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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.

THE DIVISION OF ENFORCEMENT'S RESPONSE IN OPPOSITION TO RESPONDENTS' BRIEF IN SUPPORT OF PETITION FOR REVIEW

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I. INTRODUCTION

Respondent James Winkelmann systematically violated a basic and fundamental obligation he owed his investment advisory clients: identifying and disclosing conflicts of interest. He violated these duties while targeting his clients to invest in "royalty unit" securities offered by his own advisory business, Respondent Blue Ocean Portfolios, LLC ("BOP"). The structure of the offerings presented Winkelmann with a stark and persistent conflict. He faced the recurring choice of whether to use available BOP funds to: (a) increase his own compensation; or (b) benefit investors, such as by increasing their investment returns or by using the money to increase BOP's revenues, which would also lead to increased investor payments. The conflict was not hypothetical. Rather, it repeatedly manifested itself as Winkelmann consistently chose to pay himself more while keeping investor payments low and reducing BOP's expenditures on revenue-producing activities such as advertising.

Compounding the egregiousness of Winkelmann's conduct, and confirming his scienter, was Winkelmann's deep understanding of his fiduciary obligations and his first-hand knowledge of the conflicts that exist when an adviser sells securities to its clients. Winkelmann gained that understanding through a 30-year career as an investment adviser and by obtaining a "Registered Fiduciary" certification. He constantly reminded clients and investors of his fiduciary duties, emphasized BOP's "conflict-free" services, and touted acting "always" or at "all times" in his clients' best interest. Moreover, Winkelmann knew the severe consequences of failing to disclose conflicts to clients. Winkelmann's business partner, Brian Binkholder, was barred for selling securities in his businesses to advisory clients without disclosing the attendant conflicts. Nevertheless, in order to increase his own compensation, Winkelmann continued to sell royalty units to clients without disclosing conflicts or that Binkholder had been barred for doing the same thing.

Refusing to accept any responsibility or acknowledge any wrongdoing, Winkelmann offers two primary defenses, both of which fail. First, Winkelmann claims the Advisers Act and his fiduciary obligations do not apply to his sale of royalty units to advisory clients. Tellingly, Winkelmann cannot cite a single case where an adviser is relieved of his fiduciary obligations while engaging in securities transactions with clients. On the other hand, the Commission and courts recognize the "broad scope" of Section 206 and prohibit advisers from abandoning their fiduciary duties without fulsome and unambiguous disclosure to clients. Moreover, Winkelmann's claim that his fiduciary duties did not extend to the royalty unit offerings is belied by his repeated representations to clients that he would "always" act in their best interest, that BOP's services were "conflict-free," and that the royalty unit offerings "aligned" Winkelmann's and investors' interests.

Winkelmann also seeks to shift responsibility, and blame a deceased lawyer, by asserting a reliance on counsel defense. But that defense does not hinge, as Winkelmann claims, on his lawyer being aware Winkelmann could offer royalty units to a limited number of clients. Rather, the defense fails, in the first instance, because Winkelmann never sought nor received advice on the subject at issue in this appeal: whether Winkelmann adequately disclosed the conflicts attendant to the royalty unit offerings.

Winkelmann's reliance defense additionally fails because Winkelmann concealed key facts from his attorneys. Even if Winkelmann told his attorneys that certain clients would be offered royalty units, he never disclosed the extent to which he would target and depend on his clients to raise funds for BOP. Winkelmann also never told his attorneys he would use offering proceeds to steadily increase his salary, or that he would concurrently suppress investor payments to the minimum allowable levels. Perhaps most importantly, Winkelmann hid from his attorneys, and investors, that his home-state securities regulator had barred Binkholder for engaging in analogous conduct.

As the ALJ correctly determined, Winkelmann's conduct warrants significant sanctions, including an industry bar, disgorgement, and meaningful penalties. The Commission should continue its precedent of barring advisers who fail to disclose conflicts or otherwise violate their fiduciary obligations. As in the Commission's steady line of decisions barring advisers, Winkelmann repeatedly placed his interests before clients' interests and benefited himself at his clients' expense. Accordingly, the Commission should protect investors and deny Winkelmann the privilege of serving as an adviser. Doing so would appropriately punish Winkelmann for his misconduct and send a strong message to other advisers that such behavior will not be countenanced.

II. WINKELMANN FAILED TO DISCLOSE CONFLICTS AND VIOLATED HIS FIDUCIARY DUTIES WHEN OFFERING ROYALTY UNITS TO CLIENTS

Winkelmann claims he did not owe his advisory clients fiduciary duties when offering them royalty units. In the first instance, that proposition fails as a matter of law. As a factual matter, Winkelmann's extensive industry background, his statements to clients, and BOP's policies which Winkelmann developed, all demonstrate that Winkelmann either knew or was reckless in not realizing he could not abandon his fiduciary duties while selling securities to clients.

A. Winkelmann's Extensive Securities Background and Understanding of His Fiduciary Obligations

Winkelmann was no neophyte, having owned brokerage and advisory firms since the 1980s. (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 and disclosures. (Stip. ¶¶20-22). He has passed multiple FINRA licensing examinations. (Stip.

¶23). Given his extensive experience, Winkelmann correctly testified that the fiduciary obligations he owed his clients included duties of honesty, good faith, loyalty, disclosure of all material facts, and disclosure of conflicts of interest. (Tr. 373:18-376:23).

While Winkelmann claims his fiduciary duties to clients did not extend to the royalty units, he developed and approved BOP's compliance policies that precluded Winkelmann from disowning his duties to clients. (Stip. ¶ 36). Indeed, the preamble to BOP's Code of Ethics ("Code") recognizes that the Code:

> is based upon the principle that [BOP] and its employees owe a fiduciary duty to [BOP's] clients to conduct their affairs... in such a manner as to avoid (i) serving their own personal interests ahead of clients, (ii) taking inappropriate advantage of their position with the firm and (iii) any actual or potential conflicts of interest or any abuse of their position of trust and responsibility.

(DX-3, BO10065). Consistent with these principles, the Code mandated that BOP "has an affirmative duty of utmost good faith to act *solely* in the best interest of its clients." (*Id.*) (emphasis added).

Similarly, BOP's Compliance Policies (DX-4) repeatedly mandate BOP and its employees to "always" place clients' interests first. Those policies, which do not restrict their applicability only to client "accounts," recognize the broad duties owed to all BOP *clients*:

- As a registered adviser and as a *fiduciary to our advisory clients*, our firm has a duty of loyalty and to *always* act in utmost good faith, place our clients' interests first and foremost and to make *full and fair disclosure* of all material facts and in particular, *information as to any potential and/or actual conflicts of interests.* (DX-4, BO10166) (emphasis added)

- The U.S. Supreme Court has held that [Advisers Act Section 206] imposes a fiduciary duty on investment advisers by operation of law...Every fiduciary has the duty and a responsibility to act in the utmost good faith and in the best interests of the client and to *always* place the client's interests first and foremost...As part of this duty, a fiduciary and an adviser with such duties, must eliminate conflicts of interest, whether actual or potential, *or make full and fair disclosure of all material facts of any conflicts* so a client, or prospective client, may make an informed decision in each particular circumstance. (DX-4, BO10188) (emphasis added).

- As an adviser and a fiduciary to our clients, *our clients' interests must always be placed first and foremost*, and our trading practices and procedures prohibit unfair trading practices and *seek to disclose and avoid any actual or potential* conflicts of interests or resolve such conflicts in the client's favor. (DX-4, BO10207) (emphasis added).

B. Winkelmann Touted His Fiduciary Obligations

Beyond crafting BOP policies compelling that he always act in their best interests, Winkelmann affirmatively touted his fiduciary responsibilities to his clients. (Tr. 396:13-17). Winkelmann often wrote directly to clients that he was required to "always" or "at all times" put their interests first. For instance, in January 2012, Winkelmann wrote to each BOP client: "Unlike the majority of wealth advisors, we assume a fiduciary role for our clients. This means that [BOP] *must always* put your interest first." (DX-90, p. 2 (emphasis added); Tr. 397:23-398:11). Three months later, Winkelmann again emailed all of his clients: "[BOP] was designed to be a true fiduciary for our clients. Our *legal duty* is to *always* put the interest of our client first." (DX-127, p. 2 (emphasis added); Tr. 398:12-399:9).[1] In January 2013, Winkelmann again wrote to clients: "As a fiduciary, we are legally compelled to put your interest first at all times." (DX-462, p. 1).[2]

Winkelmann made similar representations in press releases and on BOP's website. (DX-67, p. 2 (BOP "at all times [puts] clients' interest first."); Tr. 1523:12-1525:9 (BOP's website states: "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.")). Winkelmann

[1] Despite the ongoing royalty offering, Winkelmann's email falsely represents that BOP does not sell securities and, for that reason, BOP's clients "have better odds of achieving a favorable outcome." (DX-127, p. 2).

[2] In that letter, sent less than a month before the fourth offering, Winkelmann again falsely represents that BOP "do[es] not sell securities." (DX-462, p. 1).

also promoted his "Registered Fiduciary" certification, emphasizing that as part of that certification he is "committed to *always* acting in the best interest of clients, using the skills, ethics and focus on the client needs that the Certification represents." (DX-310, p. 2) (emphasis added).

Despite these promises to always put client interests first, Winkelmann claims he fully informed clients that he ceased owing fiduciary obligations when offering royalty units. Yet the disclosures he provided to clients prove otherwise. The best example is the "Conflicts of Interest Disclosure" form provided to BOP's clients that purported to disclose situations where BOP acted, or did not act, in a fiduciary capacity. (DX-228, p. 1; Tr. 391:16-23). That form identified three scenarios, each with a box for BOP to check when applicable:

- BOP "***always*** acts <u>in a fiduciary role for the client</u> and only offers options and recommendations in the clients' best interest. This would include all products (mutual funds, stocks, variable annuities, etc) plus advisory services." (DX-228, p. 1 (emphasis in original).

- BOP "***occasionally*** acts as a fiduciary when providing some services." (*Id.* (emphasis in original)).

- BOP "***do[es] not*** operate under a fiduciary duty." (*Id.* (emphasis in original)).

<u>Fiduciary Role</u>

X Advisor and/or Firm ***always*** acts <u>in a fiduciary role for the client</u> and only offers options and recommendations in the clients' best interest. This would include all products (mutual funds, stocks, variable annuities, etc) plus advisory services.

☐ Advisor and/or firm ***occasionally*** acts as a fiduciary when providing some services. Please list or explain:

____

____

____

☐ Advisor and/or Firm ***do not*** operate under a fiduciary duty. As such, our recommendations are not necessarily in the clients' best interests but are instead "suitable" based on their needs.

(DX-228, p. 1). Winkelmann testified that clients received forms with the box checked for the first paragraph, where BOP represents that it ***always*** acts in a fiduciary capacity, and that it does so for "all products." (Tr. Tr. 391:20-392:10). Conversely, no evidence exists of Winkelmann ever disclosing on this form, or anywhere else, that BOP did not act in a fiduciary capacity when offering royalty units.

Further confirming that Winkelmann did not "take off his adviser hat" and absolve himself of fiduciary duties when promoting royalty units to clients, Winkelmann 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 highlighting Winkelmann's "Registered Fiduciary" status, and contain no disclaimer that Winkelmann was not acting as an adviser or in a fiduciary capacity when offering the royalty units. (*Id.*).

C. The Royalty Unit Payment Structure Was Conflict-Ridden

The structure of the royalty units was ladled with conflicts. On one hand, Winkelmann had unfettered discretion to use the offering proceeds or other BOP funds to raise his own compensation. On the other, Winkelmann had the same discretion to increase investor payments above the minimum levels required by the offering documents. While Winkelmann now claims that investors had no expectation of receiving more than the minimum, the offering documents and Winkelmann's conduct suggested investors would be paid significantly higher amounts.

For instance, 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 the speed of investor returns. (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.*).

As early as the first offering, BOP represented: "Royalty Units Summary...Right to at Least 0.25% of Monthly Cash Receipts. Plan is to be higher! Investors get repaid first!" (RX-1, p. 111). By the third offering, BOP was representing: "Investors should expect the bulk of their return in years 3-5." (RX-3, pp. 4, 14).[3] The third memorandum contains charts reflecting that, to pay back investors in five years, BOP would have to pay, *every single month*, more than *triple* the minimum percentage. (*Id.*, pp. 4, 14, 15; Tr. 708:11-24).

Royalty Rate Per Unit	Internal Rate of Return	Months to Payback
0.10%	12%	133
0.25%	19%	83
0.40%	30%	54
0.55%	44%	38
0.70%	57%	28
0.85%	72%	22

(RX-3, p. 4).

The fourth memorandum repeats the representation about investors receiving their returns in 3-5 years (RX-4, p. 14), and 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).

[3] Winkelmann made a similar oral representation to third round investor Swardson, who Winkelmann told should expect to be fully paid within five years. (Tr. 13:18-14:3).

Royalty Rate Per Unit	Internal Rate of Return	Months to Payback
0.05%	5%	176
0.10%	19%	114
0.15%	25%	86
0.20%	31%	70
0.25%	37%	59
0.30%	43%	51

Chart assumes an Advertising Conversion Factor of 0.90

(RX-4, p. 4). The clear implication of these tables and Winkelmann's representations of a five-year payout timeframe was that investors would be paid more than the minimum.

Winkelmann now claims the memoranda dictated that above-minimum payments would not be made until BOP became profitable, but the evidence disproves him. Even though the memoranda do represent that investors should expect increased percentage payments once BOP achieves profitability,[4] the memoranda make no representation, express or otherwise, that above-minimum payments *are conditioned* on BOP becoming profitable. (RX 1-4). Indeed, for more than a year after the first offering commenced, Winkelmann increased the investor payment percentages to 75%, albeit only for the months when BOP's revenues were negligible.[5] (DX-448;

[4] *See*, *e.g.*, RX-2, p. 6 ("Once recurring sustainable profitability is achieved, larger and larger portions of the cash receipts will be used to pay back the Royalty Unit holders); RX-3, p. 14 ("Once [BOP] achieves profitability, the plan is to pay at least 50% of the profits to the Royalty Unit holders").

[5] For the every third month in which BOP received nearly all of its revenues (management fees which were deducted quarterly), Winkelmann always paid the minimum percentage. (DX-448).

DX-315). Thus, from the onset, investors expected to receive more than minimum payments, regardless of BOP's profitability.[6]

However, even if the royalty units did not have the discretionary payment feature, the investment would still saddle Winkelmann with a recurring conflict of interest. Winkelmann would still face the routine decision whether to deploy BOP funds in ways that would increase BOP's revenues (a percentage of which would insure to investors) or ways that would have no benefit to investors.[7] One example would be the decision whether to use available funds for advertising (increased advertising presumably leads to increased revenues) or to raise Winkelmann's salary. In late 2011, this precise conflict manifested itself, when Winkelmann created an "Action Plan" to simultaneously: (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). Notably, Winkelmann's "Action Plan" did not contemplate deploying BOP's funds to increase BOP's revenues or otherwise benefit investors.

D. Winkelmann Targeted His Clients as Investors and Did So to Repeatedly Raise his Compensation

Winkelmann overwhelmingly targeted as investors the same clients to whom he owed strict fiduciary duties. Indeed, ten of the initial fourteen investors were BOP clients, eighteen of

[6] Winkelmann's claim that BOP "never contemplated," and could not afford, to make increased payments until it achieved sustained profitability (Resp. Br. at 20) is belied by the fact Winkelmann: (a) briefly made 0.75% payments, albeit for low revenue months; and (b) consistently used excess funds, that could have been used to pay investors more, to increase his own compensation.

[7] Winkelmann's brief apparently accepts this notion, by noting that for investors to benefit BOP needed to spend money on "revenue-generating activities." (Resp. Br. at 20). Winkelmann does not and cannot explain how consistently raising his compensation increased BOP's revenues or otherwise benefited investors.

the 24 total investors were BOP clients, and BOP clients accounted for more than $1 million of the total $1.4 million raised in the royalty offerings. (Stip. ¶¶5-6; DX-455; Tr. 110:11-111:20).

Despite promising his clients he would always act in their best interest, Winkelmann repeatedly used the royalty offering proceeds to pay himself more. The below chart shows Winkelmann's steadily rising income from BOP:[8]

Year	Amount	Payee	Source
2011	$20,000	Longrow Insurance ($10,000) and Blue Ocean ATM ($10,000)	DX-457; Tr. 111:22-112:25
2012	$125,000	23 Glenn Abbey Partners	Stip. ¶ 64
2013	$197,200	23 Glenn Abbey Partners ($182,000) and Winkelmann ($7,200)	Stip. ¶ 64
2014	$227,557	Winkelmann	Stip. ¶ 64

There is no genuine dispute that Winkelmann funded his salary increases by virtue of the royalty unit offerings. (*See*, *e.g.*, Stip. ¶46 (on 3/31/11, when the first offering started, BOP had only $239 in its bank account); DX-83 (12/20/11 Winkelmann email to Binkholder advocating initiating second offering to raise their monthly compensation from $2,000 to at least $8,500); RX-4, p. 5, (2/15/13 memorandum noting that BOP would not have enough money to pay employees absent fourth offering)). Winkelmann even admits this fact in his opening brief, conceding that he "increase[ed] his salary once the Offerings were successful." (Resp. Br. at 22).

While the offering memoranda generally represent that Winkelmann would be compensated (*e.g.*, RX-1, p. 14), they do not disclose his compensation or the fact that it was

[8] Winkelmann and/or his family members owned and controlled each of the "Payee" entities listed in this table. (Stip. ¶¶30, 31)

increasing.[9] The memoranda also contain repeated representations that investor proceeds would be put to uses that would increase BOP's revenues and investor returns. (RX-1, p. 5 ("The proceeds of this offering will be used to increase the advertising budgets and to make needed additions to the sales and administration staff."); RX-2, p. 6 ("[BOP "is planning to use the proceeds of the Royalty Offering to expand its advertising reach…"); RX-3, p. 4, "[BOP] is planning to use the proceeds of the Royalty Offering to expand into the Chicago market"). Indeed, the memoranda specifically represent that 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; RX-3, p. 5). These representations were false and misleading, given Winkelmann repeatedly chose to use offering proceeds and BOP funds to finance his compensation increases that in no way benefited investors.

E. Respondents Violated the Antifraud Provisions

1. The Advisers Act Mandates Disclosure of Conflicts to Advisory Clients

Advisers owe their clients fiduciary duties, including the "'duty to disclose any potential conflicts of interest accurately and completely, and to recognize ... a potential conflict.'" *Timbervest, LLC*, Advisers Act Rel. 4197, 2015 SEC LEXIS 3854, *15 (Sept. 17, 2015) (citations omitted).

Accordingly, the Commission consistently holds that an adviser violates Advisers Act Section 206 by failing to disclose conflicts. *Timbervest* at *26; *James Tagliaferri*, Advisers Act Rel. 4650, 2017 SEC LEXIS 481, *10, *21-22 (Feb. 15, 2017) (Respondent violated Section 206 and "the fiduciary duties he owed his clients as an investment adviser by failing to disclose the conflict of interest inherent in receiving kickbacks for investing client funds."); *Robare Group,*

[9] The memoranda additionally represent that any bonus would be based on BOP's profitably (RX-1, p. 14; RX-2, p. 19; RX-3, p. 17), which further reinforced investor belief that Winkelmann's compensation would not rise unless the firm became profitable.

Ltd., Advisers Act Rel. 4566, 2016 SEC LEXIS 4179, *17 (Nov. 7, 2016) ("Because Section 206 was designed 'to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser--consciously or unconsciously--to render advice which was not disinterested,' the '[f]ailure by an investment adviser to disclose potential conflicts of interest to its clients constitutes fraud within the meaning of Sections 206(1) and (2).'") (citations omitted); *Edgar Page*, Advisers Act Rel. 4400, 2016 SEC LEXIS 1925, *14 (May 27, 2016) ("Advisers are required as a matter of law to disclose 'economic conflicts of interests' to their clients.") (citations omitted); *Dennis Malouf*, Advisers Act Rel. 4463, 2016 SEC LEXIS 2644, *61 (July 27, 2016) ("By failing to correct UASNM's multiple representations that he did *not* have a conflict, Malouf breached his fiduciary duties as an investment adviser."); *Larry Grossman*, Advisers Act Rel. 4543, 2016 SEC LEXIS 3768, *24 (Sept. 30, 2016) (failure to disclose conflicts violated Sections 206(1) and (2)); *Montford & Co., Inc.*, Advisers Act Rel. 3829, 2014 SEC LEXIS 1529, *51-52 (May 2, 2014) (same); *J.S. Oliver Cap. Mgmt., L.P.*, Advisers Act Rel. 4431, 2016 SEC LEXIS 2157, *29 (June 17, 2016) ("Respondents were under a 'duty to disclose any potential conflicts of interest accurately and completely...It is indisputable that potential conflicts of interest are "material" facts with respect to clients and the Commission.'") (citations omitted).

Similar conflicts existed for Winkelmann. He faced the recurring conflict of whether to deploy BOP funds in ways that would (a) benefit investors, such as by increasing their monthly payments or by deploying BOP's resources to increase BOP's revenues; or (b) increase his own compensation. It is undisputed that Winkelmann never disclosed this conflict or that the conflict manifested itself through Winkelmann continuously raising his compensation at investors' expense. As in the above-cited decisions, Winkelmann's failure to disclose conflicts to his clients who purchased royalty units violates Section 206 of the Advisers Act. Winkelmann's breach of his disclosure obligations similarly violated the Securities Act's and Exchange Act's antifraud provisions. *J.S. Oliver*, 2016 SEC LEXIS 2157, *27 n.27 (June 17, 2016) (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) (citations omitted).

2. Winkelmann Acted With Scienter

In failing to disclose conflicts and otherwise breaching his fiduciary duties, Winkelmann acted with scienter. Prime evidence of Winkelmann's scienter is that after learning of Binkholder's bar, Winkelmann continued to offer BOP securities to clients without any disclosure of conflicts or that Binkholder had been barred for engaging in similar conduct. Just as Winkelmann concealed Binkholder's bar from investors, as discussed below, Winkelmann hid the bar from his attorneys, and then falsely testified at trial that he immediately sought attorney advice about the bar's implications. Beyond the Binkholder bar, the record is replete with evidence demonstrating Winkelmann's intent to deceive:

- Winkelmann steadily raised his own salary at investors' expense, when he could have spent the money on increased investor payments or on other activities, such as advertising, which would increase BOP's revenues and investor returns.

- Winkelmann initiated the second offering so that he could sharply increase his and Binkholder's compensation. (DX-83). Yet he falsely told investors that BOP would use the offering proceeds to "expand its advertising reach" and fund "revenue-producing activities [that] would need to result in the potential for recurring revenues inuring to [BOP] and to investor returns." (RX-2, p. 6)

- Winkelmann concealed from investors and clients 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. (DX-211; Tr. 725:22-726:2, 727:16-728:14).

- Winkelmann required clients who purchased royalty units to falsely "represent" and "warrant" that BOP had not provided them any investment advice. (RX-1, p. 95).

- Winkelmann used BOP money to fill the ATMs belonging to one of Winkelmann's other companies, and attempted to structure the transaction to avoid "regulatory scrutiny by the SEC" during an ongoing OCIE examination. (Tr. 809:14-813:11; DX-274, EBT000910).

- All the while, Winkelmann consistently touted his fiduciary obligations to his clients, such as by routinely telling them he would always act in their best interests or put their interests above his.

These repeated instances of Winkelmann's breaches of his duties of loyalty, honesty, and full disclosure of material facts readily establish Winkelmann's scienter. *See, e.g. J.S. Oliver*, 2016 SEC LEXIS 2157, *40 (adviser acted with a "high degree of scienter" when he "persistently and systematically failed to act in the best interests of [his] clients"); *Grossman*, 2016 SEC LEXIS 3768, *18-19 (adviser "knew both that he was receiving [undisclosed compensation] and that he did not disclose this fact to his clients. In light of that knowledge, he acted with scienter."); *Malouf*, 2016 SEC LEXIS 2644, *64 ("Given this awareness and his admitted periodic reviews of the disclosures, we find that Malouf must have been aware that his conflict had not been disclosed to UASNM's clients.").

In addition to showing Winkelmann's intent to deceive, the above facts demonstrate that Winkelmann acted, at best, recklessly. As the ALJ correctly observed:

> Winkelmann did not just fail to disclose the actual and potential conflicts, but instead affirmatively misrepresented that he had "eliminated" them. As CCO and a licensed securities professional with more than thirty years of experience, Winkelmann's belief that he had somehow eliminated conflicts of interest was extremely reckless.

(I.D. at 55).

While Winkelmann's intent is irrelevant to the Advisers Act Section 206(2) and Securities Act Section 17(a)(2) and (3) claims, *J.S. Oliver*, 2016 SEC LEXIS 2157, *12, the Division established that Winkelman acted not only intentionally, but negligently. The Division did so by presenting unrebutted expert testimony from Professor Arthur Laby that Winkelmann violated applicable industry standards of conduct with respect to disclosure and fiduciary obligations. (Ex. 363, pp. 3, 20-28). On the other hand, Winkelmann presented no testimony, expert or otherwise, that his conduct satisfied the standards or norms of the asset management industry.[10]

3. Section 206 Applies to Winkelmann's Offer of Royalty Units to Clients

Seeking to avoid liability, Winkelmann argues that Section 206 and his fiduciary obligations do not extend to him selling royalty units to clients. He falsely claims that affirming the Initial Decision would result in a "new, bright-line rule that investment advisors, in discussing any investment with any person, are necessarily acting as fiduciaries." (Resp. Br. at 13). But Winkelmann's case doesn't involve an adviser discussing "any investment" with "any person." Rather it centers on an adviser selling *securities in his own business* and targeting his *own advisory clients* as investors. To embrace Winkelmann's position, that securities transactions between an adviser and his clients falls outside the broad scope of Section 206, would gut the investor protections on which the Advisers Act is premised.

It is telling that Winkelmann cannot cite a single case holding that Section 206 does not apply to securities transactions between an adviser and its clients. To the contrary, Sections 206(1) and 206(2) broadly prohibit defrauding "any client or prospective client." Those provisions contain no limitation of the sort suggested by Winkelmann, such as a restriction that fraud must be against a client account or in the course of the adviser providing investment advice.[11]

In *Timbervest*, the Commission interpreted the Advisers Act, recognized the "broad scope of Section 206," and rejected adviser-respondents' argument that Section 206 did not apply

[10] Winkelmann's expert witness, Palubiak, conceded that he lacked qualifications to opine on the fiduciary obligations of investment advisers or whether Winkelmann's conduct satisfied industry standards. (Tr. 1106:21-1110:11).

[11] The statute's reference to "potential" clients further reinforces the notion that advisers are precluded from misconduct vis-à-vis actual people, not just their advisory accounts.

because the investments at issue involved real estate, as opposed to securities. 2015 SEC LEXIS 3854, *51-53. The Commission specifically held:

> Where an investment adviser has an advisory relationship with a client, the Act provides (among other things) that "[i]t shall be unlawful for any investment adviser . . . to employ any device, scheme, or artifice to defraud any client." This language is not limited to fraud in connection with a securities transaction. Had Congress intended such a limitation, it would have said so. Thus, once an investment advisory relationship is formed, the Advisers Act does not permit an adviser to exploit that fiduciary relationship by defrauding his client in any investment transaction connected to the advisory relationship. We believe that our long-standing interpretation of the scope of the Advisers' Act is appropriate because a contrary reading, which would allow investment advisers to exploit the advisory relationship by engaging in misconduct such as that at issue in this matter, would undermine the "climate of fair dealing which is so essential to maintain public confidence in the securities industry."

Id. at *51-52 (citations omitted).

The Commission then articulated sufficient elements for Section 206 to apply: (a) respondents were investment advisers; (b) the allegedly defrauded clients had entered into advisory agreements with respondents; (c) the agreements empowered respondents to render advice regarding securities; and (d) respondents had provided the clients advice about securities. *Id.* at *53. Once these prerequisites were met, subsequent fraud against the advisers' clients was actionable under Section 206. *Id.* In this case, it is undisputed that each of these elements are satisfied for the eighteen BOP clients who purchased royalty units.

The Commission recently affirmed this concept in *Harding Advisory LLC*, Advisers Act. Rel. 4600, 2017 SEC LEXIS 86 (Jan. 6, 2017). In that case, respondents argued that Section 206 did not apply because their advisory clients were "essentially controlled" by the investment bank that structured and marketed the collateralized debt obligation ("CDOs") investments at issue, which were managed by respondents. The Commission rejected this argument, finding that the test for Section 206 to apply was whether the adviser's conduct ran contrary to its *client's* interests. *Id.* at *39-40 ("despite the involvement of Merrill as the originator of the CDOs, Harding owed a fiduciary duty to the legally distinct SPVs [who were the adviser's clients]... Harding owed the SPVs the same duty of care that Harding owed any other advisory client, without regard to how the SPVs originated.").

Curiously, Winkelmann cites the Tenth Circuit's *Geman* decision in support of his argument that he could "disclaim" his fiduciary obligations by merely telling clients that he could not "recommend" the royalty units as investments. (Resp. Br. at 14-16). But *Geman* expressly rejected that argument given that the respondent-adviser, like Winkelmann, repeatedly touted its fiduciary obligations when promoting its advisory services:

> Geman argues emphatically that the firm should not be held to a fiduciary standard because it was not acting as an investment advisor with respect to the transactions. However, Geman fails to address what we perceive to be the cornerstone of the Commission's holding on this point - that the firm held itself out as a fiduciary...the firm's promotional material, which included the statement quoted above to the effect that the firm would act as a fiduciary, established an agency with its attendant fiduciary duties.

Geman v. SEC, 334 F.3d 1183, 1189 (10th Cir. 2003). As was the case in *Geman*, given Winkelmann's repeated proclamation of his fiduciary duties when communicating with clients, including systematically representing he would "always" act in clients' best interests, he cannot escape those duties even assuming he was not explicitly advising clients to purchase royalty units.[12]

Consistent with *Geman*, Professor Laby offered unrebutted expert testimony that – even assuming Winkelmann told his clients he could not recommend the royalty units – because Winkelmann did not expressly and unambiguously advise the clients he was no longer acting as their adviser, he could not dispense of his fiduciary obligations. (Tr. 319:22-320:20). Similarly,

[12] Winkelmann attempts to distinguish *Geman* on the grounds that the case involved investments "within" client advisory accounts. (Resp. Br. at 15). In doing so, Winkelmann ignores that many of his investors purchased royalty units using funds from their own BOP advisory accounts. (*See, e.g.*, DX-455; Tr. 17:20-23, 349:14-21, 1015:5-22, 1423:22-1430:15). This further reinforces Section 206's applicability to Winkelmann's conduct.

Laby testified that, under the same assumption, Winkelmann acted as an adviser because he "implicitly" recommended the royalty units by virtue of presenting the royalty units, as opposed to other investment options, to clients. (Tr. 326:11-328:22).

The ALJ reached a similar conclusion, correctly recognizing that adopting Winkelmann's position, that securities transactions between an adviser and clients falls outside the broad scope of Section 206, would frustrate the client protections at the heart of the Advisers Act:

> By the very language of the Advisers Act, which prohibits certain conduct by an investment adviser with respect to "any client or prospective client," an investment adviser cannot take off his fiduciary hat in exchange for a non-fiduciary hat when it suits him. 15 U.S.C. § 80b-6. It would be inconsistent with the purposes of the Advisers Act to permit an adviser to disown his fiduciary obligations especially with respect to an investment he is intimately involved with, as Winkelmann was here. Winkelmann repeatedly went to his advisory clients, told them about the opportunity, and, in effect, attempted to persuade them to invest, typically by using funds in their advisory accounts. While Winkelmann caveated his overtures with the assertion that he was not giving advice or making a recommendation, he nonetheless had a fiduciary obligation to each client in presenting them the investment opportunity to purchase with their BOP-managed advisory account, to disclose conflicts. To find otherwise would mean that all investment advisers, simply by telling a client it is not advice or a recommendation, can now present any other investment opportunity to them, fail to disclose conflicts of interest, and empty the advisory clients' accounts into such investments.

(I.D. at 56).[13]

III. WINKELMANN'S RELIANCE DEFENSE FAILS

Winkelmann's primary defense is his claim that he orally asked his attorney – Michael Morgan of the Greensfelder firm – whether he could offer royalty units to clients and that Morgan responded in the affirmative. (Resp. Br. at 26). Even assuming this is true, Winkelmann's cannot

[13] Chief ALJ Murray reached a similar conclusion in *Lawrence LaBine*, Initial Decision Rel. 973, 2016 SEC LEXIS 795 (Mar. 2, 2016) (decision became final on April 22, 2016, Advisers Act Rel. No. 4376). In response to an argument similar to the one Winkelmann now makes, Chief Judge Murray found: "It would be inconsistent with the remedial purposes of the Advisers Act to hold that LaBine could have 'switched hats' and disclaimed the fiduciary duties of an adviser without giving notice to his clients. LaBine's proposed 'transaction-by-transaction' approach has no basis in the statute, and it would be impossible under such approach for clients to ascertain what role their financial professional was playing." *LaBine* at *82.

satisfy the requisite elements to invoke a reliance defense. In particular, Winkelmann *did not seek or receive specific advice from Morgan on the issue of whether conflicts were adequately disclosed.*

At best, the limited advice Winkelmann received was conflicting, given that Greensfelder prepared Subscription Agreements, which Winkelmann approved, that precluded clients from purchasing royalty units. Winkelmann also failed to disclose, and in fact concealed, key information from Morgan that would be necessary for Morgan to render informed advice. Indeed, Winkelmann never told Morgan the extent to which he would target advisory clients, or that he would keep investor payments at minimal levels while steadily increasing his own salary. Perhaps most importantly, when Winkelmann learned that Binkholder had been barred for selling securities in Binkholder's businesses to Binkholder's advisory clients without disclosure of conflicts, *a fact that would necessarily call into question any advice that such conduct was permissible*, Winkelmann concealed the bar order from Morgan. Accordingly, and for the reasons discussed below, Winkelmann's reliance defense fails.

A. Legal Standards

To invoke a reliance defense, and disprove they acted with scienter, 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. 77492, 2016 SEC LEXIS 1209, *25-26 and nn.37-38 (Mar. 31, 2016). To assert good faith reliance to rebut the Division's negligence-based charges, the same elements must be satisfied. *Robare Group*, 2016 SEC LEXIS 4179, *33-35. Simply retaining securities counsel is insufficient. *Id.* at *33-35.

B. Winkelmann Neither Sought Nor Received Advice that BOP's Failure to Disclose Conflicts was Permissible

Winkelmann claims he establishes a reliance defense because he asked for and received permission from Morgan to offer royalty units to clients. (Resp. Br. at 26). Winkelmann asserts he asked for and received this advice orally, and then asked Morgan to review draft letters which would indicate BOP intended to offer royalty units to certain clients. (*Id.* at 26-28). However, even crediting these interactions with Morgan, there is no evidence that Winkelmann sought or received specific advice on the violation at issue in this appeal: whether Winkelmann adequately disclosed conflicts when offering royalty units to clients.

Winkelmann claims that Morgan – who is deceased and can neither corroborate nor rebut Winkelmann's testimony – orally advised him that it "would be no problem" to offer royalty units to clients. (Resp. Br. at 26). Winkelmann posits that he then asked Morgan to review a draft letter Winkelmann wanted to send to "clients that are suspects for participation" in the royalty unit offering. (RX-106, p. 2 (2/15/11 email)). Notably, the draft letter is not part of the record, nor is there any evidence in the 2,443 pages of email correspondence between Winkelmann and Greensfelder that Morgan responded to Winkelmann's email. (RX-106).

The record does show that six weeks later, on March 28, 2011, Winkelmann sent Morgan an email titled "what about our accredited investors," in which Winkelmann asked Morgan to review a draft letter to send "to a handful of accredited investors." (RX-106, p. 399). That draft letter, which Morgan edited and sent back to Winkelmann on March 29, indicated that at least one BOP client would be offered a royalty unit. (*Id.* at 399-401). However, there is no evidence that Winkelmann asked Morgan whether such an arrangement required any tailored disclosures addressing actual or potential conflicts of interest.

The draft letter and related emails, sent in the context of Winkelmann seeking advice on the tangential issue of offerings involving "accredited investors," are the only documentary evidence Winkelmann cites to support his argument that Morgan advised that Winkelmann could offer royalty units to clients prior to the start of the offering. Notably absent from this evidence is: (a) any inquiry from Winkelmann whether the offering materials adequately disclosed conflicts of interest, or (b) any advice from Greensfelder that any conflicts disclosures were adequate. This lack of inquiry is consistent with Winkelmann's testimony that he believed no conflict existed. (Tr. 551:5-8). Given his belief there was no conflict, there would be no reason for Winkelmann to seek guidance on whether conflicts were adequately disclosed. Instead, Winkelmann simply sent Morgan a draft of the first offering memorandum and generally asked for Morgan's review without seeking advice on any particular topic, such as whether the memorandum adequately disclosed conflicts. (RX-106, p. 30).[14]

Such failure to seek or receive advice on a specific topic precludes a reliance defense. *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 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

[14] Notably, Morgan provided Winkelmann his comments on the offering memorandum on March 15, 2011 (RX-106, p. 112), *two weeks before* Winkelmann sent Morgan, and Morgan edited, the draft letter indicating Winkelmann might offer royalty units to at least one client. (RX-106, pp. 399-401).

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)); *SEC v. AIC, Inc.*, 2013 U.S. Dist. LEXIS 130249, *24 (E.D. Tenn. Sept. 12, 2013) (rejecting reliance defense, reasoning: "whether Troutman Sanders's attorneys prepared each form is immaterial... as the drafting of documents does not constitute rendering legal advice on a specific transaction.").

Moreover, to the extent Winkelmann sought to disclose conflicts via the draft letter he sent Morgan in March 2011, as opposed to the offering memoranda, his own testimony shows that Winkelmann believed any such disclosure would be insufficient. Specifically, Winkelmann testified that, based on his 30 years in the securities industry, he understood that investors could only rely on disclosures contained in the offering documents, as opposed to extraneous materials. (DX-327 (Winkelmann investigative testimony) at 97:2-14). In fact, Winkelmann conceded that Morgan specifically advised him that the only representations investors could rely on where those contained in the offering memoranda. (*Id.* at 99:4-21).

Consistent with that advice, Greensfelder prepared a Subscription Agreement that royalty investors were required to complete, which required investors to "represent" and "warrant" that they did not rely on any representations or disclosures beyond those contained in the offering memoranda. (RX-106, p. 96 (¶ 2(l)); Stip. ¶54; RX-1, p. 96 ¶ 2(l)). Winkelmann admitted he reviewed and approved that Subscription Agreement before it was sent to investors. (Tr. 535:23-536:6). Those Subscription Agreements constitute the most precise advice Winkelmann received from Greensfelder on the issue of offering royalty units to clients, and expressly prohibited the practice. (*See, e.g.*, RX-106, p. 95 (requiring investor representation that BOP "has not provided any investment advice")). For these reasons, Winkelmann cannot credibly claim that he believed disclosures not contained in the offering documents but instead in draft letters to clients, whether approved by Greensfelder or not, were sufficient to advise clients of any conflicts of interest.[15]

Thus, even assuming that Greensfelder advised Winkelmann he could offer royalty units to clients, in the face of Greensfelder's conflicting advice through the Subscription Agreements, Winkelmann was obliged to do more. Such measures would include following-up with Greensfelder, discussing the inconsistency, and obtaining confirmation he could proceed with the offering that required clients to falsely represent that they had not received any investment advice from BOP. *See, e.g., Jones v. SEC*, 115 F.3d 1173, 1184 (4th Cir. 1997) (no reliance defense where client "chose to disregard the terms of the offering materials" prepared by counsel); *SEC v. Scott*, 565 F. Supp. 1513, 1535 (S.D.N.Y. 1983) ("The reliance-on-counsel defense, however, does not mean that one can totally abdicate responsibility by consulting counsel...[the] defense requires more than such a complacent attitude."); *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 276 (2d Cir. 1986) ("The proper exercise of due care by a director in informing himself of material information and in overseeing the outside advice on which he might appropriately rely is, of necessity, a pre-condition to performing his ultimate duty of acting in good faith").

For the same reasons, once Winkelmann saw the Binkholder bar order prior to the second offering (Stip. ¶ 56), and learned that Binkholder had been barred for failing to disclose the conflicts attendant to selling his advisory clients securities in his businesses, Winkelmann was on notice that offering royalty units to clients without disclosing conflicts was illegal. At that point,

[15] Even if Winkelmann believed investors could rely on extraneous disclosures, there is no evidence in the record of any client who purchased royalty units actually receiving a letter disclosing a conflict of interest. Indeed, the draft letter Winkelmann references in his brief (RX-106, p. 401) was not addressed to a client who purchased any royalty units (DX-455).

regardless of any advice he had previously received, it was incumbent on Winkelmann to consult Greensfelder, apprise Greensfelder of the order, and specifically seek guidance on whether Winkelmann could continue to engage in conduct that had caused his business partner to be barred.[16]

While Winkelmann claims that he immediately notified Greensfelder of the bar order, as detailed below, the evidence proves otherwise. Indeed, it is hard to imagine that any experienced securities lawyer such as Morgan would review Binkholder's bar order and then advise Winkelmann that he need not disclose conflicts to clients being offered royalty units. To that end, it is telling that only after Winkelmann finally disclosed Binkholder's bar order to Greensfelder in late 2012 and consulted with Greensfelder on the issue, did Winkelmann disclose to investors Binkholder's bar and the reasons for the bar, albeit only to the three investors who received the fourth offering memorandum. (Stip. ¶59; RX-4, p. 16).

Conspicuously, most of the communications with Morgan that Winkelmann cites in support of his reliance argument are from 2013. (Resp. Br. at 28-36). Those communications cannot sustain a reliance defense for the first three offerings, the latter of which had concluded by October 2012. (DX-455). Moreover, those communications took place *after* Winkelmann belatedly disclosed Binkholder's bar order to Morgan (DX-220) and *after* Greensfelder began advising Winkelmann how to respond to a Missouri Securities Division investigation into him and BOP. (DX-212; RX-113, p. 47 (billing entries re "Binkholder Termination Agreement" and "research case law re: disclosures of proceedings") and p. 49 (billing entries re "state investigation")). Indeed, only in February 2013 did Greensfelder attorneys begin researching the

[16] Winkelmann should additionally have reached out to Greensfelder even earlier, at the start of the first offering, when a client and one of the first investors, Jason Grau, asked Winkelmann whether the royalty units were "legal" and presented any conflicts-related issues. (DX-455, Tr. 621:25-622:22, 654:6-655:4).

"limits on clients investing in investment adviser." (RX-113, p. 53). The flurry of activity related to Binkholder reflected in the November 2012 to February 2013 Greensfelder invoices indicates that until that time, Winkelmann had not apprised Greensfelder of Binkholder's regulatory issues or the extent of Winkelmann's reliance on clients for the royalty unit offerings. (RX-113, pp. 38-53).

In discussing these 2013 communications, Winkelmann's brief falsely claims that for the subsequent fourth offering, Greensfelder "made no changes...to the disclosures in the offering documents." (Resp. Br. at 36). Winkelmann ignores that the fourth memorandum, unlike the previous versions, expressly discloses Binkholder's bar and the reasons for the bar. (RX-4, p. 16). This indicates that had Greensfelder actually known about Binkholder's bar at the time of the second and third offerings, it would have insisted that Winkelmann disclose the bar and the reasons for the bar to investors.

Regardless of his consultations with Greensfelder, 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 omit important information, misrepresent a lack of conflicts, or prioritize his personal interests. Indeed, the Commission routinely rejects the defense in similar circumstances. *See, e.g., Mohammed Riad*, Exchange Act Rel. 78049A, 2016 SEC LEXIS 2396, *135-136 (July 7, 2016) ("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,* 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."); *Malouf*, 2016 SEC LEXIS 2644, *67 ("*regardless of what others may have thought*, Malouf, 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") (emphasis added); *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."); *WHX Corp.*, Exchange Act Rel. No. 47980, 2003 SEC LEXIS 1350, *44-45 (June 4, 2003) (corporation could not claim good faith reliance, even where attorney approved tender offer, when firm's "sophisticated and experienced chairman" was aware that the Commission staff had informed the attorney that the tender offer was illegal).

C. Winkelmann Concealed Key Information from Greensfelder

Winkelmann's reliance defense additionally fails because Winkelmann did not make full disclosure to attorneys of the facts necessary to provide advice regarding whether Winkelmann adequately disclosed conflicts of interest to 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).

To begin, Winkelmann never disclosed to Morgan the extent to which he relied on clients to purchase royalty units, and that the overwhelming majority of investors were clients. Instead, immediately prior to the first and second offerings, Winkelmann emailed Morgan draft Forms ADV to review, in which Winkelmann represented that BOP does *not* "sell products…to [its] advisory clients." (RX-106, pp. 163, 195 (Item 6.B), pp. 525, 603 (Item 6.B)). Similarly, in the course of the second offering, Winkelmann emailed Morgan another draft Form ADV which indicated that the only product BOP sold to clients was, "from time to time...life insurance products." (RX-106, pp. 1099, 1115). Thus, Winkelmann failed to provide Morgan the information needed to advise on whether BOP's conflicts disclosures, *in an offering targeting clients*, were adequate.

Winkelmann also failed to apprise Morgan of the facts necessary to inform him of the full scope of the conflict created by the royalty unit offering structure. Indeed, Winkelmann never told his attorneys that he would keep investor payments at minimum levels. Rather, the offering materials Winkelmann asked Greensfelder to review contained representations and charts indicating that investors would receive well above minimum returns. Nor did Winkelmann tell Greensfelder that he would use royalty unit proceeds to steadily increase his compensation. Winkelmann also never told Greensfelder that he would drastically reduce BOP's advertising budget (which would lower BOP's revenues and royalty investor returns) and instead devote BOP's resources to even greater increases in his and Binkholder's compensation. (DX-395, BO5317 (*see* "Action Plan"); Tr. 590:3-6, 591:20-592:4).

Rather than disclosing these facts, Winkelmann 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 "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). Thus, the offering memoranda Winkelmann prepared gave Greensfelder the same false impression that investors received: that BOP would pay more than minimal payments, and that investment proceeds would not be used to fund Winkelmann's salary increases.

But the key fact Winkelmann concealed from Greensfelder was that Binkholder had been barred for engaging in the same conduct as Winkelmann: selling securities in his own businesses to advisory clients. (DX-84, ¶16). Binkholder's bar, issued by the same Missouri securities regulators with jurisdiction over BOP, would be of paramount importance to any attorney advising on whether Winkelmann was adequately disclosing conflicts to clients. Winkelmann admittedly had seen the bar order by late December 2011. (Stip. ¶ 56). Despite Winkelmann's protestations that he immediately advised Greensfelder of Binkholder's bar, the evidence proves Winkelmann would wait nearly a year to bring the bar to Greensfelder's attention.

Winkelmann testified that upon learning of Binkholder's bar in late 2011: (a) he alerted Morgan; (b) Morgan and his partner, Wendy Menghini, scrutinized the bar 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).

Moreover, common sense alone refutes the notion that Winkelmann apprised Greensfelder of Binkholder's bar order prior to late 2012. Indeed, upon learning that Winkelmann's partner had been barred for selling his businesses' securities to clients without disclosing conflicts, no lawabiding securities lawyer would advise Winkelmann that it was appropriate to engage in the same conduct. It further strains credulity to suggest that an attorney would give such advice without first devoting thorough attention to the matter. As the Greensfelder invoices demonstrate, the firm performed *no legal services whatsoever* for BOP between June 2011 and January 2012. (RX-113, p. 11-13). Those invoices prove that Winkelmann's testimony that he advised Greenfelder of the bar, prior to the second and third offerings, is a lie.

IV. THE SANCTIONS IMPOSED BY THE ALJ ARE WELL JUSTIFIED

As a result of Winkelmann's violations of the Securities Act, Exchange Act, and Advisers Act's antifraud provisions, the ALJ imposed an industry bar, cease-and-desist order, disgorgement of $415,000 plus prejudgment interest, and second-tier civil penalties of $180,000. (I.D. at 64-70).[17] Those sanctions very much serve the public interest, even if premised solely on the finding that Winkelmann failed to disclose conflicts when offering royalty units to clients. (*Id.*). However, considering the other aspects of Winkelmann's fraud discussed in the Division's brief supporting its cross-petition – his failure to disclose Binkholder's bar, his mispresenting his alignment and lack of conflicts with investors, his misrepresentations and omissions about BOP's advertising ratio, and his false statements about BOP's success in raising funds and repaying investors – sanctions in the public interest are even more justified.

[17] The ALJ additionally imposed a $7,500 civil penalty for Winkelmann's conduct related to BOP's violation of the Custody Rule. (I.D. at 69). Winkelmann's petition for review did not address that aspect of the Initial Decision, but Winkelmann appears to briefly challenge the custody-related findings in his brief. (Resp. Br. at 45). Winkelmann's sole basis for challenging the custody-related findings is his claim he did not act "willfully." (*Id.*). However, a respondent "acts willfully when he intends to commit the act which constitutes a violation; willfulness does not require that the actor 'also be aware that he is violating one of the Rules or Acts.'" *Dembski*, 2017 SEC LEXIS 959, *45 (quoting *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)). Moreover, in post-hearing briefing, Respondents conceded that custody-related violations occurred and that sanctions are appropriate. (Resp. Post-hearing Br. at 62-63 (Respondents admit having "accepted the SEC's conclusion that [BOP] inadvertently tripped the 'Custody Rule'" and suggest that the ALJ "should award, at most, a Tier 1 penalty for the custody violation.")).

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

As detailed herein, Winkelmann acted egregiously and with scienter by failing to disclose conflicts to advisory clients, breaching his fiduciary duties, and otherwise making misstatements and omissions while offering royalty units. *See, e.g., Larry Grossman*, 2016 SEC LEXIS 3768, *84-85 ("Grossman's conduct [repeatedly failing to disclose conflicts] was egregious...We conclude that Grossman's efforts to defraud his clients and abuse their trust demonstrate that he lacks the competence and requisite professional ethics required for him to meet these standards and operate as a fiduciary."); *Tagliaferri*, 2017 SEC LEXIS 481, *22 ("We 'consistently view[] misconduct involving a breach of fiduciary duty . . . as egregious.'") (quoting *Edgar Page,* 2016 WL 3030845 at *5).

The other *Steadman* factors likewise support strong sanctions. Winkelmann's fraud continued over the course of two years and four separate offerings. Winkelmann has offered no assurances against future violations and refuses to acknowledge the wrongful nature of his conduct. To the contrary, he testified he has done nothing wrong, and continues to blame the

Commission and Missouri regulators for his current situation. (Tr. 600:7-16; 827:7-828:24).[18] Winkelmann went so far as to testify that his investors have received "everything they deserve" and have been made "whole." (Tr. 832:10-18). And demonstrating his current lack of remorse and failure to understand his fiduciary obligations, Winkelmann's brief describes the charges against him as "absurd" and states that any failure to disclose conflicts would have been cured had the offering memoranda merely disclosed that Winkelmann would set his own salary. (Resp. Br. at 19 n.78). Absent an appropriate sanction, Winkelmann will continue to operate as an adviser and fiduciary to investors, and will have ample opportunity to commit future violations.

A. The Commission Should Enter Cease-and-Desist Orders

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

[18] Further evidencing Winkelmann's scienter and refusal to accept responsibility, shortly before trial Winkelmann drafted an email for his assistant to send to the royalty unit investors, including multiple trial witnesses. (DX-464; Tr. 828:25-830:23). In an apparent effort to influence witness testimony, Winkelmann's email presents investors with quotes from his attorneys, including: (a) "This is a classic case of prosecutorial overreach," (b) "Not only did [BOP] and Winkelmann do nothing wrong, to the contrary, they objectively strove to do everything right," and (c) "If anyone is guilty of harming the investors, it is the Division itself, and its wholly predictable decision to plead this case as 'fraud.'" (DX-464; Tr. 830:24-832:9). Winkelmann was shown DX-464 and discussed the email during his testimony, but the exhibit was not moved into evidence. So that the Commission may consider the document in its full context, the Division attaches DX-464 hereto as Exhibit 1.

violations of the antifraud provisions, and his failure to recognize the wrongful nature of his conduct, the Commission should impose cease-and-desist orders.

B. The Commission Should Order Disgorgement and Prejudgment Interest

Exchange Act Section 21C(e), Section 8A(e) of the Securities Act, and Advisers Act Section 203(k) authorize the Commission to order disgorgement, plus reasonable interest. Ordering "disgorgement restores the *status quo ante* by depriving violators of ill-gotten profits." *Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009). The disgorgement award "need only be a reasonable approximation of the profits causally connected to the violation," and "the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that uncertainty." *Id.* at 473.

Winkelmann devotes only a single paragraph to arguing against the ALJ's disgorgement award. (Resp. Br. at 43). He merely argues he did not violate the securities laws and should not have to disgorge *any* ill-gotten gains. However, as discussed herein and in the Division's opening brief in support of its cross-petition, Winkelmann and BOP violated the antifraud provisions in a variety of ways.

At minimum, the Commission should order Winkelmann to disgorge the $678,757 he personally benefitted from the royalty unit offerings. This figure includes the $125,000, $189,200, and $227,557 yearly sums BOP paid to compensate Winkelmann, respectively, in 2012, 2013, and 2014. (Stip. ¶ 64). It also includes the additional: (a) $41,000 BOP paid Longrow Insurance Agency to compensate Winkelmann for his services to BOP (DX-457; Tr. 774:6-777:15, 1486:1-17); (b) $46,000 BOP paid Blue Ocean ATM (DX-457); and (c) $50,000 BOP paid to extinguish Winkelmann's personal settlement obligation in a lawsuit against him (DX-170, §3.1(c); Tr. 800:10-23, 802:19-24, 804:20-23).

Winkelmann relied on the fraudulent royalty unit offerings to keep BOP's business afloat and his compensation flowing. Indeed, BOP's financial condition was dire at the time Winkelmann decided to initiate the first, second, and fourth offerings. (Stip. ¶¶ 45-46; DX-83; DX-211; DX-225).[19] Without the proceeds of those offerings, BOP would have had difficulty staying in business, let alone funding the significant and increasing payments made for Winkelmann's benefit.[20] Accordingly, the payments Winkelmann and his companies received from BOP are properly subject to disgorgement. *See, e.g.*, *Bernerd Young*, Exchange Act Rel. 774421, 2016 SEC LEXIS 1123, *92-93 (Mar. 24, 2016) (ordering disgorgement of percentage of respondent's compensation resulting from illegal conduct); *Gregory Trautman*, Exchange Act. Rel. 61167, 2009 SEC LEXIS 4173, *84-89 (Dec. 15, 2009) (same); *CFTC v. British Am. Commodity Options Corp.*, 788 F.2d 92, 93-94 (2d Cir. 1986) (ordering disgorgement of all compensation received by principal of unregistered commodity broker).

The ALJ generally agreed with this disgorgement framework, subject to a few modifications to the Division's $658,757 figure, and concluded that $415,000 was an appropriate award. (I.D. at 68). First, the ALJ deducted the $50,000 in BOP funds that Winkelmann used to pay his *personal* settlement obligation in a lawsuit filed against him. (Tr. 797:14-798:18, 802:19-24; DX-170, § 3(c)). The ALJ concluded the settlement payment "benefitted BOP and

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[19] While the record does not detail BOP's finances at the start of the third offering, the fact that Winkelmann initiated the offering despite having serious health problems suggests that the offering proceeded out of financial necessity. (Tr. 689:6-691:22).

[20] Winkelmann's dependence on the royalty unit offerings to fund his compensation is best demonstrated by DX-83, a December 2011 email to Binkholder in which Winkelmann presents two options: (1) cutting the meager $2,000 per month they were receiving at the time, or (2) initiating a second offering and using the proceeds to raise their monthly compensation to $8,500. Another prime example is the disclosure in the fourth memorandum – which Winkelmann concealed from all but three investors – that BOP would not be able to make payroll without raising at least $50,000 by March 1, 2013. (RX-4, p. 5; Stip. ¶ 59).

its clients" because the settlement ended a lawsuit filed against both BOP and Winkelmann. (I.D., pp. 57, 68). However, Winkelmann undisputedly used BOP money, funds that could have been paid to the royalty unit investors, to settle a personal debt that Winkelmann would otherwise have been required to pay using his own money. (Tr. 803:7-12). That amount is properly subject to disgorgement.

The ALJ also deducted $72,000 from the disgorgement figure, representing the $2,000 Winkelmann received in monthly BOP compensation prior to the start of the second offering. (I.D. at 68). The ALJ reasoned that because Winkelmann received $2,000 per month before he initiated the second offering, Winkelmann should not disgorge the amount he would have received from 2012 to 2014 had he not raised his compensation ($2,000 times 36 months). (*Id.*). But the ALJ ignored that prior to the *first* offering, BOP was out of money and unable to pay Winkelmann *any* compensation. (Stip. ¶¶45, 46). Thus, even the modest compensation Winkelmann received prior to significantly raising his salary was only available by virtue of the fraudulent royalty unit offerings. Indeed, just as the ALJ reasoned that Winkelmann should disgorge the money Winkelmann received when he raised his monthly salary *above* $2,000, Winkelmann should also have to disgorge the money he received when he earlier raised his salary *to* $2,000.

For his third adjustment, the ALJ reduced the disgorgement award by 25%, representing the relative percentage of royalty unit proceeds from investors who were not BOP clients. (I.D. at 68). However, Winkelmann defrauded all of the investors, not just clients, by concealing Binkholder's bar, misrepresenting the "alignment" and lack of conflicts between Winkelmann's and investors' interests, and by making misstatements and omissions about BOP's advertising ratio. Thus, should the Commission rule in the Division's favor on its cross-petition, the ALJ's rationale for cutting disgorgement by 25% would not be warranted.[21]

Alternatively, the Commission could order disgorgement based on the $1.4 million BOP received in ill-gotten royalty unit offering proceeds. This methodology is supported by other offering fraud cases, where courts routinely order issuers to disgorge the moneys fraudulently raised from investors. *See, e.g., SEC v. Manor Nursing Centers, Inc.* 458 F.2d 1082, 1104 (2d Cir. 1972); *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1192 (9th Cir. 1998); *SEC v. Capital Solutions Monthly Income Fund*, 28 F. Supp. 3d 887, 898-99 (D. Minn. 2014), *aff'd* 818 F.3d 346 (8th Cir. 2016). Here, BOP's proceeds from the fraudulent royalty unit offerings (net of repayments to investors) are properly the subject of disgorgement. That amount is $874,327.49 ($1.4 million raised minus the $525,672.71 returned to investors). (Stip. ¶¶ 1, 14).

If the Commission utilizes this disgorgement approach, it should hold Winkelmann jointly and severally liable for disgorgement of the offering proceeds because doing so "is appropriate in securities cases when two or more individuals or entities collaborate *or* have a close relationship in engaging in the illegal conduct." *Edgar Page*, 2016 SEC LEXIS 1925, *52 (quoting *SEC v. Whittemore*, 659 F.3d 1, 10 (D.C. Cir. 2011)) (emphasis in original); *see also SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004) (recognizing the "well settled principle that joint and several liability is appropriate in securities laws cases where two or more individuals or entities have close relationships in engaging in illegal conduct."); *Gordon Pierce*, Exchange Act Rel. 71664, 2014 SEC LEXIS 4544, *91 (Mar. 7, 2014) ("where joint and several liability is found,

[21] Winkelmann and BOP each executed tolling agreements in this matter which excluded the period March 10 through May 21, 2016 from the statute of limitations. (DX-357; DX-358). The tolling agreements thus allow the entire proceeds of the royalty offerings, and any compensation Winkelmann received as a result, to be included within a five-year statute of limitations. For this reason, the Supreme Court's decision in *Kokesh v. SEC* should have no bearing on the Commission's disgorgement analysis.

courts routinely order disgorgement of the entire amount of ill-gotten gains jointly and severally from individuals who received only part of the proceeds of the wrongdoing, or did not receive any of the proceeds at all."); *J.S. Oliver*, 2016 SEC LEXIS 2157, *49-50 (ordering joint and several disgorgement).

C. The Commission Should Order Civil Penalties

The public interest likewise supports requiring Winkelmann to pay significant civil penalties for his misconduct. In considering whether to impose penalties, relevant factors include: (1) whether the violations involved fraud, deceit, manipulation or reckless disregard of a regulatory requirement; (2) the harm caused to others; (3) the extent to which any person was unjustly enriched; (4) prior violations by the respondent; (5) the need for deterrence; and (6) such other matters as justice may require. Exchange Act § 21B(a)(2); Securities Act § 8A(g); Advisers Act § 203(i). Third-tier penalties are properly imposed for "each act or omission involving fraud or deceit that additionally resulted in (or created a significant risk) of substantial losses to other persons or that resulted in substantial gains to the wrongdoer." *Anthony Fields, CPA,* Exchange Act Rel. 74344, 2015 SEC LEXIS 662, *102-104 (Feb. 20, 2015); *Riad*, 2016 SEC LEXIS 2396, *161-162; *Bernerd Young*, 2016 SEC LEXIS 1123, *95.

Relying on these standards, the Commission routinely imposes significant penalties on advisers who fail to disclose conflicts to clients. *See, e.g., Malouf,* 2016 SEC LEXIS 2644, *108 (third-tier penalty); *Montford & Co.*, 2014 SEC LEXIS 1529, *102-103 (third-tier penalties); *J.S. Oliver*, 2016, SEC LEXIS 2157, *70-71 ($1,325,000 in second-tier penalties); *Robare*, 2016 SEC LEXIS 4179, *42-44 (second-tier penalty for negligence based violations). As in these decisions, heavy penalties are warranted for Winkelmann's failure to disclose conflicts when offering royalty units to clients.

Third-tier penalties are also justified for Winkelmann's fraud that went beyond failing to disclose conflicts, including his: (a) failure to disclose Binkholder's bar; (b) misrepresenting his alignment and lack of conflicts with investors; (c) false statements and omissions regarding BOP's advertising ratio; and (d) false statements about BOP's success in raising funds and repaying investors. Winkelmann's misconduct involved fraud, deceit, and reckless disregard of the statutorily imposed fiduciary duties owed to his advisory clients. *ZPR Inv. Mgmt. v. SEC*, 2017 U.S. App. LEXIS 11761, *8 (11th Cir. June 30, 2017) ("The Advisers Act sets 'federal fiduciary standards for investment advisers.'") (citation omitted). Winkelmann has harmed his clients by keeping their royalty payments at near-minimal levels that are not commensurate with the returns suggested by the offering memoranda. Winkelmann further harmed investors by diverting to himself significant sums – that could have been used to repay investors – resulting in Winkelmann receiving substantial gains.[22] For these reasons, the amount of any civil penalty assessed should be sufficient to deter Winkelmann and others from engaging in the fraudulent conduct at issue in this proceeding.

For its penalty analysis, the ALJ utilized a "per violation" framework, considering each occasion Winkelmann illegally sold royalty units to an investor to constitute a single violation. (I.D. at 70). To that end, the ALJ imposed 18 second-tier penalties of $10,000 each, representing the 18 of the 23 total royalty unit sales to BOP clients that the ALJ determined fell within the five-year limitations period. (*Id.*). In other words, the ALJ excluded occasions when royalty units were sold to non-clients, as well as the five occasions clients purchased royalty units prior to May 20, 2011. (*Id.*)

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[22] BOP also realized substantial gains as a result of the royalty unit offerings. BOP raised $1.4 million, money that was "critical" to allowing BOP to stay above water and implement its business plan. (RX-3, p. 12; Stip. ¶ 1).

To the extent the Commission adopts the ALJ's analysis, the Division submits that framework should result in increased penalties. First, for the reasons detailed in the Division's brief in support of its cross-petition, Winkelmann defrauded both advisory clients and non-clients alike. Thus, there were 30 "occasions" where Winkelmann sold royalty units to investors in violation of the antifraud provisions. (DX-455). Next, because Winkelmann and BOP executed tolling agreements (DX-357; DX-358), there is no reason to exclude royalty unit sales based on statute of limitations concerns. Finally, the ALJ chose to impose second-tier, as opposed to third-tier, penalties based on his finding that no single "occasion" of royalty unit sales resulted in or created the risk of "substantial losses" or resulted in "substantial pecuniary gain" for Winkelmann. (I.D. at 70). This finding ignores the fact that many investors bought multiple royalty units via $100,000, $75,000, and $50,000 purchases. (DX-455). Through these sales of BOP securities to BOP clients, Winkelmann was engaging in conduct he knew could result in him being barred, just like his business partner Binkholder. Thus, each royalty unit sale created the risk of substantial loss, each a minimum of $25,000, to investors. Moreover, the royalty unit sales collectively resulted in Winkelmann receiving more than $650,000 in compensation, very much a substantial pecuniary gain for Winkelmann.

Accordingly, the Commission would be well justified to impose third-tier penalties. If the Commission finds that third-tier penalties for each royalty unit sale would be excessive, the Commission should, at minimum, order a third-tier penalty for each of the four fraudulent offerings.

D. The Commission Should Bar Winkelmann

Under Section 15(b)(6)(A) of the Exchange Act and Section 203(f) of the Advisers Act, the Commission may bar or suspend persons from being associated with an investment adviser or other types of securities industry participants. *Larry Grossman*, 2016 SEC LEXIS 3768, *53. In order to bar Winkelmann or BOP, the Commission must find that: (1) they willfully violated the Advisers Act or its rules; and (2) based on the *Steadman* factors, a bar is in the public interest. *Grossman* at *81-84. In assessing the *Steadman* factors, "the 'degree of risk [that the respondent] poses to the public' and the extent of the respondent's 'unfitness to serve the investing public' are central considerations." *Grossman* at *83-84 (quoting *Meadows v. SEC*, 119 F.3d 1219, 1228 & n.20 (5th Cir. 1997)). Moreover, an industry bar is in the public interest where the respondent's degree of scienter is "at least reckless." *Edgar Page*, 2016 SEC LEXIS 1925, *23 (citation omitted).

Applying the *Steadman* factors, the Commission routinely bars advisers who fail to disclose conflicts of interest to clients, finding such conduct to be "egregious." *See, e.g., Tagliaferri*, 2017 SEC LEXIS 481, *21-22; *Grossman*, 2016 SEC LEXIS 3768, *84-85; *Malouf*, 2016 SEC LEXIS 2644, *94-96; *J.S. Oliver*, 2016 SEC LEXIS 2157, *40-41; *Edgar Page*, 2016 SEC LEXIS 1925, *14-15; *Timbervest*, 2015 SEC LEXIS 3854, *59-60; *Montford*, 2014 SEC LEXIS 1529, *78-80.

Winkelmann's conduct in failing to disclose conflicts was similarly egregious and committed with scienter. Given his lengthy career in the securities industry, his understanding of fiduciary obligations, and the fact that he systematically touted his fiduciary duties, there is no excuse for Winkelmann's failure to disclose conflicts when offering royalty units to clients. As the ALJ correctly observed, "Winkelmann's activities were at least extremely reckless" and "such activities attempt to sidestep the fiduciary duty of an adviser to his client and cannot be tolerated." (I.D. at 65).[23] The fact that Winkelmann knew his partner Binkholder had been barred for failing to disclose conflicts in extremely similar circumstances only compounds the severity of Winkelmann's misconduct, and demonstrates that Winkelmann acted with scienter.

Even though the ALJ correctly determined Winkelmann's failure to disclose conflicts was a sufficient basis to bar Winkelmann, an industry bar is further justified as a result of the other false statements and omissions Winkelmann repeatedly made in the course of the royalty offerings. Indeed, the fraudulent representations and omissions at issue in the Division's cross-petition provide independent and well-justified grounds for an industry bar. *See, e.g., Bennett Group Services*, Advisers Act Rel. 4676, 2017 SEC LEXIS 1003, *11-12, *17-18 (Mar. 30, 2017) (industry bar for adviser fraud "which spanned more than a year and involved repeated, knowing misstatements" regarding assets under management and investment returns), *Dembski*, 2017 SEC LEXIS 959, *46 (bar for adviser who "lied repeatedly to multiple clients for close to two years"); *Riad*, 2016 SEC LEXIS 2369, *153-154 (adviser barred for misleading statements and omissions in two periodic mutual fund reports); *Bernerd Young*, 2016 SEC LEXIS 1123, *90-91 (bar for adviser CCO who approved "false and misleading" disclosures); *Anthony Fields*, 2015 SEC LEXIS 662, *61, *92 (bar for adviser who "made numerous material misrepresentations to potential investment adviser clients").

Providing additional context for the Commission's industry bar determination, both of Winkelmann's previous two advisory business partners, Weir and Binkholder, in unrelated cases,

[23] The ALJ also correctly observed that the other *Steadman* factors supported an industry bar. Namely, the ALJ recognized that Winkelmann's misconduct was relatively recent, occurred for multiple years, over four offerings, and involved sales to clients on 23 occasions. (I.D. at 65). The ALJ additionally found, correctly, that "Winkelmann has not acknowledged the wrongful nature of his conduct and has not offered meaningfully sincere assurances against future violations, which is troubling given his desire to remain in the advisory business until retirement." (*Id.*).

were criminally convicted and imprisoned for defrauding clients. (Stip. ¶¶ 27, 58). Moreover, during the time period at issue in these proceedings, Winkelmann was held in contempt for violating an injunction in a trademark dispute. (DX-205). Winkelmann's history of associating with crooked advisers and ignoring a prior court injunction provides still more reason, in addition to his violations and recalcitrance in this matter, why he should not be entrusted with the fiduciary responsibilities of an investment adviser.

E. The Commission Can Impose Significant Sanctions on Winkelman But Not BOP

Just as Winkelmann's conduct supports an industry bar and significant monetary sanctions, substantial sanctions against BOP, of which Winkelmann was CEO and directly responsible for BOP's actions, would be justified. However, the Division recognizes that barring or imposing large monetary sanctions on BOP could result in harm to the royalty unit investors. For this reason, the Division suggested to the ALJ, and the ALJ agreed, that Winkelmann could be sanctioned while allowing BOP to stay in business. (I.D. at 65-66).

While Winkelmann claims BOP would not survive if he were removed from the company, his testimony suggests otherwise. Indeed, Winkelmann testified BOP is a viable business that generates well over $200,000 in *net* annual income. (Tr. 1479:12-24, 1527:12-1529:2). Moreover, ninety percent of BOP's client base remained with BOP despite this enforcement action. (Tr. 1526:10-17). Neither BOP nor Winkelmann asserted – rather they waived – any inability to pay defense. (Tr. 1417:8-12). And Winkelmann testified he has other available income sources to fund his personal obligations. (Tr. 750:12-751:9). Given BOP's commercial viability, even if Winkelmann is barred, BOP can continue to operate, either under its current ownership structure in which Winkelmann does not have an equity interest (Stip. ¶¶ 31, 42), or through a sale to a third-party.

V. RESPONDENTS' CONSTITUTIONAL CHALLENGE FAILS

The Commission should reject Respondents' argument (Resp. Br. 8-12) that the Commission's method of hiring administrative law judges violates the Appointments Clause of the Constitution. *See* U.S. Const. art. II, § 2, cl. 2. The Commission has consistently held that the Appointments Clause's requirements apply only to officers of the United States, not employees, and that its administrative law judges are employees. *See, e.g., Bennett Gr. Fin. Serv.*, 2017 SEC LEXIS 1003, *23-24, *pet. filed* May 26, 2017 (10th Cir. No. 17-9524). The Commission has also reiterated that holding in two decisions that post-date the Tenth Circuit's contrary determination in *Bandimere v. SEC*, 844 F.3d 1168 (10th Cir. 2016), on which Respondents rely. *Bennett* at *23-24; *Harding Advisory LLC*, 2017 SEC LEXIS 86, *67-70, *pet. filed* Mar. 6, 2017 (D.C. Cir. No. 17-1070). The Commission's position remains correct, and Respondents have offered no compelling reason why the Commission should depart from its carefully considered and established approach.

VI. CONCLUSION

For the foregoing reasons, the Division of Enforcement respectfully requests that the Commission affirm the findings that Respondents violated the antifraud provisions, and impose significant sanctions in the public interest.

Dated: July 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 13,244 words, exclusive of the tables of contents and authorities.

Benjamin J. Hanauer

Exhibit 1

Jim Winkelmann

From: [redacted]
Sent: [redacted]
To: [redacted]
Subject: [redacted]

[redacted]

[redacted]

[redacted]

Re: [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

DIVISION
EXHIBIT
464

[redacted]

[redacted]

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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 July 7, 2017, he caused a true and correct copy of The Division of Enforcement's Response in Opposition to Respondents' Brief in Support of Petition for Review to be served on the following:

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