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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of:

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

Respondents.

ADMINISTRATIVE PROCEEDING
File No. 3-17253

RESPONDENTS' RESPONSE TO THE DIVISION'S POST-HEARING BRIEF

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I. INTRODUCTION

This case has migrated a long way from where it began. The Division, after a years-long investigation, charged Respondents with certain, articulated, specifically-pled, allegedly misleading statements. Specifically, the Division alleged that with regard to each offering memoranda, the stated advertising conversion factor was incorrect and the factor set forth by the Division was correct. The Division continuously reaffirmed its belief that, in running its own calculations of the factor, (1) it had used the same data that the Firm had used at each relevant time period; (2) that its calculations accurately replicated the calculations performed by the Firm; and (3) that its calculations, and not the Firm's, were correct.

At hearing, it became clear almost immediately that the Division would be unable to support its own calculations. First, Mr. Collins testified that he based his calculations (and the Division, in turn, based its entire case) on a few lines of testimony given by Mr. Winkelmann during the investigation. Despite the Division the acknowledging that Ms. Juris was the "advertising guru" it built its entire case on this small excerpt from Mr. Winkelmann, despite his constant protestation, during the examination, that he could not specifically recall what was done at the time (although he tried his best to do so). Further, when confronted during the examination with the fact that his numbers did not match those Mr. Collins had collected, Mr. Winkelmann was obviously baffled, telling the investigators "we wouldn't make this stuff up."

Essentially, the investigation stopped there. The Division, despite collecting the monthly advertising reports and advertising data generated and preserved by the Firm, seemingly relied upon a random series of documents created in June and December 2012. While the data was, as the Division insists "accurate" it was accurate as of those specific dates. The Division incorrectly assumed that past data contained in those 2012 documents was identical to the data the Firm possessed in prior time periods. The Division never noticed (or ignored) that it possessed other internal documents kept by the Firm (the monthly advertising reports) that showed contemporaneous advertising factors within decimal points of those disclosed. That remained the case until its erroneous assumptions were pointed out at hearing and the advertising calculations were explained by Ms. Juris.

The importance of Ms. Juris' testimony did not go unnoticed. Following her testimony, and explanation of how the Firm calculated and traced the advertising factor, the Court gave the Division special leave to re-call Mr. Collins and have him replicate Ms. Juris (and the Firm's) mathematics. Alternatively, the Division had leave to submit revised analyses by Mr. Collins, presumably, that would apply the correct methodology and show that the Firm's *actual* calculations – opposed to Mr. Collin's *attempt* to recreate those calculations - were in error. The Division did neither – leaving Ms. Juris' testimony unrebutted and Mr. Collins' unsupported by the evidence.

Now, at the close of hearing, the Division has an evidentiary void that cannot be filled. Instead, it focuses its post-hearing brief on distracting from its failure – blaming Mr. Winkelmann for his inability to specifically recall the factor calculations during his deposition; dragging Mr. Winkelmann's son into this dispute and suggesting his son's decision to cease litigating a copyright infringement case is evidence that Mr. Winkelmann is untrustworthy. But perhaps most alarming is not what the Division <u>does</u> say in its brief, but what it <u>ignores</u> in its brief. For example, the fact that it fails to even *mention* the overwhelming the evidence that undermined Mr. Collins' mathematical assumptions. Or the fact that the Division refuses to even acknowledge that Mr. Winkelmann was represented by counsel at every single step in the process for each of the offerings (as well as each ADV filing). The evidence showed that

Greensfelder drafted, reviewed and approved all of the offering documents and every single Form ADV prior to filing. The Division ignores this evidence. The Division also ignores, with respect to Form ADV that Greensfelder *expressly counseled* Respondents that they did not have custody of client funds and *expressly advised them not to revise their Form ADV otherwise.* Mr. Winkelmann complied. (Then, when he later amended it during the investigation, the Division characterized this as a stubborn refusal to admit wrongdoing).

In the end, however, the Court's decision will be based not on insinuation but on evidence. The Division carried the burden of proving its claims, as alleged in the OIP, by a preponderance of the evidence. They failed to do so. While the Respondents carried no burden (aside from their reliance on counsel defense, which was established) they nonetheless presented abundant evidence that disproved the Division's allegations and showed that Mr. Winkelmann did nothing wrong, strove to do everything right, and even were some small errors made, that there is no basis for punishment the Division seeks.

For the reasons set forth herein, the Respondents respectfully request that the Court deny the Division's allegations as set forth herein and reject their request for sanctions, disgorgement, and other remedies.

II. RESPONSE TO DIVISION'S ARGUMENTS

The vast majority of the Division's Post-Hearing Brief ("Brief")[1] is devoted to a recitation of supposed "facts," most of which are addressed in Respondents' Response to the Division's Proposed Findings of Fact.[2] As the Court will see, however, there are certain topics

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[1] Cited as Div. PHB at ___.

[2] Filed herewith.

that the Division continuously revisits – and misstates – throughout its Brief. On those issues, Respondents are compelled to respond.

A. Offering Structure

1. Mandatory Payments

The parties appear to agree on the basic structure of the four offerings at issue. Each sought an initial investment in exchange for the right to receive a certain percentage of the Firm's cash receipts.[3] The percentage likewise varied by offering and ranged from 0.05% to 0.25%. Under the terms of each offering, the investor would receive the Percentage Payments until they were repaid their principal investment, plus a multiple thereof.[4] That multiple varied by offering and ranged from 2.25 to 3.0.[5] The explicit terms of the offerings provided that there was no set timeframe in which full repayment needed to be made.[6] On this part of the offering structure, the parties agree and have so stipulated.[7]

B. Discretionary Additional Payments

The parties disagree as to whether Respondents owed any additional payment obligations to investors. While each offering contemplated additional payments that could be made to investors, such payments were to be made at Mr. Winkelmann's sole discretion, and were never obligatory.[8] Those additional payments, if made, would mean an investor would be repaid his principal-plus-multiple more quickly. As the parties have stipulated, however, there was no

[3] Findings of Fact 1,7,8, 9, 11 and 13 ("FOF") (November 15, 2016 Order).

[4] *Id.*

[5] *Id.*

[6] FOF 7, 9, 11, 13.

[7] FOF 7,8, 9, 11 and 13.

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

promise that investors would be repaid in any particular time frame.[9] Nor was there any promise that the additional payments would occur *at all*.[10]

To the contrary, the offering documents expressly disclosed that the Firm's ability to make additional payments was entirely conditional on its performance. Specifically, that additional payments would not be made until the Firm *reached and maintained* lower advertising factors and sustained profitability. The Firm projected that it would reach sustained profitability once it achieved and AUM of $124 million (a threshold the Firm never crossed).[11] The disclosures on the additional payments were express:

- No assurance can be given that the business will continue to experience growth at this conversion ratio[.][12]

- Of course, no one can predict the future; actual rates of returns will depend on several variables. It is important for investors considering the purchase of royalty units to realize the sensitivity of the key drivers that will impact their return:[13]

    Royalty per Unit: The higher the payment of royalties per month, the faster the investors realize their returns; however higher royalty payments could erode the working capital and jeopardize advertising budgets. ***Investors should expect the minimum of (0.25%) of total revenue per unit initially. Once Blue Ocean achieves profitability, the current plan (although not required) is to pay at least 50% of the profits, which we expect will exceed 0.25% of revenue, to the Royalty Unit holders until their 2.50x payback is achieved.***

- The offering is being made to investors and the rate of return to the investors will depend on how fast the recurring revenue stream grows and how many units are sold.[14]

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[9] *Id.*

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

[11] Except, as noted, above, for Round 1 which projected $150 million. Mr. Winkelmann testified to the same at hearing. Tr. 1515:24-1516:24. The investors called to testify likewise understood that the repayment was dependent on the Company achieving this level of stability. Tr. 1056:8-19 (Mr. Swift).

[12] RX-001 p. 9.

[13] RX-002 p. 16 (emphasis added). Similar disclosures appear in Rounds 3 and 4. The language of Round 1 differs slightly. (RX-001 pp. 11-12).

- Of course, the rate of return will also depend on the conversion rate of the advertising budget and the valuation of the client portfolios which are impacted by unpredictable macro-economic events.[15]

- Higher conversion ratios will cause the payback period to be drawn out lowering investor returns.[16]

- High advertising yield factors and low advertising budgets will reduce investor returns and lengthen the payback period.[17]

- ***Blue Ocean Portfolios will have the ability to increase the investors' royalty per unit participation if lower advertising yield factors are achieved and maintained.***[18]

- Under the planned expenses and advertising assumptions, Blue Ocean Portfolios will produce ***a positive cash flow at approximately $124*** million in AUM. It is the objective of Blue Ocean to achieve this threshold within 24 months. Any unforeseen event that slows down or prevents this threshold will result in lower returns for the investors, lower bonus payments for the employees, and a delay in any potential distributions to the owners[19].

- Once ***recurring sustainable profitability*** is achieved, larger and larger portions of the cash receipts will be used to pay back the Royalty Unit holders.[20]

The above disclosures, in addition to the potential repayment schedules set forth in each memorandum[21] demonstrated that the timing of the repayment was extremely variable – and could range from just over two years to over 10 years.[22] There can be no dispute that investors

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[14] RX-001 p. 12 (emphasis added).

[15] *Id.*

[16] *Id.*

[17] RX-002 p. 16; RX-003 p. 14; RX-004 p. 14.

[18] *Id.*

[19] RX-002 p. 18. Similar language for the other offerings at RX-001 p. 13 (Round 1); RX-003 p. 16 (Round 3); RX-004 p. 16 (Round 4). All of the offering memoranda use the $124 million threshold to profitability and higher payments, except for Round 1, which estimated $150 million.

[20] RX-002 p. 6 (Round 2); RX-003 p. 14 (Round 3); RX-004 p. 13 (Round 4).

[21] RX-001 p. 11; RX-002 p. 17; RX-003 p. 14-15; RX-004 p. 15.

[22] This is one of the more paradoxical arguments raised by the Division. On the one hand, it argues that a reasonable investor who reviewed the offering memorandum would have believed that he was going to receive his money back in three to five years. On the other hand, the Division has admitted that the charts contained in the offering documents showed that investors might not be repaid for more than 10 years, and has stipulated that the documents

were expressly advised that the speed at which they would be repaid was both uncertain and based entirely on the Firm's performance.[23] No reasonable investor could have expected any additional discretionary payments to be made on any particular time period - or at all. This is especially true given that the Firm never achieved the prerequisite profitability.

The investors awareness of these risks is expressly set forth in the Subscription Agreements where investors acknowledged and warranted that (1) the Firm's future performance was not guaranteed; (2) there were risks associated with the investment; (3) the financial forecasts provided may not ever come to be; and (4) the Royalty Units were not required to be repaid by any specific date:

- The Subscriber acknowledges that...the Subscriber has been given no assurances with respect to the future performance of the Company.[24]
- The Subscriber understands that there are substantial risks involved in an investment in the Company. The Subscriber understands the speculative nature of this investment and the fact that it is possible that the Subscriber may lose is, her or its entire investment.[25]
- The Subscriber has considered that all financial forecasts ... contain data that is the Company's estimate of possible results of its operations and represent a prediction of future events based on assumptions that may or may not occur. They should not be relied upon to indicate the actual results that will be attained. The company believes that the underlying assumptions provide a reasonable basis for the forecasts, but some assumptions may not materialize and unanticipated events and circumstances may occur subsequent to the date of the financial forecasts. Accordingly, the actual results achieved during the forecasted periods may vary from the financial forecasts. The variations may be material.[26]

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do not provide any set time period by which the repayment would be made. (FOF Nos. 1,7,9,11,13). It is simply not reasonable, in light of these disclosures, that a reasonable investor would believe that he would be repaid within three to five years.

[23] Indeed, the Division's own proposed statements of fact reflect that the offering documents informed investors that they may not see a full return for more than 10 years.

[24] RX-003 p. 129. While the Third Round offering memorandum is quoted herein, nearly identical language appeared in the Subscription Agreements for Rounds 1 (RX-001 p. 98) 2 (CX-124); and 4 (RX-004 p. 146).

[25] *Id.* at 130.

[26] RX-003-130-133

- Some of the information in the materials provided to the Subscriber may contain forward-looking statements... Forward-looking statements typically are identified with use of terms such as "may", "expect", "anticipate", "estimate", "potential," "could" and similar words...You should be aware that the Company's actual results could differ materially from those contained in the forward-looking statements due to a number of factors[.][27]

- The subscriber acknowledges that the royalty...may never be paid in full by the company and the royalty is not required to be paid in full before any scheduled date.[28]

In light of the offering documents' clear explanation as to the speculative nature of the additional payments and the purchaser's acknowledgement and acceptance of the same, there is no evidence that a reasonable investor would have believed he was entitled to additional payments above and beyond the minimum promised. Nor is there any evidence that a reasonable investor would have expected, faced with the above disclosures, that he would have received his investment back by some time certain.

C. The Division's "Empty Coffers" Theory

Ignoring this language, the Division has proposed an "Empty Coffers" theory. Under the Division's reading of the offering documents, the Firm's "goal" of repaying investors more quickly once the Firm was profitable – a goal which should be applauded and not condemned – meant that *every single dollar* held in the Firm's operating account or available to the Firm was somehow owed to the investors. This theory reappears in several areas in the Division's Brief. For example, it alleges that Mr. Winkelmann's compensation for running the Firm created a conflict because instead of paying him, Blue Ocean could have emptied out its coffers and paid those funds to investors.[29] The Division reasons that, if the Firm had money to pay Mr.

[27] *Id.*

[28] RX-003 p. 132.

[29] Div. PHB pp. 17,38-39,56.

Winkelmann, it had funds available to investors.[30] Thus, because it had the *authority* under the offering document to make additional payments, it was somehow *obligated* to do so.

The Division makes a similar argument with regard to Blue Ocean's decision to pledge the funds in its operating account as collateral for a loan taken out by Blue Ocean ATM. If those funds were available for such a pledge, it reasons that they were likewise available to use for investor repayments.[31] Thus, under the Division's theory Mr. Winkelmann should have emptied out the Firm's account and paid the balance to investors.

This theory is the only thing supporting the Division's allegation that a conflict exists. If the "Empty Coffers" approach is rejected (as it should be, for the reasons set forth below), then the Division necessarily has failed to identify a conflict between Mr. Winkelmann and his investors and, in turn, the allegations based on non-disclosure of that conflict fail as well.[32]

1. The Division Ignores the Prerequisite of Profitability.

The Division's Empty Coffers[33] theory has two equally fatal defects. First and most obvious, it is expressly contradicted by the offering documents themselves. As set forth above, all payments above the minimum were discretionary and entirely dependent on the performance of the Firm, with larger payments from cash receipts to be made only "once recurring sustainable profitability is achieved."[34]

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[30] *Id.*

[31] *Id.*

[32] Including their charges under the Securities Act, Exchange Act and Rules 206(1) and (2).

[33] This theory was wholeheartedly accepted and advocated by the Division's expert, despite his admission that the offerings categorized these extra payments as an aspirational "goal" and not as an entitlement. Tr. 262:19-263:6 (Laby).

[34] RX-001 p. 13; RX-002, p. 6; RX-003 p. 4, 16; RX-004 p. 14.

2. The Division's Theory Conflicts with the Terms of the Offering.

In addition, the Empty Coffers theory is contradicted by the language describing what investors' funds *were* to be used for: funding the Firm's advertising campaign.[35] The sole objective of the offerings was to grow Blue Ocean's customer base through selective advertising. On this point, the documents are clear and unequivocal:

- Blue Ocean 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 can also be used to fund other revenue-producing activities that are directly or indirectly related to Blue Ocean Portfolios' business activities. Any of these activities would need to result in the potential for recurring revenues inuring to Blue Ocean Portfolios and to investor returns. [36]

- The drum beat of the Blue Ocean Portfolios message is that investors are misled by overly priced portfolio management and stock picking, and that the majority of so-called financial advisors are really just salesman. Blue Ocean Portfolios uses a combination of on air, online, direct mail and print advertising to get this message out and attract people who are dissatisfied with their current situation. This overt and provocative message creates leads and clients which results in recurring revenue streams.[37]

- Going forward, Blue Ocean Portfolios intends to expand its advertising to incorporate print ads, social media, YouTube and Google Ad-words to generate additional leads. Additionally, there are plans to syndicate the Financial Coach Show and Blue Ocean Portfolios to other markets like Chicago, IL. Blue Ocean portfolios will use a substantial portion of the proceeds of this offering and future cash flows to fund media buy for both Blue Ocean Portfolios and The Financial Coach Show. The media buy will be ongoing and targeted towards markets with college graduates of the age of 45.[38]

- **Monthly Advertising Budget.** This is a necessary expense. In order to drive revenue it must be funded optimally. Too much could overwhelm the sales and

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[35] As well as its general and administrative expenses. RX-002 pp. 6-7.

[36] RX-002 pp. 6-7. Nearly identical language appears in the other three offerings.

[37] RX-002 p. 10. Nearly identical language for Round 1 (RX-001 pp. 8-9) and Round 3 (RX-003 pp. 4-5). Round 4 differs slightly due to its specific circumstances.

[38] *Id.*

> marketing function and reduce the advertising efficacy. Too little and the cash will be idly costing the investors' returns, the employees' bonuses, and the owners' profits.[39]

This language made clear that money raised was intended to cover the "expansion of [the Firm's] advertising reach" and pay for "general and administrative expenses" incurred.[40] Further, the expenditure of funds on advertising opportunities was to be "optimally" apportioned.[41] The documents expressly cautioned that spending too much too quickly would reduce efficacy. As a result, the documents specifically contemplated a slow, contemplated spend, with funds held in reserve, waiting for their "optimal" use.[42]

Investors who purchased Royalty Units expected their funds to be utilized in this manner to grow the Firm and generate revenues[43] – revenues from which they would be repaid. Investors would not have expected – because the offerings do not even contemplate – that they would be repaid from the very funds they invested (earmarked to be used on advertising and held by the Firm). The Division's suggestion to the contrary is contradicted by the evidence.

For each of these reasons, individually, but certainly when considered together, the Division's insinuation that every dollar held or paid by Blue Ocean was a potential investor repayment dollar should be rejected out of hand.

3. Because the Empty Coffers theory fails, the Division as failed to show the existence of a conflict of interest.

The Division's claims under the Exchange Act, the Securities Act and the Advisers Act are based on two alleged misrepresentations. The first involves the advertising ratios, which are

[39] *Id.*

[40] RX-002 pp. 6-7.

[41] RX-002 p. 10.

[42] *Id.*

[43] And, as disclosed, cover general and administrative expenses. RX-002 pp. 6-7.

addressed below. The second is Mr. Winkelmann's alleged failure to disclose the purported conflicts of interest that arose between him and his clients. Those alleged conflicts all arise under the above theory, i.e., that by using money to pay his salary or fund some business expense, Mr. Winkelmann was using funds that could have been used to repay investors. As demonstrated above, however, there was no obligation – only a goal – to make additional payments to investors once the Firm achieved sustained profitability.

Beyond that, the offering documents expressly stated that the invested funds were to be used on advertising and to cover the general and administrative expenses of the Firm. Because funds were used for this expressly disclosed purpose those payments cannot give rise to a conflict of interest. In the absence of such a conflict, the Division's claims fail.

D. The Advertising Ratios

The other – and arguably primary – alleged misrepresentations at issue in this case are those set forth in paragraphs 7-10 of the OIP, where the Division alleged that the calculations of the Firm's advertising ratios as set forth in the offering memoranda were incorrect given that the Division had calculated different, higher ratios.

The parties have clearly staked out their positions as to these factors. The Division sticks with Mr. Collins' calculations, despite the evidence presented at trial that (1) Mr. Collins did not, as he believed, replicate Mr. Winkelmann's calculations[44] and (2) Mr. Collins' calculations were not, as he believed, based on the Firm's actual data at the time of each offering.[45] The Division's adherence to its calculations, despite that evidence, is surprising, given it had other options.

[44] And because he failed to replicate the Firm's methodology, his testimony and summary exhibits cannot be used to show Mr. Winkelmann's computations were incorrect.

[45] Resp. PHB pp. 23-27.

Following the close of Ms. Juris' testimony, when she explained how the Firm's data was collected, maintained, and utilized to track the advertising efficacy, and following the "revelation" that those calculations differed from what the Division had understood them to be (based on a few lines of Mr. Winkelmann's deposition testimony), the Court permitted the Division leave to introduce additional testimony or evidence from Mr. Collins – during the trial or sometime thereafter – which would review Mr. Winkelmann's calculations using the proper methodology and the proper data.[46]

The Division declined that opportunity and chose not to review Mr. Collins' calculations in light of Ms. Juris' testimony or the exhibits introduced at trial. And, in its Brief, it sticks to its original, faulty calculations. For example, the Division fails even to address the fact that its calculations of the advertising factor as of the March 2011 and March 2012 offerings were calculated using June 2012 data. It also fails to address the fact that its calculations for the March 2011 and March 2012 offerings used incorrect revenue data (Mr. Collins' calculations assumed a 0.77% management fee, while the Firm actually utilized a 0.1% fee). Nevertheless, despite unrebutted and even admitted[47] errors in Mr. Collins' assumptions, and despite leave of Court to cure it, the Division persists with its unsupported allegations.

Respondents have addressed Mr. Collins' errors in their opening brief[48] and will abstain from repeating themselves herein.[49] There are, however, certain statements made by the

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[46] Tr. 1078: 7-23; Tr.: 1080:5-22; Tr.,: 1081:8-20 (Judge Patil).

[47] *See,* Division's Proposed FOF 212.

[48] Div. PHB p. 19-27.

[49] Respondents are compelled to point out, however, that the Division goes to great lengths to dance around these issues in its brief, attempting to "backdate" Mr. Collin's data using Mr. Winkelmann's general investigative testimony that the document was "one of" the documents used by BOP to track the ratio and that, in general, "longer look-back periods" were more reliable. As stated in Respondents' opening brief, notwithstanding this general testimony, there can be no doubt the Firm did not use in March 2011 a document that did not come into existence until June 2012. Further, as Ms. Juris explained, the numbers contained on the June 2012 document differed from

Division regarding the advertising factor which Respondents are compelled to respond to and correct.

1. Contemporaneous Data

The Division repeatedly argued in its Brief[50] that the Firm had no contemporaneous documents that were created to show the calculations of the advertising factor used in the offering memoranda. This is false. It is true that the Firm did not print and maintain a document that reflected the computations in each offering memoranda. But, it did maintain monthly reports from January 2012 through February 2013.[51] Those monthly reports were printed off by Ms. Juris in advance of the Firm's regularly-held monthly management meetings, where Ms. Juris, Mr. Winkelmann, and other Firm employees would review the data from the prior month, make necessary changes to that data, and make decisions about advertising spends going forward.[52] These reports show the Firm's computation of the advertising factor as of each month end.[53] From these documents, the Court can see, with certainty, the data the Firm *actually* possessed and was utilizing for each time period. These reports further showed the extreme attention the Firm put into accurately tracking its advertising spend and revenue data.[54]

At trial, the Firm introduced the monthly reports, highlighting those that bookended each offering.[55] So, for example, the Court could look to the February 2012 monthly report and the March 2012 monthly report and see what the factors were just before and just after the Round 2

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the data possessed by the Firm in 2011 and early 2012. Tr. 861:24-863:11; Tr. 892:17-893:23; Tr. 928:23-929:24 (Juris).

[50] Div. PHB at pp. 3, 28, 30, 31 and 37.

[51] RX-054 and 55.

[52] Tr. 885:3-886:2 (Juris).

[53] RX-54 and 55.

[54] *Id.*

[55] *Id.*

offering. These numbers are *extremely close* to the number that was disclosed in the offering documents. Further, while the monthly advertising reports were printed and stored in connection with monthly management meetings, the underlying data was available for review at any time and by any Firm employee.[56] Thus, the fact that no "report" exists for the day the memorandum was prepared does not mean the Firm lacked the data to run a computation as part of its preparation of the document.

Additionally, the Division is correct that the disclosed factors differ slightly from those on the monthly reports that immediately precede or follow each offering. After all, they were created at different times. Nonetheless, the numbers are directly aligned:[57]

Round	Factor in Monthly Report Preceding Offering	DISCLOSED FACTOR
2	.67	.62
3	.71	.67
4	.89	.89

The evidence supports Mr. Winkelmann's testimony that, when he prepared each memorandum, he looked to the Firm's advertising data and calculated the most recent factor as of that moment.[58] The Division's argument that there are no contemporaneous documents is

[56] Tr. 909:19-910:2; Tr. 912:15-23 (Juris).

[57] RX-002; RX-003; RX-004; RX-36; RX-054, p. 63; RX-120. Round 1 was issued before the monthly reports were generated. For Round 4, the Division takes issue *not* with the current factor but with the factor for 2012. For that number, the factor computation for 2012 contained in the monthly report matches the disclosed 2012 factor exactly.

[58] Tr. 456:4-17; Tr. 459:11-460:7; Tr. 692:11-22 (Winkelmann);

false. There are plenty of contemporaneous documents the Court can look to in order to corroborate Mr. Winkelmann's calculation.

2. Ms. Juris

Ms. Juris is, to borrow the Division's term, the "advertising factor guru" at Blue Ocean.[59] An incredibly smart and well qualified analyst,[60] Ms. Juris' job was to track the source of each client's business and enter that information into the Firm's database.[61] Then, at each monthly meeting, she would pull the (then) current advertising spend and revenue data for review.[62] The monthly reports also calculated the efficiency of the spend compared to the revenue received: the advertising factor.[63] Over time, the Firm's reports became more detailed and tracked the factor in new and different ways, all in an attempt to determine how efficiently it was using its advertising funds.[64]

Ms. Juris was able to explain this process, including how the data was collected and how the computations were performed, flawlessly. This is hardly surprising given that preparing the computations was part of her role at the Firm.[65] It is also not surprising that Mr. Winkelmann stumbled when attempting to explain the computations with the same level of detail. He never wavered, however, in his adamant belief that the computations they did – the computations that went into the offering memoranda – were based on the Firm's data at the time.[66]

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[59] Tr. 683:3-6; Tr. 1297:14-21 (Winkelmann).

[60] Tr. 857:23-860:23; RX-002 p. 21

[61] *Id.*

[62] Tr.: 863:12-864:5; 871: 22-872:1 (Juris); Tr. 1400:2-18. (Winkelmann)

63 RX-54; X-55; RX-120.

[64] Compare RX-36 and RX-120.

[65] Tr. 683:3-6; Tr. 1297:14-21 (Winkelmann).

[66] Indeed, the Division has leaned heavily, throughout the hearing and its Brief, on Mr. Winkelmann's inability during his deposition to articulate the exact formula and exact data he had used years earlier when the offering memoranda were drafted. It was clear at the time he testified that he did not recall *specifically* what calculations he

Ms. Juris was also able to verify the calculation of the advertising factor used in Round 1.[67] The Division accurately (and repeatedly) points out that she did not work at the Firm at the time the first round memorandum was prepared and discredits her calculations entirely based on that fact. But the Division then goes on to ignore Ms. Juris' testimony that, while she was not at the Firm at the time, she was familiar with its records and its methodology for calculating the advertising factor.[68] She was further able to look at the Firm's advertising costs and revenue from that time period, correct the revenue data to reflect a 1% fee (not the 0.7 which Mr. Collins assumed applied) and calculate the advertising factor for Round 1.[69] Her math matched Mr. Winkelmann's. The Firm's January 2011 numbers (which would have been available to the Firm in February of 2011 as it prepared the Round 1 offering memorandum) showed an advertising conversion factor of 0.22 – the same factor disclosed in the memorandum.[70]

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had performed, but recalled that the Firm was comparing its advertising spending to the amount of money the Firm brought in. Mr. Winkelmann was unable, during his deposition, to recall specifically, and he alerted the Division to that many, many times. Exasperated, he told them: "That's the only response I'd have. We just wouldn't make that up. It would have to be based on statistics, the longest we had." Tr. 1177:6-1178:8.

The Division's entire case is premised on the few lines of testimony that contain Mr. Winkelmann's strained memory as to how each factor was calculated. From that testimony, it extrapolated its own calculations, never realizing that the data it was relying upon differed from the real time data collected by the Firm.

Then, at hearing, faced with Ms. Juris' testimony and the actual documents the Firm used to track the advertising factor, it became clear that the Firm's calculations were correct and that it was the Division's numbers and calculations that were wrong. Not wanting the Division to be prejudiced by its over-reliance on Mr. Winkelmann's testimony during the exam, the Court gave the Division leave to submit new calculations, based on the evidence adduced from Ms. Juris at hearing. The Division declined and, instead of taking advantage of the Court's leave to amend Mr. Collins' calculations, the Division chose instead to continuously refer back to Mr. Winkelmann's deposition. As though those few lines of testimony would somehow make Ms. Juris explanations and calculations any less accurate.

[67] Tr. 924:24-925:4 (Juris).

[68] Tr. 891:14-24; Tr. 925:12-928:6.

[69] Tr. 924:24-925:4; Tr. 926:11-24 (Juris).

[70] *Id.*

Ms. Juris' testimony shows that the disclosed factor is accurate notwithstanding Mr. Winkelmann's difficulty recalling its calculation.[71] Further, Mr. Winkelmann readily conceded that, were there any contradiction between his calculation of the advertising factor and Ms. Juris' the Court should look to Ms. Juris.[72]

3. Round 1

Respondents set forth in their opening brief, in great detail, the calculation of the advertising factor contained in the Round 1 offering memorandum.[73] Only two observations are required to respond to the Division's argument on this point. First, the Division submits that Mr. Winkelmann's calculation of the 0.22 advertising factor is incorrect and Mr. Collins' calculation (of 0.37) is correct.[74] The OIP, in contrast, alleges that the "accurate" advertising factor was 0.45 – a figure that does not appear anywhere in the Division's Brief.[75] Second, the 0.37 number that the Division cites, as calculated by Mr. Collins, is the advertising factor for March 2011. The first round offering memorandum was dated March 31, 2011. But, that memorandum was drafted prior to March 31, 2011. Blue Ocean's month-end data for March 2011 (similar to that Mr. Collins used) was not available until the first week of April.[76] All else being equal, Mr. Collins' inclusion of *final* March numbers in his computation erroneously utilized data the Firm did not possess – and could not have possessed – at the time the document was drafted.

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[71] The Division also argues in its Brief that Mr. Winkelmann's failure to address the advertising ratios in his Wells Submission is somehow indicative of wrongdoing. The Wells response, written by Mr. Winkelmann and transmitted by his counsel to the Division, responded to the allegations raised in the Wells letter as he understood them. While he did not address the advertising ratios, he was adamant that he had done nothing wrong. DX-345-346..

[72] Tr. 1461:21-1462:7 (Winkelmann).

[73] Resp. PHB pp. 6-9.

[74] Div. PHB pp. 28-29,

75 OIP ¶7.

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

Second, Mr. Collins' calculations are based on March 2011 data, but as of June 2012.[77] The June 2012 data, including the newly recurring revenue figure (the denominator in the advertising factor equation), assumed a 0.77% management fee.[78] In March 2011, however, the Firm used a 1% management fee assumption.[79] Thus, the revenue data Mr. Collins used when he made his calculations differed from the data calculated by the Firm at the time. Assuming *arguendo* that March 2011 data should be used at all (given that the Firm would not have had access to it at the time the memorandum was prepared), Mr. Collins' should have divided the advertising cost ($5,607) by a 1% fee – not a 0.77% fee – earned on the $1,980,798 in new assets under management ($19,807). The result of that equation is 0.28 – just slightly over the 0.22 disclosed by the Firm.[80]

March, however, is *not* the proper month to look to when determining the (then) current factor. Ms. Juris testified that in February 2011, when the memorandum was being drafted, the Firm would have looked to the January 2011 numbers.[81] In January 2011, the Firm received new assets under management totaling $1,351,432.82.[83] At that time, all of the Firm's revenue estimates assumed that clients paid an annual advisory fee of 1% of their assets under management.[84] Applying that assumption here, 1% of $1,351,432 is $13,514.85. The Firm's

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[77] Compare DX-159 and RX-54 pp. 51-61; Tr. 920:4-9; Tr. 928: 17-22 (Juris).

[78] *Id.*

[79] Tr. 926:11-24 (Juris).

[80] And, to be clear, the 0.28 figure would have represented all of March 2011 – data the Firm would not have had access to at the time the First Round Offering Memoranda was drafted.

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

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

[83] DX-159.

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

[85] 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% annual advisory fee. Tr. 925:12-926:18. By comparison, DX-159, upon which Mr. Collins based his computations, was created in or around June 2012, and assumed a 0.77% advisory fee. This may

advertising spending for January 2011 came to $3,024.[86].[87] $3,024 divided by $13,514 equals 0.22, the exact number that appears in the Offering Memorandum.[88]

Accordingly, the 0.22 factor is correct and no misrepresentation exists in the First Round offering document.

4. Round 2

As with Round 1, the Firm's explanation of the Round 2 offering and the disclosed factor has already been set forth in detail in the Respondent's Brief.[89] So, as above, Respondents respond only to the additional arguments the Division raises.

a. The 2011 Factor[90]

The 0.79 factor in Round 2 is supported by the data contained in the offering memoranda itself as well as the Firm's internal documents.[91] Nevertheless, the Division has, once again, sought to establish its purportedly "correct" advertising factor (1.28) by relying on Mr. Collins' calculations.[92] Mr. Collins based his computation of 1.28 on the data contained in Exhibit 159 which, as stated previously, was part of a document created in 2012 and which applied a 0.77% management fee assumption in all calculations contained therein.[93] In 2011, however, the Firm

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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.

[86] DX-159; *See* Section III.A.2., discussing the data contained in DX-159; Tr. 878:2-14. Tr. 924:14-925:4 (Juris).

[87] Tr. 492:10-12 (Winkelmann).

[88] Tr. 924:24-925:4 (Juris); RX-001.

[89] Resp. PHB at pp. 10-14.

[90] This factor is repeated in the Round 3 memorandum as well.

[91] As set forth in Resp. PHB at pp. 10-14.

[92] Div. PHB p. 29.

[93] DX-441.

used a 1% fee assumption (*not* 0.77) to calculate its newly recurring revenue (the denominator in the advertising factor equation).[94]

If Mr. Collins had, as the Firm did at the time, assumed a 1% management fee but otherwise applied the exact same methodology, he would have calculated the Firm's 2011 advertising factor to be 0.98 – which is higher than the Firm's estimate of 0.79 but significantly lower than the Division's allegedly "correct" factor of 1.28. The following chart shows what Mr. Collins' 2011 calculations (contained in DX-441) would look like assuming the correct 1% factor: [95]

Month	New AUM	1% Revenue	Ad Cost	Factor
January 2011	**$1,351,432.00**	**$13,514.32**	**$3,024.00**	**0.223763**
February 2011	$2,131,408.00	$21,314.08	$10,054.00	0.471707
March 2011	**$1,980,798.00**	**$19,807.98**	**$5,607.00**	**0.283068**
April 2011	$3,391,131.00	$33,911.31	$11,264.00	0.332161
May 2011	**$68,500.00**	**$685.00**	**$18,720.00**	**27.32847**
June 2011	$892,233.00	$8,922.33	$36,670.00	4.109913
July 2011	**$3,047,956.00**	**$30,479.56**	**$30,970.00**	**1.016091**
August 2011	$3,719,674.00	$37,196.74	$18,962.00	0.509776
September 2011	**$1,817,346.00**	**$18,173.46**	**$26,467.00**	**1.456354**
October 2011	$1,539,823.00	$15,398.23	$25,952.00	1.685389
November 2011	**$1,685,000.00**	**$16,850.00**	**$24,386.00**	**1.44724**
December 2011	$1,842,500.00	$18,425.00	$18,881.00	1.024749
TOTAL	**$23,467,801.00**	**$234,678.01**	**$230,957.00**	

Dividing the total advertising costs in 2011 ($230,957) by the total revenue ($234,678) yields a factor of 0.98.[96] The Division's allegation in paragraph 8 of the OIP, that the "real" advertising factor for 2011 was 1.28 fails and, as a result, must be dismissed.

[94] Tr. 926:11-24 (Juris).

[95] Compare to DX-441, which calculates the new revenue using a 0.77% fee assumption.

[96] This factor is .18 higher than the factor disclosed in the memorandum but 0.30 *lower* than the "actual" factor calculated by Mr. Collins.

Nonetheless, as stated in Respondents' Brief, as of the very end of 2011, the Firm's advertising factor was at 0.80 – and falling.[97]

b. The 0.62 Advertising Factor

With regard to the 0.62 advertising factor disclosed in the March 2012 Round 2 offering memorandum, the Division had little argument to offer other than to disparage Ms. Juris in an attempt to cast doubt onto her testimony. That tactic is unlikely to succeed given that Ms. Juris' testimony as to how the factor was calculated is wholly supported by the surrounding monthly advertising reports.[98]

Beyond that, the Division does not even mention the "correct" advertising factor that it alleged in the OIP (1.11).[99] Having apparently abandoned that allegation, the Division tried to create confusion where none exists. For example, the Division suggests that the Firm's 1% management fee, which Ms. Juris testified was used in 2011 and early 2012 (a fact which is corroborated by the monthly advertising reports for that period), "conflicts" with the offering memorandum which the Division alleges "discloses" a 0.80 fee assumption.[100] This new theory (not contained in the OIP and appearing for the first time) likewise fails.

First and foremost, the 0.80 assumption that the Division points to is not even from the Round 2 Offering Memorandum – it is from the First Round memorandum.[101] Further, the

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[97] Resp. Brief at pp. 13-15.

[98] Respondents' PHB at p. 21.-13.

[99] Div. PHB pp. 30-31.

[100] *Id.* p. 31.

[101] Div. Proposed Finding of Fact 241; RX-001 p. 5.

Second Round offering memorandum specifically discloses the following methodology used to calculate the advertising factor[102]:

> 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 62/1000 ratio or an "advertising conversion factor" of 0.62.

This single paragraph dispels the Division's new theory in that paragraph states that the $2.42 million in new assets are generating $24,200 in fees, which works out to 1%.[103]

5. Round 3

As was the case with Round 2, the Division's Brief does not even mention the purportedly "accurate" advertising factor alleged in paragraph 9 of the OIP (1.03). Instead, the Division has abandoned its own calculations and Mr. Collins' charts and focuses instead on an alleged change in methodology. Specifically, it contends that Mr. Winkelmann was obligated to disclose that the Third Round advertising factor used a 6-month look back period, whereas the prior rounds had calculated the factor as of the month of the offering. The Division goes so far to call this calculation "cherry picking."[104]

As Mr. Winkelmann testified, however, the Firm was continuously learning and improving both its advertising strategy and the manner in which it tracked the efficiency

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[102] *Werner v. Werner,* 267 F.3d 288, 299 (3rd Cir. 2001) (affirming dismissal of 10b-5 claim where "the shareholders had access to all of the information necessary to calculate the exact amount of the benefit management incurred" in the challenged transaction).

[103] The Division also suggests that if Ms. Juris applied Mr. Winkelmann's explanation of the advertising factor calculation to the February 2012 monthly advertising chart, a different factor would have been created. Div. PHB p. 30. As stated above, however, Mr. Winkelmann did his best to describe generally how the Firm analyzed and calculated its efficiency. Jennifer, however, was able to explain that process in great detail, given that it was her job to run those computations and maintain those documents. As Mr. Winkelmann testified, should there be any inconsistency between himself and Ms. Juris, the Court should defer to Ms. Juris. Tr. 1461:21-1462:7 (Winkelmann).

[104] Div. PHB pp. 2,37,39.

thereof.[105] Once the Firm gained measurable experience in this area, and had more and more data to review, it began to look at its efficiency in new ways – monthly, six months, and later 12 months.[106] The intent, Mr. Winkelmann explained, was to get an accurate picture of how efficient the Firm was.[107] Monthly factors could vary significantly; whereas six-month factors were less volatile and "smoothed out" any monthly variance which, in Mr. Winkelmann's opinion, gave a more accurate view of the Firm's efficiency.[108]

There was no change in methodology, however. The Firm continued to compare its advertising spend to its advertising revenue. Further, the Division has become so focused on one single fraction contained in the offering documents that it has lost sight of the offering's objective. The Firm was attempting to increase its assets under management and resultant revenues by advertising efficiently. As the Round 3 Offering Memorandum expressly stated:[109]

> The key driver to the Blue Ocean Portfolios model is the efficacy, or yield, of the money spent on advertising... *While the advertising and sales system generated relatively large increases in both AUM and recurring revenue, it was a learning experience.* Moving forward, the objective is to have the advertising yield become more efficient. The key indicator on the advertising efficacy is to determine how much advertising is needed to generate one additional dollar in new recurring revenue; currently this 'factor' is 0.67.
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> ***
>
> ***Going forward, the objective of Blue Ocean Portfolios is to bring this factor down with the goal of achieving and maintaining a factor of 0.50 – or $0.50 in advertising spent to add one new dollar of recurring revenue.***

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[105] Tr. 449:3-11.

[106] Tr. 459:11-460:7.

[107] *Id.* Tr. 469:8-22.

[108] Tr. 485:24-486:25.

[109] RX-003 pp. 3 and 11. For the reasons set forth in Respondent's Brief, the calculation used in this disclosure is accurate. Resp. PHB pp. 15-16.

That is, the goal of the offering, the advertising push, and the Firm, was to reach a *maintained* factor of 0.50. This goal of sustained efficiency undermines the Division's theory that a longer look back – less vulnerable to monthly variables that could send the factor soaring or plunging – was somehow *misleading.* The mere fact that the advertising factor *could* have been calculated differently does not render Respondents' calculations misleading.[110] Indeed, as the Court held in *Ironworkers Local 580--Joint Funds v. Linn Energy, LLC*, 29 F. Supp. 3d 400, 428 (S.D.N.Y. 2014)[111]:

> In the end, Plaintiffs are really arguing that there were better ways for [the Company] to calculate its non-GAAP metrics—ways that would have more accurately forecast the decline in available cash that occurred during 2013. They may well be correct about that. But the federal securities laws do not protect the marketplace from flawed business decisions, which is what choosing to calculate a metric in a particular way is where, as here, there is no settled formula. The securities laws prohibit only the telling of untruths and the concealment of information necessary to prevent other disclosures from being materially misleading. Here, no untrue statements were uttered and nothing was concealed or omitted—at all times, [the Company and is Management] told the truth about how it chose to calculate adjusted EBITDA, DCF, the distribution ratio, and maintenance capex.

Here too, the Firm disclosed its formula for computing the advertising factor – a measure for which no set formula exists.[112] As a result, under *Ironworkers* and *Netflix,* no misrepresentation has occurred.

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[110] *Kademian v. Ladish Co.*, 792 F.2d 614, 626 (7th Cir. 1986) ("Requiring a company to append a disclaimer, explaining why it chose each accounting practice and reciting the effects of all alternative methods, is tantamount to mandating a confession of motive. This, as we have already noted, the securities laws do not require.")

[111] *See also In re Netflix, Inc. Sec. Litig.,* C04-2978 FMS, 2005 WL 1562858, at *6 (N.D. Cal. June 28, 2005)("There is, however, no official formula for calculating churn. Plaintiffs...offer no authority for the proposition that their method is proper and Netflix's method is improper. Defendants point out and plaintiffs concede that there exists no official GAAP methodology for calculating churn. Importantly, Netflix clearly and repeatedly disclosed its formula for calculating churn.... Given Netflix's disclosure of its method of calculating churn, Netflix's reporting of the churn rates obtained by using this formula cannot be considered to be false.") (internal citations omitted).

[112] RX-125 p. 10.

Beyond that, the Round 3 offering memorandum likewise includes the raw data supporting the computations it contains. RX-003 p. 14 contains a chart showing the Firm's AUM, newly recurring revenue, advertising spend, *and the advertising factor* for each month going back to June 2011. From this chart, potential investors could review and evaluate the Firm's efficiency on a month-to-month basis. Or, they could run similar calculations of the six- and 12-month look back.[113] Where, as here, the Firm provides the raw data for the prospective investor to review and consider prior to investing, no omission can occur:[114]

> Plaintiffs, however, contend that the Company's calculation of churn was misleading because the Company did not disclose the actual number of customer cancellations in the first three of its quarterly reports during the class period. Plaintiffs allege that "there was no way for investors to perform the true calculation in the absence of disclosure of the number of subscriber cancellations during the quarter," and "the Company omitted to disclose the number of subscriber cancellations to hinder investors in performing their own calculation of churn."
>
> The plaintiffs' argument is unavailing. Even in the financial reports in which the number of subscriber cancellations was not expressly disclosed, this number could be calculated through simple arithmetic using other numbers that were disclosed. More specifically, the number of subscriber cancellations could be calculated by adding the number of beginning subscribers to the number of new trial subscribers and subtracting the number of ending subscribers, all of which were accurately disclosed in all quarterly reports during the relevant period. Similarly, plaintiffs-and investors generally-could have calculated churn in the manner they preferred using the numbers that were disclosed in each of the Company's quarterly reports. Because the number of subscriber cancellations could be easily calculated, this allegation does not meet the required standard for a false or misleading statement.

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[113] Tr. 916:10- 917:11 (Juris).

[114] *In re Netflix,* 2005 WL 1562858, at *6. *See also Werner v. Werner,* 267 F.3d 288, 299 (3rd Cir. 2001).

In light of the foregoing, and in the absence of any authority cited by the Division in support of its theory, the Round 3 offering memorandum does not contain any misstatements or omissions and, as a result, cannot give rise to the Division's claims.

6. Round 4

The sole allegation in the OIP regarding the Round 4 offering memorandum was that it disclosed a 2012 year-end advertising factor of 0.89 when the "real" advertising factor, as calculated by the Division, was 1.02.[115] Similar to Round 3, the Division does not mention the 1.02 advertising factor in its brief.[116] This is hardly surprising for the reasons set forth in Respondents' Post-Hearing Brief (showing that the disclosed factor of 0.89 was accurate).[117]

Instead, the Division argues that the 0.89 advertising factor (which it appears tacitly to concede is accurate) for the 12 months ending in December 2012 (i.e. calendar year 2012) was misleading because it only included data for the St. Louis office and not the recently-opened Chicago office.[118] Thus, the Division argues, had Chicago been included, a higher ratio would have resulted.[119] This new allegation,[120] not included in paragraph 10 of the OIP or anywhere else in the charging document, is contradicted by the language of the offering memoranda itself,

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[115] OIP ¶10.

[116] *Id.*

[117] Resp. PHB pp. 17-18.

[118] Div. PHB p. 32.

[119] *Id.*

[120] As set forth in Respondents' Pre-Hearing Brief at pp. 27-30, the Division should be confined to the parameters of the allegations contained in the OIP.

which limits the figures contained therein to the St. Louis market.[121] The Fourth Round offering memoranda explicitly stated[122]:

> So each $10,000 in new recurring revenue is currently costing Blue Ocean Portfolios $6,700 in advertising – an 89/100 ratio or an "advertising conversion factor of 0.89. Advertising spend in other markets could be higher or lower. This conversion factor experience will be different in the Chicago market.

Additionally, the Chicago office was opened in October 2012.[123] The office manager (and sole employee in Chicago) was not hired until November 2012.[124] Additionally, Mr. Winkelmann testified that, due to the unforeseen events that occurred in November and December 2012 (the Binkholder issue and the Missouri Division of Securities investigation), the Firm had to stop funding its Chicago campaign momentarily, which meant that the Firm was unable to follow up on initial leads it had received.[125] Given that the office had only just opened and had little data to contribute,[126] Mr. Winkelmann did not believe that the Chicago data would have been useful, meaningful information.[127]

Further, even were there any confusion on this issue, Mr. Winkelmann testified (and Mr. Swift confirmed) that he sat down with each of the investors in Round 4 and explained to them the issues with the Chicago office and the fact that the Firm had decided to suspend it.[128] Thus, if the Chicago office's finances are assumed to be potentially relevant to a reasonable investor,

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[121] For those figures or projections where Chicago was included, that was *affirmatively* stated. RX-004 p. 21 ("Five Year Financial Projection - Assumes…$7,000 per month total in advertising for both the St. Louis and Chicago markets…").

[122] RX-004 p. 11.

[123] Tr. 689:23-24.

[124] RX-004 p. 113.

[125] Tr. 1310:8–1314:15.

[126] Tr. 1313:15-1314:15.

[127] *Id.*

[128] Tr. 1313:15-1314:15.

Mr. Winkelmann testified and Mr. Swift, one of the two investors in Round 4, confirmed that he met with each Round 4 investor and told them the detailed status of the Chicago office.[129] Accordingly, the investors in Round 4 were not "misled" with regard to whether or not the stated factor included Chicago numbers.[130]

E. Binkholder

The Division makes two arguments with regard to Mr. Binkholder: (1) that payments made to him for advertising consulting services should have been included in the advertising ratios; and (2) that the Firm was required to disclose his investment adviser bar in the offering memoranda.[131] Respondents have already addressed both theories in their Brief.[132]

Instead, Respondents address the new argument raised by the Division for the first time in its Brief. The Court will recall that the Division failed to set forth any authority or accounting standard requiring the Firm to classify the payments to Mr. Binkholder as "advertising expenses." To the contrary, the SEC Staff Accountant, Mr. Collins, testified at hearing that there is nothing in GAAP that supports characterizing the payments to Mr. Binkholder under his agreement with Blue Ocean as advertising expenses.[133] In the absence of any such standard or authority, the Division instead cites to the payments made to radio host Charlie Brennan who, like Mr. Binkholder, hosted a radio show sponsored by Blue Ocean.[134] Because the payments

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[129] Tr. 1313:15-1314:15. Tr. 1487:21-1488:4.

[130] The Fourth Round offering document *expressly discloses* the Firm's financial situation, letting potential investors know that the Fourth Round raise is because "Blue Ocean Portfolios is currently experiencing a shortage of cash and...[i]f Blue Ocean Portfolios fails to raise at least $50,000 prior to March 1, 2013, then there may not be enough money to meet payroll[.]" RX-004 p. 5.

[131] Div. PHB pp. 16,19-20,26.

[132] Resp. Brief at pp. 37-41.

[133] 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).

[134] Div. Brief p. 26.

made to Mr. Brennan were treated as advertising, the Division reasons, therefore it was improper for Mr. Binkholder's payments to be treated any differently.

The problem with the Division's logic on this point is that it fails to appreciate Mr. Binkholder's role vis- a-vis Blue Ocean. Mr. Brennan merely ran a radio show. Mr. Binkholder also provided a "whole host" of advertising and marketing consulting services to Blue Ocean.[135] For the airtime purchased for the radio show, 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.[136] It was only the consulting payments that were not treated as an advertising expense.[137] Indeed, Mr. Winkelmann testified that after the Division raised this issue, Mr. Winkelmann asked his CPA about the propriety of this classification.[138] His CPA advised him that the payments to Mr. Binkholder booked as consulting fees, not advertising expenses, was not inconsistent with any GAAP standards and was therefore acceptable.[139]

As to the second alleged disclosure failure relating to Mr. Binkholder, the Division insists that his bar by the State of Missouri was a requisite disclosure for two reasons: (1) because Mr. Binkholder's conduct bar arose out of his failure to disclose conflicts of interest, and (2) because he played a "central" role at Blue Ocean and was featured "prominently" in the offering documents.[140] Accepting these arguments, however, requires one to ignore Mr. Binkholder's

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

[136] 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.

[137] *Id.* Tr. 1371:21-24 (Winkelmann).

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

[139] *Id.*

[140] Div. PHB at p. 39.

specific role at Blue Ocean. The unrebutted evidence in the record is that Mr. Binkholder was not registered with Blue Ocean as an investment representative, nor was he retained or compensated as such.[141] Instead, Mr. Binkholder's connection to the Firm was exclusively restricted to the consulting and advisory services he provided and in connection with his radio show.[142]

Further, the Division is correct that Mr. Binkholder's relationship to Blue Ocean was expressly disclosed in the offering memoranda. As an initial matter, the Marketing Agreement entered into by Mr. Winkelmann and Mr. Binkholder was attached to the offering memoranda as an exhibit.[143] Additionally, the offering memoranda, in the section that "prominently" – to use the Division's word – discussed Mr. Binkholder, highlights his important work delivering the Firm's message to his listener base while informing potential investors that:[144]

> Mr. Binkholder receives no direct compensation from any Blue Ocean Portfolio client for investment advisory services or insurance products of any kind.

Further, Mr. Binkholder was not listed among the "Key People" listed in the offering memoranda or the "Key Vendors," which further evidences the parameters of his role.[145]

None of Mr. Binkholder's functions involved acting as an investment advisor or otherwise receiving or managing client funds.[146] The bar entered by the State of Missouri did not impact Mr. Binkholder's ability to continue his radio show, or act as an advertising

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

[142] *Id.*

[143] RX-001, p. 26; RX-002, p. 34; RX-003 p. 32.

[144] RX-001 p 8; RX-002 p. 10;

[145] RX-001, p. 10; RX-002, p 14; RX-003, pp. 11-12; RX-004, pp. 11-12.

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

consultant.[147] Thus, the bar did not impinge on or in any way affect his ability to perform the task he had been retained by Blue Ocean to do. Accordingly, there was no reason to disclose to investors[148] in those two rounds that Mr. Binkholder was barred by Missouri.[149]

F. Custody

The only notable part of the Division's Brief on the issue of custody is the fact that it does not even mention Greensfelder, despite the fact that Greensfelder was specifically retained to provide compliance advice to BOP including advice on the content of Form ADV.[150] Additionally, the Division did not even acknowledge Mr. Winkelmann's unrebutted testimony (corroborated by his email communications) that (1) he sought and obtained advice from Greensfelder on the question whether or not Blue Ocean had custody of customer funds, (2) the advice was that the Firm did not maintain custody,[151] (3) he relied on that advice, and (4) he had

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

[148] 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.

[149] The Division also alleges, without citation or support, that Mr. Winkelmann "hid" Mr. Binkholder's bar from his attorneys "because he knew they would make him disclose the bar." Div. Brief pp. 2-3. There is a reason no citation is provided for these assertions – none exists. The opposite, of course, is true. Mr. Winkelmann testified that his counsel was well aware of Mr. Binkholder's investigation and the subsequent bar. When Mr. Winkelmann learned about the bar order, he called Mr. Morgan to discuss it. Tr. 1360:7-13. Tr. 1494:21-1495:10. Beyond that, the record is filled with email communications (before the January 2013 date proffered by the Division at p. 49 of its brief) reflecting Mr. Winkelmann's communications with Greensfelder regarding Mr. Binkholder's legal issues. (RX-106 pp. 1855 ("how should we deal with Binkholder?"); RX-106 pp. 1866-1868; RX-113 p. 39. At no time during those communications did Mr. Morgan (or anyone else at Greensfelder) suggest this was brand-new information just brought to the Firm's attention. *Id.*

Additionally, the record shows that Mr. Winkelmann was not looking to hide anything – even negative information on his former colleagues. As an example of Mr. Winkelmann's willingness to over-disclose, *see* RX-106 p. 2-3 (regarding the Binkholder investigation); p. 1188 (regarding Mr. Weir).

[150] SOF 52.

[151] There can be no doubt that Greensfelder had all necessary information on the custody issue, as it was the drafter of each offering memoranda, as well as the Firm's ADV. Further, Mr. Morgan was sent a copy of the email that Mr. Winkelmann drafted that announced to investors that their monthly payments would now become quarterly payments. RX-106 pp. 1834-1839. Mr. Morgan circulated it to other attorneys on his team, but never raised any question or issue regarding custody.

no "reason to believe the advice was not correct."[152] For example, Mr. Winkelmann asked his attorneys in an email:[153]

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

Greensfelder responded:

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

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)[154] which stated:[155]

> 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...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.

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

[153] RX-106, pp. 2409-2410.

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

[155] DX-298.

At all times relevant to this dispute, Mr. Winkelmann relied upon this advice, believing that he was accurately representing in each Form ADV that the Firm did not have custody.

The fact that Greensfelder was specifically retained to provide this advice is also relevant to the Court's assessment of the custody issue, as it shows that even securities experts, like the team at Greensfelder, could incorrectly (albeit adamantly) conclude that custody did not exist.[156] Further, Mr. Winkelmann's reliance on this express advice of his counsel weighs heavily against the imposition of any penalty, especially the type sought here by the Division.[157]

G. No Scienter

1. The Division's stated indicia of scienter are unsupported by the evidence and misconstrue the record.

The Division puts forth a handful of alleged indicia of scienter, none of which actually exist. First, the Division cites the "misstatement" of the advertising ratios in the offering memoranda. For the reasons stated above, because those factors were accurate and not misleading, they are likewise not evidence of *scienter.*

Second, the Division alleges that Mr. Winkelmann's failure to disclose the alleged conflicts of interest between himself and his clients is indicative of scienter. This basis likewise fails, as the evidence showed (1) no conflict existed under the advertising structure, and (2) Mr. Winkelmann reasonably relied on his counsel in the preparation of approval of the offering memoranda – each of which expressly recited the absence of any conflict (and, to the contrary, an alignment of interests).

Third, the Division argues that Mr. Winkelmann issued the Royalty Units solely to "increase his own compensation." This is false. If anything, the evidence contradicts the

[156] As set forth in Respondents' Brief, p. 64.

[157] *See* pp. 64-65 of Respondents' Brief discussing the *Slocum* case. *S.E.C. v. Slocum, Gordon & Co.,* 334 F. Supp. 2d 144, 186–87 (D.R.I. 2004)

Division's theory, as it showed that Mr. Winkelmann frequently took no salary at all in order to get the keep expenses low as the business was launched.[158] Additionally, once he did begin drawing compensation, the evidence showed that Mr. Winkelmann earned an average of $123,000 per year in salary.[159] The Division attempted to make a mountain out of this salary-molehill by introducing a chart showing Mr. Winkelmann's *cumulative* earnings over the entire time period at issue (a total of $454,000 over a three- year-and-eight-month period).[160] Then, in truly misleading fashion, the Division introduced a chart comparing Mr. Winkelmann's *cumulative* salary over the time period at issue against the Royalty Unit payments *not cumulative* and *only* for Round 1.[161] If anything, this chart and Mr. Collins' testimony evidences the Division's desperation to show that Mr. Winkelmann's conduct was somehow compensation-driven.[162]

Beyond that, the Division has failed to prove, set forth any evidence, or set forth any authority, that would allow it to carry its burden of showing that Mr. Winkelmann's

[158] Tr. 186:1-14 (Collins). Mr. Winkelmann's salary from January 2011 through September 2011 was $0. *Id.*

[159] Tr. 184:21-185:21 (Collins).

[160] *Id.*

[161] Tr. 186:10-187:20.

[162] As a close corollary, the Division also argues that *scienter* can be found in Mr. Winkelman's "concealment from investors" of BOP's "failing finances." Div. PHB p. 41 This assertion is incredibly weak and, actually, self-contradictory. First, the Division argues that Mr. Winkelmann "concealed" the Firm's failing finances in December 2012 when he sent an email to Mr. Swift detailing those pressures. No offering was active in December 2012, however, and there has been no authority set forth by the Division that the information contained in the email was required to be disclosed to past investors.

In the very next sentence of its brief, the Division cites to its second "example" of "concealment" alleging that the Firm only provided the Round 4 offering memoranda to three investors. In making this allegation, the Division expressly concedes that the Round 4 memorandum "actually disclosed BOP's dire financial condition." Div. PHB p. 41. That is, the Division is arguing that Mr. Winkelmann "concealed" the Firm's "failing finances" by *disclosing this to them* in writing in the offering document. This argument should be rejected for reasons that are so obvious they require no explanation.

compensation was not disclosed.[163] Each of the offering documents stated that the funds raised in the offering would be used to fund the advertising campaign as well as its general and administrative expenses.[164] A reasonable investor – including the investors called to testify at hearing – would expect that Mr. Winkelmann would be compensated for running the company.[165]

Fourth, the Division points to an email from Mr. Mahoney, a Round 1 investor, asking if and how he could sell his unit. The Division contends Mr. Winkelmann's failure to market this unit to potential 4th Round investors evidences scienter. A closer look at the evidence, however, reveals that while Mr. Mahoney asked about the *possibility* of selling his Unit, he never asked Mr. Winkelmann to try to do so.[166] Absent some evidence, the Division's theory is pure speculation. It is not evidence of anything, least of all scienter. [167]

The fifth and final indicia of scienter offered by the Division is Mr. Winkelmann's purported decision to ignore the advice of his attorneys by offering royalty units to clients.[168] This point is addressed in Respondents' Brief, but bears addressing again here. Mr. Winkelmann testified that Mr. Morgan was well aware he was selling Royalty Units to clients and had advised

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[163] The Division also argues that Mr. Winkelmann failed to disclose payment of a settlement of a lawsuit filed against both he and Blue Ocean (DX-170 p. 2), but which he, personally, consented to the judgment for. Mr. Winkelmann testified he understood the $50,000 to be owed by both he and Blue Ocean and that his attorney at the time confirmed the same. Tr. 801:18-802:18.

[164] RX-002 pp. 6-7.

[165] Tr. 1034:11-22 (Mr. Hipsky); Tr. 1057:1-4 (Swift). *Augenstein v. McCormick & Co., Inc.*, 581 F. Supp. 452, 458 (D. Md. 1984); *O'Sullivan v. Trident Microsystems, Inc.*, C 93-20621 RMW (EAI), 1994 WL 124453, at *4 (N.D. Cal. Jan. 31, 1994) ("If the material containing the alleged omissions "actually discloses the facts that Plaintiffs claim are absent, there is obviously no omission.")

[166] DX-210 p. 2.

[167] The Division's allegations with regard to representations in other customer emails were addressed in Respondents' Brief.

[168] Div. Br. p. 41. Mr. Winkelmann's reliance on his attorneys is discussed in detail in Respondents' Brief, as well as in the section immediately following.

him those sales were fine, so long as he was not recommending the investment.[169] Mr. Morgan's awareness is evidenced by Greensfelder's emails with Mr. Winkelmann.

In those emails, Mr. Winkelmann writes regarding the Firm's Form ADV, seeking advice on whether he had to disclose the fact he was selling Royalty Units to clients.[170] Mr. Walsh responded that Mr. Winkelmann only needed to make that disclosure if he "recommended" the unit purchase.[171] 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.[172] Had this come as a surprise to them, as the Division suggests, one would expect some response. None occurred.[173]

The only other "evidence" the Division offers of this "rejection" of counsel's advice is Paragraph 2(a) of the subscription agreement, which reads: "The Subscriber acknowledges that (i) the Company has not provided any investment advice to subscriber."[174] This relatively standard language is not reasonably 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

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

[170] In response to Part 1 Item 8(A)(3), which would not apply unless clients were investing.

[171] RX-106, pp. 2400-2402.

[172] *Id.*

[173] Relatedly, as stated in Respondents' Brief, 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 the attorneys 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.

[174] RX-003, p. 129.

particular investment, it is more properly read to state only that the Blue Ocean did not advise the Subscriber as to whether or not this particular investment was proper for them. This reading of the document is supported by the fact that none of the investment clients who executed a subscription agreement raised any concerns with the document or otherwise indicated the provision was "ambiguous." This includes each investor witness that testified for the Division and stated that they read the document and understood the representations they were making.[175]

2. Respondents offered substantial evidence that they reasonably relied upon the advice and counsel of their attorneys – good faith conduct which rebuts any inference of scienter.

The Division simply ignores the evidence presented at hearing to show Mr. Winkelmann's retention of and reliance upon his attorneys. Even though Greensfelder was explicitly retained to provide advice on compliance issues, Form ADV and the offerings at issue here[176], the Division refuses to even acknowledge the central role Greensfelder played in the events at issue. Specifically:

- Greensfelder was retained to provide advice to the Firm on its Form ADV, compliance issues, and the offerings at issue.[177]
- Greensfelder reviewed each and every offering memorandum prior to its distribution to clients.[178]
- Greensfelder and Mr. Winkelmann came up with the Royalty Unit structure together.[179]
- Greensfelder reviewed the language in the offering documents stating that no conflicts existed between the Firm and the investors – and that instead their interests were aligned.[180]

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[175] Tr. 32:8-12; Tr. 35:13-21(Swardson); Tr. 360:18-21(Buckowitz); Tr. 644:18-647:23 (Grau).

[176] FOF 51-55.

[177] *Id.*

[178] FOF 53.

[179] Tr. 439:16-440:9.

- Greensfelder approved the language regarding the absence of conflicts.[181]
- The language regarding the absence of conflicts appears in each of the 4 offering documents.[182]
- Greensfelder and Mr. Winkelmann exchanged voluminous communications prior to each offering, exchanging drafts and making edits. A sample of those communications is collected in RX-106 which is over 2,000 pages long.[183]
- Despite other changes to the draft offering documents – and despite changes to the disclosures between the various offerings, the conflict language was never amended or updated.
- Greensfelder was aware that the offerings contemplated a monthly payment to Royalty Unit Holders.[184]
- Greensfelder was aware that the Firm changed its payment timing from monthly to quarterly.
- Greensfelder never raised any question or issue with the Firm regarding the change – specifically including any concerns that the change could implicate the custody rule.
- Even after the SEC raised concerns that the Firm had custody, by virtue of this change, Greensfelder advised Mr. Winkelmann that the SEC's position was incorrect. [185]
- Greensfelder advised Mr. Winkelmann not to change his ADV disclosure to indicate client custody, believing no such custody existed.[186]
- Mr. Winkelmann heeded Greensfelder's advice on this complicated issue.[187]
- Greensfelder reviewed the advertising calculations contained in the offering documents when it reviewed the drafts of the same. Greensfelder never identified

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[180] FOF 53,55; Tr. 1325:6-16; Tr. 1247:21-1251:23 (Winkelmann).

[181] *Id.*

[182] RX-001-RX-004.

[183] RX-*1006.*

[184] RX-001, p. 10; RX-002 p. 15; RX-003 p. 13; .

[185] *See* Section F, above.

[185] DX-*298.*

[186] *Id.*

[187] *Id.*

any inconsistencies in the representations made within each offering memoranda.[188]

- Greensfelder was aware of Mr. Binkholder's relationship with Blue Ocean, not only through the offering documents but as drafters of the Exclusive Marketing Agreement.[189]

- Greensfelder was aware that Mr. Binkholder had been barred.[190]

- Greensfelder was aware that the bar was not disclosed in certain of the offering memoranda.[191]

- Greensfelder never indicated that this was a potential or required disclosure – neither before or after the January 2013 date that the Division (incorrectly) alleges was when Greensfelder first saw the Order.[192]

- Mr. Winkelmann had discussions with Greensfelder about the disclosures that are contained in the Offering Memoranda.[193]

- Greensfelder provided him advice about the disclosures contained in the Offering Memoranda that are at issue in this case.[194]

- 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.[195]

- The Offering Memoranda in this case include all the disclosures that Greensfelder advised Mr. Winkelmann to make.[196]

- Mr. Winkelmann followed the advice that he received from Greensfelder in connection with the preparation of the Offering Memorandum and related documents.[197]

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188 FOF 53, 55.

189 Tr. 1325:*22*-1326:13 (Winkelmann).

190 *See, Section* E, above.

191 *Id.*

192 *Id.*

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

194 *Id.*

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

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

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

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 *scienter* is effectively rebutted.[198]

H. No Evidence of Willfulness.

For the reasons set forth in Respondents' Brief and in Section II.F., above, the Division has failed to prove that Mr. Winkelmann's conduct was "willful" in violation of Rule 207.[199]

III. RESPONSE TO SANCTION REQUEST

The Division's request for sanctions is based on the same arguments already addressed above (with regard to the element of scienter). Predictably, the Division argues that because of the alleged wrongful conduct, sanctions fall within the "public interest" and asks for the highest penalties available: disgorgement, bars, and third-tier penalties.

A. The Division has failed to establish the Steadman Factors or demonstrate that sanctions are in the public interest.

The public has no interest in seeing Mr. Winkelmann ejected from the industry, clawing back the salary he earned (when he was able to take a salary at all), or unwinding the investment which, while it did not take off as quickly as everyone had hoped, remains a viable business with the potential for success (and devoid of the alleged fraud).

The appropriateness of any sanction is guided by the public interest factors set forth in *Steadman.*[200] The Court should weigh these factors in light of the entire record. No one factor is

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[198] *S.E.C. v. Prince,* 942 F. Supp. 2d 108, 138, 143-44 (D.D.C. 2013) (quotation in fn. 87, *supra*); *In re Digi Int'l, Inc., Sec. Litig.,* 14 F. App'x 714, 717 (8th Cir. 2001).

[199] Resp. PHB pp. 54-57.

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

dispositive:[201] (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction; (3) the degree of scienter involved;(4) the sincerity of the respondent's assurances against future violations; (5) respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. Other factors that have been considered include: (7) the age of the violation;[202] (8) the degree of harm to investors and the marketplace resulting from the violation;[203] (9) the extent to which the sanction will have a deterrent effect;[204] and (10) whether there is a reasonable likelihood of violations in the future.

1. No evidence of "egregious" conduct

None of the above factors warrants the imposition of sanctions in this case. First, the Respondents' conduct was not "egregious," despite the Division's diligence in repeatedly flaunting in its Brief every incident of purportedly "improper" conduct by Mr. Winkelmann that it could find. In the absence of evidence of actual misconduct, fraud, theft or deceit, the Division is reduced to arguing that Mr. Winkelmann's appropriate conduct was, somehow, inappropriate.

When taken in context and viewed in the light of the evidence and stripped of the Division's spin, the allegedly "egregious" conduct upon which the sanction request is based is reduced to the following: (1) Mr. Winkelmann earned a salary for running Blue Ocean; (2) Mr. Winkelmann went above and beyond in the offering documents and provided investors with as much data regarding the Firm's performance as possible (reciting specific amounts spent and conversion ratios); (3) Mr. Winkelmann attempted to be as precise as possible in the offering

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[201] *Id.*

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

[203] *Id.*

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

documents, providing investors with the most up-to-date data the Firm possessed at the time the offering was prepared; (4) Mr. Winkelmann and his team meticulously tracked the Firm's performance and attempted to advertising in a manner that produced the greatest return to the company and, thereby, investors; (5) Mr. Winkelmann engaged securities attorneys to advise him at every step of the process, solicited that advice, and followed it; (6) Mr. Winkelmann hoped that the Firm would be able to repay investors more than the minimum payment amounts promised by the offering, but the Firm has yet to reach a level of profitability anticipated; and (6) Mr. Winkelmann employed a team of intelligent and hard working professionals to assist him with the Firm – those individuals assisted in the meticulous tracking of the advertising efficacy.

Even were some error or typographical mistake made, the following remains true: Mr. Winkelmann did everything in his power to ensure that the structure of the offerings and the disclosures made in connection therewith were proper and accurate. His "conduct" alleged to be sanctionable was entirely proper and, equally importantly, was intended to ensure that investors fully understood Blue Ocean's message.[205]

2. Isolated or Recurrent nature

There is no "recurrent" wrongdoing in this case, primarily because there is no wrongdoing at all. Beyond that, however, the alleged "repeated" disclosure failures are the *same* disclosure items over and over – the advertising factors and the purported conflict of interest. As stated above, the statements regarding both the factors and the absence of conflicts were true and accurate. But, even were some error to have been made, it is not tantamount to "recurrent"

[205] The allegation that Mr. Winkelmann desired to hide anything from the investors is belied by the record. There are many examples of him providing sensitive or potentially unfavorable information to investors. None of that was hidden. For example, offering memoranda for Rounds 1 and 2 went so far as to include a statement from his physician regarding his health status, because the documents disclosed he had a prior, potentially fatal, health incident; the offering memoranda for Round 4 contained a detailed recitation of the Firm's need for more cash on hand. RX-001, RX-004.

conduct, which assumes a repeated volitional choice of some act. Instead, Mr. Winkelmann made one decision to include the Firm's advertising calculations and one decision to abide by Greensfelder' advice that no conflicts of interest existed. If that decision was wrong, it was a single, isolated decision – a fact which weighs heavily against the imposition of sanctions.

3. No scienter

The third *Steadman* factor looks for the degree of scienter established by the evidence. As stated previously and herein, there is no evidence that Respondents acted with scienter. To the contrary, Respondents established that they acted properly and relied on the advice and counsel of their attorneys (a fact which rebuts scienter). This *Steadman* factor also weighs against the imposition of any sanction.

4. Sincerity against future violations and acceptance of wrongful conduct

The Division rolls these two factors together, arguing that (1) Mr. Winkelmann was once the subject of a contempt order, and (2) he "blames" the Commission for his situation. As to the contempt order, Mr. Winkelmann explained at hearing both the impetus for the order and his (and his son's) decision simply not to contest it.[206] This is not evidence that Mr. Winkelmann is untrustworthy or lacking of respect for the law.

As to "blaming" the Commission, that is a common assertion made by the Division that is unsupported by the record. Mr. Winkelmann is frustrated and tired, to be sure, that he is in this predicament.[207] This is hardly surprising given that he has spent the last three years defending himself against allegations of fraud despite his attempt to do everything right. He incurred

[206] Tr. 1442:24-1445:7. ("I gave -- we didn't challenge -- we didn't challenge the -- the motion that we were in contempt. I just didn't have any fight that day. And I just said, you know, Albert, just whatever. Just make it up. We'll agree -- we'll agree to take The Butt Face off. And they – we agree that The Butt Face was in violation of The South Butt consent order.")

[207] Tr. 1445:4-5.

significant expense retaining Greensfelder to assist him with the offerings and his Form ADV – the very documents that gave rise to this dispute.[208]

Defending oneself against unfounded allegations of fraud, however, is not evidence a person is likely to commit some future violation.[209] Accordingly, this *Steadman* factor weighs heavily against the imposition of sanctions.

5. Respondent's recognition of the wrongful nature of his or her conduct and the likelihood that the respondent's occupation will present opportunities for future violations.

For the reasons set forth in the section immediately above, these two *Steadman* factors weighs heavily against the imposition of sanctions.

6. The degree of harm to investors and the marketplace resulting from the violation

There is no evidence of 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. Beyond that, the evidence showed that the disclosures contained in the offering documents were accurate and that, even if some incorrect data point was cited, that the investors knew and understood that their returns dependent on the Firm's ability to bring in cash receipts. The investment's failure to perform as plan – both in terms of the cash payments made to date and the contemplated additional payments upon profitability – was not the result of any act or omission by the

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[208] RX-113.

[209] Instead, "[i]n predicting the likelihood of future violations, a court must assess the totality of the circumstances surrounding the defendant and his violations[.]"*S.E.C. v. Capital Sols. Monthly Income Fund, LP*, 28 F. Supp. 3d 887, 893 (D. Minn. 2014). To do so, "[c]ourts have weighed a number of factors to determine whether a permanent injunction is appropriate: (1) the degree of scienter involved; (2) the isolated or repeated nature of the violations; (3) the defendant's recognition of the wrongful nature of her conduct; and (4) whether, because of the defendant's professional occupation, future violations could be anticipated. *Id. citing SEC v. Shanahan,* Civ. No. 07–2879, 2010 WL 173819, at *9 (D.Minn. Jan. 13, 2010).

Respondents; nor did it derive from any of the purported misstatements in the documents. Instead, the investors have not yet been fully repaid because the Firm has thus far been unable to get to the $124 million AUM assumption to which the offerings aspired.

Nevertheless, the Firm has made each and every payment owed to investors since inception. The Division did not introduce any evidence to suggest that those payments are at risk of ceasing. Instead, the Firm's growing AUM is a sign of the investment's strength and potential. Beyond that, if and when the Firm's performance improves (perhaps once this matter is resolved) and the Firm reaches its profitability threshold, additional discretionary payments could be made. The Division has failed to prove any current or future likelihood of customer harm. Thus, this *Steadman* factor weighs against the imposition of any sanction.

Assuming *arguendo* that the Court were required to consider imposition of a sanction, because each of the *Steadman* factors weigh against sanctions in this case, the Division's request should be denied.[210]

B. Disgorgement is not warranted.

The Division's request for disgorgement is premised entirely on its presumption that the funds received by Respondents (i.e., Mr. Winkelmann's salary during the time period and the amount invested) were "ill-gotten profits" obtained by "wrongdoers" pursuant to a "fraudulent offering."[211] As an equitable remedy, disgorgement "does not serve to punish or fine the

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[210] Further, recent settlements, while not precedential, provide useful guidance to the Court as to the propriety of sanctions imposed. In July 2012, the Commission settled a case involving some similar allegations to those here, but with far more egregious conduct. *In the Matter of Concert Global Group Ltd., et al.,* AP File No. 3-17354 (July 21, 2016). In *Concert G,* the respondent misstated its AUM in an offering document by a *billion dollars* and then used the proceeds of the offering contrary to the disclosed terms. *Id.* The Commission imposed a $180,000 penalty against Concert and a managing individual, but imposed no bar and no disgorgement.

[211] *S.E.C. v. Wyly*, 71 F. Supp. 3d 399, 405–06 (S.D.N.Y. 2014). "[B]ecause disgorgement is not punitive, the securities violations and the allegedly unlawful gains must be causally connected." *United States Sec. & Exch. Comm'n v. Markusen*, 143 F. Supp. 3d 877, 893 (D. Minn. 2015).

wrongdoer, but simply serves to prevent [his] unjust enrichment." Further, the Division carries the burden of showing that the funds received were "causally connected to the fraud."[212]

For the reasons already set forth above, the evidence reflected the opposite. Nothing was "ill-gotten." There was no "fraud." Respondents have not been "unjustly enriched." The investors made their investments based on accurate information regarding the Firm's advertising strategy and its efficacy. The funds went, as disclosed, to the Firm to fund its expenses and the promotion of the Blue Ocean name.[213]

None of the case law cited by the Division, in support of its request suggests disgorgement is warranted here. Those cases involve instances of blatant conversion of investor funds.[214] Here, no similar facts exist. The Division has failed to meet their burden of proof necessary to show that disgorgement is warranted. Its request should be denied.

C. No penalties[215]

Predictably, the Division requests third-tier penalties in this case – the highest and most severe level available. In order to prove such penalties are warranted, the Division must prove

[212] *Id.*

[213] *S.E.C. v. Jones*, 476 F. Supp. 2d 374, 386 (S.D.N.Y. 2007) (refusing to grant disgorgement because "although the Court need only determine a reasonable approximation of Defendants' compensation causally connected to the alleged violations before ordering disgorgement, the Commission has provided no evidence which would allow the Court to do so.")

[214] *SEC v. Manor Nursing Centers, Inc.* 458 F.2d 1082, 1104 (2d Cir. 1972) (instead of returning funds of failed offering, as required, issuer kept the money); *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1192 (9th Cir. 1998)(same); *S.E.C. v. Capital Sols. Monthly Income Fund, LP*, 28 F. Supp. 3d 887, 896 (D. Minn. 2014) ("To keep their ongoing scheme afloat, Defendants developed documents and e-mails and made statements to investors that attempted to convince new investors that their investments were unique. Defendants represented to potential investors that while other investments were failing as a result of the crashing economy, Defendants' investments would actually benefit from the failing economy. At the same time, Defendants knew that their business model and their past similar investments had failed.").

[215] 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).

that Respondents acted with fraud or deceit[216] which resulted in substantial losses (or created a significant risk of substantial losses) or resulted in "substantial" pecuniary gain. Neither occurred here, and those penalties (or even second tier penalties) are unwarranted.

The Division argues that third tier penalties are warranted in order to deter future similar misconduct by Respondents or others.[217] Here, however, penalties would serve no such purpose. 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 and their Form ADV; (2) they believed that the information contained in the offering documents was entirely truthful and accurate and that it complied with the applicable securities laws; (3) they complied with the terms of the offering and used the funds as promised; (4) investors received all funds owed to the under the offering; and, most importantly, (5) 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.

D. No bar

For the same reasons set forth in support of other sanctions, the Division asks for a bar against both Mr. Winkelmann and Blue Ocean. For the same reasons set forth in response to those allegations, no bar is warranted here.

First, none of the *Steadman* factors indicates that barring Mr. Winkelmann would be in the public interest. Second, for the reasons set forth immediately above, no deterrent value would be achieved through a bar (i.e., there is no public interest in imposing the harshest penalty

[216] 15 U.S.C. §78u-2(c). Proving fraud or deceit is also a prerequisite for second-tier sanctions. *Id.*

[217] Div. Brief p. 53.

on one who did everything possible to ensure compliance). Indeed, even in cases where a "high level" of scienter is established (not this case), bar orders have been declined.[218] Here, in the absence of any scienter, a bar is overly punitive and serves no public interest.

Moreover, the Division outright suggests that Mr. Winkelmann should be barred because two of his former business associates were convicted of crimes, which means that Mr. Winkelmann "has proven to be a terrible judge of character."[219] The fact that the Division cites to this at all is indicative of its desperation to find *any evidence* to support the request for this sanction. Mr. Winkelmann had nothing to do with the conduct of either Mr. Binkholder or Mr. Weir. In fact, it was Mr. Winkelmann who caught, reported, and assisted in the prosecution of Mr. Weir.[220] He has never been investigated or accused of having any involvement in or contemporaneous knowledge of Mr. Weir's crimes.[221] Further, Mr. Winkelmann expressly disclosed all this to investors in every single one of the offerings.[222]

Now, eight years later, instead of recognizing Mr. Winkelmann's detection and reporting (of his associate) to the authorities, the Division casts his conduct as something warranting an industry bar. That is, despite Mr. Winkelmann's demonstrated willingness to take action against those who commit crimes, steal client funds, and break the law, the Division now argues he should be ejected from the industry. Its request should be rejected and the Court should decline to the bar.

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[218] *U.S. S.E.C. v. Boey*, 07-CV-39-SM, 2013 WL 3805127, at *3 (D.N.H. July 22, 2013) ("In addition, although he acted with a high level of scienter, the SEC has not shown that there is any plausible risk that he will commit future violations.")

[219] Div. Br. p 55.

[220] RX-004 p. 84.

[221] *Id.*

[222] RX-001 p. 72.

IV. CONCLUSION

For the reasons stated herein, Respondents respectfully request that the allegations against them be dismissed in their entirety and no sanction awarded. In the alternative (or with regard to the Custody allegation) if some violation is found to have occurred Respondents respectfully request no sanction or the minimum be assessed against them for the conduct at issue in this dispute.

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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 16,000-word limit. The brief contains 15,811 words, according to the word processing system used to prepare the brief.

Heidi VonderHeide

CERTIFICATE OF SERVICE

I hereby certify that on December 22, 2016, I served a copy of the foregoing **RESPONDENTS' RESPONSE TO THE DIVISION'S 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
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