HARD COPY

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

RECEIVED
NOV 23 2016
OFFICE OF THE SECRETARY

RESPONDENTS' POST-HEARING BRIEF

Alan M. Wolper
Heidi E. VonderHeide
500 W. Madison Street
Suite 3600
Chicago, IL 60610
(312) 658-6500
Fax: (312) 658-6501
awolper@ulmer.com
hvonderheide@ulmer.com

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes and Rules

I. INTRODUCTION

It seemed abundantly clear from the manner in which the Division of Enforcement (the "Division") framed the allegations in the Order Initiating Proceedings (OIP") that this matter would be characterized as a fraud case – an intentional, *scienter*-based fraud case – undisputed facts to the contrary be damned. After six days of hearing, that conclusion is now inescapable. Respondents James Winkelmann and his investment advisory firm Blue Ocean Portfolios, LLC ("Blue Ocean") not only did not commit intentional fraud, but they did not commit any fraud, even fraud under 206(2), which can be supported by a finding of mere negligence. The offerings at issue here, and the documents relating to those offerings, may not have been perfectly executed, but Respondents met or exceeded every legal standard that governs their conduct.

In short, in making their investment decisions, the investors all got from Respondents what the law mandates in terms of disclosures, more than enough, in fact. Then, after the money was received, Respondents delivered on every promise they made to the investors regarding how the money would be used, and how, when and how much the investors would be paid. Any effort by the Division to paint a different picture fails. Accordingly, dismissal of all charges is the only appropriate result.

II. FACTS

The relevant facts are set forth in Respondents' Proposed Findings of fact, filed herewith.

III. ARGUMENT AND AUTHORITIES

With regard to each alleged violation set forth in the OIP,[1] the Division carries the burden of proof. To carry this burden, it is required to prove by a preponderance of the evidence each

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

element of each and every claim.[2] As a matter of law, if the Division fails to carry its burden, Respondents are entitled to judgment in their favor.[3]

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

Rule 206(1)[4] of the Advisers Act, Section 17(a)(1) of the Securities Act[5] and Section 10(b) of the Exchange Act and SEC Rule 10b-5[6] 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; (2) in connection with the offer, sale, or purchase of securities; and (3) that they acted with scienter.[7] To prove a Rule 206(1) violation, the Division must show that Respondents (1) engaged in fraudulent activities; and (2) breached their fiduciary duty to their clients by making false or misleading statements or omissions of material fact.[8]

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

---

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

[3] *Id.*

[4] 5 U.S.C. §§ 80b-6(1).

[5] 15 U.S.C. §77h(a).

[6] 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5.

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

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

1. Respondents did not make any misrepresentations in the offering documents because the advertising conversion factor calculations were correct.

The OIP sets forth seven purported misrepresentations in the offering documents at issue.[9] Some allegations relate to specific offerings, while some apply universally. Each alleged misrepresentation is addressed separately below.

a. Advertising Factor in the Round 1 Offering Memo (Paragraph 7 of the OIP).

The Division alleges in Paragraph 7 of the OIP that the Round 1 Offering Memorandum, dated March 31, 2011,[10] misrepresented the advertising conversion rate[11] when it stated that "each $10,000 in new recurring revenue will cost [Blue Ocean] $2,200 in advertising – a 22/100 ratio." The Division alleged that "[i]n reality each $10,000 in new recurring revenue cost Blue Ocean $4,548 in advertising – a 45/100 ratio."[12] The Division failed to carry its burden of proving that the factor Respondents used in the Offering Memorandum was either incorrect or misleading.[13] The Division also failed to prove that the "real" or "actual" factor was 0.45, as alleged.

[9] OIP ¶¶ 7-10, 12-15.

[10] RX-001.

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

[12] OIP ¶ 7.

[13] It must be noted at the start that the Division not only pled in the OIP that the advertising factors identified in the various Offering Memoranda that Respondents distributed were inaccurate, but it also alleged what the supposed "correct" advertising factors were. *See* paragraphs 7, 8, 9, and 10 of the OIP. Thus, to prevail, the Division must prove that Respondents' advertising factors were not correct, *and* that the Division's computations of the advertising factors were correct. Tellingly, however, the Division failed to introduce *any* evidence to support that latter notion. Indeed, the Division went so far as to stipulate during the hearing that the one witness it presented to discuss the advertising factors – Mr. Collins – did not perform any calculations to substantiate the figures that the Division alleged in the OIP to be "correct." In the absence of any evidence establishing the accuracy of the Division's computations of the advertising factor for each offering, the Division has failed to carry its burden and the allegations made in paragraphs 7 -9 must be denied as a matter of law. This issue is addressed fully in Section 3.A.2., below.

i. Inception of Blue Ocean's advertising campaign and the Royalty Units.

Blue Ocean is an investment advisory firm that focuses on monitoring and optimizing its clients' asset allocation, as opposed to tracking the performance of individual investments.[14] The Firm's focus stems from its belief that the pursuit of returns on specific, individual investments creates a conflict of interest between the client and the adviser (in that the adviser is drawn to the commission payments attached to a particular security instead of that security's potential to help the client).[15]

While the Firm had always advertised its approach to investment management, in June 2010 it began an aggressive advertising campaign aimed at expanding and its audience and, ultimately, increasing its assets under management ("AUM"). In launching that advertising campaign, the Firm did not simply pump additional money into advertising willy nilly. Instead, it attempted to spend its advertising dollars as carefully and effectively as possible. To do this, the Firm tracked the efficiency of each of the various advertising venues it was utilizing to determine which was yielding the best return on advertising dollars spent (with return measured by new income generated by new assets coming under the Firm's management). This tracking system would evolve significantly over the coming years, becoming more and more detailed and elaborate.[16]

In early 2011, Mr. Winkelmann began exploring conducting a capital raise to fund the new advertising campaign. After many discussions with his attorney, Michael Morgan,[17] Mr.

[14] RX-001, p. 6-7.

[15] *Id.* at 6.

[16] Tr. 891:1-4 (Juris); Tr. 449: 3-6 (Winkelmann).

[17] Tr. 1246:10-1248:8; Tr. 1249:11-1250:16. At all times relevant, Mr. Morgan was a partner at the Greensfelder law firm ("Greensfelder"). Mr. Morgan and Greensfelder are discussed in much greater detail, *infra*, in connection

Winkelmann and Mr. Morgan settled on a Royalty Unit structure.[18] 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 on a monthly basis, regardless of whether the Firm managed to achieve a profit that month.[19] That right to a minimum percentage of the Firm's monthly cash receipts continues until the investor is paid back his or her principal investment, plus some stated multiple of the investment.[20] It is undisputed that the explicit terms of each Offering stated that there was no established timeframe within, or deadline by, which investors had to be repaid; rather, those payments would simply continue for as long as necessary for investors to receive their promised returns.

The success of the campaign depended on the Firm's ability to successfully use advertising to recruit new advisory clients.[21] The more new advisory assets were acquired, the more fees (i.e., revenue) the Firm would bring in.[22] Since investors in the Offerings were entitled to be paid purely out of revenue, the higher the Firm's revenue, the more quickly investors would be repaid.[23]

---

with the argument that Respondents reasonably relied upon legal advice they received from Mr. Morgan and Greensfelder. FOF 52, 53, 54.

[18] Tr. 1249:11-1250:16; Tr. 1246:10-1248:8 (Winkelmann).

[19] Tr. 1274:19-25-1275:1-4 (Winkelmann); Tr. 277:2-7 (Laby) As discussed in Section IV.C., below, the monthly payments were later made quarterly.

[20] The multiple changed slightly from offering to offering. In Round 1, it was 3; in Round 2, it was 2.5; in Round 3, it was 2.25; and, in Round 4, it was 2.5 . In addition, Round 1 investors were also granted a warrant which gave them the option to purchase 1.0% of BOP for $100,000. FOF 7,9,11,13, respectively.

[21] RX-001 p. 9.

[22] Tr. 45:20-23 (Swardson); Tr. 1248:20-25; 1249: 1-10 (Winkelmann).

[23] *Id.*

ii. Preparation of the Round 1 Offering Memorandum and calculation of the advertising factor.

Beginning in February 2011,[24] Mr. Winkelmann and Mr. Morgan began exchanging drafts of the Round 1 offering documents that would be provided to potential investors.[25] The final Offering Memorandum for Round 1 was dated March 31, 2011.[26] It included a detailed overview of the Firm's sales and marketing plan, which was designed to attract new leads, new advisory clients, and, ultimately, increase the Firm's revenue.[27] The Offering Memorandum also included a list of the Firm's "business drivers," and identified both as "*a* key business driver" and "*the* key business driver" for Blue Ocean its "client acquisition cost," i.e., how much money needed to be spent in advertising actually to bring in new clients. In order to inform potential investors about that acquisition cost, Blue Ocean included in the Offering Memorandum an overview of how its current advertising spending was translating into new revenue at the time of the Offering, and how it speculated that trend would fare going forward.[28]

That language – and the purported misrepresentation identified in paragraph 7 of the OIP – appears on page 9 of the 116-page offering memorandum:[29]

> 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.

---

[24] RX-106, p. 30-31.

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

[26] RX-001, p. 1.

[27] RX-001, p. 8.

[28] RX-001 p. 9.

[29] RX-001, p. 9.

The Division has alleged that this information is inaccurate because "in reality" the Firm's advertising conversion ratio was actually 45/100 – not 22/100.[30] As set forth in Section III.A.2., below, the Division failed to introduce any evidence whatsoever that the "real" advertising conversion rate was actually 45/100.

Beyond that, the evidence that was adduced at the hearing showed that the Firm's stated ratio of 22/100 was accurate and, therefore, not misleading. In 2011, the Firm worked with Greensfelder to prepare the Offering Memorandum for Round 1. Mr. Winkelmann prepared the initial draft of the document, and that included an overview of the Firm's advertising campaign as of that time period.[31] To create that view, Mr. Winkelmann looked back to the start of the new advertising campaign – June 2010 – and calculated the *average* amount the Firm was spending on advertising each month.[32]

While the Firm had certain identifiable (but extremely modest) advertising expenses for the six months prior to June 2010, it did not have the elaborate source-tracking system that the Firm implemented at the very end of May 2010.[33] In or around that date, the Firm started a master advertising spreadsheet[34] that tracked the source of potential leads (i.e., potential clients).[35] This spreadsheet was the beginning of the source-tracking advertising strategy and it

---

[30] OIP ¶ 7.

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

[32] The Division refuses to recognize June 2010 as the beginning of the new campaign, insisting that 2010 must be considered as a calendar year whole.

[33] RX-008. Very little was spent on advertising prior to June of 2010.

[34] RX-006; Tr. 871:5-872:1; Tr. 870:19-871:4. The master advertising spreadsheet tracked the Firm's new clients, the size of their accounts, the date they learned of Blue Ocean, the source (i.e. advertisement) from which they heard of the Firm, and the date they transferred their assets over (if ever).

[35] RX-006. Note that the first contact date input is May 20, 2010 – exactly when Mr. Winkelmann testified the new campaign began and the point from which he began his collection of advertising data. The dates move forward in time from there. Tr. 1179:3-8; Tr. 1465:25-1466:9 (Winkelmann).

contained the most complete data showing which clients came from which advertising sources.[36] The master advertising spreadsheet also kept track of the total assets each new client deposited.[37] Multiplying those new assets by the Firm's advisory fee, the Firm was able to estimate the new annually recurring revenue those new assets would generate.[38] Mr. Winkelmann selected June 2010 as the appropriate start date for his effort to compute the advertising factor since that was the first data the Firm had collected on the spreadsheet.[39]

Mr. Winkelmann used this data when preparing the initial draft of the Round 1 Offering Memorandum. At that time, the Firm's most current revenue data would have been for the month of February 2011.[40] Mr. Winkelmann testified the Firm's advertisements (as February 2011) were bringing in about $2.6 million in new assets.[41] Assuming a 1.0% annual advisory fee, those assets would generate $26,000 in recurring annual revenue. These figures were input into the Offering Memorandum,[42] "approximated" at $2.5 million and $25,000, respectively.

Then. to determine the advertising spending, the Firm looked to its QuickBooks, which reflected all advertising expenses.[43] From June 1, 2010 through the end of February 2011[44] the

---

[36] *Id.*

[37] *Id.*

[38] Like many investor advisors, the advisory fee the Firm charged depended on the amount of assets the client had under management: 1.0% on the first $500,000, 0.75% on the next $500,000 and 0.50% on the balance over $1 million.

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

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

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

[42] RX-001, p. 9. The Firm calculated that its advertising campaign was generating $2.67 million in new assets as of the time of drafting. The Firm further assumed it would receive a 1.0% management fee. 1.0% of $2.67 million is $26,700 or "approximately" $25,000. Tr. 1464:1-14; Tr. 518:20-519:4; Tr. 518:20-519:4 (Winkelmann).

[43] RX-008.

[44] While the Offering Memorandum for Round 1 is dated March 31, 2011, the evidence was that the drafting process began in the very beginning of March and was finalized in the weeks leading up to the offering date, i.e., mid-March 2011. RX-106, p. 30.

Firm incurred a total of approximately $45,000 in advertising expenses.[45] The majority of those expenses had occurred in the September – December 2011.[46] Mr. Winkelmann "approximated" these expenses were about $5,500 per month. To reach the 22/100 ratio set forth in the Offering Memorandum, then, one need only replicate Mr. Winkelmann's math and divide the average monthly spend by the newly recurring revenue derived therefrom.

Mr. Winkelmann's calculation of the 0.22 advertising factor is supported by the Firm's own internal data. In January 2011, the Firm received new assets under management totaling $1,351,432.[47] At that time, all of the Firm's revenue estimates assumed that clients paid an annual advisory fee of 1.0% of their assets under management.[48] Applying that assumption here, 1.0% of $1,351,432 is $13,514.[49] The Firm's advertising spending for January 2011 came to $3,024.[50] To double check Mr. Winkelmann's calculation of the advertising factor, the advertising spend ($3,024) is divided by the estimated annual recurring revenue ($13,514).[51] The quotient equals 0.22 - the exact number that appears in the Offering Memorandum. This verifies that Mr. Winkelmann's calculations – and the representation – were correct.

---

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

[46] Advertising expenses for September 2011 were $4,490; Advertising Expenses for October 2011 were $5,469; Advertising Expenses for November 2011 were $5,928; and Advertising Expenses for December 2011 were $9,854.

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

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

[49] Tr. 923:23-924:1; Tr. 924:14-23; Tr. 920:16-923:22 (Juris). As Ms. Juris testified, in January 2011, the Firm's computations assumed a 1.0% annual advisory fee. Tr. 925:12-926:18. By comparison, CX-159, upon which Mr. Collins based his computations, was created in or around June 2012, and assumed a 0.77% advisory fee. This may explain, at least in part, why the Division was willing to stipulate that Mr. Collins' computations did not serve as the basis for what the Division maintained were the correct advertising ratios.

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

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

Therefore, with regard to the advertising conversion factor set forth in the Round 1 Offering Memorandum, the number was accurate. Accordingly, there is no misrepresentation, and the Division's claim necessarily fails.

b. Advertising Factor in the Round 2 Offering Memorandum (Paragraph 8 of the OIP).

The Division alleges in Paragraph 8 of the OIP that the Round 2 Offering Memorandum, dated March 15, 2012,[52] misrepresented the advertising conversion rate when it stated that "each $10,000 in new recurring revenue is currently costing [Blue Ocean] $6,200 in advertising – a 62/100 ratio or an 'advertising conversion factor' of 0.62." The Division further alleged that "[i]n reality the current advertising conversion factor was 1.11, not 0.62."[53] As was the case with Round 1, the Division failed to submit any evidence that the "real" advertising conversion factor at the time of the Round 2 offering was 1.11.[54] More importantly, the Division likewise failed to prove that the figures the Firm used in the Round 2 Offering Memorandum were incorrect.

By the time the Firm was preparing the Round 2 offering in March 2012, it had recently (January 2012) implemented the use of monthly advertising reports to track the advertising data (amount spent, clients acquired, assets acquired and projected new revenue).[55] The data in the monthly advertising reports was pulled from the Firm's master advertising spreadsheet, discussed above. The reports were generated in the first week after the month ended.[56] So, for example, the January 2012 report would have been available after the first week of February

[52] RX-002.

[53] OIP ¶8.

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

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

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

2012.[57] It was Ms. Juris' responsibility to generate the report from the Firm's master spreadsheet for use in the monthly management meeting.[58] After each monthly meeting, that report was placed in a binder and preserved.[59]

While the advertising data was pulled and preserved when used in monthly management meetings, it was also always available to Firm employees in real time by accessing the data on the computer.[60] Thus, just because a report did not happen to be printed and preserved on a particular date and time, that does not mean the information was not readily available.[61] Because the monthly advertising reports *were* printed off and maintained, however, they are contemporaneous evidence reflecting the Firm's calculations at a particular time. Those reports bookend the issuance of the Round 2, 3 and 4 Offering Memoranda.[62]

Round 2 was issued March 10, 2012.[63] At that time, when Mr. Winkelmann was working with Mr. Morgan at Greensfelder[64] to prepare the Round 2 Offering Memorandum, the most current monthly management report would have been the February report.[65] According to the February 2012 report, the Firm's current advertising costs were $14,804 and its estimated first

---

[57] *Id.*

[58] Tr. 871:5-872:1 (Juris).

[59] Tr. 885:3-886:3 (Juris). The monthly reports frequently contained Ms. Juris' handwritten notes, taken during the meeting. Tr. 885:17-22 (Juris).

[60] Tr. 909:19-910:2 (Juris).

[61] *Id.*

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

[63] RX-002.

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

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

year revenues were $22,000.[66] To calculate the advertising factor, the costs ($14,804) are divided by the new revenue ($22,000), which equals 0.67[67]:

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

Years	Cost per Lead	Cost per Client	Estimated First Year Revenues 2012	Factor
November 2011	$143.45	$1,108	$16,850	1.45
December 2011	$178.13	$1,180	$18,425	1.02
January 2012	$164.50	$1,923	$34,005	0.74
February 2012	149.54 ~~#VALUE!~~	$987	$22,000	0.67
March 2012				
2012 Total				

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

> 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.

The February advertising factor of 0.67 is just above the factor included in the Offering Memorandum (0.62). When Mr. Winkelmann prepared the Offering Memorandum in March, he

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

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

was able to access the master spreadsheet,[68] and thus he could use the most up-to-date data reflecting the annual recurring revenue, which had increased slightly (to $24,200)[69] since the February 2012 report (to 0.67).[70]

Therefore, with regard to the advertising conversion factor set forth in the Round 2 Offering Memorandum, the number is accurate. Accordingly, there is no misrepresentation, and the Division's claim necessarily fails.

i. The 2011 Advertising Factor.

Paragraph 8 also alleges that the Offering Memorandum recites that the "advertising factor for 2011 was 0.78" when "in reality" the advertising factor for 2011 was 1.28. The statement at issue in paragraph 10 appears in the executive summary of the Round 2 Offering Memorandum:[71]

> In 2011, Blue Ocean Portfolios invested approximately $328,000 in advertising. The result was that AUM increased by $25 million to $57 million and recurring annual revenues increased from approximately $200,000 at the end of 2010 to $404,000 at the end of 2011...The key indicator on the advertising efficacy is to determine how much advertising is needed to generate one additional dollar in new recurring revenue. In 2011, this "factor" was 0.79. Or, in other words, Blue Ocean Portfolios spent $0.79 in advertising to buy $1.00 in new recurring revenue.

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

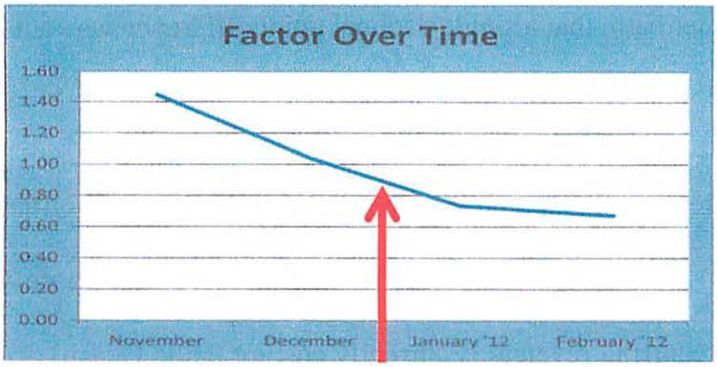
[68] Tr. 909:19-910:2. Mr. Winkelmann would have had the ability to access the spreadsheet in between monthly meetings and viewed the most current calculation advertising factor. Tr. 912:15-23 (Juris).

[69] RX-002 p. 13.

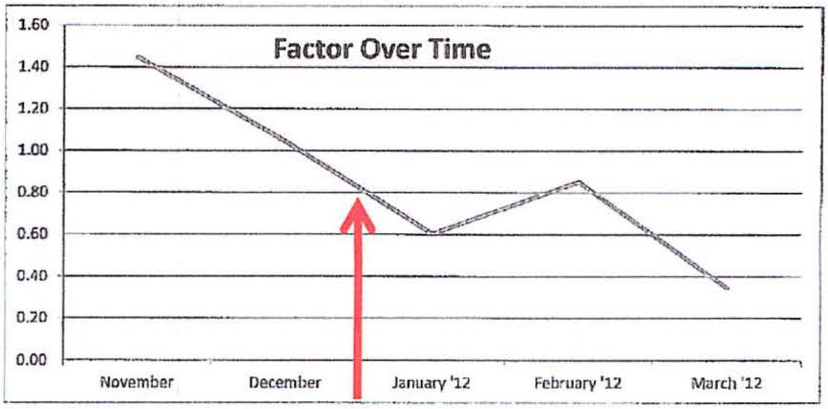
[70] Indeed, by the time the March report was generated in April 2012 (after the second offering), the Firm's estimated first year revenues had increased to $53,540 and the advertising factor had dropped to 0.35. RX-037, p. 1.

[71] RX-002, p. 5.

The monthly management reports included a graph that tracked the advertising factor over time. In the February monthly advertising report, the graph appeared as follows:[72]



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



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

In addition, the data provided in the Offering Memorandum supports the calculation. The quotation above states that in 2011, the Firm invested "approximately $328,000" in advertising, which resulted in recurring annual revenues of 404,000.[73] To double-check the factor computation, one would only need to divide the stated advertising spend ($328,000) by the stated annual recurring revenue ($404,000") to calculate an advertising factor for 2011 of 0.81. This

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

[73] RX-002, p. 5.

computation (which is based only on the "approximated" advertising costs) is within two decimal points of the calculation contained in the OIP. Notably, the Division's own staff accountant testified, under oath, that a single decimal point difference was not material.[74]

c. Advertising Factor in the Round 3 Offering Memorandum (Paragraph 9 of the OIP).

The Division alleges in Paragraph 9 of the OIP that the Round 3 Offering Memorandum, dated September 1, 2012,[75] misrepresented the advertising conversion rate when it stated that "each $10,000 in new recurring revenue is currently costing [Blue Ocean] $6,700 in advertising – a 67/100 ratio or an 'advertising conversion factor' of 0.67." The Division alleged that "[i]n reality the current advertising conversion factor was 1.03, not 0.67."[76]

As with the prior offerings, the Division failed to submit any evidence that the "real" advertising conversion factor at the time of the Round 3 offering was 1.03.[77] The Division likewise failed to prove that the figures the Firm used were incorrect.

When the Firm and Mr. Morgan prepared the offering documents for the Round 3 Offering Memorandum in August 2012, the Firm's final August numbers were not yet available.[78] Instead, the most recent monthly report would have been the July report.[79] The format and substance of the July report had evolved since the last Royalty Unit offering in March

---

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

[75] RX-002.

[76] OIP ¶9.

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

[78] Obviously, the August figures would not be complete until August was over. The August monthly advertising report, with the final numbers, would have been generated the first week of September – after the Round 3 offering. Tr. 913:5-23 (Juris). Thus, the numbers for July would have been the most recent and complete data set.

[79] RX-54, p. 62; Tr. 913:5-23 (Juris). This is another error Mr. Collins makes in his calculations. His calculation of the 1.02 advertising factor in DX-443 uses August revenue and spending numbers. The Firm would not have had this information when it was preparing the offering memorandum *during* the month of August. Tellingly, Mr. Collins' chart in DX-443 shows the July month-end factor as being 0.63 – just slightly less than the factor disclosed in the Round 3 offering memorandum.

2012.[80] One of those changes was the addition of a computation of a six-month trailing factor. The Firm found that the six-month trailing factor was a better representation of the data, since it considered an extended period of time, instead of looking at just one month.[81] The July 2012 monthly advertising report computed a trailing six-month average advertising factor of 0.71[82]:

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

The advertising factor that was used in the Round 3 Offering Memorandum was calculated in August 2012 – after the generation of the July report but before the August report was available. At the time of drafting, the six-month average factor had dipped slightly, to 0.67. Therefore, when Mr. Winkelmann provided Mr. Morgan with the financial data for the Round 3 Offering Memorandum, he provided him with the following information:[83]

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

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

i. The 2011 Advertising Factor.

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

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

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

[82] RX-054, p. 63.

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

d. Advertising Factor in the Round 4 Offering Memorandum (Paragraph 10 of the OIP).

For the Round 4 Offering, the Division alleges that the Firm "misrepresented the advertising conversion rate by approximately 15%" when it "incorrectly stated that Blue Ocean's 2012 conversion rate was 0.89."[84] The Division further alleged that the "actual" conversion rate for 2012 was 1.02.[85]

As above, the Division failed to introduce any evidence that the "actual" conversion rate was 1.02. Respondents, while they carry no burden to *disprove* the allegations, were easily able to do so.[86] Round 4 was offered on February 15, 2013.[87] As of the time the Offering Memorandum was prepared, in early February/late January of 2013, the Firm's data showed that the advertising conversion factor for the year 2012 was 0.89.

While it is not possible to view the Firm's master spreadsheet as of the precise date the Round 4 Offering Memorandum was created, as was the case with the above offerings, the surrounding, preserved, monthly reports can be used corroborate the numbers that would have been available at the time. In late January/early February 2013, when the Round 4 Offering Memorandum was in preparation, the Firm had access to the December monthly advertising report.[88] That report calculated the 12-month trailing advertising factor (i.e., the factor for calendar year 2012) to be 0.89 – the exact number that appears in the Round 4 Offering Memorandum[89]:

[84] RX-4, p. 4.

[85] OIP ¶10.

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

[87] RX-004, p. 1.

[88] RX-120.

[89] *Id.*

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

Therefore, with regard to the 2012 advertising conversion factor set forth in the Round 4 offering document, the number is accurate. Accordingly, there is no misrepresentation, and the Division's claims set forth in Paragraph 10 of the OIP fail.

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

As shown above, Enforcement failed to prove that the advertising conversion factors stated in the various Offering Memoranda were incorrect. Beyond that, the Division also failed to prove that its own calculations of the supposed "real" advertising conversion factors were accurate. Paragraphs 7-9[90] of the OIP each alleges a purportedly incorrect calculation by Respondents which is contrasted with an alleged "correct" calculation computed by the Division. To prove these allegations, Enforcement needed to introduce evidence proving that its numbers were, in fact, accurate. It failed to do so.

Mr. Collins, the SEC Staff Accountant,[91] performed the only calculations the Division offered in support of its allegations in Paragraphs 7-9. As an initial matter, none of those calculations precisely replicates the allegedly "real" advertising factor. At best, Mr. Collins' numbers come within .01 and .21 of the numbers the Division is required to prove.[92] Beyond that, Enforcement stipulated at hearing that Mr. Collins did not calculate the "real" advertising

[90] Mr. Collins was able to replicate the Division's calculation of 1.02, alleged in paragraph 10 of the OIP. For the reasons explained here, however, that number was simply incorrect.

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

[92] When confronted with this discrepancy, Mr. Collins testified he did not believe the differences between his numbers and those in the OIP were "material." Tr. 91:15-18 (Collins).

factors alleged in paragraphs 7-9 of the OIP.[93] This, perhaps, explains why not even Mr. Collins could replicate the Division's numbers.

a. Mr. Collins' calculations assume the wrong management fee.

Beyond this, however, Mr. Collins' calculations have a much more serious defect: they are based on faulty mathematical assumptions. As Ms. Juris testified, in all of 2011 and in January, February and March of 2012, the Firm calculated its estimated revenues using the assumption that it would earn a 1.0% advisory fee on its assets under management.[94] Thus, $100,000 in assets under management would generate $1,000 in revenue. In April 2012, however, the Firm changed its fee assumption from 1.0% to 0.77%, to better reflect the fees that the Firm was actually earning, which were less than 1.0% (due to those instances in which clients negotiated a lower fee, as well as those instances where the fee charged was reduced to reflect a higher amount of assets being deposited).[95] Using the same example, $100,000 in assets was presumed to earn only $770 in annual revenue.

When the Firm made this change in its advisory fee assumption in the spring of 2012, it updated the master advertising spreadsheet, changing this mathematical input from 1.0% to 0.77%. This update meant that when the Firm used the spreadsheet to create its monthly advertising reports (or ran any equation that used the advisory fee as a variable), its calculations reflected a 0.77% fee. This changed variable, however, also applied to equations based on *past* numbers. Thus, if the Firm generated a report after April 2012 showing the 12 months prior,

[93] Tr. 175:16-20 (on the record stipulation).

[94] Ms. Juris explained that the Firm charged different management fees based on the size of the account. In some cases, however, the Firm and the client negotiated a different management fee. While the Firm initially used a 1.0% management fee assumption for the purposes of its revenue projections, it continuously revised this assumption in an attempt to capture more accurately what the Firm actually charged and received. Tr. 986:15-987:1; Tr. 926:25-928:1.

[95] *Compare* RX-54, p. 29 (April) (New AUM of $6,449.000 times 0.77% equals estimated new revenues of $49,657) *with* RX-54, p. 17 (March) (New AUM of $5,354,000 times 1.0% equals $53,540 in estimated first-year revenues).

each of those calculations would also reflect a 0.77% management fee – even though the Firm had actually employed a 1.0% fee during that prior time period.

This change to the fee assumption is what led to Mr. Collins' first error in his computation of the Round 1 and Round 2 advertising factors. In June 2012, as part of the Firm's monthly advertising report, it generated a chart calculating the advertising factor on a monthly basis going back to January 2011.[96] Every single monthly revenue figure on that chart – which is now Division Ex. 159 – calculates the annual revenue using a 0.77% advisory fee assumption *even though* the Firm did not implement a 0.77% assumption until April 2012. This time period includes both the Round 1 and 2 Offerings.[97] Mr. Collins used this chart exclusively to calculate the purportedly "correct" factors the Division relies upon in the OIP.[98]

For example, looking at the February 2012 data on DX-159, the annual revenue ($17,697) is 0.77% of the New AUM for the same month ($2,296,000)[99]:

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

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

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

[99] DX-159.

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

Using the above June 2012 data, Mr. Collins calculated the factor to be 1.11[100]:

In February 2012, however, the Firm actually used a 1.0% assumption.[101] Thus, based on an AUM of $2,296,000, the Firm *would have calculated* a 1.0% annual revenue of $22,960. Dividing this 1.0% revenue ($22,960) by the stated advertising spend ($19,562) would yield a factor of 0.85. Yet, this factor would still be incorrect, because of Mr. Collins' second erroneous assumption (discussed below).

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

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

Even though Mr. Collins' chart (DX-159) contains a line item for February 2012 the February data on that chart represents February data *as of June 2012*. This is different than the

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

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

February data *as of February 2012*. As Ms. Juris testified, the Firm often had to make adjustments to its data in the weeks or months following a particular months' end.[102] Ms. Juris explained that the Firm was meticulous in its attempt to track how its advertising spending translated into client acquisition and, then, revenue.[103] To do so, the Firm strove to determine the specific source of each client and then, once engaged by the client to provide advisory services, to attribute the resultant revenue to a particular advertisement.[104] For example, if a prospective client called the Firm in July and reported he had heard the Firm's commercial on the *Charlie Brennan Show* in January, when that prospect actually became an advisory client, the Firm would go in and update its records to attribute that client's assets to the January spend on the *Charlie Brennan Show*.[105] Because clients would frequently call weeks or even months after hearing a particular advertisement, the advertising data for a particular month continued to change even after the calendar month ended.[106]

The addition of new revenue, however, was not the only reason a month's totals could be updated. As Ms. Juris testified, often times the Firm would receive late or erroneous invoices from a radio station and would have to go back and update its monthly totals to properly allocate the dollars spent.[107] Thus, the advertising totals for a particular month could be – and were – updated, to ensure accuracy, even after the month ended.

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

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

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

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

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

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

This brings us back to Mr. Collins' calculations. All of Mr. Collins' calculations are based off of the Firm's data as of June 2012.[108] By June 2012, the data for January, February, March and April had already been updated, as needed, to reflect most or all of the changes discussed above. The June 2012 data, therefore, which Mr. Collins relied on, differed substantially from the real-time data the Firm possessed when the Offering Memoranda for Rounds 1 and 2 were prepared:[109]

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

As the above chart demonstrates, the data Mr. Collins relied on to "replicate" the Firm's calculations, in fact, constituted information that the Firm did not possess prior to June 2012. Understanding Mr. Collins' error, we return to the example above comparing Mr. Collins' calculation of the February 2012 advertising factor with the Firm's. Mr. Collins calculated the February 2012 advertising factor using the following data:

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

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

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

The section above addresses his calculation of the annual recurring revenue and why it is incorrect, given the 0.77% fee assumption.

The data *also* cannot be used to replace the Firm's February 2012 calculations, however, because the Firm did not possess the above data in February 2012. Instead, the Firm's real-time February 2012 data showed an AUM of $2,200,000 (translating into $22,000 in annually recurring revenue) and $14,804 in advertising costs:

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

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

Years	Cost per Lead	Cost per Client	Estimated First Year Revenues 2012	Factor
November 2011	$143.45	$1,108	$16,850	1.45
December 2011	$178.13	$1,180	$18,425	1.02
January 2012	$164.50	$1,923	$34,005	0.74
February 2012	149.54 ~~#VALUE!~~	$987	$22,000	0.67
March 2012				
2012 Total				

When these advertising costs were divided by the estimated revenues, the quotient (factor) was 0.67.

The February 2012 example highlights how Mr. Collins' calculations can be mathematically correct (in that his division is accurate), but nonetheless fail to recreate the actual calculations that the Firm ran in 2011 and early 2012, when it had used a 1.0% advisory fee assumption based on different data.

Thus, contrary to the Division's assertion, Mr. Collins' calculations of the advertising factor did not, in fact, replicate those calculations the Firm made. Nor did Mr. Collins' calculations compute a "correct" factor for the applicable time period.

Accordingly, Mr. Collins' calculations do not support the Division's allegations that the advertising factors expressed in the Offering Memoranda were inaccurate.[110]

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

With regard to his calculations of the Round 3 factor, Mr. Collins made a new error. The Round 3 Offering Memorandum is dated September 1, 2012.[111] The Firm and Mr. Morgan prepared the documents for the Round 3 Offering Memorandum in August 2012.[112] At that time, the Firm's final August numbers were not available (and they would not be available until after the September 1 offering).[113] Instead, the most recent monthly report available was the July report.[114] The most recent data in the master spreadsheet (which Mr. Winkelmann had access to) would only have included a part of August. Mr. Collins, however, calculated the purportedly correct factor by using the *final* August 2012 numbers (which, obviously, existed by the time of Mr. Collins' 2013 examination of the Firm).

The Firm could not have utilized data it did not possess – data which had yet to come into existence. Accordingly, Mr. Collins' calculations do not support the Division's allegations that the advertising factors expressed in the Offering Memorandum for Round 3 were inaccurate

[110] The Division was given leave by the Court to introduce additional evidence on this point, specifically, to recall Mr. Collins to allow him to correct his work in light of Ms. Juris' testimony and actually do what the Division claimed he was engaged to do: replicate Respondents' computation of the advertising factors in an effort to show that Respondents' computations, as expressed in the Offering Memoranda, were not accurate. The Division declined this opportunity. As a result, the record is devoid of evidence that would support the Division's calculations in the OIP.

[111] RX0003.

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

[113] Obviously, the August figures would not be complete until August was over. The August monthly advertising report, with the final numbers, would have been generated the first week of September – after the Round 3 offering. Tr. 913:5-23. Thus, the numbers for July would have been the most recent and complete data set.

[114] RX-54, p. 62; Tr. 913:5-23. Tellingly, Mr. Collins' chart in DX-443 shows the July month-end factor as being 0.63 – just slightly less than the factor disclosed in the Round 3 offering memorandum.

d. There are many ways to compute advertising efficacy.

Ultimately, the fatal flaw with the manner in which the Division framed its allegations regarding the advertising factor is that it fails to take into account what the Court acknowledged *after* the fourth day of the hearing (and, more specifically, after Ms. Juris' testimony), that "there are different ways to capture this factor, there are different ways to calculate it, and there are different ways then to report it." [115] The import of this conclusion is that the advertising factors that Respondents included in the Offering Memoranda are not necessarily incorrect, and, therefore, misleading to investors, even if the Division successfully establishes that its computations yielded different results.

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

As noted above, the Division's allegations in the OIP about the advertising factors were quite specific. It did not merely allege that the statements of the advertising factors in the Offering Memoranda were materially inaccurate; rather, it expressly alleged that the advertising factors that appeared in the Offering Memoranda were inaccurate because they were materially different that the supposed "real" advertising factors, which the Division explicitly articulated. Thus, to prove its case, the Division necessarily must show that its computations of the "real" advertising factors were correct.

Oddly, however, at the hearing, the Division failed to introduce any evidence to support its allegations in the OIP regarding the "real" advertising factors. In fact, the Division stipulated that the one witness it presented to testify about the advertising factor, Mr. Collins, the Staff Accountant, "did not perform the ad ratio calculations that went that form the basis of the

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

allegations in the OIP"[116] (which was not a particularly remarkable concession given Mr. Collins' admission that he did all his calculations *after* the OIP was issued).[117] The end result is that no one testified on behalf of the Division how it computed the supposed "real" advertising factors. There is no evidence in the record, therefore, that the "real" advertising factors alleged in the OIP were accurate.

Indeed, the Court acknowledged this during the arguments on Respondents' Motion for Partial Summary Disposition, made at the close of the Division's case-in-chief under Rule 250: "It's not an allegation that [at] this point has been supported by any evidence."[118] Although the Court ultimately denied the motion, it again concluded that "some of the facts alleged in the OIP aren't directly supported by evidence."[119] The simple fact is, and as the Court expressly observed, the Division "didn't have to get this specific . . . in the allegation."[120] Respondents agree, the Division did not have to be so specific. But, for whatever reason, it chose to frame its allegations in this manner. It therefore bears the burden of proving them, and paying the price – dismissal – for not doing so.

---

[116] Tr. 175:16-20 (stipulation on the record).While the Division's expert, Mr. Laby, offered his opinion that the advertising factors expressed in the Offering Memoranda were materially incorrect, he readily acknowledged that he was merely relying on Mr. Collins' computations, and had done nothing independently to reach that conclusion. Tr. 212:9-24; 215:12-216:16 and 216:25-218:17. Thus, if Mr. Collins' calculations are wrong, then so is Mr. Laby. Tr. at 223:17-21.

[117] Tr. 128: 13-22 (Collins).

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

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

[120] Tr. at 843-844 (Judge Patil).

a. The Division did not plead – and cannot pursue for the first time at trial – additional purported misrepresentations outside those in the OIP.

At hearing, the Division suggested that, notwithstanding the precise allegations it made in paragraphs 7-9 of the OIP, it should nonetheless be free to pursue *any* misrepresentation under paragraph 6 of the OIP[121]:

> I just wanted to provide some commentary on the record with respect to the fact that I think that what Mr. Collins did, though, was very helpful, it would have been more helpful if the only sort of way that we had been looking at these numbers was with respect to the sort of month in, month out sort of methodology that Mr. Winkelmann had originally testified to...[T]he testimony we had today sort of, you know, suggested that there were different methodologies that were used and reported at different times. I'm saying that simply from the perspective if there are some numbers that you want to run or have someone -- anyone look at that and, you know, if you feel it would be useful or helpful. If not, that's fine.
>
> ***
>
> MR. HANAUER: Yeah, and let me think about that, Your Honor. I mean, I just want to remind the Court that paragraph 6 of the OIP makes the general allegation that each of the offering memorandum contain material misrepresentations about the advertising conversion rate. Period. And I will stand by here today without needing to think about anything else that that allegation supports all of our fraud charges. That we offer specifics later on, but let me think about the specific --

While this argument is a creative way for the Division to avoid addressing the evidentiary deficit regarding the purportedly "correct" advertising factors, Paragraph 6 is not a "general" allegation of misrepresentation. It makes no allegations on its own, and instead introduces the specific allegations regarding the advertising factor included in paragraphs 7-9, each of which addresses one of the four Offering Memoranda. The allegations in paragraphs 7-9, introduced by paragraph 6, are concluded in paragraph 11. The OIP then turns to a different topic (than the advertising factor). The Division's late realization that it could not prove paragraphs 7-9, and its attempt to manufacture new claims out of paragraph 6, should not be allowed.

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

Indeed, the specificity with which the Division must plead its case has already been ruled upon by this Court. Judge Foleak, on July 20, 2016, entered an Order requiring the Division to specifically identify the alleged "other misrepresentations" it hinted at (but did not identify) in paragraph 15 of the OIP.[122] In so doing, Judge Foleak overruled the Division's objections and required that it identify the exact misrepresentations at issue.

Moreover, and relevant here, in opposing Respondents' motion, the Division stated the following with regard to paragraphs 7-9[123]:

> Paragraphs 5-15 contain specific allegations relating to misstatement and omissions contained in four offering memoranda that Respondents gave their advisory clients and other prospective investors. These paragraphs lay out Respondents'...false statements concerning the effectiveness of their advertising program and their ability to generate revenue.

It is those "specific allegations" – and not some after-conceived general allegation – that Respondents were called upon to defend. To the extent the Division attempts to abandon its original pleading and pursue modified claims, it should be estopped from doing so, as such a tactic would be prejudicial to Respondents and inconsistent with this Court's prior order.

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

The evidence presented at hearing showed that there are multiple methods of calculating the efficiency of an advertising program. Respondents chose to divide their advertising spend into the newly recurring revenue produced by that spend. As Respondents' expert, Mr. Palubiak, testified, this method was both "reasonable" and "conservative"[124] in its calculation. In addition,

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

[123] Division's Opposition to Respondents Motion for More Definite Statement.

[124] Mr. Palubiak concluded that the Firm's approach was conservative because it only assumed the Firm would receive one year of revenue from its new accounts, despite the fact that the Firm had an excellent client retention rate. RX-125, p. 8.

Mr. Palubiak testified that Respondents' advertising campaign and its calculation of the advertising conversion factor were in line with industry standards.[125] In fact, Mr. Palubiak testified that "[t]his practice was as good as I have ever seen" and[126]:

> [T]he Blue Ocean practice of computing the "advertising factor" is one of the more conservative approaches to take as evidenced by their existing and still recurring revenue streams continuing years after the advertising campaigns have ended.
>
> It is also my opinion that the ROI calculated by Blue Ocean provides potential investors with an accurate assessment of the Firm's advertising efficacy. In fact, if anything, it understates how effective the Firm truly was. An alternate and more aggressive means of calculations (again, there is no one correct way to calculate ROI) would also factor in the value of long-term customer retention. When that is factored in, the true return on investment extends well past the first year of revenue and results in a higher ROI.

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

5. Respondents' disclosure as to conflicts of interest was accurate.

a. No Fiduciary Duty.

The Division alleges that Respondents failed to disclose the existence of a conflict of interest existing between them and potential investors and that this alleged failure violated Section 10(b), Section 17((a) and Rule 206(1). The duty to make this type of disclosure flows from the existence of an investment advisory relationship, which is fiduciary in nature. Investment advisers have an obligation to avoid conflicts and, when they cannot be avoided, to disclose all material conflicts pending between them and their clients.[127] This obligation attaches

[125] RX-125, p. 6.

[126] RX-125, p. 6.

[127] *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

when investment advisers are soliciting new investment advisory clients, acting as advisers and making recommendations, or, again, acting as advisers and giving investment advice.[128]

In the context of the Royalty Unit offerings, however, Mr. Winkelmann and Blue Ocean were not soliciting new investment advisory clients, making recommendations or giving investment advice – they were offering securities as part of a capital raise.[129] Outside of the investment adviser/client relationship, there does not exist a similar obligation to disclose conflicts of interest. Further, when communicating with potential investors that happened to be investment advisory clients of Blue Ocean, Mr. Winkelmann was careful to tell them that he could not recommend they purchase the investment.[130] Even the investor witnesses called by the Division admitted that Mr. Winkelman so informed them.[131] Indeed, in the very first representation in the Subscription Agreement, the investor acknowledged that Blue Ocean had not provided any investment advice.[132]

---

investment adviser -- consciously or unconsciously -- ***to render advice*** that was not disinterested.") (Emphasis supplied).

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

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

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

[130] *Id.*

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

[132] RX-003, p. 129. The Division attempted to construe this particular representation and warranty as a "set up," arguing it should be interpreted to mean that Blue Ocean had *never* provided any investment advice, in any context, to the particular investor at any point in the history of the world. Given the context of the paragraph, however, in a document accepting the purchase of a particular investment, it is more properly read to speak only to the specific investment that is contemplated.

The Division also suggested this single sentence proved that Greensfelder was unaware that Mr. Winkelmann intended to (and did) sell Royalty Units to Firm clients. This wild extrapolation is contradicted by Mr. Winkelmann's unrebutted testimony was that he and Mr. Morgan discussed this issue and that Mr. Morgan advised him he could sell it to Firm clients. Tr. 1251:5-23 (Winkelmann). Moreover, were there any reason to doubt Mr. Winkelmann's testimony, the issue was discussed in their written email communications (with Mr. Walsh and Ms. Menghini). In those emails, Mr. Winkelmann, working with Mr. Walsh and Ms. Menghini to prepare the Firm's

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

b. No Conflict Existed.

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

In paragraph 12 of the OIP, the Division alleges that Respondents failed to disclose a supposed "material conflict of interest" that existed between themselves and the investors in the Offerings. Specifically, the Division alleges that Respondents had a "financial interest in their advisory clients' decision regarding whether to purchase Royalty Units," but did not disclose this. Stated differently, as amplified in paragraph 13 of the OIP, the Division essentially posits

Form ADV, wrote to them seeking advice on how to answer Part 1 Item 8(A)(3) and, specifically, whether he had to disclose the fact he was selling Royalty Units to clients. Mr. Walsh responded that Mr. Winkelmann only needed to make that disclosure if he "recommended" the unit purchase. RX-106, pp. 2400-2402. This response dovetailed perfectly with Mr. Morgan's advice, that Mr. Winkelmann could sell – but not recommend – the Royalty Units to Firm customers. Further, when Mr. Winkelmann responded that he had never made any such "recommendation," but only made clients aware, neither Mr. Walsh nor Ms. Menghini reacted with shock or surprise. There is no evidence that they suddenly realized that their client had done something "contrary" to a prior recommendation, as the Division suggests. Instead, the email continues without any sign the boat had been rocked.

Further, in response to the Division's theory, it is worth noting that in response to the Division's subpoenas, Greensfelder was required to produce *all* email communications on this topic – not only those it exchanged with Mr. Winkelmann. The record reflects several emails that were produced between Ms. Menghini, Mr. Walsh and/or Mr. Morgan on which Mr. Winkelmann was not copied. Tellingly, the Division did not produce any email communications among Greensfelder counsel evidencing that this email from Mr. Winkelmann was met with surprise.

Finally, it is worth noting that Mr. Walsh was not only listed on the Division's witness list, but subpoenaed to appear and testify at the hearing in rebuttal if needed. The Division did not call him to testify. Mr. Winkelmann's testimony, therefore, remains unrebutted.

that there was a conflict between the investors' right to a minimum percentage of monthly cash receipts, on the one hand, and Mr. Winkelmann's decision to compensate himself, on the other. In fact, the evidence established that there was no conflict, thus obviating any need to disclose its supposed existence.

The principal problem with the Division's view of things is that it continually loses sight of the unique nature of the investments at issue, Royalty Units.[133] A typical equity or debt investment in a private placement requires the issuer to make ongoing interest or dividend payments for a stated length of time, followed by the return of the investors' principal. The offering is – again, generally speaking – silent as to the source of funds from which the payments are to be made. The risk investors take is that the issuer will not earn enough profits to make the promised payments.

By comparison, with Royalty Units, the Offering Memoranda spell out explicitly two unique facts that make this investment quite different. The first is the source of funds for investors' payments: Blue Ocean's cash receipts, rather than its profits. As a result of that fact, investors are paid first, before any expenses are paid, including, most notably, expenses relating to compensation to Mr. Winkelmann, and regardless of whether or not there were any profits in any given month.[134] The unrebutted testimony adduced at the hearing confirmed that no

---

[133] It also ignores the fact that not all of the investors in the Offering were investment advisory clients of Blue Ocean. To those investors, Respondents owed no fiduciary duty. In the absence of a fiduciary duty, there was no obligation even to disclose conflicts of interest.

Moreover, the evidence in the record – including testimony from Mr. Winkelmann as well as the investor witnesses – established that Mr. Winkelmann did not recommend the investment. Tr. 37:12-25; 38: Tr. 46:5-10; (Swardson); 783:20-784:2 (Winkelmann) (The best that the Division was able to do to rebut that fact was its expert's opinion that the evidence "suggested" to him that Mr. Winkelmann "implicitly" recommended the investment. Tr. 326:17-327:12. That is not enough.) Because Mr. Winkelmann made it clear to all investors, regardless of whether they were advisory clients of Blue Ocean, that he was not "wearing his investment advisor hat," he had no duty to disclose conflicts of interest.

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

expenses that Blue Ocean ever paid, including compensation paid to Mr. Winkelmann, had any impact whatsoever on how much investors were entitled to receive.[135]

Second, the Offering Memoranda make it abundantly clear that there was no set *timeframe* for investors to receive their money. The Subscription Agreement that each investor signed included in the Representation and Warranties section an acknowledgement from the investor "that the Royalty . . . may never be paid in full by the Company *and the Royalty is not required to be paid in full before any scheduled date.*"[136] If those words were somehow not clear enough, the Offering Memoranda each contain a table showing varying payout schedules, each based on different assumptions of the monthly percentage paid. Importantly, they all expressly depict a scenario where only the minimum percentage is paid, revealing a very wide range of possible "payback" dates, none of which was actually promised.

While Blue Ocean admittedly *aspired* to be able to pay more than the minimum monthly percentage of cash receipts to its investors,[137] which, naturally, would cause the investors to be repaid sooner than if only the minimum percentage was paid, it is undisputed that Blue Ocean had absolutely no *obligation* actually to do so. The Division argues, correctly, that Blue Ocean had the ability to pay more to investors than the minimum percentage. That is true. But,

---

because the existence or non-existence of profits was immaterial, necessarily, so was the existence, or amount, of any expenses that Blue Ocean paid *after* the investors received their promised percentage of the cash receipts.

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

[136] RX 1, p. 98. In addition, each investor that testified, including those the Respondents called as well as everyone the Division called (Tr. 41:20-42:4 (Swardson) ; Tr. 365: 1-9 (Buckowitz); Tr. 647: 12-23 (Grau)) acknowledged his awareness of this fact. Interestingly, Mr. Swardson claimed that Mr. Winkelmann had told him to expect to get his money back in five years, but also testified that he knew the terms of the deal did not specify any particular timeframe for repayment. Tr. 41:20-42:4 (Swardson). Of course, it is, perhaps, no surprise that Mr. Swardson was aware of this, as he also testified that he read the Offering Memorandum a couple of times before investing, spending at least a couple of hours each time. Tr. 39:10-18.

[137] The Division accurately referred to this in its Pre-hearing Brief as a "goal.," DOE Pre-Hearing Br. p. 7 (""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 Division's expert, Mr. Laby, agreed that a goal is "aspirational," and not a "duty." Tr. 262:19-263:6 (Laby).

according to the terms of the deal, the decision to pay more than the minimum was in Blue Ocean's "sole and absolute discretion,"[138] and there were no stated circumstances under which Blue Ocean ever *had* to pay more than the minimum.[139]

The result is that the only *duty* that Blue Ocean had under the Offerings was to pay the minimum monthly percentages. Whatever compensation Blue Ocean deigned to pay Mr. Winkelmann, if any, had no impact on that duty, as that constituted an expense paid *after* the royalty payment was computed.

Instead, as the Offering Memoranda stated, the interests of Blue Ocean and its investors were aligned. Because the investors were entitled to a percentage of cash receipts, both investors and Blue Ocean were interested in increased revenues.[140] Higher revenues for the Firm meant the Firm was growing (its stated objective). Higher revenues for the Firm also meant the investors received higher monthly payments, even if only the minimum percentage was applied. The higher their payments, the more quickly they would be repaid their principal plus the promised multiple (which varied by offering).

Therefore, because compensation paid to Mr. Winkelmann did not influence in any way Blue Ocean's duty under the Offerings, the statements in the Offering Memoranda quoted in paragraph 13 of the OIP regarding the "alignment" of the investors' interests and Mr. Winkelmann's interest were accurate, as there was no conflict of interest. Because the Offering

---

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

[139] The Division insistently pushed its theory that any remaining capital in Blue Ocean's account at the end of a particular quarter was money that "could have" been paid to investors and *implied* – but stopped short of alleging – that any other use of the funds was somehow improper. In the absence of any obligation to make additional payments, however, this is simply untrue. Beyond that, it runs contrary to Blue Ocean's stated objective in the Offering Memoranda. The Firm's intention was to use the capital to grow the company – whether by promoting its name in the area, retaining its personnel, or pushing forward with the advertising campaign. The Division's theory that the Firm should have emptied its coffers each quarter simply because it had the legal right (but not the obligation) to make additional payments to investors lacks both legal support and a common sense appreciation of how a business is run.

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

Memoranda were accurate, and there was no conflict of interest to disclose, the Division's claims based on that alleged omission must be dismissed.

6. Respondents did not make any material misrepresentations regarding Brian Binkholder.

In paragraph 14 of the OIP, the Division alleges that Respondents made materially misleading statements regarding Brian Binkholder in the Offering Memoranda for Rounds 2 and 3. Specifically, the Division maintains that Respondents should have informed investors in those two rounds that in December 2011, Mr. Binkholder was the subject of an Order from the Missouri Division of Securities that barred him from acting "as an agent or investment adviser representative in the State of Missouri." According to the Division's argument, this information was necessary due to "the prominence of [Mr. Binkholder] and his radio show in the offering memoranda."

Frankly, this is an odd argument, given the actual role that Mr. Binkholder played at Blue Ocean as of the date of the Offering. Most notably, he was ***not*** registered as an investment adviser representative.[141] Accordingly, the fact that he was barred by the State of Missouri from acting in that capacity had no impact whatsoever on the tasks that he was actually performing for Blue Ocean.[142] What Mr. Binkholder was doing for Blue Ocean was acting as a lead generator,[143] principally through his radio show, but through his website, as well. Prospective customers would hear Mr. Binkholder on the radio as he endorsed Blue Ocean, or they heard Blue Ocean advertisements placed on Mr. Binkholder's radio show. In theory, as well as

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

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

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

practice, the customers would then find their way to Blue Ocean, either directly or through Mr. Binkholder's website.[144]

It is also undisputed that following his Missouri bar, Mr. Binkholder continued to perform the exact functions for Blue Ocean as he had prior to the bar. He continued to host his radio show, and he continued to drive customers to Blue Ocean.[145] That did not change until *after* Rounds 2 and 3. Accordingly, there was no reason to disclose to investors in those two rounds that Mr. Binkholder was barred by Missouri, as that Order did not affect in the slightest Mr. Binkholder's described role at Blue Ocean.[146]

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

- In none of the four Offering Memoranda, and specifically including those for Rounds 2 and 3, is Mr. Binkholder even included among the list of Blue Ocean's "Key People."[147]
- In none of the four Offering Memoranda, and specifically including those for Rounds 2 and 3, is Mr. Binkholder or his dba – The Financial Coach – included among the list of Blue Ocean's "Key Vendors & Relationships."[148]

---

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

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

[146] Mr. Winkelmann testified that he told at least three of the investors about Mr. Binkholder's bar when it occurred. Tr. 1384:6-13. At least one investor witness, ironically, one who the Division called to testify, corroborated that. Tr. at 340:11-341:6.

[147] The Key People listed in Round 2 are Mr. Winkelmann, David Arns, Carey Mulwee, Lee Pelligreen, Sara Meystedt, Kelly Hennessy, Jennifer Elbert and Megan Mathews. In Round 3, the list is the same except for the addition of Shepard Swift.

- Mr. Binkholder's radio show was merely one piece of a much larger advertising strategy, not its focal point. Indeed, the Offering Memoranda essentially give equal attention to Charlie Brennan, the host of another radio show that Blue Ocean sponsored.
- There was no evidence that Mr. Binkholder was particularly successful in generating business for Blue Ocean.[149]

On balance, there was nothing about Mr. Binkholder's Missouri bar that investors needed to know. He was engaged by Blue Ocean exclusively to generate leads[150] by hosting a radio program. And that is precisely what he did. Had the Missouri bar somehow prevented Mr. Binkholder from doing that, the Division might have a leg to stand on; but, since the bar created no impediment to Mr. Binkholder's ability to do his show, it was immaterial to Blue Ocean and its investors. As Mr. Winkelmann testified, it simply did not matter that Mr. Binkholder was barred from functioning as an investment advisor because Mr. Binkholder "wasn't being retained or compensated in that capacity of being an investment advisor representative."[151]

a. Respondents' accounting of Mr. Binkholder's payments was proper.

There is one .other issue relating to Mr. Binkholder, but it is more pertinent to the allegations about the disclosure of the advertising factor than it is to the omission of the Missouri

---

[148] According to the Offering Memoranda, Blue Ocean's Key Vendors & Relationships were Scottrade, AssetBook, RedTail Technologies, Tamarac Advisor Xi, Grasshopper, Dropbox and McGowan Crain. RX-001-004.

[149] While there was evidence adduced that the biggest source of leads for Blue Ocean came from radio advertising, that data did not breakdown those leads that came from Mr. Binkholder's radio program and those that came from ads run at other times on the same radio station. RX-013 and RX-014. Mr. Winkelmann testified that Mr. Binkholder's show was only on the air for an hour a week, while Blue Ocean ads essentially ran around the clock, seven days a week, on the station that aired his show. Tr. at 429 and 431. It is not surprising, therefore, that Mr. Binkholder's actual contribution to the bottom line appeared to be modest.

[150] *See* RX -001, p. 27, which outlines the entirety of Mr. Binkholder's "obligations" under the Marketing Agreement: "to prominently and exclusively display and promote Blue Ocean services . . . ." It is important to note that the provision of any kind of investment advice is *not* included here.

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

bar. In short, Blue Ocean entered into a written agreement[152] with Mr. Binkholder to serve as the exclusive sponsor of his radio program. Pursuant to the terms of that arrangement, Blue Ocean agreed to pay Mr. Binkholder "a monthly sum that is at least equal to" Mr. Winkelmann's monthly compensation as Blue Ocean's CEO. It is undisputed that Blue Ocean did not consider those payments it made to Mr. Binkholder under the agreement to be "advertising expenses," and, thus, Blue Ocean did not include them in its computation of the advertising factor. The Division argues that they were advertising expenses, and the decision by Blue Ocean not to treat them as such served to artificially lower the advertising factor, creating the false impression that Blue Ocean's advertising was more efficient than it actually was.

The problem for the Division, as it is elsewhere in this case, is that it failed to introduce any evidence in support of this argument. Indeed, its own Staff Accountant, Mr. Collins, readily admitted that as far as he was aware, there is nothing in GAAP that supports characterizing the payments to Mr. Binkholder under his agreement with Blue Ocean as advertising expenses.[153] Moreover, consistent with that, Mr. Winkelmann provided unrebutted testimony that his own CPA advised him that the payments to Mr. Binkholder were correctly treated as consulting fees, not advertising expenses.[154] Of course, that made perfect sense in light of the "whole host" of advertising and marketing consulting services that Mr. Binkholder was providing to Blue

[152] RX-001, pp. 26-30.

[153] Tr. 168:11-18 (Collins).. Rather than relying on GAAP, and in the absence of any other "authority" he could find, Mr. Collins admitted that, instead, he relied on "common sense." *Id.* at Tr. 168:11-18 (Collins) and Tr. 170: 9-11 (Collins)..

[154] Tr. 1308:17-1309:2 (Winkelmann).

Ocean.[155] Finally, the record showed that payments that Blue Ocean made to the radio station on which Mr. Binkholder's show aired *were* treated as advertising expenses.[156]

In sum, while the Division may not like the manner in which Blue Ocean characterized its payments to Mr. Binkholder, it failed utterly even to attempt to introduce any evidence that would permit a finding in the Division's favor on this issue.

7. Blue Ocean's payment of fees to related companies was not fraudulent.

In paragraph 16 of the OIP, the Division includes an allegation that the Offering Memoranda omitted a disclosure that in addition to paying Mr. Winkelmann compensation, Blue Ocean also was paying "material amounts of Royalty Unit investor proceeds to companies owned and controlled by Winkelmann," including over $100,000 "as purported 'management fees.'"[157] For reasons discussed above, these allegations fail.

In short, it comes back to the fact that pursuant to the terms of the Offering, Royalty Unit holders were paid first, before any other creditors, as a specified percentage of Blue Ocean's "cash receipts." Any payments that Blue Ocean made after that, no matter to whom, no matter in what amount, had no impact on Blue Ocean's duty – and, equally important, ability – to pay its investors their required portion of the monthly cash receipts. While any payments Blue Ocean made *after* it made its required distributions to Royalty Unit holders, including payments to affiliated companies, could, theoretically, have impacted Blue Ocean's ability to make *additional, discretionary* distributions to its investors, because it is undisputed that Blue Ocean

---

[155] Tr. 1371:18-24 (Winkelmann); RX 101.

[156] Tr. 1308: 2-5 (Winkelmann). It is also worth noting that in the Marketing Agreement itself, the payments to Mr. Binkholder were explicitly deemed by the parties to be "over and beyond the direct expenses of advertising." RX-001, p. 27, Section 1.02. If the parties to the agreement themselves, i.e., Mr. Winkelmann and Mr. Binkholder, did not treat the payments as advertising expenses, it seems clear that a stranger to that agreement, i.e., the Division, cannot change that determination.

[157] The Division does *not* allege that any of these payments was improper; rather, the sole allegation is that the payments should have been disclosed to investors.

had no obligation to make additional distributions, it is immaterial whether or not Blue Ocean, in fact, made them. Investors necessarily made their decisions to invest based on what Blue Ocean was required to do under the terms of the Offering, not what it may have aspired to do, or what they may have hoped Blue Ocean would do.

a. No non-disclosure with regard to the "management fee" payments.

The Division has alleged that the Offering Memoranda failed to disclose that Blue Ocean was paying "management fees" to other Blue Ocean entities, specifically, Blue Ocean Management and Longrow Insurance. The Division also alleges, not in the OIP but through its expert, that the Firm failed to disclose a four-day short term collateral pledge to its ATM subsidiary.

None of these allegations are supported by the evidence. With regard to Blue Ocean Management, that entity was an umbrella company formed to pay common costs (such as rent, salaries and supplies) of the Blue Ocean entities. Each entity made payments to Blue Ocean Management for its share of the costs. This structure almost immediately proved overly complicated and was abandoned. By the end of 2011, Blue Ocean paid its own expenses directly.

During Blue Ocean Management's brief tenure, Blue Ocean made regular payments to cover the salaries of its employees, its rent, and other expenses normally incurred by the business (health insurance, copiers, supplies, etc.). After reviewing Respondents' proposed hearing exhibits, prior to the hearing, which included Blue Ocean Management's General Ledger, the Division decided not to pursue charges based on those payments. The Division's expert revised his initial report to remove any opinion as to the propriety of the "management fees" paid to Blue Ocean Management.

The Division also challenged certain payments to Longrow Insurance Agency, another Blue Ocean affiliate. 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, Blue Ocean used Longrow's email and file servers to conduct its operations. Using Longrow's servers, which were very powerful and very expensive, saved Blue Ocean the expense of purchasing the same. In exchange for use of these facilities, Blue Ocean paid Longrow a monthly stipend.[158] Contrary to the Division's insinuation, none of these expenses was unusual, improper, or required express disclosure in the offering documents.

The Division has also alleged that the Firm should have disclosed a four-day collateral pledge Blue Ocean made to Blue Ocean ATM. Blue Ocean ATM used the funds to secure a bank loan it took out to stock its ATMs with cash for a three-day festival.[159] The Division argues that the $70,000 pledged as security for the Blue Ocean ATM loan for three days were funds that "could" have been turned over to Royalty Unit holders, thus creating a conflict. This argument repeats one of its defective theories addressed above: that any funds remaining in Blue Ocean's account at the end of a quarter should have been paid to investors. The $70,000, however, while available for use by Blue Ocean ATM for four days (two of which were Saturday and Sunday), was not "surplus" money that the Firm could afford to give away. Instead, it was earmarked for future advertisements.[160] Because there was no conflict created by the collateral pledge, there was no attendant disclosure obligation. The Division's flawed and unsupported theory, once again, fails.

[158] One of the payments to Longrow was Mr. Winkelmann's salary payment.

[159] Tr. 809:14-810:6 (Winkelmann).

[160] Tr. 1396:2-22 (Winkelmann).

Beyond that, even *were* this collateral pledge considered a required disclosure (which it is not, given the absence of a conflict), it was disclosed. Prominently featuring Blue Ocean ATMs – which include the Blue Ocean name and logo – at local events was the type of promotional activity specifically contemplated by the Offering Memoranda[161]:

> Blue Ocean Portfolios is planning to use the proceeds of the Royalty Offering to expand its advertising reach, syndicate its sponsorship of *The Financial Coach Show* radio program to other smaller markets in the 150 mile radius of St. Louis, improve creative aspects of the advertising message, and pay for general and administrative expenses. ***Proceeds could also be used to fund other revenue-producing activities that are directly or indirectly related to Blue Ocean Portfolio's business activities.***

While the Firm did not realize any revenue on the pledge, it did gain name recognition.[162] As Mr. Winkelmann testified[163]:

> Q: And you didn't make Blue Ocean ATM pay Blue Ocean Portfolios any money for using Blue Ocean Portfolios' funds as collateral, correct?
>
> A: Again, I thought there was a great advertising benefit. I talked about this in my Wells notice is that clearly there's a good advertising benefit to have Blue Ocean in front of all these people. So there was certainly a benefit for Blue Ocean Portfolios to have Blue Ocean ATM in front of all these people.

Even were the Court to conclude the ATM loan a required disclosure, it was already sufficiently disclosed in the Offering Memoranda, which contemplated that these types of promotional events may occur.

8. Respondents' email communications are not actionable.

Similar to the above allegations, the Division has failed to prove that any of the information contained in the emails discussing the adverting factors were incorrect.[164] Mr. Winkelmann testified that he obtained the information by accessing the Firm's records and the

---

[161] RX-2, pp. 6-7.

[162] Tr. 1397:11-13 (Winkelmann)

[163] Tr. 815:7-16 (Winkelmann)

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

contents of the emails reflected what he had reviewed. Further, some of these emails repeat the advertising factors already addressed above, none of which was incorrect or misleading.

The emails in Paragraphs 1-3[165] set forth the same advertising data addressed above with regard to Round 1. The first email, sent over a month before the offering, stated that the Firm was spending $2,200 to generate $9,000 in revenue, or a 0.24 factor. This is almost the same as the factor of 0.22 that would be later disclosed in the Offering Memorandum, suggesting it was retrieved directly from the Firm's data. The second email, sent after the offering, provides a $22,000 to $100,000 ratio – or 0.22 (identical to the offering memorandum). The third email equates to a 0.31 factor (but was based on post-offering information, given it was sent in May)[166]. The data in each email, like the data in the Offering Memoranda, was calculated using the Firm's then-existing data. For the same reason the Offering Memoranda are not misleading, the emails are likewise not misleading.[167]

Paragraph 7 fails to state a claim for relief, since the statement was not made "in connection with" the purchase or sale of any security. On August 1, 2012, there was no open offering.[168] Because the statement, even if incorrect, was not made in connection with the purchase or sale of a security, it cannot form the basis for the Division's Section 10(b) or 17(a) claims.[169]

---

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

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

[167] Paragraphs 4-6 repeat the 2011 advertising factor, addressed in Section 3.A.1.i. above. With regard to the statement in paragraph 5 that Blue Ocean spent 0.56 in advertising to earn $1.00 in revenue, there is no evidence that statement is false. To the contrary, it is a reasonable factor for mid-February 2012. The month end numbers for February 2012 were 0.67.

[168] Tr. 1364:1-15 (Winkelman).

[169] 17 C.F.R. § 240.10b–5(b); *U.S. v. Harris*, 919 F. Supp. 2d 702, 709 (E.D. Va. 2013); *Harris*, 919 F. Supp. at 709 ([Section 17(a)] is still limited to actions taken in the offer or sale of a security ***and does not include post-sale conduct*** . . . [a]ccordingly, where fraud in the sale of a security is alleged, the fraud must ***facilitate*** the sale of that security. Under this logic, any acts occurring post-sale would fall outside the scope of [the Section].") (emphasis added); *Bosio v. Norbay Sec., Inc.*, 599 F. Supp. 1563, 1566 (E.D.N.Y. 1985) ("This principle has been reiterated in

With regard to paragraphs 8-11, all sent within days of one another,[170] Mr. Winkelmann testified that he believed each of those statements, regarding the current status of the Round 3 raise, to be true when he made them based on the commitments he had received and that he "had every reason to believe" were firm.[171] These statements were not false or misleading because Mr. Winkelmann believed them to be true and accurate.[172]

Moreover, for each of the emails sent immediately prior to or contemporaneous with an offering, – even were the statements deemed misrepresentations (which they are not), the distribution of the Offering Memoranda, with their accurate information, provided the investor with information needed to make the prior statement not misleading.[173] Additionally, each subscription agreement required each investor to affirm the following statement to be true[174]:

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

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

---

numerous district and circuit court cases in this circuit. The fraud practiced must have been *prior to or contemporaneous with* the sale of securities.") (internal citations omitted, emphasis added); *Kogan v. Nat'l Bank of N. Am.*, 402 F. Supp. 359, 361 (E.D.N.Y. 1975) (same); *Freschi v. Grand Coal Venture*, 551 F. Supp. 1220, 1227 (S.D.N.Y. 1982) ("Therefore, there can be no causal connection where the alleged misrepresentation or omission occurred after the purchase.").

170 Paragraphs 8-10 reflect emails all sent on the same day.

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

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

173 RX-001 – RX-004.

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

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

1. Standard for materiality.

Rule 206(1),Section 10(b) and Section 17(a)(1)-(3) all require that the alleged misrepresented or omitted fact be "material." "[T]o fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"[175] Further, whether a fact is material "depends on the significance the reasonable investor would place on the withheld or misrepresented information."[176] "Whether or not a particular description, representation, illustration, or other statement involving a material fact is misleading depends on evaluation of the context in which it is made."[177] Further, "if it is questionable whether a fact is material, or its material is marginal, that tends to undercut the argument that defendants acted with the requisite intent or extreme recklessness in not disclosing the fact."[178] Where the lack of importance of the omission is so plain that reasonable minds could not differ on the issue, it is proper for the trier of fact to pronounce the omission immaterial as a matter of law.[179]

2. Enforcement failed to prove materiality.

Assuming *arguendo* that the advertising conversion factors that appeared in the Offering Memoranda were incorrect (which they were not), the Division's Section 10(b) and Section 17(a) claims nonetheless fail because the information specifically at issue was not material. To be

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

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

[177] 17 C.F.R. § 230.156(b).

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

[179] *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 161–64 (2nd Cir.2000).

material, there must be a "substantial likelihood" that the misrepresented fact would have "significantly altered" the "total mix of information" available.

The focus of the Offering was the Firm's advertising campaign and, specifically, the Firm's ability to spend its advertising dollars efficiently to bring in new clients. Thus, the Offering Memoranda focus heavily on the Firm's advertising plan, devoting pages to a detailed explanation of how it would use investor funds to spread its message to potential investors/new clients most efficiently.[180] The offering documents expressly identified the Firm's primary advertising venues (The Financial Coach Show and the Charlie Brennan Show), as well as its expansion plans going forward.[181] The offering documents also included a tremendous amount of financial data about the Firm, its historical, current and projected AUM, and charts that projected revenue based on the projected growth.

All of this information allowed investors to assess (1) Blue Ocean as a company; (2) Mr. Winkelmann as its manager; (3) the Firm's approach to investing (i.e., its advertising message); (4) the advertising expansion plan; (5) advertising partners; (6) revenue projections based on assumed growth and fees; and, importantly, (7) the attendant risks. This description included graphs and pie charts which explained visually what the above paragraphs communicated verbally.[182] Even transcripts of the radio advertisements was provided for investors to review.[183]

From this "total mix" of information, an investor could reasonably assess the Firm's advertising strategy and make a fully informed decision on whether to invest. There is no evidence that a single sentence of the Offering Memoranda containing the advertising factor, a

---

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

[181] RX-3, p 7.

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

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

short-hand arithmetic expression of what otherwise took pages to describe in words, "significantly altered" that analysis. To the contrary, the investors who testified at the hearing stated that they attributed no importance to the listed factor. Instead, they invested because they *believed in* the Firm's message, its strategy for achieving growth via efficient advertising, and Mr. Winkelmann himself.[184]

This is even more obvious with regard to the Round 3 Offering. In Round 3, the Firm included in the Offering Memorandum a full chart, produced out of the Firm's internal data, showing the advertising spend and revenues received on a monthly basis for the prior year. The chart also calculated the advertising factor on a monthly basis. Thus, in addition to the single sentence in the Offering Memorandum on which the Division focuses, investors also received the following[185]:

	New AUM	Projected New Annual Recurring Revenue	Advertising Spend	Sales Rep Commission Paid	Administrative Bonus Payments	Total Acquisition Cost	Months to Payback	Advertising Factor
June-11	$ 892,234	$ 8,030	$ 42,921	$ 2,231	$ 833	$ 45,985	68.7	5.35
July-11	$ 3,047,957	$ 27,432	$ 27,884	$ 7,620	$ 1,100	$ 36,603	16.0	1.02
August-11	$ 3,719,673	$ 33,477	$ 17,763	$ 9,299	$ 1,100	$ 28,162	10.1	0.53
September-11	$ 1,817,347	$ 16,356	$ 18,626	$ 4,543	$ 1,100	$ 24,270	17.8	1.14
October-11	$ 1,539,823	$ 13,858	$ 32,447	$ 3,850	$ 1,320	$ 37,616	32.6	2.34
November-11	$ 1,887,106	$ 16,984	$ 24,386	$ 8,115	$ 1,320	$ 33,821	23.9	1.44
December-11	$ 1,928,116	$ 17,353	$ 18,881	$ 8,291	$ 1,320	$ 28,492	19.7	1.09
January-12	$ 3,379,121	$ 30,412	$ 25,004	$ 14,530	$ 1,890	$ 41,425	16.3	0.82
February-12	$ 1,925,153	$ 17,326	$ 15,636	$ 8,278	$ 1,890	$ 25,804	17.9	0.90
March-12	$ 5,235,951	$ 47,124	$ 22,112	$ 19,832	$ 1,890	$ 43,834	11.2	0.47
April-12	$ 5,183,446	$ 46,651	$ 32,966	$ 9,126	$ 1,283	$ 43,376	11.2	0.71
May-12	$ 2,860,477	$ 25,744	$ 16,462	$ 11,616	$ 1,283	$ 29,361	13.7	0.64
June-12	$ 1,677,083	$ 15,093	$ 7,689	$ 8,748	$ 1,283	$ 17,720	14.1	0.51
	$ 35,093,437	$ 315,841				$ 436,469	16.58	

Even if the "current" factor listed in the Round 3 memorandum was inaccurate, it would not be misleading or material in light of the full information provided. The above includes all relevant data regarding the Firm's past spending and performance – including a calculation of the

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

[185] RX-003, p. 14.

advertising factor on a monthly basis. In light of the inclusion of the above data, even if the language at issue is incorrect, it did not alter the total mix and, therefore, is not material as a matter of law.

C. <u>Mr. Winkelmann and Blue Ocean did not violate Section 10(b) of the Exchange Act, Section 17(a)(1) of the Securities Act or Section 206(1) of the Advisers Act because they did not act with *scienter.*</u>

As noted above, and as outlined in Respondents' Pre-hearing Brief, the reasonable reliance upon advice of counsel is a recognized defense to the *scienter* element that the Division must prove to establish the alleged violations.[186] The advice of counsel defense requires that Mr. Winkelmann and Blue Ocean establish four elements: (1) complete disclosure to counsel; (2) request for counsel's advice as to the legality of a contemplated action; (3) receipt of advice that the contemplated action was legal; and (4) good faith reliance on that advice.[187] Here, the record amply supports the conclusion that Respondents, in fact, reasonably relied on the legal advice that they obtained from their competent and experienced attorneys at Greensfelder.

Mr. Winkelmann principally worked with attorney Michael Morgan, whom he had known since the mid-1990s, when Mr. Morgan assisted on a successful securities offering.[188] At the time, Mr. Morgan was not associated with Greensfelder.[189] Subsequent to that, however, in 2005 or 2006, Mr. Winkelmann had engaged Greensfelder's services.[190] So, when Mr. Morgan later joined Greensfelder, it was logical for Mr. Winkelmann to continue to look to Greensfelder when Blue Ocean needed legal advice regarding the Offerings.[191] The record is clear that

---

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

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

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

[189] *Id.*

[190] *Id.*

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

Greensfelder held itself out to the public as a firm that possessed expertise and experience in banking and financial services, and was trusted by investment advisors, among other clients.[192]

Mr. Winkelmann engaged Greensfelder to provide legal services in connection with two separate matters – securities compliance and the Offering – which were related, given that the Offering triggered the need to make certain regulatory filings.[193] The securities compliance matter included the provision of advice regarding "ADV filings and U4 filings, Reg D filings. Any kind of regulatory filing that would be needed to be reviewed, updated, filed with the appropriate regulatory agencies."[194] Regarding Greensfelder's work in connection with the Offerings, "[a]ny kind of investor-facing or regulatory-facing document, they would have had at least a review role, if not a drafting role, on that document."[195] To that end, Greensfelder drafted the certificate that investors received, the subscription agreement (including the risk disclosures), the exclusive marketing agreement between Blue Ocean and Mr. Binkholder, the warrant that Round 1 investors received, the cover letter that was used to transmit the offering materials to investors, Blue Ocean's business plan that was included in the offering materials, and, most importantly, Greensfelder "reviewed and . . . proofed the PPM or the offering memo" for each round.[196]

It was undisputed that Mr. Winkelmann had lots of communications back and forth with Greensfelder regarding the Offering Memoranda.[197] In fact, the Division stipulated that Mr.

[192] RX-114.

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

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

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

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

[197] RX-106.

Winkelmann "consulted with Greensfelder for each of the offerings, and that Greensfelder did review all of the offering memoranda."[198] More specifically, it was undisputed that:

- Mr. Winkelmann had discussions with Greensfelder about the disclosures that are contained in the Offering Memoranda;[199]
- Greensfelder provided him advice about the disclosures contained in the Offering Memoranda that are at issue in this case;[200]
- Mr. Winkelmann never declined to accept any advice he received from Greensfelder about the disclosures contained in the Offering Memoranda that are at issue in this case;[201]
- The Offering Memoranda in this case include all the disclosures that Greensfelder advised Mr. Winkelmann to make; and[202]
- Mr. Winkelmann followed the advice that he received from Greensfelder in connection with the preparation of the Offering Memorandum and related documents.[203]

In light of the evidence establishing that Respondents solicited and received advice on each of the above topics, and that Respondents reasonably relied upon the advice of their counsel for the duration of the time period at issue, the Division's allegation that Respondents acted with

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

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

[200] *Id.*

[201] Tr. 1251:5-23 (Winkelmann).

[202] Tr. 1347:4-12 (Winkelmann).

[203] Tr. 1335:1-1337:4 (Winkelmann).

scienter is effectively rebutted.[204] As a result, the Divisions' *scienter*-based allegations must be dismissed.

D. **Mr. Winkelmann and Blue Ocean did not violate Section 17(a)(2) or (a)(3) of the Securities Act or Rule 206(2) of the Investment Advisers 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.

The lack of existence of a material misrepresentation has already been addressed in Section III.B., above. With regard to the elements already discussed in that section (except for scienter) Respondents incorporate them herein, by reference. Accordingly, because the Division has failed to show that Mr. Winkelmann or Blue Ocean made any misrepresentations of a material fact (required elements), the Division's claims fail and should be dismissed.

Beyond that, the alleged violations under Rule 206(2) and Section 17(a)(2) and (3) of the Securities Act require that the Division establish Respondents acted negligently.[205] Negligence is the failure to uphold a legal duty owed another.[206] In the context of an investment advisory relationship, the applicable duty arises out of the fiduciary relationship. *Id.* Respondents,

---

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

[205] *See, e.g., In the Matter of David J. Montanino*, Release No. 773 (Apr. 16, 2015).

[206] *Byron G. Borgardt*, 56 S.E.C. 999, 1021 (2003).

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.[207]

The Division likewise failed to establish Respondents acted negligently. For the same reasons set forth above, with regard to *scienter*, Respondents acted reasonably to avoid misleading their advisory clients and investors. Further, the fact that Respondents relied on the advice of their counsel likewise rebuts the Division's allegation that they acted negligently. A reasonable person, who is not entirely familiar with – let alone an expert on – securities laws or disclosure requirements in offering documents acts reasonably by obtaining and relying on the advice of experienced counsel.[208] In fact, it would be *un*reasonable to presume that a person unsophisticated in securities law would take it upon themselves to "independently examine" the applicable laws "after taking the reasonably prudent step of securing advice" from a qualified attorney.

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

E. Respondents did not Violate Section 207.

The final allegation is that Respondents violated Section 207 of the Act,[209] 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

---

[207] *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194, 84 S. Ct. 275, 284 (1963).

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

[209] 15 U.S.C.A. § 80b-7.

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

Specifically, the claim is that Respondents filed an inaccurate Form ADV because they stated that the Firm did not have custody of client assets.

In order to carry its burden on this claim, the Division must show that Mr. Winkelmann and Blue Ocean "willfully" omitted material facts from Form ADV. Even if the Court concludes that the Firm did, in fact, have custody of client assets after May 2012, the Division still had to establish that the violation was "willful." The record establishes that the Division failed to meet this burden.

Mr. Winkelmann's unrebutted testimony was (1) that he sought and obtained advice from Greensfelder on the question whether or not Blue Ocean had custody of customer funds, (2) that the advice was that the Firm did not maintain custody, (3) that he relied on that advice, and (4) that he had no "reason to believe the advice was not correct."[210] Indeed, even during the SEC examination, when the exam team (headed by Mr. Collins) expressed its opinion that the Firm was custodying customer funds, Greensfelder steadfastly continued to hold firm to its contrary view and advised Mr. Winkelmann to do the same. For example, Mr. Winkelmann asked his attorneys in an email:

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

Greensfelder responded:

> We need to be consistent. If we take the position, as I think we should, in the SEC exam deficiency response that we don't have custody we should be taking the

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

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.[211]

Mr. Winkelmann followed Greenfelder's adamant advice and, on April 7, 2014, the Firm responded to Mr. Collins' deficiency letter (in a letter prepared by Greensfelder[212]) which stated[213]:

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

This evidence of Mr. Winkelmann's mindset – specifically his good faith compliance with his attorney's advice – when he filed 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, fail to make a necessary disclosure in its Form ADV, the Court

---

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

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

[213] DX-298.

nonetheless held that it did *not* violate Rule 207 because the Division failed to prove the failure was "willful":

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

Id. at 181-82 (internal citations omitted). Here, as in *Slocum*, the Division did not – because it could not – rebut Mr. Winkelmann's sworn testimony that he relied on advice from Greensfelder that the Firm did not maintain custody, and that he had no "reason to believe the advice was not correct."[214] Thus, as in *Slocum*, the § 207 claim should be dismissed for lack of willfulness.

F. <u>No Aiding and Abetting.</u>

In addition to the above primary allegations, the Division has charged Mr. Winkelmann with aiding and abetting Blue Ocean's alleged violation of Sections 17(a)(1) – (3), Section 10(b), and Rule 206(1). As with the other allegations, the Division bears the burden of proof on each element of this claim and must prove, by a preponderance of the evidence that (1) Blue Ocean has committed a primary violation; (2) Mr. Winkelmann had a general awareness that his role was part of an overall activity that was improper; and (3) Mr. Winkelmann knowingly and

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

substantially assisted the principal violation.[215] It is assumed that *scienter* is required to establish secondary liability for causing a primary violation that requires *scienter*.[216]

Because no primary violations has occurred, for the reasons set forth above, the aiding and abetting allegations fail. The existence of a primary violation is the first element of an aiding and abetting claim. Without proving that element, the Division fails to carry its burden.

Even if the Court finds some primary violation of the above regulations, however, the aiding and abetting claim nonetheless fails because the Division has failed to prove the second and third elements of this claim: that Mr. Winkelmann was aware that his activity was improper and that he provided "substantial assistance" to the primary violator. To prove "awareness," the Division must show that Mr. Winkelmann must have been aware of wrongdoing or that he was "extremely reckless" in disregarding the wrongdoing and his role in furthering it.[217] In the absence of the required knowledge, an aiding and abetting claim fails.[218]

To satisfy the element of "substantial assistance," the Division must prove that Mr. Winkelmann associated himself with the conduct giving rise to the primary violation, that he participated in it "as something he wished to bring about," and that he sought by his action to make it succeed.[219]

Here, the unrebutted testimony presented at the hearing was that with each and every Offering Memorandum, and in every investor communication, Mr. Winkelmann believed the documents to be complete, accurate, and in compliance with the Firm's obligations. Moreover,

---

[215] *Investors Research Corp. v. S.E.C.*, 628 F.2d 168, 178 (D.C. Cir. 1980).

[216] *In re Brandt*, Release No. 289 2005 WL 1584978 *7 (June 30, 2005).

[217] *See Decker v. S.E.C.*, 631 F.2d 1380, 1388 (10th Cir. 1980); *In the matter of Thomas R. Delaney II and Charles Yancey*, Release No. 755 p. 33 (March 18, 2015).

[218] *Steadman*, 967 F.2d 636 at 647.

[219] *SEC v. Apuzzo*, 689 F.3d 204, 212-213 (2nd Cir. 2012); *Delaney*, Release No. 755, p. 33 (March 18, 2015).

in preparing these documents, in order to insure not only their accuracy but their compliance with the securities laws, Mr. Winkelmann engaged the expertise of experienced legal counsel to assist him and the Firm in drafting the disclosures at issue. Not only did his legal counsel review the documents, they participated substantially in their creation and Mr. Winkelmann relied upon that advice in believing them accurate and compliant.

In light of this evidence, the Division has failed to prove either that Mr. Winkelmann acted with the requisite *scienter* or that he "substantially assisted" in an unlawful venture that he wished to see succeed.[220] For this reason and those stated above, the aiding and abetting claim fails.

II. SANCTIONS ARE NOT WARRANTED

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

The Division failed to carry its burden of proof and establish that Respondents violated Section 17(a)(1)-(3) of the Securities Act, Section 10(b) of the Exchange Act, Sections 206(1) or (2) of the Advisers Act, or Section 207 of the Advisers Act.[221] As a result, Respondents request that each of those allegations be dismissed in its entirety and that no sanctions be assessed.

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

That being said, even if unintentional violations are found, no sanction is warranted. The appropriateness of any sanction is guided by the public interest factors set forth in *Steadman*.[222] The Court should weigh these factors in light of the entire record. No one factor is dispositive:[223] (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the

[220] *Delaney*. Release No. 755 p. 33 (March 18, 2015).

[221] Or any aiding and abetting liability thereunder.

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

[223] *Id.*

infraction;(3) the degree of scienter involved;(4) the sincerity of the respondent's assurances against future violations; (5) respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. Other factors that have been considered include: (7) the age of the violation;[224] (8) the degree of harm to investors and the marketplace resulting from the violation;[225] (9) the extent to which the sanction will have a deterrent effect;[226] and (10) whether there is a reasonable likelihood of violations in the future.[227]

Here, assuming a violation exists, the Steadman factors show that sanctions are not in the public interest. The Division's sole argument for the imposition of sanctions is based on two allegations: (1) that Mr. Winkelmann intentionally "manipulated" the advertising factor and (2) that he "diverted" funds that "could have" been paid to investors for his own benefit. Neither of these allegations was supported by the evidence. As addressed in great detail, above, Mr. Winkelmann did not manipulate – intentionally or otherwise – the Firm's advertising data.[228] Instead, he attempted to be as detailed as possible in his description of the program and its efficiency. As for the "diversion" of funds, the Division has failed to show that Mr. Winkelmann failed to pay any amounts he owed to investors or that he used funds for a purpose not expressly permitted in the offering documents.[229]

Beyond that, as stated above, there is no evidence that Respondents acted with *scienter*. To the contrary, at all times they strove to comply with the applicable rules and requirements.

---

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

[225] *Id.*

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

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

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

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

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, it is undisputed that Royalty Unit holders continue to receive their regular payment of a percentage of the Firm's cash receipts as promised – and will continue to receive it until they are fully repaid.

Finally, were the Court to contemplate civil penalties,[230] the Division was unable to set forth *any* evidence that *anything* over a first-tier penalty is even conceivable in this case. Second- and third-tier penalties are only awarded where the Division establishes the respondent acted with "fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement.[231] 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. To the contrary, the evidence showed that Respondents made every attempt to comply with the applicable laws.[232]

---

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

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

[231] 15 U.S.C. §78u-2(c); *S.E.C. v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144, 186–87 (D.R.I. 2004) ("However, because no losses were demonstrated, and because this Court concludes that Defendants' actions were not intentional or deliberate, second and third tier penalties are inappropriate. Rather, the Court will impose a civil penalty under the first tier only."); *In the Matter of J.P. Turner & Co., LLC*, Release No. 395 (May 19, 2010).

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

C. 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.

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.[233] In May 2012, the Firm determined that monthly payments required a lot of work for a small check.[234] 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.[235] Mr. Winkelman so informed them.[236] 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. 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.

---

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

[234] *Id.*

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

[236] *Id.*

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

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

No cease and desist order is appropriate in this case. First, the evidence shows 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. Disgorgement is not Warranted.

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

Moreover, even were some technical violation found, disgorgement would be solely punitive and would not serve any deterrent value.[237] First, for the reasons set forth above, there are no "ill-gotten gains" or "wrongfully obtained profits."[238] Mr. Winkelmann and Blue Ocean did everything right in this case: (1) they hired experienced legal counsel to advise and assist in the drafting and preparation of the offering documents at issue; (2) they hired experienced legal counsel to advise and assist in the drafting and preparation of the Form ADV; (3) they

---

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

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

objectively believed that the information contained in the offering 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 were 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.

III. 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: November 22, 2016

ULMER & BERNE LLP

Alan M. Wolper
Heidi E. VonderHeide
500 W. Madison Street
Suite 3600
Chicago, IL 60610
(312) 658-6500
Fax: (312) 658-6501
awolper@ulmer.com
hvonderheide@ulmer.com

CERTIFICATE OF COMPLIANCE

In accordance with the Court's Order, I certify that this brief, exclusive of the cover page, table of contents, table of authorities, and signature block is in compliance with the 20,000-word limit. The brief contains 19,937 words, according to the word processing system used to prepare the brief.

Heidi VonderHeide

CERTIFICATE OF SERVICE

I hereby certify that on November 22, 2016, I served a copy of the foregoing **RESPONDENTS' POST-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