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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: **JAMES A. WINKELMANN, SR. AND BLUE OCEAN PORTFOLIOS, LLC,** **Respondents.**	ADMINISTRATIVE PROCEEDING File No. 3-17253

RESPONDENTS' RESPONSE TO THE DIVISION'S BRIEF IN SUPPORT OF CROSS-PETITION FOR REVIEW

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I. INTRODUCTION

Unlike the Respondents, who instituted this appeal to reverse the ALJ's error in overlooking certain documentary evidence that substantiated Mr. Winkelmann and Blue Ocean's defense, the Division's Cross-Appeal seeks to overturn almost every adverse factual and legal conclusion and, unexpectedly, advances several new theories of liability for the first time on appeal. Failing to carry its burden of proof on the vast majority of its allegations, it appears the Division has now pivoted, abandoning the express allegations it raised in the OIP and, instead, chases new theories it hopes it may be able to substantiate.

Not only should the Division be prohibited from pursuing new allegations for the first time on appeal, but the Commission should not disturb the findings of fact and conclusions of law challenged by the Division. The Brief in Support of the Cross Appeal[1] simply disagrees with the ALJ's rulings and fails to identify any fact, evidence or law that would justify reversal of the Initial Decision.

For the reasons stated herein, the Division's Cross-Appeal should be denied, in its entirety, and the portions of the Initial Decision contested therein, upheld.

II. RESPONSE TO DIVISION'S REQUEST FOR REVERSAL

A. Binkholder's Missouri Bar

The Division first appeals the Initial Decision's holding that the Division failed to prove that Mr. Winkelmann and Blue Ocean did not disclose, in connection with the Round 2 and 3

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[1] Cited herein as "Div. Br. p.___"

Offerings,[2] that one of the Firm's advertising and marketing vendors had previously been barred from acting as an investment adviser by the State of Missouri.

1. Facts Relevant to Division's Failed Claim relating to Binkholder

Brian Binkholder was the host of a local radio show called *The Financial Coach Show*, which ran for one hour once a week. At all times relevant, Blue Ocean had an exclusive marketing relationship with the radio show, whereby Binkholder advertised the Firm during the show. Blue Ocean also ran traditional radio ads during the show.[3]

When Blue Ocean decided to raise capital for its expansion plans which included an advertising campaign, and issued the Offering Memoranda for Rounds 1-3, Binkholder was an expressly disclosed as part of the Firm's "Advertising Sales and Marketing Plan."[4] The Offering documents disclosed that Blue Ocean and Binkholder had entered into an Exclusive Marketing Agreement and provided a description of the *The Financial Coach Show* – time, station, and its message.[5] Prospective customers who heard Binkholder on the radio (or who heard Blue Ocean advertisements during Binkholder's radio show) could call Blue Ocean to learn more about the Firm and its advisory services. The prospects could find their way to Blue Ocean either directly or through Binkholder's radio show's website.[6]

Between the Round 1 and 2 Offerings, the State of Missouri entered an Order against Binkholder that barred him from acting "as an agent or investment adviser representative in the State of Missouri" as a result of conduct that occurred at an advisory firm he owned and operated

[2] "Offering(s)" carries the same definition in this brief as in Respondents' Opening Brief, and refers, collectively, to the four offerings at issue in this case. The four offerings are individually referred to as "Round 1," "Round 2," "Round 3" and "Round 4," respectively.

[3] Tr. 1306:25-1907:18; Tr. 1378:20-22; 1372:20-23; Tr. 1378:20-22; Tr. 1306:25- 1307:4 Winkelmann).

[4] E.g. RX-002 p. 10.

[5] *Id.* The Offering Memoranda also included a copy of the Exclusive Marketing Agreement.

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

from 2004-2010 (the "Order').[7] While the Order forbid Binkholder from functioning as an investment advisor, as the Division's own expert witness admitted, the Order had no impact (and imposed no restrictions) on Binkholder's ability to host a radio show or to act in an advertising capacity – the very activities for which Blue Ocean contracted with Binkholder to conduct.[8]

Moreover, while Blue Ocean was an investment advisory firm, Binkholder did not operate as an investment advisor representative for Blue Ocean during the time period the Offerings at issue occurred, and the Offering Memoranda made this explicit.[9] Instead, based primarily on the success of his show and breadth of his listening audience, Blue Ocean retained Binkholder to act as a "lead generator" for the Firm as part of its marketing plan.[10] Beyond that role, Binkholder also advised the Firm on how best to allocate its advertising dollars.[11] Again, Binkholder's role, as a marketing/advertising consultant, was explicitly outlined in the offering documents.[12]

The Division contends that the intervening bar imposed on Mr. Binkholder by the State of Missouri, retracting his investment advisory functions, was a material fact that the Offering documents were required to disclose, despite the fact that he was not functioning in an advisory capacity at Blue Ocean.

[7] DX-84. The Commission will note how the Division's narration of the "facts" surrounding Binkholder in its Opening Brief are crafted to blur the relevant time periods, and make it sound as though Binkholder's conduct bore some connection to Blue Ocean, Mr. Winkelmann, or any of the four Offerings at issue. Div. Br. pp. 5-6. In fact, the conduct at issue in the Missouri action happened years prior at an entirely different advisory firm.

[8] Tr. 292:14-20 (Laby).

[9] *Id;* Tr. 1372:18-20 (Winkelmann); RX-002 p.10.

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

[11] Tr.1306:25-1307:18; 1378:20-22 (Winkelmann).

[12] RX-002 p. 10; RX-003 p.7-8.

In light of Binkholder's limited specific role at the Firm, Initial Decision properly concluded that the Order was not material. In rejecting the Division's arguments, the Initial Decision found that its theory was "undercut" by five facts proven at hearing:[13]

(1) Binkholder was not acting as an investment advisor for Blue Ocean.[14]

(2) None of the Offering Memoranda include Binkholder on the list of Blue Ocean's "Key People."[15]

(3) Neither Binkholder nor his radio program, *The Financial Coach,* is included in the list of "Key Vendors & Relationships."[16]

(4) Binkholder's radio show, which aired only one hour per week, had only a "modest" impact on advertising and was merely part of Blue Ocean's daily promotional mix across all advertising sources.[17]

(5) Binkholder's bar did not preclude him from providing advertising services to Blue Ocean or restrict his ability to function in that capacity in any way.[18]

For the reasons stated below, the Order is not material to the Offerings. The Division's assertion to the contrary should be denied, and the Initial Decision upheld.

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[13] Initial Decision p. 53.

[14] *Id;* Tr. 1372:18-20 (Winkelmann).

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

[16] RX-002 p. 19-22; RX-003 pp. 17-20..

[17] RX-013 and RX-014. Mr. Winkelmann testified that Binkholder's show was only on the air for an hour a week, while Blue Ocean ads essentially ran around the clock, seven days a week, on the station that aired his show. Tr. at 429 and 431. It is not surprising, therefore, that Binkholder's actual contribution to the bottom line appeared to be modest.

[18] The Initial Decision found this to be the most important factor undermining the Division's theory.

2. The Division Failed to Prove Materiality with regard to Binkholder.

In appealing the Initial Decision, the Division ignores the above facts and advances two arguments for reversal, both relating to the alleged materiality of the Order. First, the Division advances a new argument:[19]

> Binkholder defraud[ed] his advisory clients by selling them securities in his own business without disclosing the attendant conflicts. Any reasonable investor would want to know that Winkelmann, BOP's CEO and Principal, could also be barred for selling royalty units to clients.

This argument is so absurd on its face that it almost does not require a response. Essentially, the Division submits that because Binkholder had been barred for failing to disclose a conflict in an entirely unrelated setting, Mr. Winkelmann was required to disclose that fact to his investors. Importantly, the disclosure was supposedly necessary *not* because it was relevant background information regarding Binkholder, but because the Order put Mr. Winkelmann on notice that he "could also be barred." The mental gymnastics required to follow the Division's theory reveals its ludicrousness. First, the Order did not bar Binkholder from selling royalty units to clients, or express that such a transaction was in any way problematic. Thus, even if it was theoretically possible for Mr. Winkelmann to be placed "on notice" by the Order, the text of the Order was woefully insufficient to "notify" that "he could also be barred for selling royalty units."[20] In fact, the Division overstates the content of the Order significantly.

Even more ridiculous is the application of the Division's argument beyond this case. Essentially, it posits that any offering of securities must disclose that other issuers, in other cases, at different times, involving different facts and circumstances, have been barred for conduct

[19] Div. Br. p. 37. *See,* Section II.D.3.

[20] DX-201. This is only the Division's latest attempt to suggest there exists some precedent that forbids, per se, allowing clients to invest in their investment advisory firm. No such authority exists or existed at the time the Offerings were made.

undertaken in connection with a securities offering. This is purportedly because a "reasonable investor would want to know that" the issuer or one of its principals "could also be barred" for conduct relating to the offering[21]

Not only is such a rule futile, accepting such a tenuous application of materiality ignores the well-established case law on its parameters. "[T]o fulfill the materiality requirement 'there must be a *substantial likelihood* that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'"[22] In determining whether a fact is "material," it must be examined in the "context in which it is made."[23] In the event that the lack of importance of the omission is so plain that reasonable minds could not differ on the issue, it is proper for the trier of fact to pronounce the omission immaterial as a matter of law.[24]

To reverse the Initial Decision's findings, the Division must show that the Order is "material" because there was a "substantial likelihood" that it would have "significantly altered" investors' view of the investment, because it would have enlightened them that Mr. Winkelmann – like every other issuer – was potentially subject to a bar. This argument fails, out of the gate, because the Order was incapable of carrying the "materiality" that the Division now assigns to it.[25]

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[21] *Id.*

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

[23] 17 C.F.R. § 230.156(b). Additionally, and relevant here, the element of materiality is tightly intertwined with the element of scienter and "if it is questionable whether a fact is material, or its materiality is marginal, that tends to undercut the argument that defendants acted with the requisite intent or extreme recklessness in not disclosing the fact." *City of Dearborn Heights v. Waters Corp.*, 632 F. 3d 751 (1st Cir. 2011).

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

[25] The Order does not mention royalty units, or otherwise state or even suggest that Binkholder was barred because he offered royalty units to his clients. The closest the Order gets is a reference to conflicts of interest. What those conflicts were, however, was not noted.

The Division's second argument for materiality is the same one raised before the ALJ, which was overwhelmingly refuted by the evidence. It argues that the Order is material because Binkholder held (1) a "key position" at the Firm and (2) "prominence" in the Offering Memoranda.[26] As the evidence showed, however, and the ALJ properly found, Binkholder was not a "key person" at Blue Ocean, nor was his radio show a "key relationship."

Instead, the pages of the Offering documents the Division cites (primarily the section entitled "Sales and Marketing Plan") discuss the Firm's advertising relationship with *The Financial Coach Show* alongside several other relationships, including the Charlie Brennan Radio Show, Grasshopper.com, YouTube, and Google Adwords.[27] Aside from the exclusive marketing relationship, Binkholder enjoys no greater "prominence" than Mr. Brennan or Grasshopper's, both of which the Firm also utilized as part of its advertising campaign.

Considering both the documents and the testimony presented regarding Binkholder's relationship to the Firm, the ALJ firmly rejected the Division's position:

> I also find that the Division failed to prove materiality with respect to the Division's allegations that Respondents'...misleadingly failed to disclose that the Missouri Division of Securities had barred Binkholder from acting "as an agent or investment adviser representative in the State of Missouri" in 2011.
>
> Binkholder was not acting as an investment adviser for BOP. ...Although the Division intimates that Binkholder was so important to the offerings that the bar should have been disclosed, that argument is undercut by a number of factors...[28]

The Initial Decision's well-reasoned conclusions, incorporating the testimony of the Division's own expert witness, should be upheld.

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[26] Div. Br. p. 35.

[27] RX-002 pp.10-12; RX-003 pp.7-10.

[28] Initial Decision p.52-53. Internal citations omitted. The fact that Binkholder was not acting as an investment advisor distinguishes this case from those cited by the Division in support of its appeal, as discussed later in this Section.

3. The Case Law Cited by the Division does not Support a Finding of Materiality.

Nor does the authority cited by the Division support a finding of materiality. First, the Division points to *SEC v. Bolla,*[29] which is easily distinguishable. *Bolla* involved a barred individual who continued to work as an advisor and wield "virtually unlimited control" over his firm, despite his bar. He also failed to tell his clients he had been barred (allowing everyone to make vague excuses as to why he was not returning calls). His former partner, who inherited the firm when he was barred, allowed him to do this, in direct violation of the bar order.

Here, unlike the "virtually unlimited control" the barred individual exercised in *Bolla,*[30] Binkholder's role was narrow and explicitly disclosed in the Offering documents, and related entirely to the advertisements read on his radio show, *The Financial Coach,* and the services provided under the Exclusive Marketing Agreement.[31]

Further, while the Division points to *Bolla* to show that a "co-founder's bar is 'clearly' material,"[32] *Bolla* more properly underscores why the Initial Decision properly held the bar was not material. *Bolla* involved an *investment advisor* who had been barred, yet his partner allowed him to continue to work *as an investment advisor,* providing *investment advice* to *clients and prospective clients* notwithstanding the bar. Additionally, the barred individual was allowed to control the firm's bank accounts, and maintain involvement in client matters.[33]

The Court went to great lengths detailing the two central relationships – the barred advisor's interactions with advisory clients and the barred individual's control over the

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[29] *S.E.C. v. Bolla,* 401 F. Supp. 2d 43, 70 (D.D.C. 2005), *aff'd in part and remanded sub nom. S.E.C. v. Washington Inv. Network,* 475 F.3d 392 (D.C. Cir. 2007).

[30] *Id.* at p. 68. Stip No. 34, 35 and 38.

[31] RX-002 p. 10.

[32] Div. Br. p. 35.

[33] *Id.* p. 65

investment advisory firm – because those relationships is what gave rise to materiality. Neither relationship exists here. Accordingly, *Bolla* has no application and carries no weight.

The Division also relies upon *Bolla* for its argument that Mr. Winkelman's mention of Binkholder and his radio show in the Offering documents "triggered" an affirmative duty to disclose background information, such as the Missouri bar. Again, *Bolla* is fully distinguishable.

In *Bolla* (which did not involve an offering of securities), the Court considered whether Mr. Bolla's firm acted properly when, instead of informing the investment advisory clients that their investment adviser and controlling member of the firm had just been barred, it made up excuses and told clients that Bolla was "out of the office," had "left" the firm or was "working in California." Considering the outright lies told by the firm, *Bolla* does not mince words, clearly explaining that once the firm endeavored to explain his absence, it triggered a duty to disclose it truthfully[34]:

> Accordingly, even if somehow he had no initial duty to inform WIN's clients of Mr. Bolla's bar despite the fact that he was connected with WIN as an investment adviser and they were either his clients or prospective clients, his affirmative representations to certain clients triggered such a duty. Given this fact, the Court concludes that the SEC has established that Mr. Radano had a duty to inform his clients or prospective clients of Mr. Bolla's bar in a truthful and accurate manner.

As already discussed above, Mr. Bolla's relationship to the firm and its clients starkly contrasts with those presented in this case relating to Binkholder. The only disclosures in the Offering Memoranda regarding Binkholder were in regard to his Radio Show. Specifically, the Offering documents simply describe the *Financial Coach Show*, its message, its air time, the station is plays on and the approximate listeners. There is no biography, no resume, and no statement of affirmative background facts that are made false or inaccurate by the Order.

[34] 401 F. Supp. 2d. 43 at 68.

Binkholder is not held out as an investment advisor or principal of Blue Ocean, nor did he act in those capacities during the Offerings. The Division was unable to point to a single sentence of the Offering documents that is made "false or misleading" by virtue of the imposition of the bar, triggering an obligation to disclose.

Accordingly, the Initial Decision's findings and conclusions should be upheld and affirmed.[35]

B. "Alignment" of Interest

The Division next argues that Mr. Winkelmann made "false and misleading" statements when he represented that the Firm's interests were "aligned" with those of his investors. That issue has been addressed, fully, in Respondents' Brief in Support and no response is required here.[36]

C. Alleged Misrepresentations Relating to the Success of the Offerings

The Division also contests the "erroneous failure to conclude" that certain emails Mr. Winkelmann sent "misrepresented" the amount of money the Firm had raised, although it does not appeal any specific factual finding or conclusion of law it contends is erroneous.[37] Nevertheless, the Initial Decision's rejection of this allegation should be affirmed.

First, none of the authorities the Division cites supports a finding of liability against Respondents for the representations at issue. In *Bennett Group Fin. Servs.*, the respondents made a long list of public statements (on TV, in print, and on the radio) that overstated their AUM by

[35] It is worth noting that despite the egregious nature of the conduct in *Bolla*, the total sanction imposed on both respondents was an injunction against future violations and a $65,000 fine.

[36] Respondents' Brief in Support of Petition for Review dated June 7, 2017. *See*, pages 21-25.

[37] To the extent these emails relate to discussions of advertising factors, that issue is addressed in Section II.D, below.

as much as $1.1 *billion.*[38] The finding of liability rested, almost entirely, on the size of the misrepresentation and the importance of the metric (AUM)[39]:

> [Division's expert] stated that $1 billion in AUM is an important threshold for investment advisers as fewer than ten percent of advisers reach that level. Also, AUM is widely disseminated in the financial industry by investment managers and financial publications.

There are no similar factors present here. Unlike the wide, public dissemination of the billion-dollar overstatement at issue in *Bennett,* the allegations here relate to only six statements, contained in emails, and sent within days of one another.[40] Further, unlike the respondents in the cases cited by the Division, who knew their AUM representations were *wildly* incorrect (many admitted it), Mr. Winkelmann believed each of the statements regarding the capital raised to date to be true when he made them, based on the commitments he had received, and that he "had

[38] *In the Matter of Bennett Group Fin. Services, LLC, & Dawn J. Bennett*, Release No. 1033 (S.E.C. Release No. July 11, 2016), *review granted*, Release No. 4491 (S.E.C. Release No. Aug. 22, 2016). The Division cites to the Commission's opinion which does not address the factual or legal findings in the Initial Decision, and considers only the Constitutional arguments asserted. In determining relevant precedent, however, it is important not only how the tribunal held, by why it held as it did. Thus, the Initial Decision in *Bennett* is more illuminating, albeit easily distinguishable.

[39] Several of the cases cited by the Division simply note that AUM is almost universally considered material, given its importance in determining the performance of a company. *S.E.C. v. Nadel*, 97 F. Supp. 3d 117, 123 (E.D.N.Y. 2015) ("any investor would consider the accurate amount of assets under management to be a material fact to consider before investing...because any reasonable investor would need accurate disclosure about assets under management to correctly evaluate an asset manager's performance.").

Other cases involve intentionally changing numbers to make performance appear better than it was: *S.E.C. v. Haligiannis*, 470 F. Supp. 2d 373, 381 (S.D.N.Y. 2007) ("Haligiannis' scienter was demonstrated at his plea allocution, when he admitted to knowingly sending statements to investors that artificially inflated the value of their accounts from May 2000 through July 2004 in order to avoid requests for capital distributions and solicit additional contributions"); *S.E.C. v. Seaboard Inv. Advisers,* Adivsers Act Release 1918, 2001 SEC LEXIS 2780 *13-19 (January 10, 2001) ("We conclude that the Respondents' conduct was egregious. Respondents overstated the performance of client portfolios by making inaccurate and false comparisons to market indices. These misstatements were designed to encourage Seaboard's clients to maintain their accounts at Seaboard at a time when Seaboard was losing customers. Bruce DiPietro, Seaboard's research director, testified before the law judge that Hansen had told DiPietro that Hansen had sent the misleading letters to 'help Seaboard.'").

[40] Initially, the Division identified 12 misstatements made in correspondence; it has since abandoned half of them which related to communications regarding the advertising factors. Three of the six communications were sent on the same day.

every reason to believe" were firm.[41] These statements were not false or misleading because Mr. Winkelmann believed them to be true and accurate and based on the commitments he had received at the time.[42]

Moreover, for each of the emails sent immediately prior to or contemporaneous with an offering – even assuming the statements were misrepresentations (which they are not) – the distribution of the Offering Memoranda, with their accurate information, provided the investors with information needed to make the prior statement not misleading.[43] The subscription agreement each investor completed and signed required the following statement to be affirmed as true[44]:

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

Thus, only representations contained in the Offering Memorandum and not in any other source were potentially actionable.

Accordingly, for the reasons set forth herein, the Commission should affirm the Initial Decision's rejection of this allegation.

D. The Advertising Ratios

1. Facts Relating to the Advertising Ratios

a. The Firm's Advertising Campaign, Meticulous Advertising-Tracking system, and calculation of the ratios

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

[42] With regard to Paragraph 12, Mr. Winkelmann denied the statement. Tr. 1364:16-25.

[43] RX-001– RX-004.

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

In June 2010, Blue Ocean began its aggressive advertising campaign aimed at expanding and its audience and, ultimately, increasing its assets under management ("AUM").[45] In launching that advertising campaign, the Firm's objective was to spend its advertising dollars as carefully and effectively as possible.[46] To do this, the Firm tracked the efficiency of each of the various advertising venues it was utilizing to determine which was yielding the best return on advertising dollars spent.[47] This tracking system would evolve significantly over the coming years, becoming more and more detailed and elaborate.[48]

In early 2011, Mr. Winkelmann began contemplating a capital raise to fund the campaign. After many discussions with his attorney, Michael Morgan,[49] Mr. Winkelmann and Mr. Morgan settled on a Royalty Unit structure.[50] The success of the campaign depended on the Firm's success in using advertising to recruit new advisory clients.[51] The more new advisory assets were acquired, the more fees (i.e., revenue) the Firm would bring in and the higher the payments to investors would be.[52]

[45] RX-006; Tr. 1465:25-1466:9 (Winkelmann).

[46] Tr. 1298:13-1299:9 (Winkelmann); Tr. 861: 12-23 (Juris).

[47] *Id. See also,* RX-006.

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

[49] Tr. 1246:10-1248:8; Tr. 1249:11-1250:16. At all times relevant, Mr. Morgan was a partner at the Greensfelder law firm ("Greensfelder"). Mr. Morgan and Greensfelder are discussed in much greater detail, *infra*, in connection with the argument that Respondents reasonably relied upon legal advice they received from Mr. Morgan and Greensfelder. FOF 52, 53, 54.

[50] Tr. 1249:11-1250:16; Tr. 1246:10-1248:8 (Winkelmann). The structure of the offerings is addressed in Respondents' Brief in Support of Petition for Review, pp. 2-8.

[51] RX-001 p. 9.

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

b. Advertising Factor in the Round 1 Offering Memorandum

Beginning in February 2011,[53] Mr. Winkelmann and Mr. Morgan began exchanging drafts of the Round 1 Offering documents that would be provided to potential investors.[54] The final Offering Memorandum for Round 1 was dated March 31, 2011.[55] It included a detailed overview of the Firm's sales and marketing plan, which was designed to attract new leads, new advisory clients, and, ultimately, increase the Firm's revenue.[56] The Offering Memorandum also included a list of the Firm's "business drivers," and identified both as "a key business driver" and "the key business driver" for Blue Ocean was its "client acquisition cost," i.e., how much money needed to be spent in advertising actually to bring in new clients. Blue Ocean included in the Offering Memorandum an overview of how its current advertising spending was translating into new revenue at the time of the Offering, and how it speculated that trend would fare going forward.[57]

The language the Division contends is a material misrepresentation with regard to Round 1 appears on page 9 of the 116-page Offering Memorandum:[58]

> A key business driver for Blue Ocean Portfolios is the client acquisition cost. Currently Blue Ocean Portfolios is spending approximately $5,500 per month on advertising that generates leads for the sales staff to follow up on. This $5,500 advertising spend is currently converting into approximately $2.5 million in new assets that are generating $25,000 in new annually recurring revenue. So, if this trend continues, each $10,000 in new recurring revenue will cost Blue Ocean Portfolios $2,200 in advertising – a 22/100 ratio. No assurance can be given that business will continue to experience growth at this conversion ratio of 22/100.

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

[54] FOF 51-54.

[55] RX-001, p. 1.

[56] RX-001, p. 8.

[57] RX-001 p. 9.

[58] RX-001, p. 9. This language corresponds to paragraph 7 of the OIP.

The Division alleged in the OIP that the 22/100 advertising factor was misleading because "in reality," the Firm's advertising conversion ratio was 45/100.[59] At hearing, the Division failed to prove the "real" advertising factors alleged in the OIP, due to wildly inaccurate computations by its in-house accountant, Mr. Collins.[60] Given the problems with Mr. Collins' computations, and the Division's total inability to prove the "real" factors set forth in the OIP to be accurate, Mr. Collins' calculations have been entirely abandoned by the Division (except for one, addressed below).

Faced with a dearth of evidence to support the allegations contained in the OIP, the Division bases it appeal on a new theory of liability: that the Round 1 Offering Memorandum was misleading because (1) it failed to disclose the "methodology" by which the advertising factors were computed; and (2) there was no evidence presented as to how the Firm reached its calculation. Putting aside – momentarily – the question whether it is proper for the Division to change the theory of its case so utterly at this juncture, it remains that both arguments fail.[61]

As to part 1 of its new argument, the Firm did disclose its methodology. The paragraph at issue, quoted above, states that the Firm "is currently converting" $5,500 per month on advertising into $2.5 million in new assets, generating $25,000 in new annually recurring revenue.[62] $25,000 in revenue divided by $5,500 in advertising cost equates to 0.22 – the number disclosed.

As to part 2 of its argument – the lack of evidence as to how the factor was calculated – the Firm's calculation of a 0.22 advertising factor is fully supported by the evidence. In January

[59] OIP ¶ 7.

[60] Initial Decision pp. 51-52.

[61] The Division's attempt to raise a different misrepresentation on appeal – far outside of those articulated in the OIP – is addressed in Section II.D.3, below.

[62] $25,000 in revenue on $2.5 million in new assets reflects a 1% management fee.

2011, the Firm received new assets under management totaling $1,351,432.[63] At that time, all of the Firm's revenue estimates assumed that clients paid an annual advisory fee of 1.0% of their assets under management.[64] Applying that assumption here, 1.0% of $1,351,432 is $13,514.[65] The Firm's advertising spending for January 2011 came to $3,024.[66]

When the advertising spend ($3,024) is divided by the estimated annual recurring revenue ($13,514),[67] the quotient is 0.22 - the exact number that appears in the Offering Memorandum. The above figures would have been available to the Firm in February 2011, as it prepared the Round 1 Memorandum. This, without more, supports the calculations.

Ms. Juris, who joined the Firm shortly after this offering, who was familiar with how its records were maintained, and who understood how the advertising factors were calculated, confirmed the calculations on the stand, verifying that the calculations – and the representations in the Round 1 Offering Memorandum – were correct.

The Division, in its brief, launches a preemptive attack on Ms. Juris' testimony, stating that "Mr. Winkelmann was the only witness who worked at BOP when it issued [the Round 1] Memorandum; Juris had not yet started there."[68] This is true. But, as stated above, Ms. Juris testified confidently that she was familiar enough with the Firm's books and its advertising

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

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

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

[66] Discussing DX-159 but correcting the errors in its underlying mathematical assumptions.

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

[68] Div. Br. p. 26.

calculation metrics that she could verify the January 2011 computation[69] and that those numbers would have been available to Mr. Winkelmann in early March 2011, when the Round 1 Offering Memorandum was prepared.

Therefore, with regard to the advertising conversion factor set forth in the Round 1 Offering Memorandum, the Commission should uphold the Initial Decision's finding that there was no material misrepresentation.

c. Advertising Factor in the Round 2 Offering Memorandum

The Round 2 allegation is nearly identical to that of Round 1, except for the specific advertising figured. The Round 2 Offering Memorandum, dated March 15, 2012,[70] stated "each $10,000 in new recurring revenue is currently costing [Blue Ocean] $6,200 in advertising – a 62/100 ratio or an 'advertising conversion factor' of 0.62." As with Round 1, the Division initially alleged that "[i]n reality the current advertising conversion factor was 1.11, not 0.62"[71] but has subsequently abandoned that allegation for lack of evidence.[72]

By the time the Firm was preparing the Round 2 Offering in March 2012, it had recently (January 2012) implemented the use of monthly advertising reports to track the advertising data (amount spent, clients acquired, assets acquired and projected new revenue).[73] The data in the monthly advertising reports were pulled from the Firm's master advertising spreadsheet, discussed above. The reports were generated in the first week after the month ended.[74] So, for example, the January 2012 report would have been available after the first week of February

[69] Tr. 923:23-926:22.

[70] RX-002.

[71] OIP ¶8.

[72] *See* Section II.D.3.

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

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

2012.[75] It was Ms. Juris' responsibility to generate the report from the Firm's master spreadsheet for use in the monthly management meeting.[76] After each monthly meeting, that report was placed in a binder and preserved.[77]

While the advertising data were pulled and preserved when used in monthly management meetings, they were also always available to Firm employees in real time by accessing the data on the computer.[78] Thus, just because a report did not happen to be printed and preserved on a particular date and time, that does not mean the information was not readily available.[79] Because the monthly advertising reports *were* printed off and maintained, however, they are contemporaneous evidence reflecting the Firm's calculations at a particular time.

Round 2 was issued March 10, 2012.[80] At that time, the most current monthly management report would have been the February report.[81] According to the February 2012 report, the Firm's current advertising costs were $14,804 and its estimated first year revenues were $22,000.[82] To calculate the advertising factor, the costs ($14,804) are divided by the new revenue ($22,000), which equals 0.67[83]:

[75] *Id.*

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

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

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

[79] *Id.*

[80] RX-002, p1.

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

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

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

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

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

The Round 2 Offering Memorandum, offered shortly after this report was prepared, stated disclosed revenues of $22,000, advertising costs of $15,000, and a conversion factor of 0.62.

While the numbers shown on the chart printed and utilized during the March management meeting are not identical to those in the Offering Document, they are (1) extremely close and (2) corroborated by the surrounding monthly reports.[84] That is, the charts that the Firm preserved in hard copy, and that were exhibitized at hearing, were only those utilized in the

[84] The Initial Decision properly found it reasonable that Mr. Winkelmann would have had access to the most up do date data at the time the offering memoranda were prepared, even if identical data did not appear in the printed reports. The Initial Decision concluded: "this is not a case of Winkelmann making up numbers, but instead one of Winkelmann choosing to report a ratio that was both favorable to BOP and supported by the data compilation continuously updated by Juris" Initial Decision p. 50.

monthly meetings. Changes to the spreadsheet after printing – updating either advertising cost or revenue received – would change the numbers.[85]

The February advertising factor of 0.67 is just above the factor included in the Offering Memorandum (0.62). By the time the March report was generated in April 2012 (after the second offering), the factor had dropped to 0.35. The downward trajectory of the factor, between February and March, is in line with the disclosed 0.62 in the middle of March 2012. Stated differently, the Firm's internal documents corroborate – instead of undermine – the accuracy of the disclosures at issue.

Therefore, with regard to the advertising conversion factor set forth in the Round 2 Offering Memorandum, the Commission should uphold the Initial Decision's finding that there was no material misrepresentation.

d. Advertising Factor in the Round 3 Offering Memorandum

With regard to the Round 3 Offering Memorandum (issued September 1, 2012), the OIP alleged that Blue Ocean misrepresented the advertising conversion rate when it disclosed an 'advertising conversion factor' of 0.67."[86] The OIP alleged that "[i]n reality the current advertising conversion factor was 1.03, not 0.67."[87] As above, the Division has since abandoned its claim that "in reality" the factor should have been 1.03.[88] Instead, it focuses on its revised theory of liability – failures in the methodology.[89]

[85] The March 2012 report (RX-37) shows an advertising factor for March of 0.35, which indicates that between February 2012 and March 2012, the advertising factor was decreasing.

[86] RX-002.

[87] OIP ¶9.

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

[89] Div. Br. p.28.

Also similar to the above, the Firm's documents reflect and support the calculations that were made. When the Firm prepared the documents for the Round 3 Offering Memorandum in August 2012, the most recent monthly report would have been the July 2012 report.[90] The format and substance of the July report had evolved since the last Royalty Unit offering in March 2012.[91] One of those changes was the addition of a computation of a six-month trailing factor.[92] The Firm found that the six-month trailing factor was a better representation of the data, since it considered an extended period of time, instead of looking at just one month.[93] The July 2012 monthly advertising report computed a trailing six-month average advertising factor of 0.71[94]:

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

While the calculations contained in the July 2012 month-end report are not identical to those reflected in the Round 3 Offering (because they were created for the monthly meeting, not for the creation of the Offering Memorandum), the factor Blue Ocean calculated is only a few hundredths of a point from the number in the document. This report constitutes contemporaneous evidence reflecting the Firm's calculations around the time of the Round 3 offering.

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

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

[92] Tr. 903:3-19 (Ms. Juris explains the evolution of the chart to capture different look back periods).

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

[94] RX-054, p. 63.

Therefore, with regard to the advertising conversion factor set forth in the Round 3 Offering Memorandum, the Commission should uphold the Initial Decision's finding that there was no material misrepresentation.

e. Advertising Factor in the Round 4 Offering Memorandum[95]

For the Round 4 Offering, the Division challenges the disclosed advertising conversion factor of 0.89."[96] The OIP alleged that the "actual" conversion rate for 2012 was 1.02.[97] As above, the Division failed to introduce any evidence and has abandoned that allegation.

Also similar to the prior rounds, Respondents presented ample evidence of the accuracy of the factors provided. Round 4 was offered on February 15, 2013.[98] As of the time the Offering Memorandum was prepared, in early February/late January 2013, the Firm's data showed that the advertising conversion factor for 2012 was 0.89.

While it is not possible to view the Firm's master spreadsheet as of the precise date the Round 4 Offering Memorandum was created, as was the case with the prior Offerings, the surrounding, preserved, monthly reports can be used corroborate the numbers that would have

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[95] The Division also pursues its allegation that the Round 4 factor is misleading *per se* because it omits the data attributed to the newly opened Chicago Office. This allegation was not raised in the OIP. Nevertheless, it can be summarily rejected in light of the express language of the Round 4 Offering memoranda (RX-004 p. 11):

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

Beyond this, the evidence showed that the office had only just opened and had little data to contribute, thus, Mr. Winkelmann did not believe that the Chicago data would have been useful, meaningful information that investors could use to evaluate the advertising program. Tr. 1310:8–1314:15. Mr. Palubiak confirmed that industry practice supported Mr. Winkelmann's approach "allowing for sufficient time and experience to elapse" Tr. 1196:1-1197:23. For these reasons, the Initial Decision easily rejected the Division's allegation with regard to the Round 4 Offering Memoranda. (Initial Decision p. 50). There is no error in fact or law that would justify disturbing that finding on appeal.

[96] RX-4, p. 4.

[97] OIP ¶10.

[98] RX-004, p. 1.

been available at the time. In late January/early February 2013, when the Round 4 Offering Memorandum was in preparation, the Firm had access to the December monthly advertising report.[99] That report calculated the 12-month trailing advertising factor (i.e., the factor for calendar year 2012) to be 0.89 – the exact number that appears in the Round 4 Offering Memorandum[100]:

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

Therefore, with regard to the 2012 advertising conversion factor set forth in the Round 4 Offering document, the number is accurate. Moreover, the Division's arguments that there was a change in methodology – using a 12 month look back period instead of a shorter time period – is misleading and fails.

i. The 2011 Advertising Factor

The final alleged misrepresentation relating to advertising factors applies to both Rounds 2 and 3 and asserts that the Offering Memorandum recites that the "advertising factor for 2011 was 0.78" when "in reality" the advertising factor for 2011 was 1.28. Unlike each of the above representations, the Division has maintained its reliance on Mr. Collins, and his calculation of the "real" factor of 1.28.

The Division is correct that Mr. Winkelmann was unable to recall where the 2011 factor came from, specifically, but testified that:[101]

> We pulled it off from the data available at that point. And the data available at that point had the culmination of all the spend and the

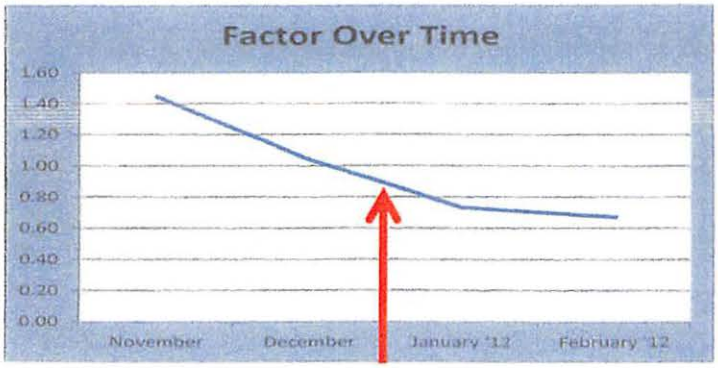
[99] RX-120.

[100] *Id.*

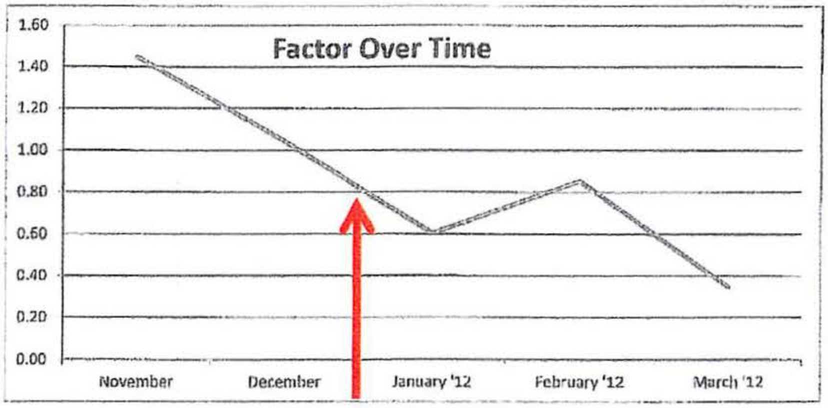
[101] Tr. 462:14-19; Tr. 465:3-7.

results.... We pulled that number, the current number off when the offering memos were issued, whatever the best number was at that point in time, the best number, the only number we had at that point in time.

What is known is that the figure provided corresponds, once again, to the Firm's internal reports. As the monthly management reports evolved, they added a graph that tracked the advertising factor over time. In the February 2012 monthly advertising report (which would have been used to prepare the Round 2 Memorandum) the graph appeared as follows:[102]



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



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

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

In addition, the data provided in the Offering Memorandum support the calculation. The quotation above states that in 2011, the Firm invested "approximately $328,000" in advertising, which resulted in recurring annual revenues of 404,000.[103] To double-check the factor computation, one would only need to divide the stated advertising spend ($328,000) by the stated annual recurring revenue ($404,000") to calculate an advertising factor for 2011 of 0.81. This computation (which is based only on the "approximated" advertising costs) is within two decimal points of the calculation contained in the OIP. Notably, the Division's own staff accountant testified, under oath, that a single decimal point difference was not material.[104]

f. Mr. Collins' Inaccurate Calculations

With regard to the 2011 data, the Division continues to rely on Mr. Collins' computations, none of which was amended or updated in response to Ms. Juris' testimony, which identified several inaccurate assumptions underlying his work. While the Division has largely dropped Mr. Collins' calculations in this appeal – and rightly so – the evidence showed that Mr. Collins based his calculation of the advertising factors on data that used (1) the wrong management fee multiplier; and (2) the wrong underlying data.

Both of his errors resulted from his reliance on data that were current and updated as of June 2012, when the spreadsheet he relied upon was printed and, later, tendered to the SEC as part of the examination (DX-159). In reviewing DX-159, which was created in June 2012 but shows advertising spends and revenue earnings going back to January 2011, Mr. Collins (wrongly) assumed that the 2011 data and January - May 2012 data contained in the document he relied upon was the same data the Firm had before it *real time* in each month from January 2011 to May 2012. This assumption was costly, since it proved incorrect.

[103] RX-002, p. 5.

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

While Mr. Collins made several errors in relying on DX-159 to retroactively attempt to compute 18 months of advertising actors, relevant here is the fact that DX-159 had a built-in assumption of a 1% management fee. From January 2011 through May 2012, however, the Firm previously assumed a 0.77% fee. By June 2012, the spreadsheet had been updated to reflect this assumption and, as spreadsheets do, also updated its calculations that involved that fee, utilizing that 1% fee – applying that assumption backwards into 2011 and early 2012.

Relevant here, it updated the projected annual revenues the Firm would earn, impacting the calculation of the advertising factor (which is advertising spend divided by projected annual revenue). Thus, the data Mr. Collins was looking at for January 2011 through May 2012 looked nothing like the data the Firm actually had to work with, in real-time, during that same period. As a result, the factors that Mr. Collins calculated for the Division were inaccurate and failed to reflect the data the Firm possessed at the relevant time period.

While the Division has abandoned Mr. Collins' calculations with regard to the vast majority of the advertising ratios initially alleged to be fraudulent, it continues to rely on him for a single calculation – the 2011 advertising factor.[105] It also continues to rely on DX-159 and Mr. Collins' summary exhibit created therefrom (DX-441). Yet, the Division has failed to correct either the incorrect assumptions underlying Mr. Collins' analysis or the resultant errors in his computations. This is true despite the ALJ's generous offer to allow the Division to have Mr. Collins re-do his calculations, in light of Ms. Juris' testimony at the hearing, explaining the errors in his analysis.[106]

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[105] Div. Br. p. 31.

[106] Tr.1079:23-1080:22 (Patil). The Division never took Judge Patil up on this offer, which, to the Respondents, is a tacit admission Mr. Collins' calculations would only confirm Blue Ocean's calculations.

Nevertheless, because the Division's evidence in support of its claim that Respondents made a misrepresentation with regard to the 2011 advertising factor is based on faulty analysis by Mr. Collins, and the data included in the Memoranda for Rounds 2 and 3 is corroborated by the Firm's internal reports, the Initial Decision's findings should be affirmed.

g. Neither the advertising factors nor the methodology constitute material misrepresentations.

Finally, even were the Commission to consider the Division's allegation that the advertising factors were somehow erroneous, despite evidence to the contrary, it should nonetheless uphold the Initial Decision's conclusion that, regardless of the specific computation used or ratio disclosed, "there is no evidence that this evolving internal approach need be relayed to investors."[107] The Initial Decision firmly held that there was no requirement that Blue Ocean disclose its internal approach to tracking efficiency: "the Division's assertion that Winkelmann "switched methodologies" is not an indicia of fraud, but simply Winkelmann's decision to report actual data reflecting success of the business....As Palubiak explains, the desirable industry practice is for businesses to pursue vigorous efforts internally to identify how to improve both its promotional mix and track its ratio. There is no evidence that this evolving internal approach need be relayed to investors."[108]

This conclusion is in line with previous decisions considering materiality. For example, *Ironworkers Local 580--Joint Funds v. Linn Energy, LLC*,[109] the Southern District of New York held that, in the absence of a specific formula for calculating some metric, use of one metric over another does not constitute securities fraud:

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[107] *Id.*

[108] Initial Decision p. 52.

[109] 29 F. Supp. 3d 400, 428 (S.D.N.Y. 2014).

> In the end, Plaintiffs are really arguing that there were better ways for [the Company] to calculate its non-GAAP metrics—... They may well be correct about that. But the federal securities laws do not protect the marketplace from flawed business decisions, which is what choosing to calculate a metric in a particular way is where, as here, there is no settled formula.

See also In re Netflix, Inc. Sec. Litig. C04-2978 FMS, 2005 WL 1562858, at *6 (N.D. Cal. June 28, 2005) (There is, however, no official formula for calculating churn. Plaintiffs...offer no authority for the proposition that their method is proper and Netflix's method is improper.... Given Netflix's disclosure of its method of calculating churn, Netflix's reporting of the churn rates obtained by using this formula cannot be considered to be false.")

Here, as in *Ironworkers* and *Netflix,* there is "no settled formula" for calculating the efficacy of one's advertising program. Nor is there an obligation that a firm "append a disclaimer, explaining why it chose each accounting practice and reciting the effects of all alternative methods."[110]

Further, as in *Ironworks* and *Netflix,* the Offering Memoranda here accurately represented that (1) for the Firm to be successful, new recurring revenue should be greater than advertising spending, (2) the Firm worked constantly to improve adverting efficiency and improve that ratio, and (3) it was successful. Beyond that, its internal analysis and efforts to track its performance on a month to month or annual basis need not be disclosed to investors.[111]

2. The Division Cites Inapplicable Law in Support of its Fraud Claim.

As for authority for its allegation the advertising ratios were material (assuming they were misleading at all), the Division has selected interesting precedent. Unlike the authority

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

[111] *Netflix,* 2005 WL 1562858, at *6; *Kademian.*, 792 F.2d at 626; *Ironworkers,* 29 F. Supp. 3d at 428;

above, which addresses disclosure obligations surrounding internal business calculations in the absence of a settled industry formula, the Division relies primarily on a decision from the Southern District of Texas relating to the 2010 explosion of the Deepwater Horizon offshore drilling rig and the subsequent catastrophic oil spill into the Gulf of Mexico. Specifically, the Division points to the following language from the case[112]:

> If those two estimates are proven to be of equal weight and 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."

The *BP* case, however, has a few extremely important differences that led to the above holding. The greatest difference is the existence of several scientifically recognized and industry-adopted equations for measuring "surface estimation."[113] To paraphrase, BP was presented with two sets of reports containing very different rates of surface estimation.[114] BP disclosed only the lower number in its public communications with shareholders (despite mounting evidence those estimates were extraordinarily low). When the court ruled against BP, and found it mislead investors by "cherry-picking" the lower estimate, it based that finding upon the presence of two scientifically-established estimates "proven to be of equal rate" where the company "merely cherry-picked the more favorable" of the two.

Unlike *BP,* there is no set methodology for calculating an "advertising factor" or "advertising conversion." There are not various accepted, methods with set scientific standards

[112] *In re: BP p.l.c. Sec. Litig.*, 4:10-MD-2185, 2016 WL 3090779, at *15 (S.D. Tex. May 31, 2016).

[113] I.e. the volume of oil contained within a slick based on its surface area and presumed thickness. *Id.* at *2.

[114] *Id.*

the Firm could have chosen from in computing the factor. The Initial Decision's conclusions on this point were unequivocal[115]:

Additionally, unlike *BP,* the evidence in this case showed that the methodology employed was "very conservative"[116] and, if anything, *understated* BOP's ability to convert advertising into revenue.[117] Thus, not only was the methodology for calculating the advertising factors proper, it was designed to be conservative – which is the opposite intent of the executives at issue in *BP*. Moreover, the evidence showed that Mr. Winkelmann did not simply "cherry pick" the more favorable of the two estimates. In fact, it is undisputed that, on several occasions, Mr. Winkelmann selected a lower (i.e., worse) advertising factor because he believed it to be the most accurate.

Thus, even if the Commission overrules the Initial Decision and finds that some misrepresentation did occur, it was not material, and there was no obligation on Respondents to disclose their particular methodology.

3. The Division cannot Assert New Claims on Appeal.

The OIP contains four allegations relating to the advertising factors contained in each of the four Offering Memoranda.[118] Each of those allegations specifically recites the purported misrepresentation in each memoranda:

[115] Initial Decision p. 51. "With respect to the Division's pejorative characterization of Winkelmann's selection of favorable ratios as "cherry pick[ing]," the Division has failed to establish that selecting favorable ratios was inappropriate."

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

[117] RX-125 p. 10. ("[U]nder any analysis, the Firm's calculations were proper. If anything, they erred on the side of caution.")

[118] OIP ¶ 7-10.

- Paragraph 7 alleged that the Round 1 Offering Memorandum that set forth a 22/100 ratio was misleading because "in reality" the ratio was 45/100.

- Paragraph 8 alleged that the Round 2 Offering Memorandum that set forth a 0.62 ratio was misleading because "in reality" the ratio was 1.11.

- Paragraph 9 alleged that the Round 3 Offering Memorandum that set forth a 0.67 ratio was misleading because "in reality" the ratio was 1.03.[119]

- Paragraph 10 alleged that the Round 4 Offering Memorandum that set forth a 0.89 ratio was misleading because "in reality" the ratio was 1.02.

Now, for the first time in this appeal, the Division has changed course and has abandoned each of the above allegations.[120] Having been unable to prove the "in reality" numbers pled, or that the actual numbers used by the Firm were misleading, it now raises a litany of new alleged misrepresentations, none of which was pled in the OIP or raised at trial. This includes:

- The allegation that the Round 2 offering is misleading because it disclosed an optimum efficiency ratio of 0.8 without disclosing that the Round 1 ratio was 0.4.[121]
- The tables included in the memoranda that showed scenarios where investors could be paid more than the minimum percentage payments.[122]
- That the Offering memoranda contained statements reelecting the Firm's hope that it would be able to pay investors more than the minimum payments once profitable.[123]

[119] Paragraphs 8 and 9 also contained an allegation that the 2011 advertising factor of 0.78 was misleading because "in reality" the factor was 1.28.

[120] Aside from the 2011 ratio of 1.28 in paragraphs 8 and 9 which is addressed in Section III.D.1.d (p. 21) above.

[121] Div. Br. p.17. This statement is not material for the same reasons set forth in Section II.D.1.f, above, nor is it misleading. The Division is referring to two separate offerings more than a year apart.

[122] Div. Br. p.18. This is not only immaterial, but the tables *also* showed that the investors could be paid *no* extra payments. E.g. RX-002 p.15. That is, they provided both optimistic and pessimistic potential outcomes, which means the statements are not misleading.

[123] Div. Br. pp. 17, 18, 19-20. The Division has wildly misconstrued these representations. For example, they state that the Firm misleadingly "reinforced" the investors' expectations by expressing the hope that they would be repaid more than the minimum and, thus, repaid more quickly. Yet, the Division ignores language in the same provisions they cite expressly cautioning investors (1) that additional payments are not required; and (2) the rate of return can

The Division's late realization that it could not prove paragraphs 7-10 of the OIP, and its attempt to manufacture new claims should not be allowed. Nor can the Division claim its new list of material misrepresentations are contemplated by some other paragraph of the OIP. In pre-hearing briefing before Judge Foleak, in response to Respondents' motion for a more definite statement, the Division stated the following with regard to the paragraphs at issue[124]:

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

It is those "specific allegations" contained in paragraphs 7-10 – and not some after-conceived theory of liability – that Respondents were called upon to defend. To the extent the Division now attempts to abandon its original pleading and pursue modified claims, it should be estopped from doing so.[125]

E. No Scienter

For the most part, issues surrounding scienter is addressed in Respondents' Brief IV.B.f, including (1) addressing the allegation that the failure to disclose purported conflicts was, at least, reckless; (2) addressing the Initial Decision's finding that Respondents "affirmatively represented" they had "eliminated" conflicts of interest; (3) and responding to the Initial

be impacted by several factors; and (3) there is no assurance any additional payments will be made or any rate of return will be realized. *E.g.* RX-002 p.16-17. The disclosures regarding these additional payments are discussed in the Respondents Brief.

[124] Division's Opposition to Respondents Motion for More Definite Statement. (Emphasis added).

[125] *SEC v. Bauer*, 723 F. 3d 758 (7th Cir. 2013) ("The problem with the SEC's argument is that it never presented the misappropriation theory to the district court. Rather, the Commission argued...an obvious invocation of the classical theory...he SEC, apparently recognizing some merit to [the misappropriation theory], has declined to defend the classical theory on appeal and advances only the misappropriation theory as a basis for sustaining the insider trading claims...It would be fundamentally unfair to limit [defendant's] defense against the misappropriation theory to a few pages of reply briefing in this Court, rather than allow her a full opportunity to develop these arguments before the district court.")

Decision's conclusion that Respondents did not rely on the advice of counsel when they sold Royalty Units to advisory clients. Additionally, other purported indicia of scienter have already been addressed herein, including (1) alleged misrepresentations to investors (Section III.C,); and (2) the advertising factors (Section III.D). Because those issues have been briefed, Respondents will not repeat themselves here.[126] To the extent the Division points to new indicia of scienter, those are addressed herein.

1. The Binkholder Bar as "Notice"

On appeal, the Division has conceived of new, creative, implications of the Missouri Order entered against Binkholder. The relevance of that Order (or lack thereof) is addressed above. Here, Respondents address only the Division's insinuation that Mr. Winkelmann's violation of the Order against Binkholder constituted scienter. The prior sentence is not a typo. The Division has, in fact, alleged that Mr. Winkelmann acted with scienter when he sold Royalty Units to Blue Ocean clients "failing to follow the order's" – the Order against Binkholder – "guidance that selling BOP securities to clients was improper."[127]

While the Division certainly deserves points for originality in its argument in support of a scienter finding, the argument itself does not even warrant consideration. As stated above, the Order against Binkholder relates to his conduct at a prior advisory firm, involving a different offering, and different conflicts of interest. Since that Order did not relate to Binkholder's role as a radio talk-show host (which was his only relevance to the Offerings), it was not material information in this context.[128]

[126] Beginning on page 22 of the document.

[127] Div. Br. p. 41.

[128] *See,* Section III.A. above for a full discussion.

In any event, the Order against Binkholder does not bind Mr. Winkelmann's conduct, nor is it "guidance." For example, the Order does not, as the Division reads it, prohibit the sale of royalty units to clients. Thus, the "bright line prohibition" against the Offering the Division suggests does not exist.

Further, in terms of how the Order could "guide" Mr. Winkelmann, the Division fails to provide any explanation whatsoever. The Order does not disclose what the underlying conflict of interest was or how it arose.[129] There are almost no facts one could use, assuming the Order could serve as "guidance" to anyone to determine the nature of the conflict, the language of the disclosures (if any), or any other similarity of conduct.

At the end of the day, this argument is nothing more than an attempt to prove Mr. Winkelmann's guilt by mere his association with Binkholder – despite the fact that the subject matter at issue in the Missouri Order has nothing to do with Blue Ocean. The Division's alleged evidence of scienter should be summarily rejected.

2. The Purpose of the Offerings

The Division also contends frequently throughout its brief that "Winkelmann needed the royalty unit Offerings to fund his pay increases" and that "BOP's financial distress led Winkelmann" is what caused Mr. Winkelmann to issue the royalty units.[130] There is simply no evidence to support this. Instead, as the Division recognizes, *if* Blue Ocean wanted to undertake its aggressive advertising push, it needed to raise capital.[131] What the Division did not prove (and cannot prove) is that the Offerings were designed and issued for the purpose of increasing Mr. Winkelmann's salary. There is tremendous evidence in the record that establishes the

[129] DX-84.

[130] Div. Br. pp. 7; 9-10; 41.

[131] Div. Br. p. 10.

purpose of the Offerings and the Firm's aggressive, detailed and time-consuming effort to meticulously track its performance.

That evidence includes several facts that directly contradict the Division's compensation-motivated-offering theory. For example, the evidence showed that from January to September 2011, as the first round Offering got going, Mr. Winkelmann took no salary at all.[132] Then, hardly indicative of someone "desperate" to increase his pay, once he did begin drawing compensation, the evidence showed that Mr. Winkelmann earned an average of approximately $123,000 per year in salary.[133]

The fact that Mr. Winkelmann earned a salary for running Blue Ocean is not an indicia of scienter. The Division's argument should be rejected.

3. Mr. Winkelmann's testimony regarding the ratios

The Division also relies on the fact that Mr. Winkelmann struggled to explain the calculations behind the advertising factors. While he understood that those calculations compared the advertising costs against the revenues received, he struggled to recall, with respect to each specific Offering Memorandum, how the specific calculations were performed.

Ms. Juris, whose job it was to maintain and update the Firm's advertising data, compile that data into reports for management meetings, and assist Mr. Winkelman in analyzing the data, was able to explain those computations flawlessly. Due in part to her intelligence and in part to the fact that it was her primary role at Blue Ocean, her testimony as to the sources of the data used and the methods used to analyze it was comprehensive and detailed. Further, as stated

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

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

above, she was able to explain what Mr. Winkelmann could not – how the data was collected and the factors computed.[134]

While he attempted to explain the factors in great detail, on cross examination, Mr. Winkelmann was unable to do so as well as Ms. Juris. Unsurprisingly, Mr. Winkelmann readily conceded that were there any contradiction between his explanation of the calculation of the advertising factor and Ms. Juris' explanation, the Court should look to Ms. Juris.[135]

In any event, Mr. Winkelmann's testimony is not evidence of scienter. Not only did he attempt to explain the factors to the best of his understanding, he regularly directed them to Ms. Juris as the appropriate witness to explain the finer nuances of the mathematics:

> **Q: That's fair. So I think -- were you then the guy that was crunching the numbers at the management meeting?** [136]:
>
> A: No.
>
> Q: Trying to come up with an ad factor?
>
> **A: No. I'm not really -- Jennifer is much better than I am. Jennifer would have – that role would have automatically defaulted to her.**
>
> ***
>
> **Q Okay. So -- this is just a basic question, when you tell investors your advertising factor for 2011 was .79, what is the period of time that you are tracking the expense portion of it? You had mentioned a six month look-back, a 12 month look-back it could be --**[137]
>
> A: I would feel more comfortable having Jennifer elaborate on that. I just -- because I don't want to tell the Court anything wrong.
>
> ***

[134] *See* Section III.D.1 above.

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

[136] Tr. 1297:14-1298:8.

[137] Tr. 467:7-15.

> My colleague, Jennifer, would be the one -- she is the one who wrote the formulas in the spreadsheet that we ended up -- she would take my ideas. I want to say code them into the Excel sheets and say, Jim, what was this for? I'd go, Did you account for that? Well, no. Well, what's this? There would be a dialogue back and forth.[138]

The Division's allegation of scienter, based on Mr. Winkelmann's trial testimony, is contradicted by the evidence, and should likewise be disregarded.

4. The Mahoney Inquiry

Next, the Division points to an email from Mr. Mahoney, a Round 1 investor, asking if and how he could sell his unit. The Division alleges that "when Mr. Mahoney requested that Winkelmann find a buyer for his...fourth round royalty unit," "Winkelmann simply proceeded with the fourth round offering" instead, apparently, of offering Mr. Mahoney's unit to a potential fourth round investor.

Contrary to the Division's position, however, while Mr. Mahoney inquired about the *possibility* of selling his Unit, he never asked Mr. Winkelmann to try to do so.[139] Shortly before the December 2012 email the Division cites, Mr. Mahoney called Mr. Winkelmann and asked him "how he could sell [his units] if he wanted to dispose of them."[140] Mr. Winkelmann responded to Mr. Mahoney, in the December 2012 email, discussing the performance of the company and then, with regard to a potential sale of the units, stated[141]:

> I want to emphasize that there is no market for the royalty units that you purchased in your IRA. However, if you would like I would attempt to find a buyer for your existing units – of course there would be no guarantee that I could find a buyer or that the terms would be favorable to you.

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[138] Tr. 464:18-24.

[139] DX-210 p. 2.

[140] Tr. 719:6-11. (Winkelmann).

[141] DX-210 p. 3.

Mr. Mahoney never responded to Mr. Winkelmann's offer to "attempt to find a buyer" and, without a direction from Mr. Mahoney to try to find a buyer, Mr. Winkelmann had nothing to sell (and no authority to sell it).[142]

In sum, this purported indicia of scienter is unsupported by the evidence. There is nothing in the record that even *suggests* that Mr. Mahoney followed up on his inquiry or took Mr. Winkelmann up on his offer to find a buyer. Without evidentiary support, the assertion should be rejected by the Commission, as it was by the ALJ.

Finally, if anything, this exchange between Mr. Winkelmann and Mr. Mahoney evidences a *lack* of scienter by Mr. Winkelmann who, despite warning Mr. Mahoney that no market existed for his units,[143] nonetheless offered to help him try and sell it, if that was what Mr. Mahoney wanted to do.

F. Respondents Established Reliance on Counsel.

The Division's Cross-Petition to Appeal to the SEC does not include scienter amongst the list of the Division's issues on appeal and it is unclear from its Brief what finding(s) by the ALJ its scienter argument applies to.[144] Further confounding the analysis is the fact that the Initial Decision found in the Division's favor on this point and Respondents have already addressed in their Brief in Support. Nevertheless, Respondents have addressed each of the indicia referenced in their brief, above. [145]

[142] Tr. 721:6-11; Tr. 722:10-17; Tr. 723:17-725:2 (Winkelmann).

[143] And despite a clear warrant in the Subscription Agreement, which Mr. Mahoney executed when he purchased the units, that Mr. Mahoney understood he was purchasing the units aware that there was a "lack of any market existing or to exist" for the Royalty Units. RX-001 p. 95-96 (paragraph e).

[144] Div. Br. p. 41-44.

[145] Except with regard to the finding of "extreme recklessness" in connection with the purportedly undisclosed conflict of interest. That issue was addressed in Respondents' Brief in Support beginning on page 22.

Beyond that, however, even had the Division succeeded in establishing an indicia of scienter, Respondents rebutted that assertion by showing their good faith reliance on counsel.[146] It is hard to find in the Division's brief, but it does raise four items on which, it contends, no reliance defense was asserted: (1) the allegedly requisite disclosure of Binkholder's bar; (2) fiduciary duties and conflicts of interest; (3) the advertising ratios; and (4) the contents of the client emails (Section III.C, above).[147]

With regard to points 3 and 4, the advertising ratios and the content of the client communications, Respondents never raised a reliance on counsel defense to those claims and, as a result, no response to the Division's assertions is required. The other two points are addressed below.

1. Conflicts of Interest

With regard to non-advisory clients investors,[148] the Initial Decision properly found that Mr. Winkelmann relied upon the advice of his counsel as to the propriety of the disclosures contained therein when he prepared and distributed the memoranda to potential investors.

The parties disagree on whether or not Mr. Winkelmann told Mr. Morgan that he planned to sell royalty units to clients. Thus, the parties disagree on whether or not the Offering documents reflected Greensfelder's legal opinion that disclosures and language of the Offering Memoranda were sufficient for use in sales to advisory clients, and that they comported with the securities laws and Mr. Winkelmann's fiduciary obligation to those clients.

[146] Respondents' Opening brief addresses Respondents' good faith reliance on his counsel with regard to the sales of royalty units to advisory clients and the disclosures in the offering memoranda relating to conflicts. In this submission, Respondents focus only on additional reliance issues raised by the Division.

[147] Div Br. p. 44-45.

[148] While the Division's brief is not explicit, Respondents understand their arguments to relate to non-advisory client investors only. This conforms to the issues listed in their Cross Petition for Appeal (point 2). To the extent the brief is meant to apply also to advisory clients investors , that topic was addressed fully in Respondents' Brief in Support.

With regard to non-advisory investors, however, there is no similar factual dispute. It is undisputed that Mr. Winkelmann hired Greensfelder to provide legal advice in connection with the four Offerings because the parties have stipulated[149]:

> 51. In anticipation of the royalty unit offerings, Winkelmann engaged the St. Louis, Missouri law firm of Greensfelder Hemker & Gale, P.C. ("Greensfelder"), specifically, Michael Morgan, to assist with those offerings. Mr. Morgan was an experienced attorney who specialized in securities law and regulatory compliance.
>
> 52. In addition, Winkelmann also engaged Greensfelder to provide compliance advice to BOP in connection with certain of its day-to-day operations. That included advice regarding the content of certain of BOP's Forms ADV.
>
> 53. Winkelmann authored the initial drafts of the royalty unit offering memoranda, which he sent to Greensfelder for it to review and edit. Greensfelder, in fact, reviewed and edited certain drafts of the offering memoranda before they were finalized and distributed to investors.

Further, because there is no factual issue as to whether Greensfelder was aware that the four offerings would be presented to non-clients (i.e., the public), there can be no doubt that they were aware this was the intent.

Instead, the Division claims that Mr. Winkelmann cannot rely on the advice that Greensfelder provided to him because he "failed to make full disclosure" to Greensfelder regarding the underlying facts of the offering. In furtherance of this argument, the Division relies primarily on two arguments: (1) that Mr. Winkelman failed to tell Greensfelder that "he would keep investor payments at minimum levels while steadily increasing his own compensation" and (2) that Mr. Winkelmann could not rely on Greensfelder's review of the memoranda unless he "asked them for or received advice" on aa specific issue in that

[149] FOF 51-53.

memoranda. The first argument lacks any factual support. The second misrepresents the relevant case law.

a. Disclosure of Compensation

To even get to the following analysis, the Commission must find that Mr. Winkelmann's compensation created a conflict of interest between him and investors who were *not* advisory clients. The duty to disclose this conflict flows from the existence of an investment advisory relationship, which is fiduciary in nature.

In presenting the Offering to non-advisory client investors, however, Mr. Winkelmann and Blue Ocean were not acting as investment advisors, soliciting new investment advisory clients, making recommendations or giving investment advice – they were offering securities as part of a capital raise.[150] Outside of the investment adviser/client relationship, there does not exist a similar obligation to disclose conflicts of interest.

Thus, even accepting *arguendo* the Division's position that Mr. Winkelmann failed to tell Greensfelder that he intended to draw his compensation from Blue Ocean (as its CEO), that fact was not "necessary" for Greensfelder to provide legal advice as to whether or not the disclosures in the Offering Memoranda complied with the federal securities laws. Thus, his "failure" to advise Greensfelder of that fact has no bearing on the affirmative defense (requiring a complete disclosure of facts necessary to render legal advice).

Separate and apart from the above, the evidence fully revealed the extent of Greensfelder's involvement in the preparation of the Offering documents. Not only did the Division stipulate to that involvement, but the record is filled with redlined drafts exchanged

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

between Mr. Winkelmann and Mr. Morgan,[151] emails discussing specific provisions or sections,[152] and other preparatory chatter.[153] The extent of the communications back and forth between the attorney and client demonstrates the communication of information as well as solicitation and receipt of advice. As for reliance, while that is also evident from the written communications, Mr. Winkelmann's unrebutted testimony confirms the same.[154]

b. The Division's Case Law Supports the Initial Decision's reasoning.

The Division points to several cases in support of its request to overturn the ALJ's finding that Respondents relied upon the advice of counsel in connection with offerings to non-client investors.

First, they cite to *Snyder,* which denied a motion for judgment as a matter of law based, in part, on the reliance defense. This case should not be relied upon, in any event, because the Federal Rules required the Court to draw all inferences in the favor of the non-moving party and, with respect to the reliance on counsel defense, caused it to conclude that the plaintiff's "contradictory evidence may have led a reasonable jury to question Defendant's reliance."[155] Beyond that, however, the Court did not, as the Division represents, "reject" the argument. It simply held it was not a proper ground for dismissing the case as a matter of law. Further, in denying the motion, the Court made sure to note[156]:

> As Defendant points out, however, even if he cannot be said to have relied upon Arthur Andersen's review, the fact that required

[151] RX-106 pp. 30-47; 110-129; 137-150; 224-231; 255-257; 321-337; 357-373; 377-392; 399-401; 440-459; 472-483; 495-642; 844-1040; 1214-1268; 1360-1383; 1553-1575.

[152] RX-106 pp. 5-14; 85; 108; 295; 357; 1211.

[153] RX-106 pp. 427-428; 62-64; 66-67; 72-75.

[154] Tr. 1251:5-23; Tr. 1326:3-23; 1344-1345; Tr. 1347:4-1348:18; Tr. 1356:5-22; (Winkelmann).

[155] *S.E.C. v. Snyder*, CIVA H-03-04658, 2006 WL 1806164, at *8 (S.D. Tex. June 29, 2006)

[156] *Id.*

> disclosures were not obvious to the Arthur Andersen accountants tends to negate a finding that Defendant acted with severe recklessness-that his actions constituted such an extreme departure from the standards of ordinary care that the danger of misleading buyers or sellers was so obvious that Defendant must have been aware of it.

That is, even if the reliance defense could not be established, the *obscurity* of the disclosure issue – and the fact that Arthur Anderson missed it – could be sufficient to negate a finding of recklessness. If there is any import to this decision, it is the Court's reasoning, not its "rejection." Like *Snyder,* this case involves disclosure issues that, apparently, were not evident even to the most sophisticated of securities attorneys. Thus, even were the Commission to find that Mr. Winkelmann failed to prove the elements of reliance, under the authority cited by the Division, he has nonetheless demonstrated that he did not act recklessly. Thus, under this decision, not only is a finding of scienter negated, the Initial Decision's finding of recklessness (with regard to offerings to advisory clients) should be reversed.

Second, the Division points to *Dembski,*[157] which held that the respondents had failed to establish a reliance on counsel defense "even where attorneys reviewed the entire PPM" because the client "never asked for or received advice about the PPM section at issue."[158] The Division argues that Mr. Winkelmann "simply provided Greensfelder with an entire memorandum and asked for Greensfelder's review" and that, under *Dembski,* that was insufficient.

The *Dembski,* ruling, however, is more complicated than the Division lets on. Far from establishing a bright line rule that transmission of a PPM is insufficient, *Dembski* held that the defense failed for a multitude of reasons. First, the misleading information in the PPMs alleged in that case was not – as it is here – related to the sufficiency of legal disclosure language under

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[157] *In the Matter of Timothy S. Dembski,* Release No. 4671 (S.E.C. Release No. Mar. 24, 2017)

[158] Div. Br. p. 46.

the securities laws. Instead, the respondents in that case had made up their personal biography that was attached to the document. They admitted at trial that the bio was "highly misleading" and that they had never accomplished most of the items listed in the bio.[159] Moreover, attorneys at issue appeared and testified that the biography was transmitted to them with the representation that they were factually accurate and needed only to be reviewed for obvious "puffery."[160] Thus, they were asked to "advise" on whether or not the respondents' professional history was factually accurate. Essentially, the respondents in *Dembski* created a fake resume, lied to their counsel telling them it was true, and failed to correct it in subsequent drafts counsel provided; they lied to their attorneys and then blamed them for not uncovering those lies.

Factually, the decision in *Dembski* has nothing in common with this case; nor can it compare with the evidence presented. Mr. Winkelmann did not "simply" send a PPM to his counsel and ask for a blessing. Instead, he and his counsel exchanged thousands of pages of emails, back and forth, discussing the drafts, making changes, asking questions and considering options. Further, unlike the respondents in *Dembski,* Mr. Winkelmann did not conceal anything from his counsel. To the contrary, he was often the one who raised issues, asking whether something should be disclosed, and deferring to Greensfelder's opinion.

Dembski does not stand for the proposition the Division asserts, and does not assist in determining the issues presented in this case.[161]

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[159] *Id.*

[160] *Id.*

[161] The Division also cites to *S.E.C. v. Enterprises Sols., Inc.*, 142 F. Supp. 2d 561, 576 (S.D.N.Y. 2001) for the same point. *Enterprises* involved a respondent who never asked his counsel whether a prior bankruptcy need be disclosed. That case does not provide any instruction where, as here, there is a clear solicitation for advice (which the Division has stipulated to). Likewise, its citation to *Sec. & Exch. Comm'n v. Savoy Indus., Inc.*, 665 F.2d 1310, 1315 (D.C. Cir. 1981) can be disregarded, since it merely dismisses the reliance on counsel argument, in a footnote, where "[respondent] has made no attempt to claim the defense of reliance on advice of counsel...we need not decide whether the defense is available in this circuit, since [respondent] plainly has failed to meet any of the prerequisites necessary for its invocation."

c. Reliance on Advice regarding Binkholder.

For the reasons already stated above, the Missouri Order against Binkholder was not material and not a requisite disclosure. Thus, Greensfelder properly did not raise it as a potential concern.

Nevertheless, should it become relevant, the unrebutted testimony reflected that:

- Greensfelder was aware of Binkholder's relationship with Blue Ocean, not only through the Offering documents but as drafters of the Exclusive Marketing Agreement.[162]
- Greensfelder was aware that Binkholder had been barred at or around the time the bar was entered.[163]
- Greensfelder was aware that the bar was not disclosed in certain of the Offering Memoranda.[164]
- Greensfelder never indicated that this was a potential or required disclosure.[165]
- It was not until Mr. Winkelmann and Greensfelder learned Binkholder was under federal criminal investigation that they determined it needed to be disclosed.[166]
- Mr. Winkelmann followed the advice that he received from Greensfelder in connection with the preparation of the Offering Memoranda and related documents.[167]

In light of the evidence establishing Respondents' reliance on Greensfelder's expertise as to what information should be disclosed regarding Binkholder, and when, even were some violation to arise out of his Missouri Order, the Commission should conclude Mr. Winkelmann properly relied up on the advice of his counsel in not making that disclosure.

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[162] Tr. 1325:22-1326:13 (Winkelmann).

[163] *See, Section* E, above.

[164] *Id.*

[165] *Id.*

[166] RX-004 p. 16.

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

2. No "rejection" of Advice

In this new argument that, like many others, is raised for the first time here, the Division suggests that by rejecting a few sentences of Mr. Morgan's track changes, Mr. Winkelmann was "rejecting" advice. Out of the thousands of redlined pages exchanged, the Division has, apparently, found two examples where Mr. Winkelmann selected his language over the attorneys. Also, somewhat paradoxically, the language Mr. Winkelmann leaves in the draft is, generally, the type of disclosure regulators like to see: one that highlights the fact that the owners of the issuer (i.e., Mr. Winkelmann) may be paid more if the issuer issues less than 14 Royalty Units total.

III. CONCLUSION

For the reasons stated herein, the Commission should deny the Division's request for judgment in its favor on the above allegations and uphold the conclusions rendered in the Initial Decision regarding the same.

Dated: July 7, 2017

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CERTIFICATE OF COMPLIANCE

In accordance with Rule 450(d) of the Rules of Practice, I certify that this brief, exclusive of the cover page, table of contents, table of authorities, and signature block is in compliance with the 14,000-word limit. The brief contains 13,783 words, according to the word processing system used to prepare the brief.

Heidi VonderHeide

CERTIFICATE OF SERVICE

I, Heidi VonderHeide, hereby certify that on July 7, 2017, I served a copy of the foregoing **RESPONDENTS' RESPONSE TO THE DIVISION'S BRIEF IN SUPPORT OF CROSS-PETITION FOR REVIEW**, as follows:

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