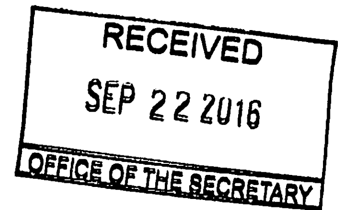
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-17253

In the Matter of

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

Respondents.

THE DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

Benjamin J. Hanauer
David F. Benson
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 900
Chicago, IL 60604
Phone: 312-353-8642
Fax: 312-353-7398

Counsel for the Division of Enforcement

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I. INTRODUCTION

Respondent James Winkelmann was an experienced investment adviser who understood that he owed strict fiduciary duties to his advisory clients. Winkelmann knew he had to be honest with his clients, to always act in his clients' best interests, and to disclose to his clients all material facts and any potential or actual conflicts of interests. Nevertheless, Winkelmann repeatedly made false and misleading statements and omissions, and breached his fiduciary duties, in the course of selling his clients securities issued by his investment advisory firm, Respondent Blue Ocean Portfolios, LLC ("BOP").

In early 2011, BOP was losing money, financially insolvent, and short on cash. To make matters worse, Winkelmann's partner and BOP's co-owner, Bryan Binkholder, was under investigation by Missouri securities regulators and would soon be barred from acting as an investment adviser. Needing money to keep BOP afloat and unable to obtain a loan, Winkelmann decided to raise capital, primarily from his advisory clients, by selling BOP-issued securities called "Royalty Units." Each Royalty Unit, which BOP sold in $25,000 increments, entitled investors to a percentage of BOP's future revenues until the investors had been paid back between 2.25 and 3.0 times their initial investment. Winkelmann propped up BOP by raising $1.4 million from 24 investors – 18 of whom were BOP clients – through four Royalty Unit offerings between April 2011 and February 2013.

Winkelmann authored an offering memorandum for each of the four offerings. These memoranda represented that Royalty Unit investor proceeds would be used to finance an advertising campaign, centered on BOP's sponsorship of Binkholder's radio show, which would expand BOP's client base and attendant revenues. In touting the success of BOP's advertising strategy, the offering memoranda described as the *key driver* to BOP's business a financial metric that calculated how efficiently BOP converted advertising spending to new client revenue.

Winkelmann called this metric the "advertising conversion rate" or "advertising factor," and he closely monitored the rate to gauge the success of BOP's advertising strategy. Beyond paying significant attention himself to BOP's advertising conversion rate, Winkelmann stressed its importance to investors, by regularly telling them that the lower the rate, the faster they would be repaid. Despite the advertising rate's prominence, each of the four offering memoranda materially misstated the rate to make it appear as though BOP was more successful in using advertising dollars to generate new revenue than it really was. These misstatements misled investors into believing that BOP would repay them in an artificially expedited timeframe.

The offering memoranda contained other misrepresentations and omissions beyond the repeatedly misstated advertising rate. For instance, despite touting BOP's successful sponsorship of Binkholder's radio show, the second and third memoranda failed to disclose that by the time of those offerings, Binkholder had received a lifetime adviser bar by Missouri regulators. It was only after Binkholder became the subject of a criminal grand jury investigation at the end of 2012 that Winkelmann began revealing negative information about Binkholder. And even then, Winkelmann revealed this negative information to only a select few investors and clients.

The offering memoranda additionally failed to disclose that a major conflict of interest existed between Winkelmann and the Royalty Unit investors. Specifically, Winkelmann consistently faced the decision whether to increase payments to the investors or to increase his own compensation. This conflict manifested itself when Winkelmann routinely chose to increase his compensation while keeping payments to investors at levels at, or virtually at, the minimum specified in the offering memoranda. Despite the actual and potential conflicts that existed between Winkelmann and the investors, each of the offering memoranda failed to

disclose *any* conflict of interest. Instead, each memorandum contained false and misleading statements that the interests of Winkelmann and his investors were "aligned."

At hearing, the Division will demonstrate that Winkelmann's and BOP's conduct violated the antifraud provisions of the Securities Act, Exchange Act, and the Advisers Act. The Division also will show that Respondents violated, or caused violations of, the Advisers Act's custody, compliance, and reporting provisions. The Division will then request the Court to appropriately sanction Respondents in the public interest, by issuing cease-and-desist orders and orders of disgorgement, prejudgment interest and civil penalties, and by barring Respondents from the securities industry as a result of their fraud.

II. FACTUAL SUMMARY

At trial, the Division will establish the following facts through testimonial and documentary evidence, most of which is not subject to genuine dispute. The Division will present an OCIE staff accountant who conducted an examination of BOP, analyzed the same advertising data Winkelmann used to calculate the conversion rate, and will testify that Winkelmann regularly misstated the rate to investors. The Division will call Professor Arthur Laby, a leading expert on the fiduciary obligations of investment advisers, who will testify that Winkelmann's conduct significantly departed from industry standards and norms. The Division will additionally present investor victims who will testify that Winkelmann's misstatements and omissions were material, and describe the harm Winkelmann has caused them. And the Division will call Winkelmann himself, whose testimony will demonstrate that he knowingly or recklessly violated the securities laws at issue here.

A. Background on Winkelmann, BOP, and Binkholder

Prior to founding BOP, Winkelmann had a long career in the securities industry. From 1986 to 2008, Winkelmann owned his own brokerage and financial services firm. Given his

long career in the industry, Winkelmann was well aware of the fiduciary obligations he owed to his advisory clients. Indeed, in BOP's compliance policies, offering memoranda, marketing materials, and his communications with clients, Winkelmann routinely emphasized his fiduciary responsibilities, including the duties to disclose and prevent conflicts and to always act in his clients' best interest.

In 2008, Winkelmann learned that Don Weir, his longtime business partner and co-owner of Winkelmann's brokerage firm, was under criminal investigation for misappropriating gold coins and other valuables from clients. After learning this, Winkelmann cut ties with Weir – who was later convicted for mail fraud and sentenced to 78 months in prison – and shuttered his brokerage firm.

In April 2009, Winkelmann heard the "Financial Coach" radio show featuring Binkholder, who was also a Missouri-based investment adviser. Winkelmann approached Binkholder about going into business together and, in October 2009, the two registered BOP as an investment adviser firm. Each owned 50% of BOP. In addition to Binkholder's co-ownership of BOP, BOP sponsored Binkholder's Financial Coach radio show. In early 2010, BOP enrolled its first advisory clients. During the period at issue in these proceedings, Winkelmann was BOP's sole CEO, Chief Compliance Officer, and Manager.

In 2010, Winkelmann learned that Binkholder was the target of an investigation by the Missouri Secretary of State Securities Division. By March 2011, Winkelmann had transferred his ownership interest in BOP to 23 Glen Abbey Partners, LLP ("23 GAP"), a company owned by Winkelmann's wife and children, but managed by Winkelmann. After learning of the Missouri Securities Division investigation, Winkelmann made Binkholder give up his ownership

interest in BOP to 23 GAP, leaving 23 GAP as the 100% owner of BOP. Binkholder also ceased being a BOP employee and adviser representative.

While Winkelmann chose to remove Binkholder as an owner and employee, Winkelmann did not sever his ties to Binkholder. Rather, they continued to share office space and work together. In February 2011, Winkelmann had BOP enter into a "Solicitor's Agreement" with Binkholder, pursuant to which Binkholder agreed to solicit potential clients for BOP. Winkelmann also had BOP enter into an "Exclusive Marketing and Sponsorship Agreement" with Binkholder. Per that agreement, BOP agreed to continue sponsoring Binkholder's radio show, and pay Binkholder monthly compensation of at least the same amount as BOP paid Winkelmann. In return, Binkholder agreed to exclusively promote BOP on his radio show, and generate potential client leads for BOP. Binkholder proved to be a successful spokesman for BOP, generating 70 to 100 prospective client leads per week.

In December 2011, after completing its investigation, the Missouri Securities Division issued a consent order barring Binkholder from acting an investment adviser. The order included findings that Binkholder sold promissory notes in entities he owned (not BOP) to his advisory clients. The order further found that Binkholder failed to disclose to his clients the potential conflict of interest that existed by virtue of Binkholder selling clients notes in his own companies. Nevertheless, BOP continued to sponsor Binkholder's radio show and utilize Binkholder to recruit new clients for BOP.

In November 2012, Winkelmann learned that a BOP client had received a grand jury subpoena relating to Binkholder. Winkelmann contacted Binkholder, who confirmed he was under criminal investigation for matters unrelated to BOP. Only then did Winkelmann suspend Binkholder's relationship with BOP. In August 2014, Binkholder was indicted for defrauding

clients in a hard-money lending scheme. Binkholder later pled guilty, and was sentenced to 108 months imprisonment.

B. The BOP Royalty Unit Offerings

In 2010, the first year it collected advisory fees, BOP grew its assets under management such that by year's end, BOP had generated over $120,000 in advisory fee revenue. However, this was not enough to cover BOP's expenses, and BOP ended 2010 with a net loss of more than $36,500 and less than $200 in its bank account. In its first year of operation, BOP spent more than a third of its advisory fee revenues on advertising, in an attempt to grow its client base.

Facing these financial difficulties, in early 2011 Winkelmann devised the idea to raise capital by soliciting investments in BOP-issued securities. Winkelmann needed money to finance a BOP advertising campaign that would aim to bring in more advisory clients and increase BOP's assets under management and attendant revenue. Winkelmann had previously tried to borrow money to finance BOP's advertising campaign and expansion, but no bank would loan BOP money.

To generate the needed capital, Winkelmann decided that BOP would raise money by selling "Royalty Units," and targeted his advisory clients as investors. Each Royalty Unit was offered in $25,000 increments, and granted the purchaser a percentage of BOP's future cash receipts until BOP repaid the investor a fixed amount ranging from 2.25 to 3.0 times the original investment amount.[1] Per the offering materials, investors were entitled to a minimum percentage of BOP's monthly gross revenues, including its client management fees and other revenues, until they received the promised payback amount. For instance, for the first two offerings, BOP

[1] For the first Royalty Unit offering, investors were promised a payout of 3 times their original investment, but for subsequent offerings, Winkelmann chose to lower the payout amount. For the first offering, but not subsequent ones, Royalty Unit investors additionally received a warrant providing an option to purchase 1% of BOP for $100,000.

promised to pay each Royalty Unit holder a minimum of 0.25% of BOP's monthly cash receipts until they received the specified amount ($75,000 per unit for the first offering, $62,500 per unit for the second offering).[2]

However, the offering materials represented that BOP could pay more than the monthly minimum and that paying more than the minimum was BOP's goal. The memoranda also contained tables showing a range of monthly payout percentages above the minimum amounts, and how those percentages impacted how quickly investors would be repaid. Those tables indicated that the higher the monthly payout percentage, the faster investors would be paid the promised returns.

In April 2011, Winkelmann commenced the first Royalty Unit offering. By February 2013, BOP had conducted four offerings, using a separate memorandum for each offering. In the course of those offerings, BOP raised $1.4 million from 24 investors.[3] Of those 24 investors, 18 were BOP advisory clients. Winkelmann personally solicited most of the Royalty Unit investors, including his clients, and discussed the Royalty Units with the investors before they invested.

C. Winkelmann's False Statements and Omissions in the Offering Memoranda

For each of the four offerings, Winkelmann authored, controlled the content of, and circulated the Royalty Unit offering memoranda to his clients and other potential investors. Each

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[2] For the third offering BOP promised investors 0.10% of BOP's cash receipts until they had been paid 2.25 times the amount of the original investment. For the fourth offering, BOP promised to pay 0.05% of BOP's cash receipts until the investors received 2.5 times the original investment amount.

[3] In the first offering, Winkelmann raised $650,000 from 14 investors. The second offering raised $350,000 from 10 investors, the third offering raised $275,000 from four investors, and the fourth offering raised $125,000 from two investors. Certain investors purchased multiple Royalty Units and/or participated in multiple offerings.

memorandum represented that a primary use of investor proceeds would be to increase BOP's advertising budget and expand its advertising reach.

1. Winkelmann Consistently Misrepresented BOP's Advertising Conversion Rate

Each memorandum described as the "key driver" to BOP's business model a metric referred to as the "advertising conversion rate" or "advertising factor." Winkelmann calculated the rate by dividing (a) BOP's advertising expenses in a given period by (b) the new annually recurring revenue (typically in the form of new advisory client management fees) BOP generated during the same period. Winkelmann considered the conversion rate to be a very important metric and paid it close attention. Winkelmann tracked and reviewed the rate on a regular basis. He also scrutinized and had unfettered access to the financial data BOP used to calculate the rate.

Consistent with Winkelmann's beliefs of the conversion rate's importance, the offering memoranda represented that a lower rate indicated a more efficient use of advertising expenses, that BOP's goal was to achieve the lowest rate possible, and that a lower rate meant faster returns for investors. The first offering memorandum represented that the "key business driver" of BOP "will be the ability of management to persistently convert advertising spending to new clients and new recurring revenues at a ratio of less than 4 [to] 10."

The first offering memorandum, dated March 31, 2011, represented that BOP was currently spending $5,500 per month on advertising, resulting in $25,000 in new annually recurring revenue. The memorandum added: "if this trend continues, each $10,000 in new recurring revenue will cost [BOP] $2,200 in advertising – a 22/100 ratio." These representations were false. In reality, using Winkelmann's own methodology, BOP's conversion rate for March 2011 was 0.37, its conversion rate for January through March 2011 was 0.44, and

its conversion rate for January 2010 through March 2011 was 0.37.[4] Accordingly, the first memorandum misstated the rate by at least 67%.

The misrepresentations about the advertising conversion rate continued into the second offering memorandum, which Winkelmann began circulating in March 2012. That memorandum represented that BOP's advertising conversion rate, which "measures how much advertising is needed to create a new dollar in recurring revenues," was 0.78 in 2011. The second memorandum further represented: "So far, in 2012 this factor has dropped to 0.62." These statements were false. In reality, BOP's conversion rate for 2011, using Winkelmann's own methodology, was 1.28, not 0.78 (a misstatement of a least 64%). Similarly, BOP's rate for February 2012, the last full month preceding the offering memorandum, was 0.90, not 0.62 (a misstatement of at least 46%).[5]

The third offering memorandum, dated September 1, 2012, contained the same misrepresentation about BOP's 2011 advertising conversion rate being 0.78. The memorandum continued: "each $10,000 in new recurring revenue is currently costing [BOP] $6,700 in advertising – a 67/100 ratio or an 'advertising conversion factor' of 0.67." This too was false. Using Winkelmann's methodology, BOP's advertising conversion rate was 1.02 for August 2012 (the first full month preceding the third memorandum), 0.77 for June through August 2012, and 0.90 for August 2011 through August 2012.

[4] For whatever reason, Winkelmann consistently chose to exclude the radio show sponsorship payments to Binkholder from the numerator component (advertising spending) of the calculation, and the "actual" conversion rates cited herein likewise exclude the Binkholder payments. Had Winkelmann included such payments, BOP's conversion rates would have been even higher.

[5] In the second memorandum, Respondents represented that "the key business driver" was BOP's ability to sustain an advertising conversion rate of less than 0.80.

The fourth offering memorandum, dated February 15, 2013, also falsely represented that BOP's advertising conversion rate for 2011 was 0.78. That memorandum additionally stated that BOP's 2012 advertising conversion rate was 0.89. In reality, BOP's 2012 conversion rate, excluding payments to Binkholder, was 1.02.

2. Winkelmann Omitted Binkholder's Investment Adviser Bar

The first, second, and third offering memorandum each touted BOP's relationship with Binkholder and BOP's sponsorship of Binkholder's radio show. Indeed, in the second and third memorandum, Binkholder's radio show is prominently discussed in a section titled "Advertising, Sales, and Marketing Plan." The memoranda describe how Binkholder's radio show generates leads for BOP, and how BOP follows up on those leads to pursue new advisory clients. The memoranda additionally state that proceeds of the offering will be used, in part, to expand the syndication of Binkholder's radio show into new markets. The memoranda also included as an exhibit BOP's Marketing and Sponsorship Agreement with Binkholder.

Despite the prominence of BOP's sponsorship of Binkholder's radio show and Winkelmann's knowledge of Binkholder's bar, the second and third offering memoranda fail to disclose that Binkholder was barred from acting as an investment adviser by the Missouri Securities Division.[6]

3. Winkelmann Failed to Disclose, and Made Misrepresentations Regarding, His Conflicts of Interest

The offering memoranda also failed to disclose, and made misleading statements about, the conflicts of interest that existed between Winkelmann and investors. For example, the memoranda made no disclosure or explanation of any conflict existing between Winkelmann and

[6] At the time of the first memorandum, Binkholder was under investigation by the Missouri regulators, but had not yet been barred. The fourth memorandum, which was only provided to a few advisory clients, disclosed both the Missouri bar order and that Binkholder was under investigation by the U.S. Attorney.

the Royalty Unit investors. To the contrary, each of the four memoranda state that BOP "creates value for its clients by eliminating conflicts of interest..." Moreover, the first offering memorandum describes the Royalty Unit investment as a "compelling way" for BOP's "investors, owners and employees to align their interest." The first memorandum further stated: "The expansion capital in the form of Royalty Units is a way to fund growth, provide immediate cash flow stream to the Royalty Unit holders, and align all interests for returns at relatively low risk." Further, the second, third, and fourth memoranda described the Royalty Units as "*the* most compelling way" for investors and BOP's owners to align their interest and "*the optimal way* to...*align all interests* for the highest potential return at the least risk." (Emphasis added).

These statements were false and misleading because the interests of Winkelmann and the Royalty Unit investors were not always aligned. As discussed below, Winkelmann routinely faced the decision of whether to increase his own compensation or to increase the payout amount for the Royalty Unit holders. Faced with this decision, Winkelmann chose to pay investors the minimum, or near-minimum, returns, while repeatedly increasing his own compensation. One way Winkelmann did so was to funnel payments from BOP to affiliated entities under Winkelmann's ownership and control. From August 2011 to September 2012 – the same period during which Royalty Unit investors were paid essentially minimal returns – Winkelmann directed more than $87,000 in such payments to his other companies. The offering memoranda make no disclosure of any such payments or potential conflicts of interest.

D. Winkelmann's Additional False Statements

Beyond the misrepresentations and omissions contained in the offering memoranda, Winkelmann made additional false statements about the Royalty Units in direct communications with advisory clients and other prospective investors. These communications included email and letters promoting the Royalty Units in which Winkelmann made false statements about BOP's

advertising conversion rate similar to the ones discussed above. Winkelmann also sent multiple emails to prospective investors, including advisory clients, in which he inflated the amount of Royalty Units that BOP had had sold, thus creating a sense of inflated demand for these securities. On another occasion, Winkelmann emailed a potential investor and misstated, by over 85% percent, the amounts earlier Royalty Unit holders had been repaid.

E. Winkelmann Increased His Own Compensation While Making Minimal Payments to Investors

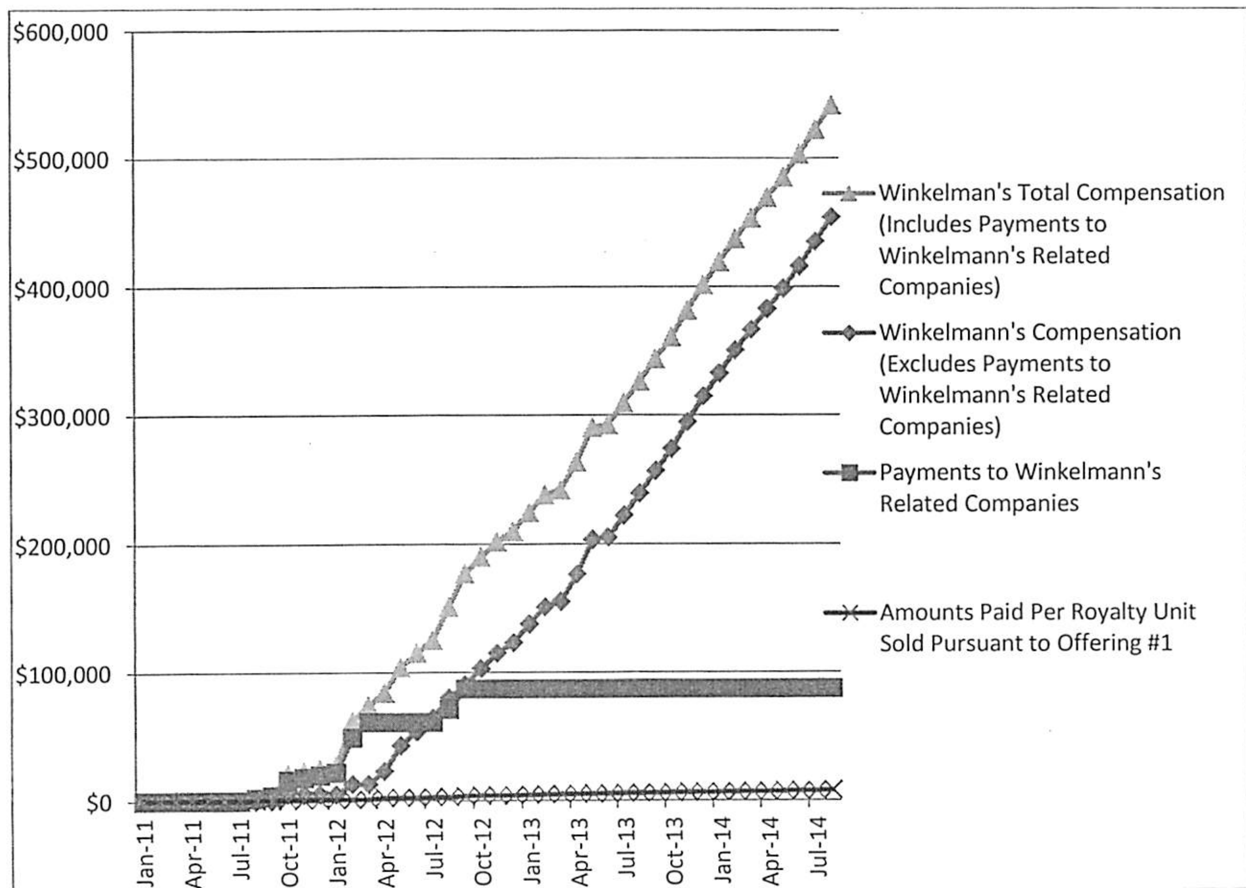
Initially, and continuing through March 2012, BOP paid Royalty Unit investors their share of BOP's cash receipts on a monthly basis. During this period, Winkelmann's practice was to pay the minimum possible returns (0.25% of BOP's cash receipts) every third month, corresponding with the months BOP received the overwhelming majority of its cash receipts: the management fees BOP's clients paid on a quarterly basis. For the intervening two months between the management fee months, when BOP's revenues were much lower, Winkelmann decided to pay Royalty Unit investors 0.75% of BOP's cash receipts. However, because BOP's cash receipts during those intervening two months were minimal, the actual amounts investors received during the 0.75% payout months were small – including multiple months where investors received less than ten dollars.

In March 2012, Winkelmann altered BOP's payout practices, and BOP started paying investors on a quarterly basis. Thus, for the three months prior to each quarterly payout, BOP held in its lone bank account the percentage of BOP's cash receipts due to the Royalty Unit investors. Every third month, BOP would then pay the Royalty Unit investors the amounts that had accrued during the prior three months. From the time this practice started until late 2013, for each quarterly payment Winkelmann paid investors the minimum, or virtually the minimum, possible amounts.

The below table shows the payout amounts and dates for a first round investor who purchased a single $25,000 Royalty Unit.

Month	Previous Month BOP Revenue	Monthly Royalty Percentage	Investor Payment Amount	Payment Date
Apr-11	$70,211.71	0.25%	$175.53	06/27/11
May-11	$3,835.72	0.75%	$28.77	06/29/11
Jun-11	$4,108.14	0.75%	$30.81	07/29/11
Jul-11	$85,020.58	0.25%	$212.55	08/26/11
Aug-11	$581.77	0.75%	$4.36	09/22/11
Sep-11	$3,827.90	0.75%	$28.71	10/20/11
Oct-11	$98,341.81	0.25%	$245.85	11/23/11
Nov-11	$1,818.82	0.75%	$13.64	12/20/11
Dec-11	$1,613.93	0.75%	$12.10	01/20/12
Jan-12	$110,967.90	0.25%	$277.42	02/22/12
Feb-12	$493.29	0.75%	$3.70	05/12
Mar-12	$1,252.97	0.75%	$9.40	05/12
Apr-12	$493,615.38	0.25%	$1,234.04	05/25/12
May-12	$755.41	0.75%	$5.67	08/12
Jun-12	$1,105.82	0.75%	$8.29	08/12
Jul-12	$152,455.21	0.25%	$381.14	08/25/12
Aug-12	$1,240.22	0.25%	$3.10	11/12
Sep-12	$250,000.00	0.25%	$625.00	11/12
Oct-12	$191,383.07	0.25%	$478.46	11/12
Nov-12	$125.34	0.75%	$0.94	02/13
Dec-12	$409.01	0.25%	$1.02	02/13
Jan-13	$176,023.49	0.25%	$440.06	02/13
Feb-13	$125,000.00	0.25%	$312.50	05/13
Mar-13	$739.40	0.25%	$1.85	05/13
Apr-13	$183,179.32	0.25%	$457.95	05/13
May-13	$191.88	0.25%	$0.48	08/13
Jun-13	$231.29	0.25%	$0.58	08/13
Jul-13	$187,399.39	0.25%	$468.50	08/13

During the period April 2011 to late 2013 – the time period in which Winkelmann chose to pay Royalty Unit holders the minimum, or close to the minimum, possible returns, Winkelmann repeatedly chose to increase his own compensation. As seen below, the rate at which Winkelmann increased his own compensation compared to the investor payouts was considerable.



Winkelmann never disclosed that he would repeatedly decide (or repeatedly had decided) to pay himself at the expense of the Royalty Unit investors. Nor did he ever disclose the conflict of interest that this discretionary payment arrangement created.

III. LEGAL ANALYSIS

The Division will establish, by a preponderance of the evidence, that Respondents violated, and that Winkelmann caused violations of, the federal securities laws as alleged in the OIP. *See Mohammed Riad*, Exchange Act. Rel. 78049A, 2016 SEC LEXIS 2396, *6 (July 7, 2016).

A respondent causes a violation when: (1) a primary violation occurred, (2) respondent's act or omission was a cause of the violation, and (3) respondent knew, or should have known, that his conduct would contribute to the violation. *Robert M. Fuller*, 56 S.E.C. 976, 984 (Aug. 25, 2003). Negligence is sufficient to establish causing liability if scienter is not an element of the primary violation. *See KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1175-76 (Jan. 19, 2001).

A. Violations of the Securities Act's and Exchange Act's Antifraud Provisions

Exchange Act Section 10(b) and Rule 10b-5 prohibit in connection with the purchase or sale of securities: (1) employing any device, scheme or artifice to defraud; (2) making material misstatements of fact or statements that omit material facts; or (3) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit. Securities Act Section 17(a) contains similar prohibitions in the "offer or sale of any securities." *See, e.g., Bernerd E. Young,* Exchange Act Rel. No. 774421, 2016 SEC LEXIS 1123, **63-65 (Mar. 24, 2016); *David F. Bandimere*, Exchange Act Rel. No. 76308, 2015 SEC LEXIS 4472, **37-41 (Oct. 29, 2015). A "breach of duty of disclosure may be viewed as a device or scheme, an implied misrepresentation, and an act or practice, violative of all three subdivisions" of Section 17(a) and Rule 10b-5. *J.S. Oliver Cap. Mgmt., L.P.*, Exchange Act Rel. No. 78098, 2016 SEC LEXIS 2157, *27 n.27 (June 17, 2016) (citations omitted). Further, a respondent violates Sections 10(b) and 17(a) by engaging "in conduct that produces a false impression." *Dennis J. Malouf,* Advisers Act Rel. No. 4463, 2016 SEC LEXIS 2644, *20 (July 27, 2016). Such conduct "encompasses

'making' a misrepresentation; it also encompasses, among other things, drafting or devising a misrepresentation." *Id.* Further, an investment adviser violates Sections 10(b) and 17(a) by "failing to correct a material misstatement in violation of a fiduciary duty to do so." *Id.* at *30, *47.

A representation or omission is material "if there is a substantial likelihood that a reasonable investor would have considered the [misrepresented information or] omitted information important in deciding whether or not to invest and if disclosure of the omitted fact would have significantly altered the total mix of information available to the investor." *David F. Bandimere*, 2015 SEC LEXIS 4472, *40-41 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 240 (1988)). Moreover, a person "who elects to disclose material facts 'must speak fully and truthfully, and provide complete and non-misleading information with respect to the subjects on which he undertakes to speak,' and incomplete disclosures 'implicate a duty to disclose whatever additional information is necessary to rectify the misleading statements.'" *Bandimere* at *40-41 (citations omitted).

To prove a violation of Securities Act Section 17(a)(1) and Exchange Act Section 10(b) and Rule 10b-5, the Division must establish scienter, which can be established through recklessness. *Bernerd E. Young*, 2016 SEC LEXIS 1123, *64. Violations of Securities Act Sections 17(a)(2) and 17(a)(3) can be proven by a showing of mere negligence. *David F. Bandimere*, 2015 SEC LEXIS 4472, *39; *J.S. Oliver Cap. Mgmt.*, 2016 SEC LEXIS 2157, *12; *Dennis J. Malouf*, 2016 SEC LEXIS 2644, *53 ("Section 17(a)(3)'s prohibition thus applies, for example, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also applies, for

example, where, as a result of a defendant's negligent conduct, prospective investors are prevented from learning material information about a securities offering.").

Winkelmann and BOP repeatedly violated Section 10(b), Rule 10b-5, and Section 17(a). They did so by making numerous false and misleading statements about BOP's advertising conversion rate, the success of the Royalty Unit offerings, and the alignment of Winkelmann's and investors' interests. Winkelmann and BOP also omitted important information from investors, most of whom were clients to whom Winkelmann and BOP owed fiduciary obligations to disclose all material facts. Such omissions included the Binkholder bar, the fact that Winkelmann was funneling BOP money to his other companies, and that Winkelmann routinely paid investors near minimal returns while increasing his own compensation.

Winkelmann's misrepresentations and omissions were material. The offering memoranda described the advertising conversion rate as the "key driver" of BOP's success and ability to repay investors. In each memorandum, and in one-on-one correspondence with investors, Winkelmann misstated the conversion rate by significant amounts. Likewise, given the central role of Binkholder's radio program in BOP's advertising campaign, and the prominence given to Binkholder in the offering memoranda, the omission of the Missouri bar order was also material. This is particularly so given the bar order's findings relating to Binkholder's failure to disclose conflicts of interest, and Winkelmann's knowledge of that order prior to the commencement of the second and third Royalty Unit offerings. Similarly material was Winkelmann's omission that BOP paid investors near minimum returns while increasing his own compensation. Any reasonable investor would want to know that excess funds available to them were being used to support Winkelmann's pay increases.

While Winkelmann's state of mind is irrelevant to the Section 17(a)(2) and 17(a)(3) claims, the Division will establish that Winkelmann acted with scienter. Regarding the consistently misstated advertising conversion rate, Winkelmann either knew it was misstated or was reckless in repeatedly misstating it to investors. Indeed, Winkelmann had access to and systematically reviewed internal BOP financial information which either showed BOP's actual advertising conversion rate or allowed Winkelmann to easily calculate it. Despite scrutinizing and having access to this information, Winkelmann repeatedly authored and approved offering memoranda, and drafted correspondence to investors, which significantly misstated the conversion rate. *See, e.g.*, *Elam v. Neidorff*, 544 F.3d 921, 929 (8th Cir. 2008) ("allegations that a defendant made materially misleading statements, while in possession of conflicting information, support a strong inference of scienter"); *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 665 (8th Cir. 2001) ("One of the classic fact patterns giving rise to a strong inference of scienter is that defendants published statements when they knew facts or had access to information suggesting that their public statements were materially inaccurate."). Further evidence of Winkelmann's scienter is the fact that when he misstated the conversion rate, he routinely did so in a way that made BOP's advertising program look more successful than it actually was.

As for the other misrepresentations and omissions in the offering memoranda – such as misrepresenting Winkelmann's "alignment" with investors and failing to disclose the Binkholder bar and that Winkelmann routinely paid himself at investors' expense – Winkelmann also acted with scienter. As BOP's CCO with over 30 years of securities industry experience, Winkelmann either knew that the offering materials misstated and omitted material information, or was reckless in authoring and approving the memoranda which contained the misstatements and omissions. *See, e.g., Dennis J. Malouf*, 2016 SEC LEXIS 2644, *67 (finding scienter when respondent

investment adviser, "an experienced securities professional, had an independent obligation to disclose his conflict, understood that obligation, and must have known that clients would be misled by his failure to correct the representation that no conflict existed.").

Respondents have asserted reliance on counsel as an affirmative defense, premised on their consultations with a securities lawyer in the course of the Royalty Unit offerings, which they claim negates their scienter. However, at hearing, the Division will demonstrate that Respondents cannot meet the requisites to invoke that defense. For instance, Respondents failed to make complete disclosures to or seek advice from counsel regarding the misstatements and omissions at issue in these proceedings; nor did counsel advise Respondents that such misstatements and omissions were legal. *See, e.g.*, *William Scholander*, Exchange Act Rel. No. 77492, 2016 SEC LEXIS 1209, *25-26 and nn. 37-38 (Mar. 31, 2016); *Riad*, 2016 SEC LEXIS 2396, *135-136 ("These were not technical, compliance-related or legal judgments that respondents could reasonably have believed others were independently evaluating. In short, [respondents] could not in good faith have relied on any advice that purported to excuse them from the duty to speak the truth to investors about the Fund's investment strategies, performance, and risks.")

B. Violations of the Advisers Act's Antifraud Provisions

Advisers Act Section 206(1) prohibits investment advisers from "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud any client or prospective client." 15 U.S.C. § 80b-6(1). Section 206(2) formulates a "broad proscription against 'any . . . practice . . . which operates . . . as a fraud or deceit upon any client or prospective client.'" *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963) (citing Section 206(2)). Sections 206(1) and 206(2) "prohibit investment advisers from misstating material facts or omitting facts necessary to make a prior statement non-misleading in promotional literature and other communications to clients or prospective clients." *Anthony Fields, CPA*, Exchange Act Rel. No. 74344, 2015 SEC

LEXIS 662, *58 (Feb. 20, 2015). Additionally, "Section 206 prohibits 'failures to disclose material information, not just affirmative frauds.'" *Montford & Co., Inc.*, Advisers Act Rel. No. 3829, 2014 SEC LEXIS 1529, *50-51 (May 2, 2014) (quoting *SEC v. Wash. Inv. Network*, 475 F.3d 392, 395 (D.C. Cir. 2007)). Investment advisers may be found liable under Sections 206(1) and 206(2) "for their fraudulent conduct regardless of whether they 'made' misstatements." *Dennis J. Malouf*, 2016 SEC LEXIS 2644, *54.

Section 206(2) further establishes a fiduciary relationship between the adviser and its clients, and imposes on the adviser "duties of 'utmost good faith, and full and fair disclosure of all material facts' and 'to employ reasonable care to avoid misleading [its] clients.'" *Bernerd E. Young*, 2016 SEC LEXIS 1123, *38-39 (quoting *Capital Gains*, 375 U.S. at 194). "These fiduciary responsibilities also include a 'duty to disclose any potential conflicts of interest accurately and completely, and to recognize ... a potential conflict.'" *Timbervest, LLC*, Advisers Act Rel. No. 4197, 2015 SEC LEXIS 3854, *15 (Sept. 17, 2015) (citations omitted); *see also, Edgar R. Page*, Advisers Act Rel. No. 400, 2016 SEC LEXIS 1925, *14 (May 27, 2016) ("Advisers are required as a matter of law to disclose 'economic conflicts of interests' to their clients.") (citations omitted); *Dennis J. Malouf*, 2016 SEC LEXIS 2644, *61 ("By failing to correct UASNM's multiple representations that he did *not* have a conflict, Malouf breached his fiduciary duties as an investment adviser.")

Section 206(1) requires a showing of scienter, while negligence suffices to establish a Section 206(2) violation. *J.S. Oliver Cap. Mgmt.*, 2016 SEC LEXIS 2157, *12; *Dennis J. Malouf*, 2016 SEC LEXIS 2644, *54.

For the same reasons that they violated the Exchange Act's and Securities Act's antifraud provisions, Winkelmann and BOP violated Advisers Act Section 206. *Dennis J. Malouf*, 2016

SEC LEXIS 2644, *70 ("Facts showing a violation of Section 17(a) or 10(b) by an investment adviser will also support a showing of a Section 206 violation." (quoting *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007)). Additionally, Winkelmann and BOP violated Section 206 by breaching the fiduciary duties owed to their advisory clients who purchased Royalty Units. By repeatedly misrepresenting BOP's advertising conversion rate, and by making the other misrepresentations and omissions discussed above, Winkelmann and BOP breached the duties of loyalty, due care, and honesty owed to their clients. By failing to disclose the conflicts attendant to the Royalty Unit offering, whereby Winkelmann faced the recurring choice of whether to increase payments to investors or to increase his own compensation, Winkelmann breached his duty to recognize and fully disclose all conflicts of interest. And by routinely choosing to pay himself more – including by funneling $87,000 from BOP to his other businesses – while keeping investor payments at near-minimum levels, Winkelmann violated the duty of loyalty to always act in his clients' best interest.

C. Violations of the Custody Rule

Advisers Act Rule 206(4)-2, the "Custody Rule," is designed to "provide for a more robust set of controls over client assets designed to prevent those assets from being lost, misused, misappropriated or subject to advisers' financial reverses." 75 F.R. 1456, 1457 (Jan. 11, 2010). The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets. An adviser has "custody" of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2). An adviser who has custody must, among other things: (i) maintain client funds in a separate account for each client under that client's name, or in accounts that contain only the clients' funds and securities under the investment adviser's name as agent or trustee for the clients; (ii) notify each

client in writing of the qualified custodian's name, address, and the manner in which the funds or securities are maintained; (iii) have a reasonable basis, after due inquiry, for believing that the custodian sends account statements directly to each client at least quarterly; and (iv) have an independent public accountant perform a surprise examination of the client funds and securities of which the adviser has custody at least once during each calendar year. *Id.* at § 275.206(4)-2(a)(1) - (4). "Lack of intent is no defense" to a custody rule violation. *Abraham & Sons Capital, Inc.*, Advisers Act. Rel. No. 1956, 2001 SEC LEXIS 2773 *27 and n.28 (July 31, 2001) (finding adviser firm's president aided and abetted custody rule violation when firm violated rule and the president was "responsible for that violation").

BOP violated the custody rule by accruing in BOP's lone operating bank account the percentage of BOP cash receipts owed to the Royalty Unit investors who were BOP advisory clients. Winkelmann understood that all accrued amounts belonged to the Royalty Unit investors. Winkelmann further understood that these accrued amounts owed to the investors were held as cash in BOP's lone bank account for months at a time, and were commingled with BOP's operating cash (and, as such, were subject to claims of BOP's creditors). Further, after being confronted during the Division's investigation with the suggestion that BOP in fact had custody of Royalty Unit investor funds, BOP changed its Form ADV disclosures to reflect that it had custody of client funds. Nevertheless, prior to 2015, BOP failed to take the measures required for advisers with custody of client funds.

Winkelmann caused BOP's custody rule violations. As BOP's CEO and CCO, Winkelmann determined BOP's process for when investors would be paid, how the amounts owed to investors would be commingled with other funds in BOP's operating account, and whether or not to have BOP comply with the requirements of the custody rule.

D. Violations of Advisers Act Section 206(4) and Rule 206(4)-7

Advisers Act Rule 206(4)-7 "requires, among other things, that an investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations by the investment adviser or its supervised persons of the Advisers Act and the rules adopted thereunder." *Anthony Fields, CPA*, 2015 SEC LEXIS 662, *69. An adviser violates Rule 206(4)-7 when it fails to adhere to its own written compliance policies. *J.S. Oliver Capital Mgmt.*, 2016 SEC LEXIS 2157, *35; *Donald L. Koch*, Advisers Act. Rel. No. 3836, 2014 SEC LEXIS 1684, *77-78 (May 16, 2014).

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

E. Violations of Advisers Act Section 207

Advisers Act Section 207 "makes it unlawful for 'any person willfully to make any untrue statement of a material fact' in Form ADV or 'willfully to omit to state . . . any material fact which is required to be stated therein.'" *J.S. Oliver*, 2016 SEC LEXIS 2157, *32 (quoting 15 U.S.C. § 80b-7); *see also Zion Capital Mgmt. LLC*, Advisers Act Rel. No. 2200, 2003 SEC LEXIS 2939, *26 (Dec. 11, 2003) (violation of Section 207 where adviser failed to disclose conflicts of interest in Form ADV). "Scienter is not required for violations of Section 207," such that there is "no requirement that the respondent 'also be aware' that he 'violat[ed] one of the Rules or Acts.'" *J.S. Oliver* at *32.

During the relevant period, BOP filed at least 20 Forms ADV which falsely represented that BOP did not have custody of client funds. Winkelmann controlled the contents of those

forms, and caused the forms to be filed with the Commission. Thus, both he and BOP violated Rule 207.

IV. THE COURT SHOULD IMPOSE SANCTIONS IN THE PUBLIC INTEREST

The public interest would be served by sanctioning Respondents. In determining whether sanctions should be imposed, the Court may consider the following elements: the egregiousness of the actions; the isolated or recurrent nature of the infractions; the degree of scienter involved; the sincerity of respondent's assurances against future violations; a respondent's recognition of the wrongful nature of his conduct; and the likelihood that a respondent's occupation will present opportunities for future violations. *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds,* 450 U.S. 91 (1981); *Mohammed Riad,* 2016 SEC LEXIS 2396, *151-52. The Commission stresses flexibility in analyzing these factors, such that "no one factor is dispositive." *Riad* at *152. The Court also may consider the extent to which a sanction will have a deterrent effect. *Schield Management Co*., Exchange Act Rel. No. 53201, 58 S.E.C. 1197, 1217-18 (Jan. 31, 2006).

A. The Court Should Enter a Cease-and-Desist Order.

Section 21C of the Exchange Act, Section 8A of the Securities Act, and Section 203(k) of the Advisers Act authorize the Commission to issue a cease-and-desist order against any person who "has violated" the statute or rules thereunder. Here, Respondents' violations raise a sufficient risk of future violations to support the entry of such an order. "The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction, and, absent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violations." *Rodney R. Schoemann*, Securities Act Rel. No. 9076, 2009 SEC LEXIS 3939, *48 (Oct. 23, 2009), *aff'd, Schoemann v. SEC*, 398 F. App'x 603, 604 (D.C. Cir. 2010).

B. The Court Should Order Disgorgement and Prejudgment Interest

Section 21C(e) of the Exchange Act, Section 8A(e) of the Securities Act, and Section 203(k) of the Advisers Act authorize the Commission to order disgorgement, plus reasonable interest. In this case, BOP's proceeds from the fraudulent Royalty Unit offering (net of repayments to investors) are properly the subject of disgorgement. So too is the significant compensation that Winkelmann received from BOP – compensation that was only made possible by virtue of the influx of cash from the Royalty Unit offerings.

The public interest likewise supports requiring Respondents to pay significant civil penalties for their misconduct. In considering whether to impose penalties, factors to consider include: (1) whether the violations involved fraud, deceit, manipulation or reckless disregard of a regulatory requirement; (2) the harm caused to others; (3) the extent to which any person was unjustly enriched; (4) prior violations by the respondent; (5) the need for deterrence; and (6) such other matters as justice may require. Exchange Act § 21B(a)(2); Securities Act § 8A(g); Advisers Act § 203(i).

Here, third-tier penalties against Respondents are warranted.[7] Respondents' misconduct involved fraud, deceit, manipulation of BOP's advertising data, and reckless disregard of the statutorily imposed fiduciary duties owed to their advisory clients. Winkelmann's misconduct has harmed his clients by keeping their Royalty Unit payments at near-minimal levels that are not commensurate with the returns suggested by the inflated advertising rates contained in the offering memoranda. Winkelmann further harmed investors by diverting significant sums – that could have been used to repay investors – for his own benefit. For these reasons, the amount of any civil

[7] Should the Court determine that third-tier penalties are not warranted, the Division requests the imposition of second or first tier penalties.

penalty assessed against Respondents should be sufficient to deter them and others from engaging in the type of conduct at issue in this proceeding.

C. The Court Should Impose Industry Bars

Under Section 15(b)(6)(A) of the Exchange Act and Section 203(f) of the Advisers Act, the Commission may bar or suspend persons from being associated with an investment adviser or other types of firms in the securities industry. Based on the relevant factors and Respondents' willful violations of the securities laws, the Court should impose an associational bar precluding Respondents' involvement in the securities industry. *See, e.g., Mohammed Riad*, 2016 SEC LEXIS 2396, *151-154. The length of Respondents' associational bar should be sufficient to protect investors from advisers who have engaged in fraud and have repeatedly failed to abide by the strict fiduciary obligations owed to their clients.

V. CONCLUSION

The Division of Enforcement respectfully requests that the Court accept the documentary and testimonial evidence presented at the hearing, find that Respondents engaged in the violations described in the Order Instituting Proceedings, and impose appropriate sanctions.

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Respectfully submitted:

Benjamin J. Hanauer
David F. Benson
Division of Enforcement
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 900
Chicago, IL 60604
Phone: 312-353-8642
Fax: 312-353-7398
Email: hanauerb@sec.gov