03/25/2011		CBS Radio - KMOX	Apr Spots	AMEX	4,380.00
Total KMOX							6,520.00

Early March Ad spend = $2,159

Total Advertising Spend Total June—early March: **$47,329.41**

Monthly Average (June—early March): **$5,258**

Average rounded up:

$$\frac{\$5{,}500}{\$25{,}500} = .22$$

OFFERING MEMORANDUM ROUND 1

RX-001, p. 9

ADDENDUM 2

Round 2 Offering: March 2012

February 2012 Month End 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	149.54 ~~#VALUE!~~	$987	$22,000	0.67
March 2012				
2012 Total				

Ad Factor decreases throughout March; Round 2 issued before March 2012 month – end totals are calculated. Firm uses real-time mid-March ad factor of .62 n the Offering Memoranda. By March 2012 month– end, ad factor has dropped to .35.

Years	Cost per Lead	Cost per Client	Estimated First Year Revenues 2012	Factor
November 2011	$143.45	$1,060	$16,850.00	1.45
December 2011	$178.13	$1,049	$18,425.00	1.02
January 2012	$138.09	$1,105	$34,855.00	0.60
February 2012	$195.62	$752	$22,960.00	0.85
March 2012	$253.04	$3,079	$53,540.00	0.35

The key business driver for Blue Ocean Portfolios is the client acquisition cost. 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 0.62. Advertising spend in other markets could be higher or lower.

ADDENDUM 3

Round 3 Offering: September 2012

Data as of July 2012:

		Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12
	Advertising Cost	$ 24,386	$ 18,881	$ 20,989	$ 19,562	$ 19,028	$ 32,966	$ 16,333	$ 7,689	$ 12,728
From THIS Month's Leads	# Leads	170	106	152	100	74	91	73	38	102
	# Appts Set from Month's Leads	26	21	22	28	14	9	7	9	12
	# Clients from Month's Leads	13	6	11	18	7	6	5	3	6
	% of Appts Set	15.3%	19.8%	14.5%	28.0%	18.9%	9.9%	9.6%	23.7%	11.8%
	% of Clients Set	7.6%	5.7%	7.2%	18.0%	9.5%	6.6%	6.8%	7.9%	5.9%
	New AUM from Month's Leads	$ 3,211,000	$ 895,000	$ 6,328,000	$ 4,452,000	$ 1,068,000	$ 1,551,000	$ 1,753,000	$ 740,000	$ 1,021,000
From ANY Month's Leads	# of Appts Came in During Month	27	28	31	29	34	16	17	13	15
	# of Appts Closed	12	13	14	16	18	8	4	7	6
	Closing %	44.4%	46.4%	45.2%	55.2%	52.9%	50.0%	23.5%	53.8%	40.0%
	# of Clients Signed During Month	11	9	24	13	19	14	10	8	7
	New AUM from Clients Signed in Month	$ 1,685,000	$ 1,842,500	$ 3,485,500	$ 2,296,000	$ 5,354,000	$ 6,604,000	$ 3,058,000	$ 1,730,000	$ 551,000
	Cost per Lead	$ 143.45	$ 178.13	$ 138.09	$ 195.62	$ 257.14	$ 362.26	$ 223.74	$ 202.34	$ 124.78
	Cost per Client	$ 1,876	$ 3,147	$ 1,908	$ 1,087	$ 2,718	$ 5,494	$ 3,267	$ 2,563	$ 2,121
	Estimated First Year Revenues	$ 12,975	$ 14,187	$ 26,838	$ 17,679	$ 41,226	$ 50,851	$ 23,547	$ 13,321	$ 4,243
	Factor	1.88	1.33	0.78	1.11	0.46	0.65	0.69	0.58	3.00

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Trailing 6-Month Factor				
Average Factor	0.71		Cummulative Cost per Lead	$ 190.47
Geometric Mean Factor	0.69		Cummulative Cost per Client	$ 2,300.84
(Jan-June)				

Revenue per client

Trailing 6-Month Factor

Average Factor 0.71

Geometric Mean Factor 0.69

(Jan-June)

Firm used real-time 6-month trailing factor in preparing September 2012 Memorandum, which had declined by .04 points since July, from .71 to .67.

The key business driver for Blue Ocean Portfolios is the client acquisition cost. 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 $2.8 million in new assets that are generating $31,000 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising – a 67/100 ratio or an "advertising conversion factor" of 0.67. Advertising spend in other markets could be higher or lower. This conversion factor experience will be different in the Chicago market.

ADDENDUM 4

Round 4 Offering: February 2013

Data as of Dec. 2012

Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12
$ 8,022	$ 16,443	$ 17,659	$ 24,083	$ 29,565	$ 15,770	$ 5,587
38	102	90	74	98	63	13
9	17	13	9	11	17	2
5	9	5	3	7	7	0
23.7%	16.7%	14.4%	12.2%	11.2%	27.0%	15.4%
13.2%	8.8%	5.6%	4.1%	7.1%	11.1%	0.0%
$ 968,000	$ 1,846,000	$ 890,000	$ 371,000	$ 2,181,000	$ 910,000	$ -
$ 7,550	$ 14,399	$ 6,942	$ 2,894	$ 17,012	$ 7,098	$ -
1.06	1.14	2.54	8.32	1.74	2.22	#DIV/0!
13	15	18	12	16	19	9
8	7	10	2	7	9	1
61.5%	46.7%	55.6%	16.7%	43.8%	47.4%	11.1%
[illegible]	[illegible]	[illegible]	5	5	10	2
[illegible]	[illegible]	[illegible]	$ 1,188,000	$ 2,695,000	$ 1,351,000	$ 196,000
[illegible]	[illegible]	[illegible]	$ 9,266	$ 21,021	$ 10,538	$ 1,529
[illegible]	[illegible]	[illegible]	2.60	1.41	1.50	3.65
$1,677,033	$2,888,4[illegible]	$3,156,709	$2,020,556	$3,318,764	$1,001,470	$911,499
$ 13,081	$ 22,530	$ 24,622	$ 15,760	$ 25,886	$ 7,811	$ 7,110
0.61	0.73	0.72	1.53	1.14	2.02	0.79
$ 211.10	$ 161.21	$ 196.21	$ 325.45	$ 301.68	$ 250.32	$ 429.73
$ 1,604	$ 1,827	$ 3,532	$ 8,028	$ 4,224	$ 2,253	#DIV/0!

Dec. 2012 trailing factor = .89

(Advertising Cost/Estimated Revenue)	Trailing 6mo.	Trailing 9mo.	Trailing 12mo.
Trailing Factor	2.00	2.0[illegible]	
Trailing Factor	1.22	0.91	
Trailing Factor	1.02	0.85	0.89

The key business driver for Blue Ocean Portfolios is the client acquisition cost. Currently, Blue Ocean Portfolios is spending approximately $10,000 per month on advertising which generates leads for the sales staff to follow up on. This $10,000 advertising spend is converting to approximately $2.8 million in new assets that are generating $31,000 in new annual recurring revenue. So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising – an 89/100 ratio or an "advertising conversion factor" of 0.89. Advertising spend in other markets could be higher or lower. This conversion factor experience will be different in the Chicago market.

RX-004; RX-120