HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17253

In the Matter of

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

Respondents.

THE DIVISION OF ENFORCEMENT'S REPLY
<u>IN SUPPORT OF ITS CROSS-PETITION FOR REVIEW</u>

Benjamin J. Hanauer
David F. Benson
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 1450
Chicago, IL 60604
Phone: 312-353-8642
Fax: 312-353-7398

Counsel for the Division of Enforcement

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Other Authorities

A. Introduction

In its opening brief, the Division demonstrated that the evidence in this case proves Winkelmann violated the antifraud provisions by making varied misrepresentations and omissions throughout four securities offerings directed at his advisory clients. Winkelmann's response fails to rebut that evidence, while continuing to offer lame excuses for his conduct. He does so by repeatedly misstating or ignoring evidence, blaming his former attorneys and subordinates, and falsely claiming the Division first raises its arguments on appeal.

Winkelmann's strident response shows he still does not appreciate that, as CEO and control person of BOP, he was responsible for the false statements and omissions he made to investors. Additionally, Winkelmann refuses to accept that his fiduciary duties obliged him to place his client-investors' interests before his own.

For these reasons and those discussed below, the Commission should find that Winkelmann violated the antifraud provisions and affirm the ALJ's decision that Winkelmann should no longer be trusted, or afforded the privilege, to act as a fiduciary to investors.

B. Winkelmann's Concealment of Binkholder's Bar Violated the Antifraud Provisions

It is undisputed that Winkelmann concealed from investors in the second and third offerings that his business partner and BOP's co-founder had been barred from being an investment adviser. Winkelmann also undisputedly never told investors that Binkholder was barred for engaging in analogous conduct as Winkelmann: selling securities in his businesses to advisory clients while failing to disclose the attendant conflicts. Winkelmann seeks to excuse this concealment by downplaying Binkholder's role at BOP and portraying him as a mere "advertising and marketing vendor" with a "limited specific role." (Resp. Br. at 2, 4). But the evidence shows that Binkholder's position at and importance to BOP were much more substantial, and that Winkelmann consistently touted Binkholder to investors. Given Binkholder's key position at

BOP, Winkelmann's representations emphasizing his importance, and the fact that Binkholder's bar confirmed to Winkelmann the illegality of offering clients securities without disclosing conflicts, Winkelmann was required to disclose Binkholder's bar. Winkelmann's failure to do so constitutes fraud.

1. Binkholder's Important Role at BOP

Winkelmann wants the Commission to believe Binkholder was merely an advertising "vendor" with minimal importance to BOP. But overwhelming evidence demonstrates that Binkholder played a central and key role. For instance, Winkelmann ignores that Binkholder cofounded BOP, owned half the firm, and served as an adviser representative from BOP's inception through the eve of the first offering. (Stip. ¶¶32, 33; Tr. 416:14-417:11).

Even after transitioning from being an owner/adviser representative, Binkholder's "separation" was more form than substance. Binkholder remained very much involved with BOP's business, and was in no way limited to the advertising function. Indeed, he and Winkelmann continued to share office space and employees, the two "worked closely" together, and both received equal compensation from BOP. (Tr. 416:3-7; RX-4, p. 16; DX-346, pp. 17, 32; DX-5, §1.02). Binkholder remained intimately involved in BOP's financial decision-making, and Winkelmann continued to share with Binkholder BOP's detailed internal financial information. (DX-70).[1] Winkelmann involved Binkholder in key structural decisions such as whether to offer royalty units, initiate the second offering, and raise their compensation. (DX-327 at 107:13-108:3; DX-83). Binkholder also participated in meetings where Winkelmann offered royalty units to investors. (DX-327 at 114:9-14). Winkelmann further confirmed that Binkholder's position at

[1] Despite arguing that Binkholder had separated from BOP, Winkelmann's email (DX-70) shows that Winkelmann considered Binkholder a part of BOP and involved him in BOP's financial decision-making. (DX-70 ("*Our* burn rate is higher than *we* want – the AUM is lower than *we* projected…*We* need to stop spending and start closing!) (emphasis added)).

BOP included discussing "investment procedures, which index funds we would use...compensation for employees [and] various strategies of [BOP]." (DX-249 at 24:23-25:18).

Putting aside Binkholder's multifaceted role at BOP and focusing solely on his marketing function, Binkholder was still of great importance to BOP. Binkholder was critical in bringing new clients to BOP, as his radio show generated between 70 to 100 client leads *per week*. (DX-327 at 116:6-12). In Winkelmann's words, because Binkholder's show "had a lot of listeners," BOP "got a lot of leads. A lot of leads were converted to [BOP] clients." (*Id.* at 116:15-18). Winkelmann similarly admitted that Binkholder's "show was *very successful in that it generated a plethora of leads* from people wanting to know more about low-cost index funds, conflicts of interest, and other industry topics." (DX-346, p. 6) (emphasis added). Indeed, Winkelmann concedes that when BOP finally stopped sponsoring Binkholder's show, after learning of Binkholder's criminal investigation, it was a "*material* change to [BOP's] business." (DX-327 at 105:16-22) (emphasis added).

Binkholder's significant compensation further establishes his importance to Winkelmann and BOP. Winkelmann paid Binkholder the same compensation he received, and raised their pay in lockstep. (DX-5, § 1.02; DX-83). BOP fully reimbursed Binkholder for the production costs related to his radio show. (DX-5, § 1.01). Winkelmann even gave Binkholder a BOP corporate credit card. (DX-327 at 300:20-22). So important was Binkholder that Winkelmann had BOP take out a $2 million insurance policy on Binkholder's life, and allowed Binkholder to choose a 50% beneficiary. (DX-5, § 104(b)(ii); DX-106, § 103(b)(ii)).

2. Winkelmann Repeatedly Touted Binkholder to Investors

Consistent with Binkholder's important role, Winkelmann systematically touted to investors BOP's relationship with Binkholder. For instance, BOP's Form ADV brochure disclosed BOP's marketing agreement with Binkholder and sponsorship of his radio show. (DX-13, PDF p.

11). Similarly, the first three offering memoranda tout BOP's sponsorship of Binkholder's show and describe how the show drives potential clients to BOP. (RX-1, p. 8; RX-2, p. 10; RX-3, p. 8). Each memorandum also attaches BOP's Marketing Agreement with Binkholder as an exhibit.[2] (RX-1, p. 26; RX-2, p. 34; RX-3, p. 32). The first two memoranda represent BOP "will use a substantial portion of the proceeds of this offering and future cash flows to fund media buys for both [BOP] and [Binkholder's] Financial Coach Show." (RX-1, p. 8; RX-2, p. 12). Similarly, the third memorandum represents that offering proceeds will be used to "syndicate" Binkholder's show to other markets. (RX-3, pp. 4-5).

Further confirming Binkholder's importance to investors, the first three memoranda disclose that Binkholder had been providing financing to BOP, and the first memorandum additionally discloses that BOP anticipates issuing membership units to Binkholder (*i.e.*, again making Binkholder an owner of BOP). (RX-1, p. 10; RX-2, pp. 14-15; RX-3, p. 12). The memoranda additionally promote the book Winkelmann and Binkholder co-authored: "The 401(k) Conspiracy." (RX-1, p. 9; RX-2, p. 13; RX-3, p. 10). Moreover, the memoranda describe Binkholder before and more prominently than the other radio host in the "Sales and Marketing" sections,[3] and their description of Binkholder comes before the descriptions of BOP's "Key Vendors and Relationships" and "Key People and Backgrounds." (RX-1, pp. 8-14; RX-2, pp. 10-

---

[2] Winkelmann's claim that Binkholder was immaterial to BOP is belied by the fact Winkelmann attached Binkholder's Marketing Agreement to the first three offering memoranda. If Binkholder's relationship with BOP was immaterial, why provide investors with the contract governing that relationship?

[3] BOP's Form ADV disclosed its relationship with Binkholder but not the other radio host. (DX-13).

19; RX-3, pp. 7-17).[4] Beyond the offering materials, Winkelmann's and his employees promoted Binkholder's show in their email signature blocks. (DX-99, DX-129; DX-130; DX-131; RX-106, pp. 492-493, 525, 1089, 1097-98, 1099, 1189-90, 1195-96, 1197-98, 1199-1200). Not surprisingly, several investors testified that they first learned of BOP through Binkholder. (Tr. 10:24-11:24, 339:12-24, 620:2-12).

3. Binkholder's Bar, and the Reasons for the Bar, Were of Paramount Importance to Investors

In the first instance, Binkholder's bar was material because any reasonable royalty investor would want to know that BOP's cofounder, Winkelmann's business partner, and a central figure at BOP, had engaged in serious misconduct at the expense of advisory clients. *SEC v. Bolla*, 401 F. Supp. 2d 43, 72 (D.D.C. 2005) ("Confronted with the fact that his/her investment adviser had been barred, the reasonable investor would likely question the firm, wondering whether the other investment advisers could also be trusted to fulfill their ethical obligations"). Confirming the materiality of Binkholder's relationship with BOP, investors Grau and Swardson testified they would have wanted to know about Binkholder's regulatory issues when they invested. (Tr. 23:10-24:7, 626:20-627:13). This testimony is consistent with common sense. Any reasonable person purchasing an adviser's securities would want to know that the adviser's spokesman and centerpiece of its marketing campaign was a defrocked adviser. Knowing this fact would cause a reasonable investor to question the judgment of the adviser's management. Indeed, none of the investor witnesses called by Winkelmann testified that Binkholder's bar did not matter to them.

[4] Winkelmann argues that because the memoranda did not list Binkholder in the "Key Vendor" or "Key People" sections, he was not important to BOP. (Resp. Br. at 4). This ignores that the memoranda discuss Binkholder first, and devote as much or more space to Binkholder *alone* than they do to the *entire* Key Vendor sections. (RX-1, pp. 8-10; RX-2, pp. 10-14; RX-3, pp. 7-11). And the "Key People" sections describe BOP *employees* which, per the bar order, Binkholder was precluding from being. (RX-1, pp. 14-15; RX-2, pp. 19-20; RX-3, pp. 17-18).

The issue is not, as Winkelmann suggests, whether BOP violated the bar by continuing its relationship with Binkholder after formally removing him from being an owner and employee. (Resp. Br. at 3, 33). Indeed, the Division does not make that allegation, nor is establishing that proposition required to support the Division's fraud claims. Rather, the issue is whether investors would want to know that someone with as key a role as Binkholder, and who was repeatedly touted by Winkelmann, had engaged in illegal conduct.[5]

Not only was the fact of Binkholder's bar of paramount importance to investors, the reason for the bar was of equal or greater importance. Any reasonable investor would want to know that an adviser selling clients securities in its business without disclosing conflicts – as Winkelmann did with the royalty units – was illegal and could result in the adviser/issuer being barred. Because the royalty investors relied on Winkelmann's and BOP's performance to drive their returns, they would want to know if Winkelmann was engaging in conduct that could result in him being removed from the company, BOP being shut down, or (at the very least) drag BOP into expensive regulatory investigations.[6] The fact that Winkelmann considers this proposition "ludicrous" and "so absurd on its face that it almost does not require a response" (Resp. Br. at 5) demonstrates he does not appreciate the strict fiduciary responsibilities owed to his clients.

---

[5] Winkelmann claims that finding a violation based on his concealment of Binkholder's bar would require any securities offering to disclose if "other issuers, in other cases…involving different facts and circumstances" have been barred. (Resp. Br. at 5). Binkholder's bar did not deal with some random issuer in a wildly different fact pattern. Rather, it involved (a) Winkelmann's business partner and a central player at BOP; and (b) analogous conduct to the royalty unit offerings (an adviser offering his own business's securities to clients without disclosing conflicts.)

[6] The latter of these possibilities materialized following the third offering, when Missouri regulators began investigating BOP. (DX-212)

While Winkelmann argues the bar order's text was "woefully insufficient" to put him on notice that he too could be barred (Resp. Br. at 5), the order was clear. The order contained the unambiguous findings that (a) "Binkholder offered and sold promissory notes in entities under the ownership and/or control of Binkholder ('Binkholder Entities') to Binkholder's investment advisory clients"; and (b) "Binkholder did not disclose to investors... the potential conflict of interest that could affect the advisory relationship between Binkholder and the investors." (DX-84, ¶¶15(c), 16)). Even though Winkelmann is correct that Binkholder's order did not involve royalty units, the type of securities Binkholder sold his clients is irrelevant. The fact investors needed to know was that Winkelmann was engaging in illegal conduct, like Binkholder, for not disclosing conflicts while offering securities to clients.[7]

Winkelmann also falsely claims the Division argues for the first time on appeal that investors would want to know Winkelmann was engaging in conduct similar to that which resulted in Binkholder's bar. (Resp. Br. at 5). Not so. The OIP alleges Winkelmann's failure to disclose Binkholder's bar as a standalone paragraph. (¶14). In support of this allegation, the Division's expert, Professor Laby, opined:

> Winkelmann's failure to disclose Binkholder's bar is particularly troublesome because of the reasons for the bar. Binkholder was barred because he sold securities in his own business to advisory clients and failed to disclose the resulting conflict of interest. The conduct giving rise to the bar, in other words, was similar to Winkelmann's conduct vis-à-vis the Royalty Unit offering. Winkelmann's and BOP's failure to disclose Binkholder's bar, given the prominence of BOP's sponsorship of Binkholder's radio show in the offering materials and Binkholder's role in soliciting new advisory clients and Royalty Unit investors, is inconsistent with their fiduciary duty of loyalty and fiduciary duty of honesty owed to clients.

[7] Winkelmann's suggests the Division claims it is "per se" illegal for an adviser to offer securities to clients. (Resp. Br. at 5 n.20). The Division makes no such assertion, as its allegations are premised on Winkelmann's failure to disclose conflicts. Curiously, Winkelmann's citations for this argument are to DX-201, a BOP Form ADV which does not appear to support Winkelmann's contentions in any way. (*Id.* at 5-6, nn. 20 and 21).

(Ex. 363, p. 25).[8] Notably, Winkelmann provided no testimony, expert or otherwise, to rebut Professor Laby's opinion that Winkelmann violated industry standards and norms by failing to disclose Binkholder's bar and the reasons for the bar.

4. *Bolla* Is On-Point Authority Involving Similar Facts

Despite its analogous fact pattern, Winkelmann argues that *SEC v. Bolla* "has no application and carries no weight." (Resp. Br. at 9). Winkelmann ignores that *Bolla*, just like this case, involves an advisory firm's founder who concealed from clients that his co-founder had received an adviser bar shortly after the firm's formation and was then removed from ownership. 401 F. Supp. 2d at 48, 50, 56-57. Like *Bolla*, Winkelmann would discuss Binkholder with clients without informing them about Binkholder's bar. *Id.* at 56. Specifically, Winkelmann admitted that when clients asked him about Binkholder's whereabouts, rather than informing them of the bar, he simply told them that Binkholder "is pursuing other business activities and no longer associated with [BOP]." (DX-249, at 66:9-67:8).[9] Moreover, Winkelmann affirmatively touted Binkholder and his contributions to BOP in the offering memoranda and in emails to investors, again without disclosing the bar. As in *Bolla*, these positive statements about Binkholder, made in an effort to sell more royalty units, "triggered an affirmative obligation" to disclose Binkholder's bar and the reasons for his bar. *Bolla* at 70-71 (by not disclosing his

---

[8] The Division continued making this argument in post-hearing briefing. (Div. Post-hearing Br. at 38-39; Div. Post-hearing Resp. Br. at 29).

[9] Investor Swardson, who learned of BOP through Binkholder, found it "quite disturbing" that Winkelmann never disclosed that "Binkholder was barred before [Swardson] even did [business] with [BOP]." (Tr. 23:10-18).

cofounder's bar, the remaining cofounder provided clients "an inaccurate, skewed version of WIN as an investment adviser entity").[10]

Winkelmann also attempts to distinguish *Bolla* by arguing that, unlike Binkholder, the barred adviser in *Bolla* continued to control the firm and act as an adviser. (Resp. Br. at 8-9). While *Bolla* addressed those considerations, it did so in the context of determining defendants violated Advisers Act Section 203(f) by permitting the barred adviser to remain associated with the firm. 401 F. Supp. 2d at 61-65. On the other hand, the remaining adviser had an independent obligation under Section 206(1) and (2), based solely on the barred adviser's *prior* relationship with the firm, to disclose the bar. *Bolla* at 72 ("with the fact that his/her investment adviser had been barred, the reasonable investor would likely question the firm, wondering whether the other investment advisers could also be trusted to fulfill their ethical obligations").

Finally, Winkelmann attempts to minimize *Bolla*'s impact by claiming that the "total sanction" in that case was an injunction and fine. (Resp. Br. at 10 n.35). Winkelmann ignores that the Commission subsequently barred the remaining adviser for failing to disclose his cofounder's bar. *Robert Radano*, Advisers Act Rel. 2750, 2008 SEC LEXIS 1504, *36-37 (June 30, 2008). In deciding to bar the adviser, the Commission reiterated the importance to clients of knowing that a former principal of their advisory firm had been barred. *Id.* at *30 ("the issue is whether those clients were notified about Bolla's bar so that they could make an informed decision about whether to continue their relationship with the Firm, notwithstanding the bar. Radano's failure to provide that notification prevented clients from making such an informed decision.").

[10] Even if Winkelmann had stayed silent regarding Binkholder, given Binkholder's importance to BOP and the fact that Binkholder's bar involved analogous conduct to the royalty unit offerings, Winkelmann had a duty to disclose the bar to clients as part of his fiduciary obligation to disclose all material facts. *Bernerd Young*, Exchange Act Rel. 774421, 2016 SEC LEXIS 1123, *38-39 (Mar. 24, 2016).

C. Winkelmann Violated the Antifraud Provisions by Misrepresenting BOP's Success in Repaying Investors

In its opening brief, the Division identified three sets of emails where Winkelmann falsely represented the amount of money BOP had raised and repaid to investors:

- Winkelmann's email to a client, during the first offering, where he falsely claimed BOP had raised $650,000 when, in reality, it had only raised $425,000 (DX-50; DX-455);
- Winkelmann's emails falsely representing that BOP had raised $325,000 to $400,000 in the third offering when, at the time, BOP had only raised $250,000 (DX-199, p. 2; Tr. 711:12-712:6; DX-203; DX-455); and
- Winkelmann's August 2012 email to a client which falsely represented investors had been repaid $4,961.95, when they had only been repaid $2,671.98 (DX-167; DX-454; Tr. 682:3-22).[11]

Winkelmann first attempts to minimize these misrepresentations by claiming they "relate to only six statements, contained in emails, and sent within days of one another." (Resp. Br. at 10). Winkelmann misstates the temporal proximity of these emails. He sent the first email in May 2011 (DX-50), the second in August 2012 (DX-167), and the third set in October 2012 (DX-199, DX-203). Winkelmann also fails to appreciate that the Commission has sustained fraud findings, and imposed an industry bar, based on a respondent sending only *two* misleading emails to potential investors. *Francis Lorenzo*, Exchange Act Rel. 74836, 2015 SEC LEXIS 1650, *19-21, *43 (Apr. 29, 2015).

Winkelmann additionally argues his emails "were not false or misleading because [he] believed them to be true and accurate." (Resp. Br. at 12). But Winkelmann's subjective belief of the emails' accuracy is irrelevant to whether they were objectively false. Moreover, the only citations Winkelmann offers relate to the October 2012 emails. (Resp. Br. at 12 n.41 (citing Tr.

[11] The ALJ did not, as Winkelmann claims, "reject" these fraud allegations. (Resp. Br. at 10). Instead, the Initial Decision noted the falsity of each of these emails, but did not address the emails in its "Conclusions of Law." (I.D. at 11, 15, 47-57).

710:7-18, 1365:9-1366:1)). Winkelmann cites no evidence to support his claims that he subjectively believed the May 2011 (DX-50) and August 2012 (DX-167) emails were accurate. However, even crediting Winkelmann's argument, Winkelmann's belief that the emails were correct would have no impact on the Division's negligence-based charges under Advisers Act Section 206(2) and Securities Act Sections 17(a)(2) and (3). *Lorenzo*, 2015 SEC LEXIS 1650, *40 ("Lorenzo claims that he did not give 'much thought' to sending the emails, but there is no dispute that Lorenzo intentionally sent them.").

Winkelmann further argues the emails are not fraudulent because the offering memoranda provided curative disclosures. (Resp. Br. at 12). But Winkelmann does not cite to any disclosures in the memoranda relating to the subject matter of the emails: the amount of funds raised by BOP or returned to investors. Indeed, the memoranda contain no such disclosures (RX 1-4), and Winkelmann's false statements were never "corrected."

Winkelmann's last attempt to excuse his fraudulent emails is to claim the non-reliance provision of the Subscription Agreements means that the investors could not have relied on any representation in the emails (and could only rely on the offering memoranda).[12] (Resp. Br. at 12). However, the non-reliance provisions are of no help to Winkelmann, because reliance is not an element to the Division's fraud claims. *See, e.g., Dennis J. Malouf*, Advisers Act Rel. 4463, 2016 SEC LEXIS 2644, *42 and n.70 (July 27, 2016); *SEC v. True N. Fin. Corp.*, 909 F. Supp.

[12] Winkelmann's citation to the Subscription Agreements' non-reliance provisions is puzzling. Given the absence of disclosure in the offering memoranda, Winkelmann claims the only way he conveyed to clients that he was not acting as their adviser, and did not owe fiduciary duties when selling royalty units, was orally or in letters. If so, the non-reliance provisions of the Subscription Agreements would nullify this purportedly prophylactic (for Winkelmann) disclosure.

2d 1073, 1097 (D. Minn. 2012) (integration clause in subscription agreement no defense to SEC's fraud claims).

D. Winkelmann Misrepresented His Alignment with Investors

In its opening brief, the Division demonstrated the offering memoranda falsely represent that the royalty units "align" the interests of Winkelmann and the investors and "align all interests for the highest potential return at the least risk." (*See, e.g.*, RX-1, pp. 5, 15; RX-2, p. 6, 15, 22; RX-3, pp. 4, 21; RX-4, pp. 4, 13, 21). These statements were false and misleading because the interests of Winkelmann and the investors, at times, directly conflicted. As detailed in the Division's opening and response briefs, Winkelmann routinely used BOP money – money that could have been used to repay or otherwise benefit investors through deployment in advertising or other revenue-generating activities – to increase his compensation, pay personal debts, or fund his other companies.

Winkelmann's only response is to say he fully addressed this issue in his opening brief. (Resp. Br. at 10). Because the Division has already responded to that brief, no additional briefing is required. The Division does note that Winkelmann's opening brief was limited to his conduct vis-à-vis clients, while the Division's appeals the ALJ's findings concerning Winkelmann's "alignment" and lack-of-conflict representations in regard to the non-client investors.

E. Winkelmann Made False Statements and Omissions Regarding BOP's Advertising Ratios

1. Winkelmann Failed to Disclose BOP's Changing Methodologies or that He Cherry-Picked to Arrive at Better Results

The Division's opening brief detailed how, throughout the four offerings, BOP changed the methodology purportedly used to calculate the advertising ratios Winkelmann selected for the offering memoranda. (Div. Br. at 26-30). The Division further demonstrated that Winkelmann never disclosed: (a) the changing methodologies or (b) that he selected the ratios from multiple available options, and always chose ratios that made BOP look better. (*Id.*).

In response, Winkelmann does not dispute BOP's shifting methodologies for calculating the ratios. In fact, he concedes that BOP's methodology "evolve[d] significantly." (Resp. Br. at 13). While Winkelmann claims BOP "did disclose its methodology" (Resp. Br. at 15), that statement is a half-truth and, at best, misleading. Winkelmann is correct that the offering memoranda generally described the ratios as adverting spending for a period divided by new recurring revenues generated by that advertising. (*See, e.g.*, RX-1, p. 9; RX-2, p. 5; RX-3, p. 3). But the memoranda never disclose BOP's methodology for determining what revenues were "generated" from a period of advertising, or that the methodology changed from offering to offering. The memoranda also do not disclose that the ratio fluctuates wildly depending on BOP's chosen methodology to determine the "generated" revenues.

BOP used two distinct methodologies that led to sharply divergent ratios: (1) revenues generated *during* a period of advertising; and (b) revenues *resulting from* a period of advertising, regardless of when BOP booked the revenues. (Div. Br. at 26-30). Tellingly, Winkelmann does not even acknowledge this critical distinction.[13] Winkelmann also selected from various "look-back" periods, ranging from one month to one year, which similarly had significant impact on the resulting ratio. (Div. Br. at 26-30). Again, Winkelmann does not deny that by changing the look-back period from offering to offering, Winkelmann was able to arrive at better ratios.

[13] To the extent Winkelmann cites to his expert, Palubiak, to support his advertising ratio arguments, the Division notes that Palubiak did not even know which methodology BOP employed for the ratios represented in the offering memoranda. Indeed, Palubiak operated under the mistaken assumption that BOP calculated the ratio presented to investors based on revenues *resulting from* a period of advertising. (Tr. 1142:25-1143:19, 1151:5-12).

Rather than address the merits of the Division's appeal, Winkelmann misstates the Division's argument. Winkelmann posits that the Division's case is premised on his simply not including BOP's methodology in the offering memoranda. (Resp. Br. at 15). Not so. Rather, the Division bases this appeal on Winkelmann failing to disclose: (a) BOP's *changing* methodologies; (b) that Winkelmann's choice of methodology led to vastly different results; and (c) Winkelmann's cherry-picking the best available ratio from a variety of options based on the different methodologies.

This is not, as Winkelmann claims, a "new theory of liability" raised for the first time on appeal. (Resp. Br. at 15). Indeed, the Division's post-hearing briefing devoted significant attention to this issue. (Div. Post-hearing Br. at 24-32, 36 ("Even believing Winkelmann's story that he based the ratios from BOP advertising reports, the evidence shows that Winkelmann: (a) cherry picked data and methodologies; and (b) did not disclose such cherry picking to investors."); Div. Post-hearing Resp. Br. at 1-2 ("Winkelmann never disclosed to investors: (a) how BOP calculated the ratios; (b) that BOP's calculation methodology purportedly changed for each offering; or (c) that Winkelmann consistently cherry-picked from a variety of available data, always selecting a ratio that made BOP look better. These omissions left investors with an inflated impression of BOP's success converting advertising dollars into new revenues – what Winkelmann called the 'key driver' of their investment.")).

In its opening brief, the Division cited recent case law holding that an issuer omits material information when it fails to disclose, for key business metrics presented to investors, that it calculated the metric using changing methodologies or choosing from available methodologies yielding significantly different results. (Div. Br. at 40-41 (citing *In re BP p.l.c. Secs. Litig.*, 2016 WL 3090779, *15 (S.D. Tex. May 31, 2016); *Von Hoffmann v. Prudential Ins.*

Co., 202 F. Supp. 2d 252, 261 (S.D.N.Y. 2002)).[14] The three cases cited by Winkelmann do not rebut this proposition. (Resp. Br. at 27-28). Indeed, in each of those decisions and *unlike* the royalty unit offerings: (a) the issuer actually disclosed the methodology; and (b) there was no change in the issuer's methodology that led to different outcomes. *Ironworkers Local 580 v. Linn Energy, LLC*, 29 F. Supp. 3d 400, 426-428 (S.D.N.Y. 2014) ("It is not fraudulent for a reporting entity to calculate metrics that are not defined under GAAP... *as long as the public is told exactly what the company is doing*") (emphasis added); *In re Netflix, Inc. Secs. Litig.*, 2005 U.S. Dist. LEXIS 30992, *24-29 (N.D. Cal. Nov. 18, 2015); *Kademian v. Ladish Co.*, 792 F.2d 614, 625-626 (7th Cir. 1986) ("all are accepted accounting techniques and *each is disclosed in the footnotes to the financial statement*").

The Division's fraud theory is consistent with the OIP's allegation that each offering memorandum "contained material misrepresentations about [BOP's] advertising [ratio]." (¶6). Winkelmann complains the OIP does not expressly plead that BOP failed to disclose its changing methodologies or Winkelmann's cherry-picking. But the OIP makes clear that it premises fraud charges on misrepresentations surrounding the advertising ratios, and Winkelmann had ample opportunity to rebut the Division's fraud theories throughout this litigation. Thus, Winkelmann had sufficient notice of, and ability to defend, the charges against him. *Wendy McNeeley, CPA*, Exchange Act Rel. 68431, 2012 WL 6457291,*9 (Dec. 13, 2012) ("the standard for determining

---

[14] Just as BOP's advertising reports presented Winkelmann with multiple ratios to choose from – based on different methodologies and look-back periods – Winkelmann concedes that in *BP*, the issuer was "presented with two sets of reports containing very different rates of surface estimation." (Resp. Br. at 29).

whether notice is adequate is whether 'the respondent "understood the issue" and "was afforded full opportunity" to justify [her] conduct during the course of the litigation.'") (citations omitted).[15]

2. Winkelmann Falsely Represented BOP's 2011 Annual Ratio in the Second, Third, and Fourth Memoranda

The ALJ correctly observed: "Winkelmann was unable to explain how BOP arrived at the 0.79 advertising ratio for 2011 in his investigative testimony, prehearing brief, expert report, or posthearing brief." (I.D. at 25).[16] Just as he was unable to provide evidence to the ALJ supporting BOP's 2011 ratio, Winkelmann still fails to establish a basis for that figure. Indeed, Winkelmann's brief cites no record evidence showing how he selected the 2011 annual ratio for the second, third, and fourth memoranda.

Instead, Winkelmann's brief contains two charts showing BOP's *monthly* ratio over time. (Resp. Br. at 24).[17] But no witness testified these charts formed the basis of BOP's 2011's *annual* ratio, and Winkelmann cites no evidence showing that he used those charts when representing the 2011 annual ratio to investors. Tellingly, Winkelmann doesn't even claim those charts reflect BOP's annual ratio, and acknowledges the charts comes from "monthly" reports. (Resp. Br. at 24).

---

[15] Winkelmann's gripes about the OIP are the product of his own gamesmanship. Indeed, Winkelmann could not explain during investigative testimony the discrepancies between the advertising ratios presented in the offering memoranda and BOP's internal documents underlying those ratios. (Tr. 447:2-478:15, 1451:2-17). When later given the opportunity to defend himself through a Wells submission, he failed to explain or otherwise inform the Division or Commission how he arrived at the ratios presented to investors. (DX-346). He then waited until his prehearing brief to present evidence or advance any argument on this issue.

[16] The OIP expressly alleges that Winkelmann misrepresented the 2011 annual ratio. (OIP ¶¶7-8).

[17] The first chart comes from RX-36, page 2. Note how the factor over time corresponds to the *monthly* factors documented on RX-36, page 1. (Tr. 881:5-20). Further, RX-36 does not contain any *annual* figures. Regarding the second chart on page 24 of Winkelmann's brief, Winkelmann does not cite any evidence supporting that chart, but claims the chart comes from a *monthly* advertising report. Nevertheless, the *monthly* factors contained on the second chart are consistent with the *monthly* factors contained in the first chart.

Perhaps this is because Winkelmann himself rejected the notion he premised the 2011 annual ratio on a monthly figure. To that end, Winkelmann testified the 2011 ratio was based off *year-long* advertising and revenue data. (Tr. 662:13-21).[18] The fact that Winkelmann attempts to address a complete absence of evidence supporting the 0.78/0.79 ratio by offering an explanation he directly refuted at trial confirms that his explanations lack credibility and should be rejected.

Winkelmann again misstates the evidence and attempts to mislead the Commission by arguing that disclosures in the second offering memorandum support a 0.78 annual ratio for 2011. (Resp. Br. at 25). Notwithstanding that no witness testified to this effect at trial, Winkelmann claims the memorandum represents that, in 2011, BOP spent $328,000 on advertising which generated new annual revenues of $404,000, resulting in a ratio of 0.81. (*Id.* (citing RX-2, p. 5)).

However, the revenue number is $200,000 too high, because the $404,000 figure includes both *new revenues* (from clients who retained BOP in 2011) and revenues generated from existing clients who opened accounts *prior to* 2011.[19] Specifically, the second memorandum represents that BOP's annual revenues **increased** "*from* approximately $200,000 at the end of

[18] Even assuming Winkelmann relied on those charts, the 0.78 ratio would still be false and misleading. First, the chart from RX-36 (the February 2012 report and last report available at the time of the second memorandum) shows a monthly ratio at year-end 2011 of approximately 0.90, not 0.78. Moreover, the charts on page 24 of Winkelmann's brief show elevated monthly ratios earlier in 2011. Even if the 0.78 ratio was based on those charts, investors would have no way of knowing that BOP's ratios from earlier in 2011 were much worse than at year-end or that Winkelmann had cherry-picked the best possible data.

[19] The second memorandum discloses that BOP's advertising "factor" is based on "*new* recurring annual revenue," as opposed to revenue generated from existing clients. (RX-2, p. 5) (emphasis added). Further establishing that the second memorandum does not support a 0.78 annual 2011 ratio, Winkelmann's own exhibits demonstrate BOP did not generate anywhere near $404,000 in new revenues during 2011. Specifically, in 2011, BOP's AUM grew $26.2 million, from $32.9 million at year-end 2010 to $59.1 million at year-end 2011. (RX-76). To generate more than $400,000 on $26.2 million new AUM would require BOP to charge in excess of 1.5% management fees, when in reality BOP charged only 0.8%. (RX-1, p. 5). $26,200,000 x 0.008 (the approximate percentage of AUM that BOP earned as fees) = $209,600, a figure consistent with the $204,000 *new* recurring revenues for 2011 reflected in the second memorandum.

2010 *to* $404,000 at the end of 2011." (RX-002, BO 9400) (emphasis added). As the ALJ correctly observed in rejecting the same argument raised by Winkelmann, the second memorandum reflects that, during 2011, BOP generated *new* recurring revenues of approximately $204,000. (I.D. at 25 ("The memorandum also states that during 2011 BOP spent $328,000 in advertising that resulted in $204,000 in new annually occurring revenue")). Accordingly, if Winkelmann is correct that the 2011 spending and revenue figures in the second memorandum are accurate, BOP's annul ratio for 2011 would be 1.61 ($328,000 divided by $204,000) – more than double the 0.78/0.79 ratio represented to investors.

Finally, Winkelmann claims that Michael Collins' calculations for the 2011 annual ratio are incorrect, arguing that the document Collins relied on (DX-159) was created in June 2012, after the second memorandum was issued. (Resp. Br. at 25-26). As detailed in the Division's opening brief (pp. 31-32), the data on DX-159 was consistent with other BOP materials devoted to its 2011 advertising data. Conversely, Winkelmann cannot point to any document he claims accurately reflects BOP's 2011 data as it existed at the time of the second memorandum. Moreover, Winkelmann concedes that DX-159 contained valid data as of June 2012, and thus offers no rationale why Collins' calculations would be inaccurate to rebut the 2011 annual ratio of 0.78 represented in the third and fourth memoranda, which both post-dated DX-159.

F. Winkelmann Acted With Scienter

The Division's opening brief detailed the many ways Winkelmann acted with scienter. (Div. Br. at 41-44). Winkelmann's attempts to excuse his conduct are unavailing.

Regarding Binkholder's bar, the Division is not arguing, as Winkelmann claims (Resp. Br. at 33), that Winkelmann acted with scienter by violating the bar order. Rather, Winkelmann demonstrated his scienter by, despite being on notice that not disclosing conflicts while selling securities to advisory clients is illegal, continuing to offer royalty units to his own clients without any conflicts disclosures.

Moreover, Winkelmann's efforts to justify his inability to explain BOP's advertising ratios all but concedes he acted, at the very least, recklessly. To that end, Winkelmann admits he was unable to describe how BOP calculated the advertising ratios and that for the contradictions between his and Juris's testimonies, Juris was accurate and Winkelmann was not. (Resp. Br. at 35-36). But Winkelmann ignores that it was he, not his subordinate Juris, who created the advertising ratio metric. (Tr. 464:18-24, 955:13-17, 1436:23-1437:1; DX-327 at 144:8-11, 157:1-19; 159:5-21; Resp. Br. at 15-16). Indeed, as Winkelmann concedes, Juris was not even working at BOP when Winkelmann developed the advertising ratio and began touting it to investors in the first memorandum. (Resp. Br. at 16).[20] Winkelmann, not Juris, chose what ratios to represent to investors. (Tr. 972:2-14, 981:8-13, 982:10-22). And Winkelmann, not Juris, decided to tell investors that the ratio was the "key driver" for BOP's business. (Tr. 448:18-449:2; RX-1, p. 9; RX-2, p. 16; RX-3, p. 13; RX-4, p. 13).

As the CEO of a small adviser and issuer, it was incumbent on Winkelmann to comprehend what he was touting to investors as the most important metric to BOP's business. Even accepting Winkelmann's statement that he did not understand the ratio, his purported ignorance merely establishes he acted recklessly by having BOP's offering materials emphasize a metric he did not understand. The egregiousness of this conduct is compounded by the fact

[20] Once Juris started working at BOP and tracking the advertising ratio, Winkelmann directed her work regarding the ratios, such as by emailing Juris to keep a "running line chart that tracks monthly add spend v monthly conversion factor." (Ex. 94, p. 1). Winkelmann later accessed one of Juris's spreadsheets and inserted the following comment in the "Advertising Factor" column: "Measure Advertising Efficacy – lower the better." (Ex. 163, Column V; Tr. 959:4-960:21).

that Winkelmann circulated the offering materials not only to non-clients, but primarily to client-investors, to whom he owed fiduciary duties.

Winkelmann also fails to justify his dealings vis-à-vis his client Mahoney. Mahoney was looking to sell his poorly performing first round royalty unit around the time Winkelmann began soliciting clients for fourth round units, which offered less favorable terms for investors than Mahoney's first-round unit. (DX-210). Winkelmann claims his conduct toward Mahoney was justified because Mahoney merely "inquired about the *possibility*" of selling his royalty unit. (Resp. Br. at 37). But Winkelmann ignores that he owed fiduciary duties to always act in the best interests of his clients, including *both* Mahoney *and* the clients who ultimately bought fourth round units.[21] Once Mahoney made his inquiry, and notified Winkelmann of his potential interest in selling, Winkelmann's fiduciary duties obliged him to gauge the interest of the upcoming fourth round investors to see if they preferred Mahoney's unit, which had a better payback percentage than the fourth round units, and also included a warrant. (Stip. ¶¶7, 13).[22] Winkelmann's failure to appreciate this concept is further evidence he should no longer be trusted to serve in a fiduciary capacity.[23]

[21] Winkelmann's email to Mahoney and Winkelmann's brief both falsely assert that there was "no market" for Mahoney's royalty unit. (Resp. Br. at 37; DX-210). This assertion is belied by the fact that Winkelmann initiated the fourth offering shortly after Mahoney inquired about selling his royalty unit.

[22] Given the obviously better terms of Mahoney's first-round unit, any reasonable investor would have purchased that unit over a fourth-round unit.

[23] Winkelmann also falsely asserts that the ALJ "rejected" the argument that the Mahoney episode evidences Winkelmann's scienter. (Resp. Br. at 38). Rather, the ALJ discussed Mahoney's inquiry – and found that Winkelmann did not inform his fourth round investor clients about Mahoney's interest in selling – but did not cite it in the ALJ's scienter analysis. (I.D. at 17).

In trying to deny he acted with scienter, Winkelmann continues to make false statements to the Commission which only reinforces his intent to deceive. He claims there "is simply no evidence to support" the contention that Winkelmann needed the royalty offerings to fund his pay increases. (Resp. Br. at 34). Winkelmann is disproven by his own contemporaneous writings. One example is DX-83, a December 2011 email to Binkholder in which Winkelmann (a) observed that BOP was on pace to run out of money in the coming months, and (b) advocated a second royalty unit offering so that he and Binkholder could sharply raise their salaries. Winkelmann similarly conceded, in the fourth memorandum, that BOP would not be able to make payroll without raising at least $50,000 by March 1, 2013. (RX-4, p. 5; Stip. ¶59). Rather than aiding his defense, Winkelmann's claim that he took no salary prior to September 2011 (Resp. Br. at 35) demonstrates that he needed the offerings to raise his salary. Indeed, Winkelmann admits that shortly after the first offering concluded, he raised his salary from zero to more than $120,000. (Resp. Br. at 35). This clear financial motive supports the finding that Winkelmann acted with scienter. *Tellabs, Inc. v. Makor*, 551 U.S. 308, 325 (2007) ("personal financial gain may weigh heavily in favor of a scienter inference").

G. Winkelmann's Reliance Defense Fails

Winkelmann confirms that he does not raise a reliance defense regarding the advertising ratios or the emails where he inflated BOP's success in raising funds and repaying investors. (Resp. Br. at 39). As for Winkelmann's inability to sustain the defense regarding his non-disclosure of the Binkholder bar and his conflicts of interest, as well as his misrepresenting his alignment and lack of conflicts with investors, the Division has fully stated its position in its opening and response briefs. (Div. Br. at 44-47; Div. Resp. Br. at 19-30).

Rather than dispute that he actually rejected Greensfelder's advice regarding the offering materials (*see* Div. Br. at 46), Winkelmann falsely claims the Division raises this argument for the first time on appeal. (Resp. Br. at 46). Again, Winkelmann ignores that the Division made the exact same argument in its post-hearing briefing. (Div. Post-hearing Resp. Br. at 37). And, further demonstrating his lack of judgment and ethical shortcomings, Winkelmann claims that "regulators like to see" the false disclosure that Winkelmann would be paid more if BOP issued fewer royalty units. (Resp. Br. at 46). As stated above, there is no genuine dispute that Winkelmann relied on the royalty unit offerings to fund his salary and salary increases.

H. Conclusion

The Division respectfully requests that the Commission find, for the reasons discussed above and in the Division's opening brief, that Winkelmann violated the antifraud provisions of the Securities Act, Exchange Act, and Advisers Act.

Dated: July 28, 2017

Respectfully submitted:

Benjamin J. Hanauer
David F. Benson
Division of Enforcement
U.S. Securities and Exchange Commission
175 West Jackson Blvd, Suite 1450
Chicago, IL 60604
Phone: 312-353-8642
Fax: 312-353-7398
Email: hanauerb@sec.gov

Rule 450(d) Certification

The undersigned counsel for the Division of Enforcement hereby certifies that this brief is 6,920 words, exclusive of the tables of contents and authorities.

Benjamin J. Hanauer