

STATE OF NEW HAMPSHIRE
BUREAU OF SECURITIES REGULATION
DEPARTMENT OF STATE
25 CAPITOL STREET
CONCORD, NH 03301

CONSENT AGREEMENT
IN THE MATTER OF:

MORGAN STANLEY DW INC.
COM03-18, 18A, and INV03-27

I. For purposes of settling the above-referenced matter and in lieu of further administrative proceedings, Morgan Stanley DW Inc. (hereinafter referred to as “Respondent”) has submitted an offer of settlement, which the Bureau of Securities Regulation, Department of State, State of New Hampshire (hereinafter referred to as “the Bureau”) has determined to accept. Accordingly, without admitting or denying the Statement of Facts, Statement of Law, or any other allegations herein, Respondent does hereby consent to the entry of this Consent Agreement as set forth below:

II. **STATEMENT OF FACTS**

1. Respondent is a broker-dealer firm with an address on record with the Bureau of 1601 Broadway, New York, New York 10019. Respondent is engaged in the business of buying and selling of securities for the accounts of others. Respondent is registered with the Securities and Exchange Commission, is a member of the National Association of Securities Dealers and New York Stock Exchange, and many of its broker-dealer registration records are kept on the NASD’s Central Registry Depository (“CRD”) system. Respondent’s CRD number is 7556. Agent was employed as a registered representative of Respondent from December 1998 to April 2001 (hereinafter the “relevant time period”). Agent was an associated person of the NASD during the relevant time period.
2. According to Respondent records, Agent was hired by Respondent as an Account Executive (hereinafter referred to as “AE”) and was designated AE #10. Upon his hiring, Agent signed a statement confirming that he reviewed and would comply with the Respondent Account Executive Compliance Guide. Agent worked out of the Manchester, New Hampshire branch office, which was designated as branch 419. Branch office 419 was considered part of Respondent’s northeast region which was designated region 8. The Manchester branch office was supervised by the Manchester branch manager who, in turn, was supervised by the Portsmouth, New Hampshire branch manager. Both managers reported to a regional director

who supervised the client accounts personally handled by the branch managers. Branch offices were required to operate in accordance with the Morgan Stanley Branch Manager's Manual.

3. Respondent's written compliance policies require AEs to have a reasonable basis to recommend the purchase of stocks. The reasonable basis for a recommendation could be based, in part, on Respondent's research reports. AEs were to recommend only those stocks that were suitable for trading and properly blue skied. A stock that was blue skied would meet the regulatory requirements in the state with jurisdiction over the transaction. AEs were generally not permitted to recommend "penny stocks" (stocks having a price of \$2.00 or less) to clients. Clients wanting to make trades in penny stocks were to be questioned by the AE, and if the client persisted, the AE was to receive the approval of branch management. When an AE placed a stock order, the computerized order screen would indicate to the AE if the stock order was restricted. Unregistered, non-exempt stocks could be cleared for trading if the trade was marked unsolicited. Stocks that were not followed by Morgan Stanley research were not flagged by the ordering system. Respondent also has a policy which prohibits the solicitation of certain stocks that exceed aggregate threshold levels within the Firm. These transactions are restricted to no purchases without prior approval from the Compliance Department. A separate screen accessed by an AE referred to as the AdvantageE Workstation would indicate to the AE if that stock was blue-skied, but that information was not automatically provided to the AE. Respondent policy required that the solicited or unsolicited nature of each trade transaction had to be properly reflected on the company's books and records, and all orders entered by AEs had to be truthful and accurate. Respondent policy was that trades entered by an AE for his or her personal accounts had to be designated solicited. Also, Respondent's written compliance policies required that Morgan Stanley client accounts not be excessively traded. CAR (Customer Activity Report) and TAR (Trade Activity Reports) are tools used by managers to monitor client accounts for trading tolerances such as number of trades, commissions, average equity, average market value, turnover, commissions versus equity, margin interest, and commission and margin as a percent of average equity.
4. During the relevant time period, Agent solicited customers of the Manchester branch office to purchase shares of Viewcast.com, Inc., Ivoice.com, Inc., CT Holdings, Inc, and Illinois Superconductor Corp., at a time when those shares were neither suitable for those clients, nor registered under the New Hampshire Uniform Securities Act, nor exempt from registration. Upon information and belief, Agent then improperly designated these transactions as "unsolicited" to circumvent the firm's policies and procedures regarding recommendations of unregistered, non-exempt stocks. During the relevant time period, Agent engaged in excessive trading and high account turnover rates in his own accounts and in a joint account held with his wife at the time. Further, upon information and belief, Agent signed his wife's name on account opening applications. In addition, in November 1999 and January 2000, without obtaining prior approval, Agent

purchased in his own account shares of stocks that had been restricted by Respondent's Compliance Department because of firm-wide concentration levels. During 1999, Respondent's New Hampshire branch management became aware of instances when Agent's trading activity in his personal accounts was excessive and not in compliance with firm policy, and Agent was warned and his trading was restricted in April 2000. Despite these events, New Hampshire branch management failed to detect or failed adequately to respond to instances where Agent executed stock trades that were unregistered and nonexempt or were otherwise restricted in violation of firm policy and procedure. In fact, the Manchester branch office manager signed an accession agreement with Pirus Networks, Inc. as custodian for one of Agent's clients, in the summer of 2000, and that transaction was later rescinded as unregistered and nonexempt. Agent was eventually terminated for failing to follow firm policy.

5. During 2002, Respondent carried out several sales campaigns that focused on certain proprietary funds and variable annuity contracts. As part of the focus on proprietary funds, Respondent devised several local and regional sales campaigns that were carried out in New Hampshire. These sales campaigns offered and distributed cash or non-cash compensation not based on total sales, and not equally weighted for all products. One campaign, which was devised by the Manchester and Portsmouth branch offices, was termed "Steak-a-thon" -- whereby over 100 steaks were awarded to agents located in those New Hampshire branches based, in part, on the dollar volume of sales of certain Morgan Stanley proprietary products. There was a campaign in the region that included New Hampshire called the Mid-Year Marathon, which ran from May-July 2002 and which featured three products, including a proprietary mutual fund asset allocation program called Portfolio Architect. In July 2002, Respondent initiated a promotion entitled "Finding the Right Fit," pursuant to which national management pressured regional management to meet specific proprietary funds sales goals. In connection with the "Finding the Right Fit" promotion, the region that included New Hampshire conducted a campaign, from September-November 2002, that focused on proprietary products and that awarded travel and expense reimbursements to successful branch offices.¹ Respondent apparently attempted to shield this focus on proprietary mutual funds from the public as much as possible to avoid public relations ramifications. This is evidenced by electronic mail messages by a regional manager directing branch managers and other employees to refrain from putting in writing details regarding contests promoting proprietary mutual funds. Further, until January 2003, Respondent did not have any supervisory or compliance systems or procedures in place governing compliance with the non-cash compensation provisions of NASD Rules 2820 and 2830.

¹ No employee of any New Hampshire branch received any cash or non-cash compensation as a result of any campaign conducted by the region in connection with the "Finding the Right Fit" promotion or "Mid-year Marathon."

6. Also during 2002, one component of branch manager compensation was tied directly to the profitability of their branches, and branches retained a greater percentage of revenue on the sale of proprietary mutual funds than non-proprietary funds.
7. Incumbent upon every broker-dealer is the obligation to reasonably supervise their agents, and establish and maintain a system to supervise the activities of the broker-dealer to ensure compliance with applicable securities laws and regulations. Respondent failed to adequately supervise Agent by allowing Agent's improper trading to continue in his own accounts, and by allowing the sale of securities to clients of the Manchester branch office that were not properly blue skied.
8. In opening a brokerage account with Respondent, a client is required to agree to the arbitration of controversies between the client and Respondent. In its forms, Respondent required its New Hampshire clients to agree to provisions which could be interpreted as requiring them to waive the application of New Hampshire securities laws in arbitration hearings, and instead required that New York law apply to those hearings. Morgan Stanley agrees that it will not assert in arbitration proceedings with New Hampshire residents or with past or current clients of Morgan Stanley's New Hampshire branch offices that the choice of law provision described in the preceding sentence precludes or in any way affects the application of New Hampshire law, and in particular the Uniform Securities Act of the State of New Hampshire.
9. By letter dated August 15th, 2003, the Bureau requested from Respondent "[a]ny document or oral statement of MSDW or any of its employees, referring or relating to any gift, bonus, prize, contest, sales contest, or incentive offered to or made available to any broker or employee of a MSDW New Hampshire branch office during the relevant time period", and asked Respondent to "[i]dentify any person, broker, or employee of a MSDW New Hampshire branch office involved in or taking part in giving or receiving a bonus, gift, or incentive for the sale of Van Kampen, in-house, or proprietary mutual funds of MSDW during the relevant time period".
10. In response, Respondent produced in October 2003 certain documents Bates stamp numbers MS 000024 through 000063 relevant to the Bureau's investigation into the "Steak-a-thon" sales campaign. These documents, which were the only responsive documents located by Respondent as of that time, consisted primarily of handwritten notes, some with drawn sketches of steaks, identifying financial advisors from Respondent's Manchester branch office who received steaks as a result of the Steak-a-thon contest.
11. Following the receipt of Respondent's production materials and the Bureau's investigation into those documents, in June 2004, the Bureau filed a Staff Petition For Relief which alleged among other violations, that Respondent violated

provisions of RSA 421-B and NASD Rule 2830 with regard to the Steak-a-thon sales campaign. On June 18th, 2004, an Order To Cease and Desist from the named violations issued. In September 2004, Respondent produced roughly 30 pages of additional documents responsive to the Bureau's document request (Bates numbered MSNH 002199 through MSNH 002230), which identified 24 employees in Respondent's Portsmouth branch office who received approximately 80 additional steaks as a result of the Steak-a-thon. In early 2005, Respondent identified five additional pages of responsive documents that had not previously been produced. These five pages were promptly produced to the Bureau.

III. STATEMENT OF LAW

1. Respondent and Agent are persons within the meaning of RSA 421-B:2,XVI.
2. Respondent is a broker-dealer within the meaning of RSA 421-B:2,II.
3. Agent was a registered person associated with a broker-dealer within the meaning of RSA 421-B:2,II.
4. Pursuant to RSA 421-B:8,X, persons licensed under RSA 421-B to conduct securities business shall abide by the rules of the Securities and Exchange Commission, National Association of Securities Dealers ("NASD"), national and regional stock exchanges, and other self-regulating organizations which have jurisdiction over the licensee, which set forth standards of conduct in the securities industry. During the period described in Paragraph 4 above, the Agent's conduct described therein was violative of NASD Conduct Rule 2310. During the period described in Paragraph 5 above, the sales campaigns of Respondent were violative of NASD Conduct Rules 2820 and 2830.
5. Pursuant to RSA 421-B:10, Respondent has a responsibility to reasonably supervise its brokers. Respondent has violated this section.
6. Pursuant to RSA 421-B:11, it is unlawful for any person to offer or sell any security in this state unless it is registered under this chapter, the security or transaction is exempt under RSA 421-B:17, or it is a federal covered security for which the fee has been paid and documents have been filed as required. As described in paragraph 4 above, Respondent has violated this section.
7. Pursuant to RSA 421-B:25, any condition, stipulation or provision binding any person to waive compliance with any provision of this chapter or any rule or order under this chapter in the purchase or sale of any security is void.

8. Pursuant to RSA 421-B:26,III, any person who, either knowingly or negligently, violates any provisions of this chapter may, upon hearing, and in addition to any other penalty provided for by law, be subject to such suspension, revocation or denial of any registration or license, or an administrative fine not to exceed \$2,500, or both. Respondent is subject to this section.
9. Pursuant to RSA 421-B:23, whenever it appears to the Secretary of State that any person has engaged or is about to engage in any act or practice constituting a violation of this chapter or any rule under this chapter, he shall have the power to issue and cause to be served upon such person an order requiring the person to cease and desist from violations of this chapter. Respondent is subject to this section.
10. Pursuant to RSA 421-B:26,III-a, every person who directly or indirectly controls a person liable under paragraph III, every principal executive officer, or director of such person, every person occupying a similar status or performing a similar function, every employee of such person who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the acts or transactions constituting the violation either knowingly or negligently, may, upon hearing, and in addition to any other penalty provided by law, be subject to such suspension, revocation, or denial of any registration or license, or administrative fine not to exceed \$2,500, or both. Each of the acts specified shall constitute a separate violation, and such administrative action or fine may be imposed in addition to any criminal penalties imposed pursuant to RSA 421-B:24 or civil liabilities imposed pursuant to RSA 421-B:25. Respondent is subject to this section.
11. Pursuant to RSA 421-B:26,V, after notice and hearing, the Secretary of State may enter an order of rescission, restitution, or disgorgement directed to a person who has violated RSA 421-B. Respondent is subject to this section.

IV. In view of the foregoing, the Respondent agrees to the following undertakings and sanctions:

1. Respondent agrees that it has voluntarily consented to the entry of this Agreement and represents and avers that no employee or representative of the Bureau has made any promise, representation or threat to induce its execution.
2. Respondent agrees to waive its right to an administrative hearing and any appeal therein under this chapter.
3. Respondent agrees to cease and desist from any alleged violations of RSA 421-B:8,X, 421-B:11, and NASD Conduct Rules 2820 and 2830, as discussed above.

4. Respondent agrees to pay administrative fines in the amount of \$425,000 to the State of New Hampshire with respect to the matters addressed in section II, sections 4, 5 and 7. This payment shall be made in two equal installments. The first installment of \$212,500 shall be due and payable within three business days of the execution of this Agreement by Respondent. The second installment of \$212,500 shall be due and payable on or about September 1, 2005. Both of these payments shall be made by 1) United States postal money order, check, bank cashier's check, or bank money order; 2) made payable to the State of New Hampshire; and 3) hand-delivered or mailed to the Bureau of Securities Regulation, Department of State, State House, Room 204, Concord, New Hampshire, 03301.
5. Respondent agrees to pay the cost of the investigation by the Bureau into this matter in the amount of \$10,000. Payment shall be made within twenty-one days of the execution of this Agreement by Respondent. Payment shall be made by 1) United States postal money order, check, bank cashier's check, or bank money order; 2) made payable to the State of New Hampshire; and 3) hand-delivered or mailed to the Bureau of Securities Regulation, Department of State, State House, Room 204, Concord, New Hampshire, 03301.
6. Respondent shall retain, within 90 days from the date of this Agreement, an independent consultant, acceptable to the Bureau, to review the current compliance and policy procedures as implemented in the Firm's New Hampshire branch offices in the following areas: (a) procedures for the solicitation of stocks that have been restricted by the Compliance Department because of concentration levels within the Firm; (b) procedures for supervising the solicitation and/or the purchase of unregistered, non-exempt stocks, including conducting a meaningful sampling review, as determined by the independent consultant, of purchase and sale transactions in New Hampshire branch offices during a 60 day period between January 1, 1999 and April 30, 2001 selected by the independent consultant; and (c) procedure for designation of order tickets as solicited or unsolicited. The independent consultant shall identify the clients who were solicited by Agent, as well as the reasons for the solicitation (to the extent they are identifiable to the consultant) to purchase any of the four unregistered, nonexempt securities identified herein under New Hampshire law during the period January 1, 1999 to the present. The consultant shall also review the adequacy of the supervisory practices in the Manchester branch office.
7. The consultant shall make written findings and recommendations within thirty days from the date of retention. The consultant shall contemporaneously provide a copy of all written reports to the Bureau and Respondent. The consultant's report must include a description of the review performed, the conclusions reached, any findings as to the adequacy of the supervisory practices in the Manchester branch office, and the independent consultant's recommendations for policies or procedures to address any deficiencies identified with respect to subsection six (a)

through (c), above, and an effective system for implementing the recommended polices and procedures.

8. Within 105 days after receipt of the independent consultant's written findings and recommendations, Respondent shall advise the independent consultant and the Bureau of the recommendations from the written report that it has determined to accept (the "agreed-upon recommendations") and the recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Respondent considers unnecessary or inappropriate, Respondent shall explain why the objective or purpose of such recommendation is unnecessary or inappropriate and provide in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. With respect to any recommendation with which Respondent and the independent consultant do not agree, Respondent shall attempt in good faith to reach an agreement within 120 days of receipt of the written recommendations from the independent consultant. In the event the independent consultant and Respondent are unable to agree on an alternative proposal acceptable to the Bureau, Respondent shall be entitled, at its own expense, to seek review by a JAMS mediator with securities expertise who is mutually agreed upon by Respondent and the Bureau. Respondent shall be required to seek such review within 150 days after receipt of the independent consultant's findings and recommendations. Should the parties be unable to reach agreement, the JAMS mediator shall render a decision that will be binding and non-appealable. With respect to the agreed-upon recommendations and any recommendations that survive the review process, Respondent annually will provide to the Bureau satisfactory proof of implementation for a period of two years following the later of (i) the independent consultant's review, or (ii) the final decision by the agreed-upon mediator.
9. Respondent shall, within 60 days of finalizing the agreed-upon recommendations, as defined above, issue a Compliance Alert to all managers and agents of New Hampshire branch offices addressing any new procedures implemented in connection with subsection seven (a) through (c), above. The Bureau will be provided a copy of such Compliance Alert.
10. Respondent shall send notification of rescission via certified mail, return receipt requested, to the last known address of each client who was solicited to purchase any of the aforementioned four stocks from a New Hampshire branch office from the period from January 1, 1999 to the present.² The notice of rescission shall be sent within 30 days of its approval by the Bureau. Respondent will offer

² The rescission offer for Illinois Superconductor Inc. will be for the period January 1, 1999 through June 6, 2002, after which time the company became registered and/or exempt from registration under the New Hampshire Uniform Securities Act. Illinois Superconductor Inc. is now known as ISCO International and has traded on the American Stock Exchange under the symbol ISO since June 7, 2002.

rescission of the purchase price plus interest at New Hampshire statutory rate at the time of the transaction, less any sale proceeds and dividends. Respondent shall bear the costs associated with the rescission. This provision shall not apply to any client of Respondent who has, at the time of the rescission offer, settled his or her claim against Respondent for the sale of the aforementioned four stocks. No rescission will be made to Agent. This Agreement shall not preclude the Bureau from taking the position that there should be rescission for any other stocks identified as unregistered and nonexempt by the consultant or the Bureau.

11. Within 120 days of the execution of this Agreement, Respondent shall also send notification to all existing clients of its New Hampshire branch offices, and to all past clients of New Hampshire branch offices during the last 6 years at the last known address, stating as follows: “The arbitration clause in your account agreement with Morgan Stanley DW, Inc. contains a provision indicating that the law of the State of New York will govern the agreement and its enforcement, including but not limited to determination of applicable statutes of limitation and available remedies. The purpose of this notice is to inform you that, in arbitration proceedings with New Hampshire residents or with past or current clients of Morgan Stanley’s New Hampshire branch offices, Morgan Stanley will not assert that the foregoing provision precludes or in any way affects the application of New Hampshire law, and in particular the Uniform Securities Act of the State of New Hampshire.” In addition, Respondent will provide similar notice to any new clients of its New Hampshire branch offices for as long as the arbitration clause of the client agreements includes a choice of law provision.
12. Respondent agrees that this Agreement is entered into for purpose of resolving only the matter as described herein. This Agreement shall have no collateral estoppel, res judicata, evidentiary, or other legal effect in any other lawsuit, proceeding, or action, not described herein. Likewise, this Agreement shall not be construed to restrict the Bureau’s right to initiate an administrative investigation or proceeding relative to conduct by Respondent of which the Bureau has no knowledge at the time of the date of final entry of this Agreement.
13. The Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this consent agreement or creating the impression that the consent agreement is without factual basis. However, nothing in this provision affects the Respondent’s testimonial obligations or right to take contrary legal or factual positions in litigation or other legal proceedings in which the State of New Hampshire is not a party.

V. Based on the foregoing, the Bureau deems it appropriate and in the public interest to accept and enter into this Consent Agreement. THEREFORE, IT IS HEREBY AGREED THAT:

1. Respondent will cease and desist from any violations of the provisions of the act discussed above, specifically RSA 421-B:8,X, and RSA 421-B:11.
2. Respondent will pay an administrative fine in the amount of \$425,000 relating to the matters addressed in section II, paragraphs 4, 5 and 7. This payment shall be made in two equal installments, as set forth in section IV, paragraph 4.
3. Respondent will pay the cost of the investigation in the amount of \$10,000 as described in section IV herein.
4. Respondent will comply with the above-referenced undertakings.
5. The Bureau shall not bring any further actions based on the acts and omissions that were alleged in the Complaint.

on behalf of Respondent
(Please print name, title below:)

dated: _____

Bureau of Securities Regulation
Mark Connolly, Director

dated: _____