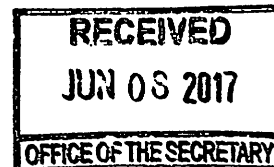

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17253

In the Matter of

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

Respondents.

THE DIVISION OF ENFORCEMENT'S BRIEF IN SUPPORT OF ITS CROSS-PETITION FOR REVIEW

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TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

I. INTRODUCTION 1

II. STANDARD OF REVIEW 3

III. FACTS 3

- A. Winkelmann's Background 3
- B. Binkholder's Securities Violations and the Formation of BOP 4
- C. Winkelmann Controlled BOP and Determined His Compensation Increases 7
- D. Winkelmann Understood and Touted His Fiduciary Obligations 8
- E. BOP's Financial Distress Led Winkelmann to Offer Royalty Units 9
- F. The First Offering 12
- G. After Closing the First Offering, BOP's Financial Situation Worsened and Binkholder Received an Investment Adviser Bar 14
- H. The Second Offering 16
- I. The Third Offering 18
- J. Binkholder's Criminal Investigation, Another Missouri Regulatory Investigation, and BOP's Failing Finances Lead to the Fourth Offering 20
- K. Winkelmann's Conflicts of Interest 23
- L. The Advertising Ratios 23
  - 1. Winkelmann's Changing and Conflicting Story 24
  - 2. Respondents' Explanations for BOP's "Current" Ratios Show that, Without Disclosure, Winkelmann Changed Methodologies and Cherry-Picked to Arrive at Better Ratios 26
  - 3. Respondents Repeatedly Misrepresented BOP's 2011 Annual Ratio 31

IV. LEGAL ANALYSIS 32

- A. Respondents Violated the Securities Act's, Exchange Act's, and Advisers Act's Antifraud Provisions 32
  - 1. Legal Standards 33
  - 2. Respondents' Failure to Disclose Binkholder's Adviser Bar 35
  - 3. Respondents' Misrepresented Their "Alignment" with Investors 37

4. Winkelmann's Misstatements About Investor Returns and the Success of the Offerings 38
5. Respondents' Misrepresentations and Omissions About the Advertising Ratios 39
6. Winkelmann Acted with Scienter 41
B. Respondents' Reliance Defense Fails 44
V. CONCLUSION 48

TABLE OF AUTHORITIES

Cases

Elam v. Neidorff, 544 F.3d 921 (8th Cir. 2008) 42

Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645 (8th Cir. 2001) 42

In re BP p.l.c. Secs. Litig., 2016 WL 3090779 (S.D. Tex. May 31, 2016) 40

In re K-Tel Sec. Litig., 300 F.3d 881 (8th Cir. 2002)..34

SEC v. Bolla, 401 F. Supp. 2d 43, 48, 50. (D.D.C 2005)...35, 36, 37

SEC v. Enters. Solutions, Inc. 142 F. Supp. 2d 561 (S.D.N.Y. 2001)..47

SEC v. Haligiannis, 470 F. Supp. 2d 373 (S.D.N.Y. 2007)..39

SEC v. Snyder, 2006 U.S. Dist. LEXIS 45185 (S.D. Tex. June 29, 2006)..46

SEC v. Wash. Inv. Network, 475 F.3d 392 (D.C. Cir. 2007)..36

U.S. v. Parker, 839 F.2d 1473 (11th Cir. 1988)...45

Von Hoffman v. Prudential Ins. Co., 202 F. Supp. 2d 252 (S.D.N.Y. 2002) 40

Commission Opinions

Anthony Fields, CPA, Exchange Act Rel. No. 74344, 2015 SEC LEXIS 662 (Feb. 20, 2015).......35

Bennett Group Fin. Servs., Advisers Act Release 4676, 2017 SEC LEXIS 1003 (Mar. 30, 2017).39

Bernerd E. Young, Exchange Act Rel. No. 774421, 2016 SEC LEXIS 1123 (Mar. 24, 2016).33, 34, 35

Dennis J. Malouf, Advisers Act Rel. No. 4463, 2016 SEC LEXIS 2644 (July 27, 2016) ..33, 34, 35, 42

Harding Advisory LLC, Advisers Act Release 4600, 2017 SEC LEXIS 86 (Jan. 6, 2017)..............34

J.S. Oliver Cap. Mgmt., L.P., Exchange Act Rel. No. 78098, 2016 SEC LEXIS 2157 (June 17, 2016)...33, 34, 35

Larry C. Grossman, Advisers Act Rel. No. 4543, 2016 SEC LEXIS 3768 (Sept. 30, 2016) 33

Mohammed Riad, Exchange Act Rel. 78049A, 2016 SEC LEXIS 2396 (July 7, 2016) 3, 47

Montford & Co., Inc., Advisers Act Rel. No. 3829, 2014 SEC LEXIS 1529 (May 2, 2014) 35

Rockies Fund, Inc., Exchange Act Rel. No. 48590, 2003 SEC LEXIS 2361 (Oct. 2, 2003) 47

Seaboard Investment Advisers, Advisers Act Release 1918, 2001 SEC LEXIS 2780 (Jan. 10, 2001) 39

Timothy Dembski, Advisers Act Rel. 4671, 2017 SEC LEXIS 959 (Mar. 24, 2017).......................46

William Scholander, Exchange Act Rel. No. 77492, 2016 SEC LEXIS 1209 (Mar. 31, 2016) 44

Statutes

Advisers Act Section 206(1), 15 U.S.C. § 80b-6(1) 34, 35

Advisers Act Section 206(2), 15 U.S.C. § 80b-6(2) 34, 35

Exchange Act Section 10(b), 15 U.S.C. § 78j(b) 33

Securities Act Section 17(a), 15 U.S.C. § 77q(a) 33

Rules

Exchange Act Rule 10b-5, 17 C.F.R. 240.10b-5 33

I. INTRODUCTION

Respondent James Winkelmann was an experienced investment adviser who systematically touted the fiduciary duties he owed his clients. Nevertheless, Winkelmann repeatedly made misstatements and omissions, and breached his fiduciary duties, when offering securities issued by his advisory firm, Respondent Blue Ocean Portfolios, LLC ("BOP"). Despite the inherent conflicts, Winkelmann targeted BOP advisory clients as investors.

During four offerings spanning two years, Winkelmann engaged in a scheme to depict BOP as a successful adviser that differentiated itself by being conflict-free and always acting in clients' best interest. Unable to achieve profitability or even obtain a bank loan, and facing a regulatory investigation into BOP's co-owner, Bryan Binkholder, Winkelmann chose to keep BOP afloat, and steadily increase his compensation, by selling $1.4 million worth of BOP "royalty units."

Winkelman marketed the royalty units by promoting BOP as a conflict-free adviser and falsely representing that his interests were "aligned" with those of the investors. Despite these affirmative statements, Winkelmann never disclosed that, as a result of his business structure, each month he faced the conflict-riddled decision of whether to increase payments to investors or to increase his own compensation. And he concealed that this conflict manifested itself, to investors' detriment, when Winkelmann routinely paid himself more while keeping investor payments at or near the minimum allowable levels.

Winkelmann additionally concealed that Binkholder – Winkelmann's partner, BOP's co-founder, and the centerpiece of BOP's advertising campaign – was under investigation and ultimately barred by Missouri securities regulators. Winkelmann's failure to disclose Binkholder's bar was even more egregious given that Winkelmann was engaging in the same conduct giving rise to Binkholder's bar: selling his clients securities in his own advisory

business, without disclosing the attendant conflicts. Yet, given the importance of Binkholder to BOP, Winkelmann hid the bar and its findings from BOP's attorneys, clients, and investors.

Winkelmann also made false and misleading statements about BOP's "advertising ratio," a metric quantifying the efficiency of BOP's advertising that Winkelmann considered the "key driver" to BOP's business. Winkelmann chose what ratios to present to investors, and claims he selected the ratios from a variety of available figures contained in BOP's advertising data. BOP calculated those disparate ratios using evolving methodologies that resulted in sharply different outcomes, depending on the methodology chosen by Winkelmann. However, Winkelmann never disclosed the changing methodologies, or that he cherry-picked from multiple options and chose the ratio that made BOP look best. Winkelmann also repeatedly misrepresented BOP's 2011 annual ratio, to make it appear BOP's advertisements were significantly more effective than they actually were.

Beyond the offering materials, Winkelmann lied about the royalty units in one-on-one correspondence with clients and other investors. In an effort to sell more units, he materially overstated both the amounts BOP had paid to earlier investors and BOP's success in raising funds.

Following a six-day hearing, the ALJ issued an initial decision ("I.D.") finding that Respondents violated the antifraud provisions of the Securities Act, Exchange Act, and Advisers Act. The I.D. sanctioned Winkelmann by imposing an industry bar, cease-and-desist order, significant disgorgement, and third-tier penalties. The Division does not appeal the findings that Respondents violated the antifraud provisions and imposition of sanctions – which the ALJ premised on Winkelmann's offering royalty units to advisory clients without sufficient disclosure of conflicts. However, the I.D. held the following did not violate the antifraud

provisions: (a) Respondents' failure to disclose Binkholder's adviser bar; (b) Respondents' misrepresenting the "alignment" and purported absence of conflicts between Winkelmann's and investors' interests; and (c) Respondents' misrepresentations and omissions regarding BOP's advertising ratio. The Division now appeals those findings, as well as the failure to find that Winkelmann violated the antifraud provisions by misrepresenting the amount of money BOP had repaid investors and had raised in the offerings.[1]

II. STANDARD OF REVIEW

For its *de novo* review, the Commission undertakes an "independent review of the record." *Robare Group, Ltd.*, Advisers Act Release 4566, 2016 SEC LEXIS 4179, *2, *18 (Nov. 7, 2016); *see also* Rule of Practice 411(a). The Commission thus determines whether, by a preponderance of the evidence, Respondents violated the securities laws provisions at issue in the OIP. *Mohammed Riad*, Exchange Act Release 78049A, 2016 SEC LEXIS 2396, *6 (July 7, 2016).

III. FACTS

A. Winkelmann's Background

Winkelmann has worked in the securities industry since 1981. (Parties' Factual Stipulations, Nov. 14, 2016 ("Stip.") ¶17).[2] He has extensive experience in financial services sales, management, administration, compliance, and regulatory relations. (Stip. ¶8). Before forming BOP, Winkelmann owned brokerage and investment advisory firms for more than 20 years. (Stip. ¶19). Winkelmann previously was chairman of the Missouri Securities Association, treasurer of a mutual fund, and an expert consultant on securities disputes involving sales practices

[1] The I.D. also found BOP violated and Winkelmann caused BOP's violation of Advisers Act Section 206(4) and Rules 206(4)-2 and 206(4)-7, and that BOP and Winkelmann violated Advisers Act Section 207. For those violations, the I.D. imposed a $7,500 first-tier penalty against Winkelmann. (I.D. at 69). Respondents have not challenged these findings.

[2] The ALJ adopted the stipulations and, per Rule of Practice 324, ordered them binding on the parties. (Order, Nov. 15, 2016)

and disclosures. (Stip. ¶¶20-22). He has passed multiple FINRA licensing examinations. (Stip. ¶23). Winkelmann claims to understand the importance of compliance and ethical selling practices. (Stip. ¶24).

Winkelmann's longtime business partner was Don Weir. They co-owned the financial services firm Winkelmann operated for 20 years before forming BOP. (Stip. ¶25). In late 2008, after Winkelmann learned that Weir had misappropriated millions of dollars' worth of gold from Weir's advisory clients, Winkelmann closed their firm. (Stip. ¶26, ¶29). Weir subsequently pled guilty to mail fraud and received a 78-month prison sentence. (Stip. ¶27).

Beyond his long securities career, Winkelmann owned the Longrow Insurance Agency ("Longrow") and an automatic teller machine company, Blue Ocean ATM. (Stip. ¶30). Winkelmann also managed his son's clothing business. (Hearing Transcript ("Tr.") 1440:7-15). In 2012, after Winkelmann and his son's company were sued for trademark infringement, Winkelmann was held in contempt for violating an injunction entered against him in the lawsuit. (Tr. 1440:16-1441:4; Division Exhibit ("DX") 205).

B. Binkholder's Securities Violations and the Formation of BOP

Following his separation from Weir, Winkelmann contacted Binkholder after listening to Binkholder's "Financial Coach" radio show. (Stip. ¶32). By August 2009, Winkelmann and Binkholder decided to become partners. (*Id.*). They formed BOP, with each owning 50% of the company. (*Id.*). In addition to co-owning BOP, Binkholder was a BOP advisory representative. (Stip. ¶33).

In early 2010, BOP began advising clients. (Stip. ¶38). When BOP was formed, Winkelmann's and Binkholder's legacy clients – clients of the separate advisory firms they independently operated – became BOP clients. (Stip. ¶39). In January 2010, BOP started sponsoring Binkholder's radio show. (Stip. ¶40).

Later in 2010, Winkelmann learned that Binkholder was being investigated by the Missouri Division of Securities. (Stip. ¶41). The investigation involved the advisory firm Binkholder owned prior to BOP's formation. (DX-84, ¶12-¶13; Stip. ¶39). Just as Winkelmann would soon begin offering BOP securities to BOP clients, Binkholder had been selling securities in his own businesses to his pre-BOP advisory clients. (DX-84, ¶15(c)). The investigation culminated in late 2011, when the Missouri regulators barred Binkholder from acting as an investment adviser. (DX-84). The bar order: (a) was premised on Binkholder selling securities in his businesses to advisory clients; and (b) found that "Binkholder did not disclose to investors the ... the potential conflict of interest that could affect the advisory relationship between Binkholder and the investors." (*Id.*, ¶15(c), ¶16). As discussed below, Winkelmann failed to disclose Binkholder's bar, or the reasons for the bar, to clients and royalty unit investors.

When Winkelmann learned of the Binkholder investigation in 2010, he told Binkholder that until the investigation ended, Binkholder needed to rescind his membership in BOP, and no longer talk to clients or "have anything to do with" BOP. (Stip. ¶41, ¶56). Despite this admonishment, Winkelmann allowed Binkholder to remain intimately involved with BOP. Winkelmann and Binkholder continued to share office space and employees, and Binkholder remained an owner and adviser representative of BOP until March 2011. (Tr. 415:25-417:11). Once Binkholder stopped being an adviser representative, he nevertheless continued to work in BOP's offices and stayed involved in BOP's financial decision-making. (Respondents' Exhibit ("RX") 4, p. 16; DX-70; DX-83). Binkholder's legacy clients remained BOP clients, and Winkelmann became their adviser representative. (Stip. ¶43).

In February 2011, during Binkholder's transition from being a BOP owner and representative, BOP and Binkholder entered a "Solicitor's Agreement." (DX-456). Per that

agreement, Binkholder's "primary role" was to "introduce and assist [prospective clients] in establishing a relationship with [BOP] which will include introducing prospective clients and providing information about [BOP]." (*Id.*, §2). The agreement noted that Binkholder was "compensated for being [BOP's] paid spokesman." (*Id.*, §3).

The following month, BOP and Binkholder entered into a separate "Marketing & Sponsorship" agreement. (DX-5). That agreement obligated BOP to sponsor the production of, and reimburse Binkholder's expenses relating to, Binkholder's radio show and other media. (*Id.*, §1.01). The agreement required BOP to pay Binkholder monthly compensation at least equal to Winkelmann's compensation, and to purchase a $2 million insurance policy on Binkholder's life, with Binkholder able to choose a 50% beneficiary. (*Id.*, §1.02, §1.04(b)(ii)). In return, Binkholder was required to: (a) "prominently and exclusively display and promote [BOP] services on all [his] web based, radio and television shows, productions and social media sites"; and (b) "exclusively enable [BOP] to generate leads from [Binkholder's] websites, social media sites, radio shows, television shows, speaking engagements and book publications." (*Id.*, §1.03). BOP's Form ADV brochure disclosed its marketing agreement with Binkholder and sponsorship of his radio show. (DX-13, PDF p. 11).

BOP promoted Binkholder's radio show by referencing the show in the signature block on Winkelmann's and his employees' emails. (*See, e.g.*, DX-99, DX-129; DX-130; DX-131; RX-106, pp. 492-493, 525, 1089, 1097-98, 1099, 1189-90, 1195-96, 1197-98, 1199-1200). Winkelmann frequently appeared on Binkholder's show as a co-host. (RX-4, p. 16). Binkholder proved key to BOP's advertising efforts, as BOP's sponsorship of Binkholder's show generated 70 to 100 leads per week for BOP. (Tr. 425:25-427:9).

C. Winkelmann Controlled BOP and Determined His Compensation Increases

Winkelmann has at all times been BOP's CEO, manager, and Chief Compliance Officer. (Stip. ¶34). Winkelmann had ultimate decision-making authority such that "the buck stopped" with him. (Stip.¶ 35; Tr. 437:11-21). He reviewed, at least monthly, BOP's financial statements; and "constantly" monitored BOP's revenues and expenses. (Stip. ¶37; Tr. 438:18-439:15). Winkelmann was responsible for BOP's compliance program and developing BOP's compliance manuals. (Stip. ¶36).

In early 2011, around the time Winkelmann removed Binkholder as BOP's co-owner, Winkelmann conveyed his personal interest in BOP to 23 Glen Abbey Partners ("23GAP"), a company owned by Winkelmann's family but managed by Winkelmann. (Stip. ¶31, ¶42). 23GAP then fully owned BOP. (Stip. ¶42).

Exercising his control over BOP, Winkelmann decided when and how much BOP would pay him. (Stip. ¶60). In 2012, BOP paid $125,000 to 23GAP as compensation for Winkelmann's services. (Stip. ¶64). In 2013, Winkelmann increased his compensation by having BOP pay 23GAP $182,000 and an additional $7,200 directly to Winkelmann. (*Id.*). In 2014, Winkelmann upped his compensation to $227,557. (*Id.*). As discussed below, Winkelmann needed the royalty unit offerings to fund his pay increases.

Beyond the compensation Winkelmann received either directly or through 23GAP, he also funneled BOP money to other companies he owned. Between August 2011 and March 2012, BOP paid $41,000 in "management fees" to Longrow, which Winkelmann admitted were to compensate him for his services to BOP. (DX-457; Tr. 774:6-777:15, 1486:1-17). Between October 2011 and September 2012, BOP also paid more than $46,000 to Winkelmann's Blue Ocean ATM company. (DX-457; Tr. 111:21-112:25).

In July 2012, Winkelmann had BOP pay $50,000 to settle Winkelmann's personal debt – Winkelmann's individual settlement obligation in a lawsuit filed by a Don Weir victim. (DX-170, §3.1(c); Tr. 800:10-23, 802:19-24, 804:20-23). Winkelmann never disclosed this payment to the royalty unit investors. (Tr. 806:4-11). A year later, Winkelmann put investor funds at risk when he used $70,000 of BOP's money as collateral so that Blue Ocean ATM could fill its ATM machines.[3] (Tr. 809:14-813:11; DX-274, EBT000910). Even though Blue Ocean ATM made $4,000 from the $70,000 loan (DX-375, BO9540), Winkelmann never gave any of this money to the royalty unit investors or otherwise compensated them for Blue Ocean ATM's use of BOP's money. (Tr. 815:17-21, 818:23-819:8, 822:19-25).

D. Winkelmann Understood and Touted His Fiduciary Obligations

Winkelmann understood the fiduciary obligations he owed his clients. He admitted owing fiduciary duties of honesty, good faith, loyalty, disclosure of all material facts, and disclosure of conflicts of interest. (Tr. 373:18-376:23). He also recognized that conflicts of interest can negatively impact investor returns. (DX-423; Tr. 380:16-381:10).

Winkelmann's fiduciary obligations were also documented in BOP's internal policy manuals which, as CCO, Winkelmann was charged with enforcing. (Stip. ¶36). To that end, BOP's ethics and compliance policies repeatedly: (a) note BOP's fiduciary relationship with its clients; and (b) state that BOP must "always" place its clients' interests "first and foremost." (DX-3, BO10065; DX-4, BO10166, BO10188, BO10207, BO10209). Consistent with these policies, BOP's clients received a "Conflicts of Interest Disclosure" form which states: BOP "***always*** acts <u>in a fiduciary role for the client</u> and only offers options and recommendations in the

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[3] In his email to the bank seeking to facilitate using BOP's money as collateral for Blue Ocean ATM, Winkelmann wrote: "[BOP] has enough in the operating account to lend out this cash...Unfortunately this creates a bunch of regulatory scrutiny by the SEC when they examine [BOP] – nothing illegal just a hassle. I would rather avoid moving money back and forth between the two companies." (DX-274, EBT000910).

clients' best interest. This would include all products (mutual funds, stocks, variable annuities, etc) plus advisory services." (DX-228, p. 1; Tr. 391:16-23) (emphasis in original).[4]

Winkelmann admitted he frequently reminded clients of his fiduciary obligations. (Tr. 396:13-17). For instance, in September 2011, Winkelmann quoted for a press release that BOP puts "at all times...clients' interest first." (DX-67, p. 2). Similarly, Winkelmann often wrote directly to clients that he was required to "always" or "at all times" put their interests first. (DX-90, p. 2; Tr. 397:23-398:11; DX-127, p. 2; Tr. 398:12-399:9; DX-462, p. 1). Winkelmann also routinely sent clients emails, using his BOP email account, touting the royalty units and the success of BOP. (*See, e.g.*, DX 129-132; DX-167, DX-172, DX-197). Those emails have a signature block describing Winkelmann as a "Registered Fiduciary," and contain no disclaimer that Winkelmann was not acting as an adviser or in a fiduciary capacity when promoting the royalty units. (*Id.*).

Winkelmann wrote on BOP's website his commitment "to always acting in the best interest of clients." (DX-310, p. 2). Even as of the trial, BOP's website represented: "A fiduciary duty is never fully satisfied, they must always seek ways to do what is best for the clients...as a fiduciary [BOP] must, at all times, put the clients' interests first." (Tr. 1523:12-1525:9).

E. BOP's Financial Distress Led Winkelmann to Offer Royalty Units

In early 2011, BOP needed money. Despite generating more than $120,000 in management fee revenues in 2010, BOP's 2010 expenses exceeded $198,000 and its net losses exceeded $36,000. (Stip. ¶44). BOP began 2011 with only $164 in the bank and $3,264 in total

[4] Immediately below the quoted section of the form, there is a section where BOP can disclose and explain instances where BOP "***occasionally*** acts as a fiduciary when providing some services" and where BOP "***do[es] not*** operate under a fiduciary duty." (DX-228) (emphasis in original). Respondents introduced no evidence of ever disclosing on this form, or anywhere else, that BOP did not act in a fiduciary capacity vis-à-vis the royalty unit offerings.

assets, while its liabilities exceeded $43,600. (Stip. ¶45). By March 31, 2011 – the date of the first offering memorandum – BOP's bank account held only $240 and BOP was past due on its office rent. (Stip. ¶46; DX-27; RX-1). At the time, BOP had between 6 and 10 employees, who BOP needed to pay along with its rent and other operating expenses. (DX-15, p. 6).

Winkelmann wanted to grow BOP's revenues (management fees based on assets under management ("AUM")) by expanding BOP's advertising efforts. (Tr. 440:10-18). But BOP couldn't afford an advertising campaign, and no bank would loan it money. (Stip. ¶46; Tr. 445:15-446:5). So Winkelmann devised the royalty units, which he acknowledged were "critical" to funding BOP's business plan and advertising campaign. (Tr. 439:16-440:9, 446:6-447:3; RX-3, p. 12). Winkelmann consulted with Binkholder on the decision to offer royalty units. (Tr. 440:5-7). Winkelmann targeted his clients to be investors. Indeed, ten of the initial fourteen investors were BOP clients, and eighteen of the 24 total investors were BOP clients. (Stip. ¶¶5-6).

Winkelmann authored the initial drafts of the offering memoranda, personally reviewed and approved the final versions circulated to investors, and had ultimate control over the memoranda's content. (Stip. ¶53, ¶55). BOP offered each royalty unit for $25,000, and granted the buyer a percentage of BOP's future cash receipts until BOP repaid the investor a fixed amount ranging from 2.25 to 3.0 times the original investment amount.[5] (Stip. ¶7, ¶9, ¶11, ¶13). Investors were entitled to a minimum percentage of BOP's monthly gross revenues, until they received the promised payback amount. (*Id.*). Below are the terms of each offering:

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[5] For the first offering only, investors also received a warrant providing an option to purchase 1% of BOP for $100,000. (Stip. ¶7). The fourth round units were offered in $5,000 increments, but BOP imposed a minimum five-unit purchase. (Stip. ¶13).

	Unit Price	Promised Returns Per Unit	Minimum Monthly Returns Per Unit (as Percentage of BOP's Monthly Revenues)
Offering 1	$25,000	$75,000	0.25%
Offering 2	**$25,000**	**$62,500**	**0.25%**
Offering 3	$25,000	$56,250	0.10%
Offering 4	**$5,000**	**$12,500**	**0.05%**

However, the offering memoranda represented BOP could pay more than the monthly minimum and that doing so was BOP's goal. (RX-1, pp. 11, 111; RX-2, pp. 6, 16; RX-3, pp. 4, 14). The memoranda also contained tables showing a range of monthly payout percentages, up to six times the minimum amounts, and how those percentages impacted how quickly investors would be repaid. (RX-1, p. 11; RX-2, pp. 6, 17, RX-3, pp. 4, 15; RX-4, pp. 4, 15). Those tables indicated that the higher the monthly payout percentage, the faster investors would be repaid. (*Id.*).

BOP ultimately raised $1.4 million by issuing royalty units. (Stip. ¶1). Each investor was required to complete a Subscription Agreement – written by Greensfelder law firm attorneys, and reviewed and approved by Winkelmann – which required the investor to "represent" and "warrant" that BOP "has not provided any investment advice" to the investor. (Stip. ¶54; Tr. 535:23-536:6; RX-1, p. 95; DX-2, PDF p. 2; DX-29, BOP8772; DX-33, BOP8892; DX-119, BOP9667; DX-124, BOP9375; DX-192, BOP9738; DX-347, BOP9782; DX-242, BOP9851; DX-246, BOP9865). Thus, Winkelmann was forcing his clients, to whom BOP undisputedly provided investment advice, to provide false representations in order to purchase royalty units.

F. The First Offering

In April 2011, Winkelmann began circulating the first offering memorandum to prospective investors, including non-accredited investors. (Stip. ¶50; Tr. 506:10-18, 510:15-25). The memorandum does not disclose any actual or potential conflicts between Winkelmann and the investors. (RX-1; Tr. 551:9-12). To the contrary, the memorandum repeatedly and affirmatively represents the absence of any conflicts:

- "...the concept of Royalty Financing appears to be a compelling way for the investors, owners and employees to align their interest." (RX-1, p. 5).
- BOP "creates value for its clients by eliminating conflicts of interest..." (*Id.*, p. 7)
- "The expansion capital in the form of Royalty Units is a way to fund growth, provide immediate cash flow stream to the Royalty Unit holders, and align all interests for returns at relatively low risk." (*Id.*, p. 15)
- BOP "attracts clients who are fed up with conflicts of interest prevalent at the broker/dealers where representatives/advisors make more money selling one security over another." (*Id.*, p. 6).
- "The plan is to ... be the 'go to' solution when investors are fed up with the conflicts of interest from their advisor/broker. This message is currently being broadcasted through advertising." (*Id.*, p. 8)

The memorandum's "Sales and Marketing Plan" section describes how BOP's sponsorship of Binkholder's radio show drives potential clients to BOP. (RX-1, p. 8). That section represents BOP "will use a substantial portion of the proceeds of this offering and future cash flows to fund media buys for both [BOP] and [Binkholder's] Financial Coach Show." (*Id.*). The memorandum further discloses that Binkholder had been providing financing to BOP, and that BOP anticipates issuing membership units to Binkholder. (*Id.*, p. 10). The memorandum additionally promotes a book Winkelmann and Binkholder were preparing for publication titled "The 401(k) Conspiracy." (*Id.*, p. 9). Binkholder's Marketing and Sponsorship Agreement is an exhibit to the memorandum. (*Id.*, p. 26).

Without describing BOP's methodology for calculating the advertising ratio, the first memorandum represents:

> A key business driver for [BOP] is the client acquisition cost. Currently [BOP] is spending approximately $5,500 per month on advertising that generates leads for the sales staff to follow up on. This $5,500 advertising spend is currently converting to approximately $2.5 million in new assets that are generating $25,000 in new annually recurring revenue. So, if this trend continues, each $10,000 in new recurring revenue will cost [BOP] $2,200 in advertising - a 22/100 ratio.

(RX-1, p. 9).

The memorandum further represents: "the key business driver will be the ability of management to persistently convert advertising spending to new clients and new recurring revenues at a ratio of less than 4/10. Higher conversion ratios will cause the payback period to be drawn out lowering investor returns." (RX-1, p. 13).

The memorandum states: "the investor will receive *no less than* 0.25% of the cash receipts of [BOP] on a monthly basis" until the investor receives $75,000. (RX-1, p. 10) (emphasis added). The memorandum does *not* say investors will receive only a fixed 0.25% per month. (*Id.*; Tr. 523:17-22). The memorandum contains charts showing anticipated payback times based on the monthly percentage of revenues paid per unit (ranging from 0.25% to 1.5%). (RX-1, p. 11). The charts show higher payout percentages causing significantly shorter payout timeframes. (*Id.*).

BOP attached to the memorandum a PowerPoint presentation (RX-1, p. 109; Tr. 532:17-24), which stated:

- "Growth Attributed to Advertising and Radio Show" (RX-1, p. 109)
- "Goal – Maintain Advertising Yield Conversion $25/$100." (*Id.*, p. 110)
- "Royalty Units Summary...Right to at Least 0.25% of Monthly Cash Receipts. Plan is to be higher! Investors get repaid first!" (*Id.*, p. 111).
- "Payback Time Depends on...Advertising & Lead Conversion Efficacy." (*Id.*)

- "[BOP]: Conflict Free Wealth Management...Eliminates Conflicts." (*Id.*, p. 115)

On May 17, 2011, Winkelmann emailed client Mike King about investing in royalty units, writing: "So far we have raised about $650,000 we are going to close the offering at the end of May." (DX-50). This statement was false. BOP had only raised $425,000 at the time, and the offering would continue until the last unit was sold on July 13, 2011. (Stip. ¶4, ¶6; DX-455). When the offering closed, BOP had raised $650,000 from fourteen investors, ten of whom were advisory clients. (Stip. ¶6). As discussed below, Winkelmann would continue lying to clients and other investors about the success of BOP and its royalty unit offerings.

G. After Closing the First Offering, BOP's Financial Situation Worsened and Binkholder Received an Investment Adviser Bar

Even after raising $650,000, BOP again started running out of money. By October 18, 2011, Winkelmann realized BOP's expenses were higher, and its revenues lower, than anticipated. (DX-70; Tr. 560:20-561:13). Winkelmann emailed Binkholder BOP's financial statements, and wrote: "I am just a little worried! Our burn rate is higher than we want – the AUM is lower than we projected. We need to stop spending and start closing!" (*Id.*). Winkelmann did not share this negative information with investors. Indeed, only two days later, Winkelmann emailed his client and royalty investor, Jason Grau, and touted BOP's performance while withholding the negative information Winkelmann shared with Binkholder. (DX-71; Tr. 563:3-564:14).[6]

Two months later, on December 20, 2011, Winkelmann reminded Binkholder that BOP was performing much worse than expected, and warned that BOP was heavily undercapitalized and running out of money. (DX-83). Winkelmann's email presented Binkholder with two options, the first being reducing monthly expenses by $18,000. (*Id.*). Winkelmann wrote: "This would mean cutting advertising and general office expenses. Basically watching every penny spent –

[6] Winkelman's email additionally promoted the book he co-wrote with Binkholder. (DX-71).

which means probably cutting the $2,000 per month that we each [receive from BOP].....more pain and suffering!" (*Id.*; Tr. 584:6-584:9). Winkelmann's second option was: "Raise additional $1.8 - $2.0 million in capital ... This may be more work but also more reward since the pro-forma would include at least $8,500 for each of us each month. This would be a bonanza..." (*Id.*; Tr. 586:3-19). Predictably, Winkelmann concluded by recommending BOP "be bold" and initiate a second offering. (DX-83). Consistent with his recommendation, Winkelmann contemporaneously created an "Action plan" to: (a) reduce monthly advertising spending by $7,000; and (b) raise his and Binkholder's monthly compensation from $2,000 to $10,000. (DX-395, BO5317; Tr. 587:19-23, 589:19-23, 590:3-6, 591:20-592:4).

BOP's fortunes continued to sour when, in late December 2011, Winkelmann first saw the order barring Binkholder from being an investment adviser. (Stip. ¶56). Winkelmann testified that upon learning of the order: (a) he alerted Greensfelder attorney Michael Morgan; (b) Morgan and his partner, Wendy Menghini, scrutinized the order; and (c) Winkelmann, Morgan and Menghini spoke "extensively" and "in-depth" about the order and its ramifications. (Tr. 573:20-574:9, 575:24-576:2, 577:4-18, 656:21-657:13, 1494:25-1495:13).

Contrary to Winkelmann's testimony, Greensfelder's invoices show BOP was not billed for any services in December 2011 (when Winkelmann admits first seeing the order) or January 2012, and that Menghini did not bill *any* time to BOP until **August 2012**. (Stip. ¶56; Tr. 574:22-575:19; DX-277, GHG005998-6000; RX-113, p. 25). The evidence shows that only in **2013** did Winkelmann email a copy of Binkholder's bar order to Greensfelder, and he did so only after learning of a separate *criminal* investigation into Binkholder. (DX-220; Stip. ¶57). Winkelmann agreed that this 2013 email, sent more than a year after Winkelmann learned of Binkholder's bar

order, is the only written record of him apprising Greensfelder of the order. (Tr. 580:25-581:7, 1492:25-1493:9).

Winkelmann went further than concealing the bar order from his attorneys. Rather than cutting ties with Binkholder, Winkelmann doubled down on their relationship. Winkelmann not only allowed Binkholder – now, a barred adviser – to continue to act as BOP's spokesman, he gave Binkholder a hefty pay raise. To that end, in February 2012, BOP entered an amended Marketing and Sponsorship Agreement under which BOP continued to sponsor Binkholder's show but increased Binkholder's monthly pay to $7,000. (DX-106; §1.01, §1.02, §1.03).

On February 27, 2012, Grau emailed Winkelmann with concerns about the performance of his royalty units. (DX-104, BO971). Winkelmann responded by acknowledging that BOP's "payments/revenue growth are a little behind projections but we are not worried." (*Id.*). Winkelmann did not disclose to his client Grau the negative financial information – including BOP being undercapitalized and running out of money – Winkelmann had previously shared with Binkholder. (*Id.*; DX-83).

H. The Second Offering

Needing cash to support his and Binkholder's pay raises, on March 10, 2012 Winkelmann initiated the second royalty unit offering. (DX-83; Tr. 659:19-660:2).

As in the first memorandum, the second memorandum contained numerous statements indicating a lack of conflicts between Winkelmann, BOP, and investors, while failing to disclose any actual or potential conflicts. (RX-2).[7] The memorandum also represented that "the fewer

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[7] Specifically, the second memorandum represents: (a) "the concept of capitalizing the business with a Royalty method would appear to be the most compelling way for the Investors, owners, and employees to align their interests"; (b) BOP "creates value for its clients by eliminating conflicts of interest…"; and (c) "The expansion capital in the form of Royalty Units is the optimal way to fund growth…and align all interests for the highest potential return at the least risk." (RX-2, pp. 6, 9, 22).

number of [royalty] units issued, the better for owners and employees" and BOP's use of the offering proceeds "would need to result in the potential for recurring revenues inuring to [BOP] and to investor returns." (RX-2, pp. 6-7, 16). However, the memorandum never disclosed that investor proceeds would be used to increase Winkelmann's or Binkholder's compensation. (Tr. 668:24-669:3, 671:8-19). Also, the memorandum continued to tout BOP's sponsorship of Binkholder's radio show and the "401(k) Conspiracy" book Winkelmann coauthored with Binkholder, and included as an exhibit BOP's amended agreement with Binkholder. (RX-2, pp. 10-13, 34). Consistent with Winkelmann's *modus operandi* of concealing bad news, the memorandum did not disclose Binkholder's bar.

The second memorandum stated: "The key driver to the [BOP] model is the efficacy or yield of the money spent on advertising...The key indicator on the advertising efficacy is to determine how much advertising is needed to generate one additional dollar in new recurring revenue. In 2011, this 'factor' was 0.79. Or in other words, [BOP] spent $0.79 in advertising to buy $1.00 in new recurring annual revenue." (RX-2, p. 5). The memorandum later represents: "**Advertising Yield Factor;** this is the key driver of the [BOP] model. This advertising factor for 2011 was 0.78. So far in 2012, this factor has dropped to 0.62." (*Id.*, p. 16). The memorandum further represents: "the key business driver will be the ability of management to persistently convert advertising spending to new clients and new recurring revenues at a factor of less than 0.80. Higher conversion ratios will cause the payback period to be drawn out, thus lowering investor returns." (*Id.*, p. 17). BOP does not disclose that it previously told investors its key business driver was keeping the ratio *below 0.4*. (Tr. 676:16-677:15)

The second memorandum contained multiple representations that BOP intended to pay investors more than the monthly minimum 0.25% of its cash receipts. (RX-2, p. 6 ("Once

recurring sustainable profitability is achieved, larger and larger portions of the cash receipts will be used to pay back [investors]"), p. 16 ("Once [BOP] 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...")). Further reinforcing the investors' expectation of receiving more than the minimum payments, the memorandum contained tables showing payout ranges from less than four years (for monthly payouts at 1.5%) to more than ten years (if payments were kept at a minimum). (RX-2, pp. 6, 17).

The second offering continued through May 22, 2012, cumulatively raising $350,000 from ten investors, seven being BOP clients. (Stip. ¶8). Even before that offering ended, Winkelmann invited the investors to participate in an upcoming third offering. (DX 129-132; Tr. 677:16-678:11). Winkelmann's April 23, 2012 email – which promoted Binkholder's show and book – noted that BOP "should again exceed our projections," and included positive projections of BOP's revenue growth. (*Id.*).

On August 1, 2012, Winkelmann emailed client Mark Funfsinn, asking if Funfsinn was interested in the upcoming third offering. (DX-167; Tr. 546:15-18). Winkelmann represented to Funfsinn that first round investors had been repaid $4,961 to date. (*Id.*). That statement was false, as BOP had paid only $2,671 per royalty unit. (Tr. 682:3-22; DX-454).

I. The Third Offering

By August 9, 2012, BOP was preparing the third offering memoranda. (DX-169; Tr. 683:14-22). That day, BOP employee Jennifer Juris alerted Winkelmann that the current draft disclosed different advertising ratios, writing: "We just need to be consistent on whatever number we use in the document." (DX-169).

On August 24, 2012, Winkelmann emailed each royalty investor about the third offering. (DX-172; Tr. 685:14-21, 686:5-10). Winkelmann's email, which again promoted Binkholder's

book and radio show – encouraged the investors to let him know "right away" if they were interested because "we have many prospective investors and will give preference to the current royalty holders." (DX-172). In fact, BOP did not have "many" prospective investors lined up. Rather, only four investors were ultimately willing to purchase third round units. (Stip. ¶10; Tr. 688:21-24). Demonstrating his need for cash, despite having serious health issues at the time, Winkelmann initiated the third offering on September 1. (Tr. 689:6-691:22; RX-3).

The third memorandum repeats many misstatements contained in the second memorandum about: (a) lack of conflicts; (b) the alignment of Winkelmann and investors' interests; (c) BOP issuing fewer units being better for Winkelmann; and (d) investor proceeds only being spent on activities that would result in higher revenues for BOP and better returns for investors. (RX-3, pp. 4-6, 13, 20-21). The third memorandum again promotes Binkholder's radio show and book, and attaches as an exhibit Binkholder's marketing agreement. (*Id.*, pp. 8, 10, 32). Nevertheless, the memorandum fails to disclose Binkholder's adviser bar. (RX-3; Tr. 701:6-13). The memorandum also fails to disclose any conflicts or investor proceeds being used to increase Winkelmann's compensation. (RX-3; Tr. 699:25-701:3).

The third memorandum represents: "The key driver to the [BOP] model is the efficacy, or yield, of the money spent on advertising... currently this 'factor' is 0.67. Or in other words, [BOP] spends $0.67 in advertising to buy $1.00 in new recurring annual revenue." (RX-3, p. 3). The memorandum repeats the second memorandum's representation that BOP's advertising ratio for 2011 was 0.78. (RX-3, p. 13).

The third memorandum contains multiple statements indicating investors should expect more than the 0.10% minimum monthly payment percentage, including the representation: "Investors should expect the bulk of their return in years 3-5." (RX-3, pp. 4, 14). The

memorandum contains charts reflecting that, to pay back investors in five years, BOP would have to pay, *every single month*, more than twice the minimum monthly payout percentage. (*Id.*, pp. 4, 14, 15; Tr. 708:11-24).

On October 2, 2012, Winkelmann emailed each royalty investor to again promote the third offering. (DX 197-199; Tr. 711:12-712:6). In those emails, Winkelmann falsely represented that the offering had raised $325,000. (*Id.*). In reality, BOP only had raised $250,000 at the time of Winkelmann's emails and, ultimately, would raise $275,000 during the entire third round. (DX-455; Stip. ¶4, ¶10). In an October 9, 2012 letter to a prospective investor, Winkelmann continued to lie about the success of the third offering, this time boasting BOP had raised $400,000. (DX-203; Tr. 713:15-714:6).

J. Binkholder's Criminal Investigation, Another Missouri Regulatory Investigation, and BOP's Failing Finances Lead to the Fourth Offering

By November 2012, the third offering was floundering. Winkelmann had only been able to sell units to four investors, including two BOP employees, Shepard Swift and Michael King, who had also invested in earlier rounds. (DX-455; Stip. ¶4; Tr. 1005:2-6, 1059:8-12). To make matters worse, on November 16, 2012, Winkelmann learned Binkholder was under federal criminal investigation. (Stip. ¶57; DX-206; Tr. 715:7-18). Upon learning this, Winkelmann stopped paying Binkholder, and severed Binkholder's relationship with BOP. (Stip. ¶58). Binkholder later pled guilty to wire fraud, and was sentenced to 108 months imprisonment. (*Id.*).

On December 12, 2012, Winkelmann emailed his close friend, Bryan Swift, financial projections showing BOP running out of money by February 2013. (DX-211, BO54; Tr. 727:16-728:14, 1058:22-24). Winkelmann did not want other investors to know of BOP's failing finances, writing: "I need to come up with a deal – I am hesitate (sic) to go back to some of the investor/clients with this bad news – need to be careful not to start any rumors." (DX-211, BO52;

Tr. 725:22-726:2). The bad news compounded itself when, on December 21, Winkelmann learned he and BOP were under investigation by the same Missouri regulators that had barred Binkholder. (DX-212).

In the meantime, on December 1, 2012, client Ed Mahoney asked about the performance of his first round royalty unit, which had only paid $3,778.54 on Mahoney's $25,000 investment. (DX-210; Tr. 716:24-718:15). Mahoney inquired about finding someone to buy his poorly performing unit, prompting Winkelmann to offer to attempt finding a buyer. (DX-210; Tr. 718:24-719:23). Even though Mahoney's first round unit had better payout terms (3x payout and a warrant) than the 2.5x payout of the fourth offering, Winkelmann did not inform the fourth round investors – both clients – that Mahoney had asked about selling his royalty unit. (Tr. 721:16-725:2; DX-455).

On January 25, 2013, Winkelmann wrote Morgan: "we need to raise money." (DX-225, BO3140-41). Winkelmann's email contained draft disclosures to provide in the upcoming offering. (*Id.* at BO3141). Those disclosures, which Winkelmann wrote, addressed Binkholder's criminal investigation and the regulatory investigation into Winkelmann and BOP. (*Id.*; Tr. 735:23-736:8). Three days later, Winkelmann asked Morgan if BOP, only a month from being out of money, could legally raise $500,000 over the next two months. (DX-229; Tr. 737:22-738:20). Winkelmann wrote: "I need go ahead and damn the torpedoes! I think the odds are that the state will fine us but not shut us down. If we stop growing we start [dying]." (DX-229).

On February 15, 2013, Winkelmann started the fourth offering, hoping to raise $375,000. (Stip. ¶12; RX-4, p. 3; Tr. 766:25-767:18). However, Winkelmann only provided a memorandum to three clients, each an earlier round investor. (Stip. ¶59; DX-455). Thus, only three investors received the memorandum's disclosures that: (a) Binkholder had been barred for not disclosing

conflicts to clients; (b) Binkholder was under criminal investigation; and (c) without additional capital BOP would run out of money by March 1, 2013. (RX-4, pp. 5, 16)

The fourth memorandum again fails to disclose any conflicts or Winkelmann's use of investor proceeds to increase his compensation. (RX-4). Likewise, the memorandum repeats many of the misrepresentations from the earlier memoranda concerning: (a) lack of conflicts; (b) the alignment of Winkelmann's and the investors' interests; and (c) the fact that issuing fewer units would be better for Winkelmann. (RX-4, pp. 4, 7, 13, 21).

The fourth memorandum represents that BOP's "current" advertising ratio is 0.89. (RX-4, p 11). The memorandum also repeats the misstatement from the second and third memoranda that BOP's ratio for 2011 was 0.78. (*Id.*, p. 13).

Like the third memorandum, the fourth memorandum represents: "Investors should expect the bulk of their returns in years 3-5." (RX-4, p. 14). The fourth memorandum also contains charts reflecting that BOP would need to pay, *every single month*, at least *four times* the minimum payout percentage in order to provide the promised returns in five years. (*Id.*, pp. 4, 15; Tr. 748:1-13, 763:8-19).

BOP's fourth offering only raised $125,000, from two clients. (Stip. ¶12). Before seeking additional funds, Winkelmann voluntarily agreed to the Missouri Securities Division's request to stop issuing royalty units. (Tr. 767:25-768:15, 770:22-771:13).

On May 20, 2014, client Mahoney again complained to Winkelmann about the royalty units. (DX-302, BO934). The 74 year-old Mahoney observed the pace of his returns was so slow that he would not be paid in full for another 30 years. (*Id.*).

By Respondents' October 2016 trial, BOP had only paid the royalty investors a combined $525,672.51 on their cumulative $1.4 million investment, while owing them more than $3.3 million. (Stip. ¶14, ¶15).

K. Winkelmann's Conflicts of Interest

As discussed above, Winkelmann relied on royalty unit investor proceeds to increase his own compensation, funnel BOP money to his other companies, and use BOP money for personal expenditures. While routinely determining to pay himself more, he also decided whether to pay the royalty investors the minimum, or more than the minimum, monthly percentage of BOP's cash receipts. (Stip. ¶62). Using that discretion, until August 2014 Winkelmann generally had BOP pay the investors the minimum monthly percentages. (DX-448; DX-315; Tr. 117:9-118:9). From April 2011 to June 2012, Winkelmann did increase the payout percentages two months per quarter, *but only for the months when BOP's cash receipts were negligible*. (DX-448). For the every third month BOP received nearly all of its revenues (management fees which were deducted quarterly), Winkelmann always paid the minimum percentage. (*Id.*).

Winkelmann recognizes that an adviser selling its own securities to clients could create a conflict of interest. (Tr. 778:20-779:14). Nevertheless, the offering memoranda never disclosed actual or potential conflicts, and Winkelmann never discussed such conflicts with investors. (Tr. 780:1-8, 782:22-783:8).

L. The Advertising Ratios

In each offering memorandum, Winkelmann emphasized the importance of BOP's advertising ratio or "factor," often describing the metric as the "key driver" for BOP's business. (Tr. 448:18-449:2; RX-1, p. 9; RX-2, p. 16; RX-3, p. 13; RX-4, p. 13). He personally selected what ratio to represent to investors. (Tr. 972:2-14, 981:8-13, 982:10-22). BOP undisputedly never disclosed its methodology for calculating the ratio or that BOP changed its methodologies

from offering to offering. (Tr. 484:18-485:15, 517:9-518:12, 663:5-664:21, 695:8-697:20, 705:25-706:15, 756:7-14). Moreover, Winkelmann's shifting accounts for how BOP calculated the ratio, coupled with his inability to explain how he arrived at certain ratios disclosed in the offering memoranda, belie his claim BOP fully and accurately represented the ratio to investors.

1. Winkelmann's Changing and Conflicting Story

At his investigative testimony, Winkelmann testified BOP calculated the ratios disclosed in the offering memoranda by dividing (a) total advertising spending for a given period by (b) the amount of new recurring revenue BOP generated during that same period. (Tr. 449:16-450:12, 1450:9-19). However, Winkelmann could not explain the discrepancies between the ratios disclosed in the offering memoranda and the ratios presented to him by the Division that were calculated using BOP's financial records and the methodology Winkelmann testified to using. (Tr. 1447:2-20). Even though Winkelmann realized he had been unable to explain the inconsistencies presented to him at his testimony, he offered no explanation in his Wells submission, which was submitted by his present attorneys, for how BOP calculated the advertising ratios. (Tr. 477:14-478:15, 1451:12-16; DX-345; DX-346).

When confronted at trial with his investigative testimony concerning the ratios, Winkelmann claimed his investigative testimony was inaccurate and "wrong." (Tr. 453:3-454:19, 471:10-472:22, 476:8-477:8, 1457:23-1458:4). When asked at trial to explain how BOP calculated the ratio, Winkelmann initially testified the numerator component was revenue, but later reversed himself and testified revenue composed the ratio's denominator. (Tr. 455:9-13, 458:1-8). Winkelmann eventually settled on a methodology he did not describe in his investigative testimony or Wells submission, but one he recently embraced in his prehearing brief and expert's report: advertising spending for a period divided by new revenues that *resulted* from the period of

advertising, as opposed to new revenues generated *during* the advertising period. (Tr. 471:10-472:22, 476:8-477:8, 1457:23-1458:4, 1459:6-1460:24).

Juris was the BOP employee responsible for tracking the advertising ratio. (Tr. 863:12-864:10, 865:7-866:11; 873:8-17, 876:24-877:18, 942:21-945:11, RX-6; RX-36). Juris, who Winkelmann called to testify, refuted the new methodology described in Winkelmann's trial testimony, prehearing brief, and expert report. (Tr. 872:25-879:15, 948:2-21, 950:23-952:8, 900:4-903:1). Namely, Juris testified BOP calculated the ratio using new revenues generated *during* the period of advertising at issue. (*Id.*). Juris also testified she was unaware how Winkelmann selected the ratios cited in the offering memoranda. (Tr. 967:10-16, 982:10-22). When asked whether Winkelmann or Juris more accurately described how BOP calculated the ratio, Winkelmann testified Juris's account was more accurate. (Tr. 1461:25-1462:6).

Winkelmann testified that advertising includes "messaging to entice an individual to take action," and that advertising includes sponsorship of a radio show. (Tr. 491:17-23). However, Winkelmann chose to exclude payments to Binkholder from the advertising expense component of the ratio, and agreed that had BOP included those payments, the ratio would have increased. (Stip. ¶48, ¶49; Tr. 493:15-494:1). Winkelmann's exclusion of the Binkholder payments from advertising expenses differed from his accounting treatment for payments to another BOP paid spokesman, radio host Charlie Brennan. (DX-86; RX-1, p. 8). Indeed, Winkelmann classified as advertising expenses both payments made directly to Brennan and to the radio station airing his show. (*Id.*). In deciding to exclude the Binkholder payments, Winkelmann did not consult with an accountant or accounting guidance. (Tr. 494:2-495:11).

2. **Respondents' Explanations for BOP's "Current" Ratios Show that, Without Disclosure, Winkelmann Changed Methodologies and Cherry-Picked to Arrive at Better Ratios**

a. The First Memorandum

The first memorandum does not disclose how BOP calculated the 0.22 ratio represented to investors. (RX-1; Tr. 517:9-15). Winkelmann was the only witness who worked at BOP when it issued that memorandum; Juris had not yet started there. (Tr. 937:16-19, 940:4-20). Winkelmann testified at trial, and argued in post-hearing briefing, that BOP calculated the 0.22 ratio by dividing (a) BOP's advertising expenses going back to June 2010, by (b) recurring revenues generated *during* February 2011. (Tr. 519:25-520:8, 521:6-10, 525:15-526:7; Post-Hearing Br. at 8-9). Winkelmann failed to introduce *any* contemporaneous document, or elicit testimony from any other percipient witness, supporting his purported methodology for the first memoranda's ratio. Moreover, Winkelmann's testimony and post-hearing brief conflicted with his pre-hearing brief, which claims BOP arrived at the 0.22 ratio by: (a) averaging BOP's advertising spending from June 2010 to "the middle of" March 2011, which purportedly equaled $5,300 per month; and (b) dividing that $5,300 by $25,000, the amount BOP purportedly generated, "as of mid-March 2011," *as a result* of that advertising. (Prehearing Br. at 8). Winkelmann's trial testimony also contradicted his investigative testimony, where Winkelmann testified BOP calculated the 0.22 ratio using data going back as far as BOP had it, which was January 2010. (Tr. 523:23-525:14; DX-327, 167:22-168:1).

b. The Second Memorandum

Winkelmann claims he based the second memorandum's 0.62 "current" ratio off a February 2012 advertising report, RX-036, which shows a ratio of 0.67. However, Winkelmann never testified how he came up with the 0.62 ratio, and no contemporaneous document shows BOP with a 0.62 ratio in March 2012.

Winkelmann testified he arrived at this number by using a different methodology than for the first memorandum's "current" ratio. Winkelmann testified the first memorandum divided advertising expenses for a 9-month period by revenues for a single month (February 2011), but that beginning with the second memorandum, BOP divided advertising expenses for a period by revenues *resulting from* the period of advertising. (Tr. 661:4-20, 662:11-663:3). Winkelmann concedes the second memorandum does not disclose any change in methodology. (Tr. 663:5-11). Multiple investors invested in both the first and second offerings. (DX-455). Winkelmann admitted these investors could not ascertain BOP had purportedly changed its methodology between these two offerings or that the ratios presented in the first two memoranda did not present an apples-to-apples comparison of BOP's advertising efficiency. (Tr. 663:12-664:21).

The closest Winkelmann could come to explaining the 0.62 ratio was through Juris's testimony. Juris discussed RX-36, a February 2012 advertising report that was available at the time the second memorandum was finalized. (Tr. 872:25-873:7, 878:2-20, 879:2-15, 912:2-14). Per RX-36, BOP's ratio for February 2012 was 0.67, not 0.62.[8] (Tr. 945:23-946:8). Juris refuted Winkelmann by testifying that, when the second memorandum was issued, BOP calculated the ratio by dividing advertising expenses for a month by recurring revenues generated *during* that month. (Tr. 872:25-873:7, 878:2-20, 879:2-15, 912:2-14).

The February 2012 report does contain data allowing one to calculate the ratio in the manner described by Winkelmann: $14,804 in advertising expenses for February 2012, and

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[8] The February 2012 report also showed worse factors for November 2011 (1.45), December 2011 (1.02), and January 2012 (0.74), none of which are disclosed in the second memorandum. (RX-36).

$840,000 in new AUM *resulting from* that advertising that produces $8,400 in revenues.[9] (RX-036; *see also* Juris's testimony that RX-36's top chart shows revenues *resulting from* advertising (Tr. 943:2-7, 944:24-945:11)). Juris testified that calculating the ratio for February 2012 according to Winkelmann's trial testimony and the data on RX-36 results in a ratio of 1.76 ($14,804 ÷ $8,400) – nearly 3 times worse than the reported 0.62 ratio. (Tr. 948:2-21).

c. The Third Memorandum

Winkelmann claims he based the third memorandum's 0.67 "current" ratio off BOP's July 2012 advertising report (RX-54, p. 63), which was generated in August 2012 and was the last report created prior to the third memorandum. (Tr. 898:6-18, 913:16-23). The July report shows monthly advertising factors (ratios) for November 2011 through July 2012, with the most recent monthly ratio being July 2012's 3.00 ratio. (RX-54, p. 63, bottom row of table). Juris testified the July 2012 report calculated the monthly factor in the same way the February report did: advertising spending for a month divided by new annual revenues generated *during* that month. (*Id.*; Tr. 901:3-11). The July report also showed two "Trailing 6-Month Factor[s]," both of which were significantly better than the 3.00 July monthly factor: an "Average Factor" of 0.71 and a "Geometric Mean Factor" of 0.69:

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

(RX-54, p. 63).

Juris testified the trailing 6-month factors were calculated using the same basic formula as the monthly factors – advertising expenses for a period divided by new revenues generated

[9] Juris testified that, at the time, BOP calculated the ratio by assuming it earned 1% revenues off its AUM. (Tr. 879:2-15, 912:2-14, 937:20-24). $840,000 x 0.01 = $8,400.

during that period – but with a six-month (rather than one-month) look-back period. (Tr. 901:12-903:1).

Winkelmann asserts that for the third memorandum's 0.67 "current" ratio, BOP switched methodologies and relied on the trailing 6-month factors from the July 2012 report, the lower of which is 0.69. However, this contradicts Winkelmann's trial testimony that, for the third memorandum, BOP continued to use the revenues *resulting from* advertising methodology. (Tr. 692:11-693:3).

Even assuming Winkelmann based the 0.67 "current" ratio off the trailing six-month factor in the July 2012 report (RX-54, p. 63), there is no disclosure that BOP changed methodologies from using one month of advertising expenses/revenues, as BOP did for the second memorandum, to using six months. There is also no disclosure that using the July report's six-month ratios results in a much better number than relying on the most recent month's ratio (3.00 for July 2012). (*Id.*).

d. The Fourth Memorandum

The fourth memorandum represents that BOP's "current" ratio is 0.89. (RX-4, p. 11). Winkelmann claims he selected that ratio based off BOP's December 2012 advertising report (RX-120, p.1), which shows a 0.89 trailing 12-month factor for BOP's St. Louis office. That report, *which only includes data for BOP's St. Louis office*, computes three different "trailing" factors using three different look-back periods: 6-month (ranging from 1.02 to 2.00), 9-month (ranging from 0.85 to 2.01), and 12-month (0.89).[10]

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

(RX-120, p.1.; Tr. 904:12-905:25)

[10] The report also shows December 2012 monthly factors of 0.79 and 3.65. (RX-120, p. 1).

To the extent Winkelmann actually relied on the trailing 12-month ratio for the fourth memorandum, there is no disclosure that: (a) BOP again changed look-back periods, from the six-month period purportedly used in the third memorandum; (b) doing so resulted in a better ratio; or (c) a wide variety of ratios existed and Winkelmann excluded the options that made BOP look worse.

Moreover, if Winkelmann truly used the December 2012 report's 0.89 ratio as the basis for the fourth memorandum, it demonstrates he intentionally selected misleading information to present to investors. This is because the December report, on a separate page, also contained advertising and revenue data for BOP's unsuccessful *Chicago* office. (RX-120, p. 2; Tr. 972:25-975:2). That report shows that for September through December 2012, BOP's Chicago advertising expenses were $69,660 and its new recurring revenues were only $2,574, which results in a ratio of 27.06 ($69,660/$2,574). (RX-120, p. 2). The Chicago data was so poor that it resulted in monthly ratios between 7.17 and 20.18, magnitudes higher than what BOP ever represented to investors:

Chicago		Sep-12	Oct-12	Nov-12	Dec-12
	Advertising Costs	$ [illegible]165	$ 35,355	$ [illegible]	$ 5,030
From THIS Month's Leads	# Leads	43	202	117	28
	# Appts Set from Month's Leads	3	10	6	0
	# Clients from Month's Leads	1	2	0	0
	% of Appts Set	7.0%	5.0%	5.1%	0.0%
	% of Clients Set	2.3%	1.0%	0.0%	0.0%
	New AUM from Month's Leads	$ 90,000	$ 240,000	$ -	$ -
	Estimated First Year Revenues	$ 702	$ 1,872	$ -	$ -
	Factor (1)	20.18	18.94	#DIV/0!	#DIV/0!
From ANY Month's Leads	# of Appts Came in During Month	0	8	7	5
	# of Appts Closed	0	0	1	0
	Closing %	#DIV/0!	0.0%	14.3%	0.0%
	# of Clients Signed During Month	0	0	1	1
	New AUM from Clients Signed in Month	$ -	$ -	$ 140,000	$ 90,000
	Estimated First Year Revenues	$ -	$ -	$ 1,092	$ 702
	Factor (2)	#DIV/0!	#DIV/0!	13.75	7.17

(RX-120, p. 2).

Juris confirmed that had BOP included the Chicago data in its calculations, BOP's company-wide trailing 12-month ratio would have been higher than the 0.89 St. Louis-only ratio. (Tr. 975:12-976:1, 976:24-977:4). There is no disclosure that BOP was excluding the much poorer Chicago data and that doing so allowed BOP to present a lower ratio.

3. Respondents Repeatedly Misrepresented BOP's 2011 Annual Ratio

At trial, Respondents presented *no evidence whatsoever* showing how BOP calculated the 0.78/0.79 annual ratio for 2011 cited in the second, third, and fourth memorandum.[11] Neither Winkelmann, Juris, Respondents' expert, nor Respondents' prehearing brief, offered *any* explanation for how BOP calculated the 0.78/0.79 ratio. (*Id*). Thus, the record is completely devoid of any (a) document showing BOP's 2011 annual ratio to be 0.78/0.79; or (b) witness explaining how BOP arrived at that figure. The ALJ similarly observed: "Winkelmann was unable to explain how BOP arrived at the 0.79 advertising ratio for 2011 in his investigative testimony, prehearing brief, expert report, or posthearing brief." (I.D. at 25).

While Respondents offered no explanation or support for the 2011 annual ratio, OCIE accountant Michael Collins calculated that ratio using the same methodology described by Winkelmann during his investigative testimony (which Collins attended) and Juris during her trial testimony: BOP's advertising expenses for 2011 divided by its new recurring revenues generated that year. (Tr. 55:19-23, 71:9-13, 72:23-73:3, 73:24-77:11; 92:16-93:24; DX-441).

Collins' calculations are reflected on DX-441, a summary exhibit Collins created. (Tr. 88:8-21). Collins' calculations showed that, based on BOP's internal data and the methodology

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[11] The second memorandum represents both: BOP's "advertising factor for 2011 was 0.78," and "In 2011, this 'factor' was 0.79." (RX-2, pp. 5, 16). The third and fourth memoranda represent that BOP's 2011 advertising factor was 0.78. (RX-3, p. 13; RX-4, p. 13). Winkelmann additionally represented BOP's 2011 ratio being 0.78 in February 2012 emails to Ed Mahoney and James Zenner. (DX-97, BO877; DX-102, BO423; Tr. 599:12-14, 602:21-603:6).

Juris described, BOP's advertising ratio for 2011 was 1.28, not 0.78. (DX-441; Tr. 91:19-92:5). The data Collins relied on came from Exhibit DX-159, a BOP spreadsheet that tracked, from January 2011 to June 2012, BOP's monthly advertising spending, new recurring annual revenues, and advertising ratio. (Tr. 88:10-21, 91:19-92:15; DX-159; DX-441).

Winkelmann testified DX-159 was one of the documents BOP used to track the advertising ratio. (Tr. 487:12-15). Moreover, the 2011 advertising spending information on DX-159 was consistent with two other BOP documents devoted to its 2011 advertising data: (a) DX-86, which was a listing of BOP's 2011 monthly advertising expenditures by vendor; and (b) Respondents' RX-18, which was a "2011 Advertising Analysis" spreadsheet. (Tr. 492:4-493:5, DX-86, DX-159; RX-18). Juris confirmed that DX-159 tracked revenues generated *during* each month of advertising, and that DX-159 was a printout of a July 2012 spreadsheet. (Tr. 919:9-920:9, 950:23-952:8, DX-159; RX-054, p. 58).

While Winkelmann claims the data on DX-159 did not exist when BOP issued the second memorandum, he concedes the data was available and valid at the time of the third and fourth memoranda. (Tr. 488:18-489:16). Further, Respondents never identified any document showing that the 2011 information on DX-159 was inaccurate.

IV. LEGAL ANALYSIS[12]

A. Respondents Violated the Securities Act's, Exchange Act's, and Advisers Act's Antifraud Provisions

Respondents repeatedly violated the antifraud provisions. They did so by failing to disclose Binkholder's adviser bar and making numerous false and misleading statements about BOP's advertising ratios, the success of the royalty unit offerings, the use of investor proceeds, and

[12] Respondents seek review of the I.D.'s findings that Respondents failed to disclose conflicts and breached fiduciary duties to clients who purchased royalty units, as well as the sanctions imposed. Because the Division did not seek review of those issues, the Division will address them in response to Respondents' opening brief.

the alignment of Winkelmann's and investors' interests. They also engaged in a scheme to lure clients with claims that BOP was conflict-free and always acted in their best interests, and then selling those same clients BOP securities without disclosing the significant conflicts attendant to the offerings.

1. Legal Standards

Exchange Act Section 10(b) and Rule 10b-5 prohibit in connection with the purchase or sale of securities: (1) employing any device, scheme or artifice to defraud; (2) making material misstatements of fact or statements that omit material facts; or (3) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit. Securities Act Section 17(a) contains similar prohibitions in the "offer or sale of any securities." *Bernerd Young,* Exchange Act Release 774421, 2016 SEC LEXIS 1123, **63-65, n.67 (Mar. 24, 2016). Sections 10(b) and 17(a) are violated when a respondent engages "in conduct that produces a false impression." *Dennis Malouf,* Advisers Act Release 4463, 2016 SEC LEXIS 2644, *20 (July 27, 2016). "Such conduct encompasses 'making' a misrepresentation; it also encompasses, among other things, drafting or devising a misrepresentation." *Id.*

Investment advisers, such as Respondents (Stip. ¶2), violate Sections 10(b) and 17(a) by "failing to correct a material misstatement in violation of a fiduciary duty to do so." *Malouf,* 2016 SEC LEXIS 2644, *30, *47. For advisers, a "breach of duty of disclosure may be viewed as a device or scheme, an implied misrepresentation, and an act or practice, violative of all three subdivisions" of Section 17(a) and Rule 10b-5. *J.S. Oliver Cap. Mgmt.*, Exchange Act Release 78098, 2016 SEC LEXIS 2157, *27 n.27 (June 17, 2016) (citations omitted); *see also Larry Grossman*, Advisers Act Release 4543, 2016 SEC LEXIS 3768, *24-25 (Sept. 30, 2016) (adviser's receipt of fees "by means of the undisclosed compensation agreements and the untrue

statements and omissions of material fact to his clients. . . violated Securities Act Section 17(a)(2).").

"For a misstatement or omission to qualify as material, 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by [a] reasonable investor as having significantly altered the "total mix" of information made available.'" *Harding Advisory LLC,* Advisers Act Release 4600, 2017 SEC LEXIS 86, *18 (Jan. 6, 2017) (quoting *TSC Indus., Inc. v. Northway*, 426 U.S. 438, 449 (1976)). One "who discloses material facts in connection with securities transactions assume[s] a duty to speak fully and truthfully on those subjects" and "provide complete and non-misleading information with respect to the subjects on which he undertakes to speak." *In re K-Tel Sec. Litig.*, 300 F.3d 881, 898 (8th Cir. 2002) (quoting *Helwig v. Vencor*, 251 F.3d 540, 561 (6th Cir. 2001)).

To prove a violation of Section 17(a)(1), Section 10(b), and Rule 10b-5, the Division must establish scienter, which can be shown through recklessness. *Bernerd Young,* 2016 SEC LEXIS 1123, *64. Violations of Sections 17(a)(2) and 17(a)(3) can be proven by a showing of negligence. *J.S. Oliver,* 2016 SEC LEXIS 2157, *12; *Dennis Malouf,* 2016 SEC LEXIS 2644, *53 ("Section 17(a)(3)'s prohibition thus applies, for example, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also applies, for example, where, as a result of a defendant's negligent conduct, prospective investors are prevented from learning material information about a securities offering.").

Similarly, Advisers Act Sections 206(1) and 206(2) "prohibit investment advisers from misstating material facts or omitting facts necessary to make a prior statement non-misleading in promotional literature and other communications to clients or prospective clients." *Anthony Fields,*

CPA, Exchange Act Release 74344, 2015 SEC LEXIS 662, *58 (Feb. 20, 2015). "Section 206 prohibits 'failures to disclose material information, not just affirmative frauds.'" *Montford & Co., Inc.*, Advisers Act Release 3829, 2014 SEC LEXIS 1529, *50-51 (May 2, 2014) (quoting *SEC v. Wash. Inv. Network*, 475 F.3d 392, 395 (D.C. Cir. 2007)). Section 206(2) further establishes a fiduciary relationship between the adviser and clients, and imposes "duties of 'utmost good faith, and full and fair disclosure of all material facts' and 'to employ reasonable care to avoid misleading [advisory] clients.'" *Bernerd Young*, 2016 SEC LEXIS 1123, *38-39 (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194 (1963)).

Section 206(1) requires a showing of scienter, while negligence establishes a Section 206(2) violation. *J.S. Oliver*, 2016 SEC LEXIS 2157, *12; *Dennis Malouf*, 2016 SEC LEXIS 2644, *54. "Facts showing a violation of Section 17(a) or 10(b) by an investment adviser will also support a showing of a Section 206 violation." *Malouf* at *70 (quoting *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007)).

2. Respondents' Failure to Disclose Binkholder's Adviser Bar

Given Binkholder's central role in BOP's advertising campaign, his key position at BOP, and the prominence given to Binkholder in the offering memoranda, the omission of the bar order was material. In *SEC v. Bolla*, the court faced strikingly similar facts: one of two co-founders of an investment advisory firm received an adviser bar shortly after the firm's formation and was then removed as an owner of the firm. 401 F. Supp. 2d 43, 48, 50 (D.D.C 2005). As did Winkelmann, the remaining founder failed to disclose to clients that his co-founder had been barred. *Id.* at 56-57. The court found the remaining founder's failure to disclose his co-founder's bar violated the Advisers Act's antifraud provisions.

The court determined the co-founder's bar was "clearly" material. *Id.* at 68. The court reasoned: "once [the remaining co-founder] began discussing the whereabouts of [the barred co-

founder] with [the firm's] clients and prospective clients," as Winkelmann did when he touted Binkholder in the offering memoranda, "he triggered an affirmative obligation to truthfully and accurately represent why [the barred co-founder] had 'left' [the firm]." *Id.* at 70. Using language particularly apt in this case, the court explained:

> The mere fact that Mr. Bolla was no longer with [the adviser] is significant, but not complete. Mr. Bolla left because the SEC obtained an anti-fraud injunction and bar against him. *There is a substantial difference between telling an investor that a principal had "left the firm" and notifying them that the principal "has been barred," even if the bar originated out of an unrelated matter.* Confronted with the fact that his/her investment adviser had been barred, the reasonable investor would likely question the firm, wondering whether the other investment advisers could also be trusted to fulfill their ethical obligations...By not informing [the firm's] clients and his prospective clients of the full and complete reasons for Mr. Bolla's departure, Mr. Radano opted to pursue the potential financial gain resulting from easy transfers of accounts over the hard acknowledgment that his business partner had been barred from further practice...

Id. at 72 (emphasis added).

The D.C. Circuit affirmed, finding the adviser's fiduciary "duty included disclosing Bolla's bar from the investment advisory business" and that when "such a critical player in an investment advisory firm is barred from the business on account of misconduct, the firm has a fiduciary duty to disclose that fact to its clients." *SEC v. Wash. Inv. Network*, 475 F.3d 392, 404-405 (D.C. Cir. 2007).

Here, the first three memoranda prominently discuss Binkholder, his radio show, how the show provides leads to potential clients, and the show's role in BOP's advertising campaign. (RX-1, p. 8; RX-2, pp. 10-11; RX-3, pp. 7-8). Indeed, the first memorandum specifically identifies Binkholder's show as a source of BOP's growth. (RX-1, p. 109). The first three memoranda devote more than double the attention to Binkholder than they do Charlie Brennan, the other radio host discussed below Binkholder in the memoranda's "Advertising" sections. (RX-1, p. 8; RX-2, pp. 10-11; RX-3, pp. 7-8). Winkelmann's decision to pay Binkholder the same compensation

Winkelmann himself received, and have BOP purchase a $2 million policy on Binkholder's life, further evidences Binkholder's importance to BOP.

Additionally establishing the value BOP placed on Binkholder, the signature block on Winkelmann's emails expressly referenced Binkholder's radio show. (DX129-131; RX-106, pp. 492-493, 525, 1089, 1097-99, 1189-90, 1195-1200). As in *Bolla*, once Winkelmann chose to make disclosures regarding Binkholder, "he triggered an affirmative obligation to truthfully and accurately represent why" Binkholder had "left" BOP. 401 F. Supp. 2d at 70. Confirming the bar's materiality, investors Grau and Swardson testified they would have wanted to know about Binkholder's regulatory issues when they invested. (Tr. 23:10-24:7, 626:20-627:13).

Not only was Binkholder's bar material to investors, so too was the basis for the bar: Binkholder defrauding his advisory clients by selling them securities in his own businesses without disclosing the attendant conflicts. (DX-84, ¶15(c), ¶16). Any reasonable investor would want to know that Winkelmann, BOP's CEO and principal, could also be barred for selling royalty units to clients. To that end, client Grau asked Winkelmann before investing whether the royalty units were permissible from a conflicts perspective. (Tr. 621:25-622:22; 654:13-655:4)

3. Respondents' Misrepresented Their "Alignment" with Investors

Winkelmann consistently made false and misleading statements about lack of conflicts and the alignment of his and investors' interests. Specifically, the offering memoranda repeatedly represent that Winkelmann's interests were aligned with investors and that BOP eliminates conflicts of interest. The memoranda also falsely represent that it would be better for Winkelmann to sell less units and that BOP would only use investor proceeds on expenditures that would generate revenues for BOP. Beyond the memoranda, Winkelmann on numerous occasions falsely told investors he would always act in their best interests.

These statements were false and misleading because the interests of Winkelmann and the investors, at times, directly conflicted. Winkelmann routinely used BOP money – that could have been used to repay or otherwise benefit investors through deployment in advertising or other revenue-generating activities – to increase his compensation, pay personal debts, or fund his other companies. A prime example is Winkelmann's "Action Plan" that reduced BOP's advertising spending by $7,000 per month while increasing his and Binkholder's pay by $8,000 per month. (DX-395, BO5317; Tr. 590:3-6, 591:20-592:4). Winkelmann's decision to sharply cut advertising (which would presumably lower BOP's revenues) while simultaneously raising his compensation demonstrates that his and the investors' interests were not always "aligned." Indeed, the ALJ determined that Winkelmann's misrepresentations regarding lack of conflicts were "extremely reckless" and violated the antifraud provisions. (I.D. at 54-56).[13]

Regarding materiality, any reasonable investor would want to know excess funds available to them were being used to increase Winkelmann's pay. Grau, Buckowitz, and Swardson confirmed that knowing Winkelmann would use investment proceeds to increase his compensation would have impacted their investment decision. (Tr. 22:4-12, 348:19-349:9, 622:23-623:16).

4. Winkelmann's Misstatements About Investor Returns and the Success of the Offerings

In an effort to sell more royalty units, Winkelmann additionally falsely represented in one-on-one correspondence with potential investors how much money BOP had raised and the amount of investor repayments. Examples include representations that: (a) BOP had raised $650,000 in the first offering when, at the time, BOP had only raised $425,000 (DX-50; DX-455); (b) BOP raised $325,000 to $400,000 in the third offering when, at the time, BOP had only raised $250,000 (DX-199, p. 2; Tr. 711:12-712:6; DX-203; DX-455); and (c) in August 2012 first round investors had

[13] As discussed below, the ALJ erroneously concluded Respondents established a reliance-on-counsel defense to these violations.

been repaid $4,961.95, when they had only been repaid $2,671.98 (DX-167; DX-454; Tr. 682:3-22). The Commission and courts routinely hold that an adviser violates the antifraud provisions by misstating its performance or success in procuring investments. *See, e.g., Bennett Group Fin. Servs.*, Advisers Act Release 4676, 2017 SEC LEXIS 1003, *11-12 (Mar. 30, 2017) (adviser misstated assets under management); *SEC v. Nadel*, 97 F. Supp. 3d 117, 123-126 (E.D.N.Y. 2015) (same); *Seaboard Inv. Advisers*, Advisers Act Release 1918, 2001 SEC LEXIS 2780, *13-19 (Jan. 10, 2001) (adviser misrepresented performance of client accounts); *SEC v. Haligiannis*, 470 F. Supp. 2d at 381 (same).

5. Respondents' Misrepresentations and Omissions About the Advertising Ratios

The offering memoranda contained false statements and material omissions about BOP's advertising ratios. In the second, third, and fourth memoranda, BOP represented that BOP's 2011 annual ratio was 0.78, when BOP's internal data showed that BOP's ratio for that year was 1.28. These misstatements were, at the very least, reckless given that Respondents offered no support whatsoever at trial for the 0.78 annual ratio. They were also material, given that a ratio above 1.0 indicated BOP was spending more on advertising than it was generating from that advertising. To that end, investors Buckowitz and Swardson testified it was important to them that BOP's ratio was below 1.0. (Tr. 18:2-23; 19:6-17; 346:9-347:5).

Regarding the other ratios represented in the offering memoranda, those representations are misleading and omit material information, even assuming Winkelmann based those ratios on BOP's internal reports. The below chart shows how Respondents' purported methodology for

calculating BOP's "current" ratio changed from memorandum to memorandum:

Offering Memo	Purported Supporting Report	Respondents' Purported Methodology (per post-hearing brief)	"Current" ratio cited in memo	Ratios listed on Advertising Report
1	n/a	June 2010 through February 2011 advertising expenses, divided by February 2011 new revenues	0.22	n/a
2	RX-36	February 2012 advertising expenses divided by February 2012 new revenues	0.62	1.45 (Nov. 2011) 1.02 (Dec. 2011) 0.74 (Jan. 2012) 0.67 (Feb. 2012)
3	RX-54, p. 63	Trailing six months (February-July, 2012) advertising expenses divided by trailing six months new revenue	0.67	3.00 (July 2012) 0.71 (trailing 6-month "average" factor) 0.69 (trailing 6-month "geometric mean" factor)
4	RX-120	2012 advertising expenses divided by 2012 new revenues	0.89	1.02, 1.22, 2.00 (trailing 6 months) 2.01, 0.91, 0.85 (trailing 9 months) 0.89 (trailing 12 months)

Despite the changing methodologies, BOP never disclosed: (a) the methodology, month at issue, or look-back period used for the ratios presented in the memoranda; (b) the continuing change in computation method; or (c) that Winkelmann had many methods to choose from and consistently chose the one that made BOP look best. Given Winkelmann's failure to disclose BOP's changing computation methods and the materially different results they produced, even if Winkelmann relied on BOP's data when representing the ratios to investors, those representations are misleading and omit material information. *In re BP p.l.c. Secs. Litig.*, 2016 WL 3090779, *15 (S.D. Tex. May 31, 2016) ("If those two estimates are proven to be of equal weight and [BP employee] Suttles merely cherry-picked the more favorable of the two, then the omission of the higher estimate would be misleading to a reasonable investor. Moreover, it would suggest that Suttles acted with 'intent to deceive.'"); *Von Hoffman v. Prudential Ins. Co.*, 202 F. Supp. 2d 252, 255, 261 (S.D.N.Y. 2002) (where insurer "changed its methodology for calculating dividends...a reasonable investor would have wanted to know that the method used to generate

the ... results was no longer being used and that a new, perhaps less favorable method was going to be used instead.")

Winkelmann's misrepresentations and omissions were material. The offering memoranda describe the advertising ratio as the "key driver" of BOP's success and ability to repay investors. Given the significance that BOP assigned to the ratios, a reasonable investor would want to know that Winkelmann cherry-picked among the various ratios listed on BOP's advertising reports. Further establishing the ratios' materiality, Grau, Buckowitz, and Swardson testified the ratio was important to their investment decision and they would have wanted to know if the ratios were misstated. (Tr. 18:2-23, 19:6-17, 346:9-347:5, 628:20-629:15).

6. Winkelmann Acted with Scienter

While intent is irrelevant to the Section 206(2), 17(a)(2), and 17(a)(3) claims, the Division established Winkelmann's scienter.

For instance, Winkelmann knew Binkholder was barred for selling securities in his own companies to advisory clients. Yet Winkelmann concealed the order from investors, and failed to follow the order's guidance that selling BOP securities to clients was improper. Winkelmann did so because the overwhelming majority of royalty investors were BOP clients, and Winkelmann knew that excluding clients would mean less money for BOP's coffers and Winkelmann's wallet. Indeed, Winkelmann recognized that BOP's solvency and his own compensation were dependent on fresh proceeds from royalty investors. (*See, e.g.*, DX-83; Tr. 587:19-23; DX-225; Tr. 735:23-736:8; RX-004, p. 5).[14]

[14] The fact that Winkelmann did not disclose the bar to his attorneys until 2013 (DX-220), when Binkholder became the subject of a criminal investigation, and then lied at trial that he told this attorneys about the bar a full year earlier, is additional evidence of Winkelmann's scienter. (Tr. 573:20-574:9, 574:22-576:2, 577:4-18, 656:21-657:13, 1494:25-1495:13; DX-277, GHG5998-6000)

As for the misrepresentations about Winkelmann's "alignment" and lack of conflicts with investors, and the concealment that Winkelmann routinely paid himself more at investors' expense, Winkelmann also acted with scienter. As BOP's CCO with over 30 years of industry experience, Winkelmann either knew or was reckless in not realizing the offering materials misstated and omitted material information. *See, e.g., Dennis Malouf*, 2016 SEC LEXIS 2644, *67 (finding scienter when respondent adviser, "an experienced securities professional, had an independent obligation to disclose his conflict, understood that obligation, and must have known that clients would be misled by his failure to correct the representation that no conflict existed."). Indeed, the ALJ correctly determined that Winkelmann's misrepresentations concerning lack of conflicts were "extremely reckless." (I.D. p. 55).

Similarly, Winkelmann acted either knowingly or recklessly when, in one-on-one communications with investors, he repeatedly misstated BOP's success in raising funds and repaying investors. A simple review of BOP's financial records would have shown that Winkelmann's claims were misstated by material amounts. *See, e.g., Elam v. Neidorff*, 544 F.3d 921, 929 (8th Cir. 2008) ("allegations that a defendant made materially misleading statements, while in possession of conflicting information, support a strong inference of scienter"); *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 665 (8th Cir. 2001) ("One of the classic fact patterns giving rise to a strong inference of scienter is that defendants published statements when they knew facts or had access to information suggesting that their public statements were materially inaccurate.").

For the same reason, Winkelmann acted with scienter when he repeatedly represented that BOP's 2011 advertising ratio was 0.78, when no contemporaneous record supported this figure and, to the contrary, BOP's financial data resulted in a much worse 2011 ratio of 1.28. He also

acted knowingly or recklessly by failing to disclose his cherry-picking from methodologies and look-back periods to select a more favorable ratio. Additional evidence of Winkelmann's scienter and/or recklessness is his shifting explanation for BOP's ratios, his failure to explain his methodologies in his Wells submission, his recanting of his investigative testimony, and the fact that Juris contradicted the explanations for the ratios offered in Winkelmann's testimony, prehearing brief, and expert report.

Also evidencing Winkelmann's scienter is his repeated concealment from investors that BOP's finances were failing and that he needed the proceeds from the royalty units to increase his own compensation and settle personal debts. One such example is Winkelmann's December 2012 email to his friend Bryan Swift where admitted not wanting to share the "bad news" of BOP's poor finances with the other investors. (DX-211; Tr. 725:22-726:2, 727:16-728:14). Further evidence of Winkelmann's attempt to conceal BOP's failing finances was his decision, in February 2013, to provide the fourth memorandum (which actually disclosed BOP's dire financial condition) to only three prospective investors, including Bryan Swift, each of whom had previously purchased royalty units. (Stip. ¶59; RX-4, p. 5).

Another instance demonstrating Winkelmann's scienter occurred in late 2012, when Mahoney requested that Winkelmann find a buyer for his poorly performing first round royalty unit. (DX-210, BO3578; Tr. 718:24-719:23). Rather than match Mahoney with a prospective fourth round investor – creating a win-win situation for investors whereby Mahoney would sell his royalty unit and the prospective investor would buy a unit that not only paid higher returns than the fourth round unit, but also included a warrant to buy an equity stake in BOP – Winkelmann simply

proceeded with the fourth offering in order to raise additional funds and increase his own compensation. (Tr. 721:16-723:10, 724:14-725:2).[15]

Winkelmann's pattern and practice of only disclosing good news to investors while hiding the bad – Winkelmann's conflicts, the Binkholder bar, BOP's financial issues, and that Winkelmann needed to cherry-pick and change methodologies to present more favorable ratios to investors – demonstrate that Winkelmann intended to deceive his clients and investors.

B. Respondents' Reliance Defense Fails

Respondents premise their reliance-on-counsel defense on their consultations with Greensfelder attorneys. To invoke the defense, Respondents must show: "(1) that they made complete disclosure to counsel; (2) that they sought advice on the legality of the intended conduct; (3) that they received advice that the intended conduct was legal; and (4) that they relied in good faith on counsel's advice." *William Scholander*, Exchange Act Rel. No. 77492, 2016 SEC LEXIS 1209, *25-26 and nn. 37-38 (Mar. 31, 2016).

Any reliance defense fails because, for the relevant issues, Winkelmann failed to make complete disclosures to or seek advice from counsel, and never received advice that his contemplated conduct was legal. Indeed, the best evidence of Winkelmann's consultations with Greensfelder are: (a) Greensfelder's detailed billing invoices (DX-277); and (b) the 2,443 pages of email correspondence between Greensfelder and Winkelmann (RX-106). Those documents show, prior to the offerings at issue, Winkelmann *never* sought advice on: (a) disclosure of Binkholder's bar order,[16] (b) fiduciary duties and conflicts of interest, or (c) the advertising

[15] Winkelmann's failure to follow the express advice of his attorneys, discussed below, further confirms his scienter.

[16] As discussed above, Winkelmann did not alert Greensfelder to Binkholder's bar order until 2013, after the second and third offerings concluded. (DX-220).

ratios.[17] There is also no evidence that Winkelmann consulted with attorneys before sending investors emails that misrepresented BOP's success in selling royalty units and repaying investors.

Regarding the offering memoranda's misrepresentations about the alignment of and lack of conflicts between Winkelmann's and the investors' interests, the ALJ concluded that Respondents established reliance on counsel. The ALJ based this finding on Winkelmann asking Greensfelder to review the offering memoranda Winkelmann drafted, and Greensfelder not making edits to the actionable language regarding alignment and lack of conflicts. (I.D. at 59).

The ALJ erred in this determination, in the first instance, because Winkelmann did not make full disclosure to Greensfelder of the facts necessary to advise on the issue of Winkelmann's alignment and lack of conflicts with investors. *See, e.g., U.S. v. Parker*, 839 F.2d 1473, 1482 & n. 6 (11th Cir. 1988) (defendant precluded from asserting reliance on counsel when he failed to tell attorney the investments at issue were under-collateralized). There is no evidence that Winkelmann apprised attorneys he would keep investor payments at minimum levels while steadily increasing his own compensation. To the contrary, the offering memoranda Greensfelder reviewed contained representations and charts indicating that investors would receive well above the minimum allowable returns. Further, rather than disclose that Winkelmann would use the offering proceeds to increase his compensation, he provided Greensfelder with memoranda representing: (a) the "proceeds of this offering will be used to increase the advertising budgets and to make needed additions to the sales and administration staff," (b) the offering proceeds

[17] Winkelmann claims the Greensfelder invoices and emails do not reflect consultations on these subjects, purportedly because the consultations all occurred orally and Greensfelder did not bill Winkelmann for that time. But the invoices show Greensfelder regularly billed in increments as small as 0.1 and 0.2 hours. (DX-277, GHG005993 (entries for 3/4/11, 3/11/11, 3/16/11), GHG006000 (entry for 2/2/12); RX-113, p. 47 (January 11, 2013 invoice for 0.1 hours regarding "Binkholder email.")).

"will be used exclusively for operations of [BOP]," and (c) BOP's use of the offering proceeds "would need to result in the potential for recurring revenues inuring to [BOP] and to investor returns." (RX-1, p. 5, 12; RX-2, pp. 6-7, 16)

Moreover, Winkelmann expressly disregarded Greensfelder's advice on the subject of the alignment of his and investors' interests. He did so after Greensfelder edited the first memorandum to remove Winkelmann's false representation that issuing *fewer* royalty units was "better for [BOP's] owners and employees." (RX-106, p. 121). Despite receiving this advice, Winkelmann reinserted such language in subsequent offering memoranda. (RX-2, p. 16; RX-3, p. 13; RX-4, p. 13). On March 26, 2012, shortly after Winkelmann disregarded Greensfelder's advice by adding the problematic language into the second memorandum, Morgan's associate emailed Morgan to lament Winkelmann had either "rejected all of our changes" on, or simply did not use, the investor questionnaire Greensfelder had prepared for the royalty unit offerings. (DX-114).[18]

Additionally, Respondents' reliance defense cannot succeed because Winkelmann did not seek specific advice on the relevant representations in the offering memoranda. Rather, he simply provided Greensfelder with an entire memorandum and asked for Greensfelder's review. (RX-106, p. 30). *See, e.g., SEC v. Snyder*, 2006 U.S. Dist. LEXIS 45185, *23-24 (S.D. Tex. June 29, 2006) (rejecting reliance defense, even where auditors reviewed Form 10-Q at issue, when auditor was never asked to provide opinion regarding specific adjustments at issue); *Timothy Dembski*, Advisers Act Rel. 4671, 2017 SEC LEXIS 959, *6-9, *37-38 (Mar. 24, 2017) (rejecting defense even where attorneys reviewed entire PPM, because client never asked for or received advice about

[18] Winkelmann's failure to heed Greensfelder's advice not to offer royalty units to clients, in the form of Greensfelder-written subscription agreements requiring investors to represent that BOP "has not provided any investment advice" to the investor (*see, e.g.*, RX-1 at 95), will be discussed in detail in response to Respondents' opening brief.

specific PPM section at issue); *SEC v. Enters. Solutions, Inc.* 142 F. Supp. 2d 561, 576 (S.D.N.Y. 2001) (defense failed where defendant "never sought specific advice from counsel with respect to disclosure of the bankruptcy, nor did he receive specific advice that ESI was not required to disclose the bankruptcy. Good faith reliance on the advice of counsel means more than simply supplying counsel with information... 'Compliance with federal securities laws cannot be avoided by simply retaining outside counsel to prepare required documents.'" (quoting *SEC v. Savoy Indus., Inc.* 665 F.2d 1310, 1315 n. 28 (D.C. Cir. 1981)).

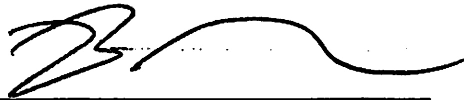
Finally, any reliance defense fails because, as an experienced securities professional who understood and routinely touted his fiduciary obligations, Winkelmann did not need to be told that he couldn't lie to clients, omit important information, misrepresent a lack of conflicts, or prioritize his personal interests. *See, e.g., Riad,* 2016 SEC LEXIS 2396, *135-136 ("These were not technical, compliance-related or legal judgments that respondents could reasonably have believed others were independently evaluating. In short, [respondents] could not in good faith have relied on any advice that purported to excuse them from the duty to speak the truth to investors..."); *Robare Group,* 2016 SEC LEXIS 4179, *36 (respondents "could not reasonably rely on any advice that the disclosures were adequate because they knew their obligations as investment advisers, that they were required to disclose potential conflicts of interest, and that the Arrangement presented such a conflict but was not disclosed."); *Rockies Fund, Inc.*, Exchange Act Rel. No. 48590, 2003 SEC LEXIS 2361, *71 (Oct. 2, 2003) ("We see no reason that the auditor's review of the Fund's reports should mitigate our view of Respondents' culpability. Given the recklessness with which the relevant Forms 10-Q and 10-K were prepared by Respondents, they can take no comfort now that the Fund's auditor failed to spot their mistakes.")

V. CONCLUSION

Respondents defrauded their advisory clients and other investors in the course of the royalty unit offerings. Accordingly, the Division of Enforcement respectfully requests the Commission find that Respondents' conduct described herein violated the antifraud provisions of the Securities Act, Exchange Act, and Advisers Act.

Dated: June 7, 2017

Respectfully submitted:



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Rule 450(d) Certification

The undersigned counsel for the Division of Enforcement hereby certifies that this brief is 13,350 words, exclusive of the tables of contents and authorities.

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17253

In the Matter of

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

Respondents.

CERTIFICATE OF SERVICE

Benjamin J. Hanauer, an attorney, certifies that on June 7, 2017, he caused a true and correct copy of The Division of Enforcement's Brief in Support of its Cross-Petition for Review to be served on the following:

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