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Montana Securities Law — Its Rules and Regulations

[*Editors note:* In 1961 the Montana Legislature adopted the Uniform Securities Act. However, the Montana Securities Law did not “come of age” until March 30, 1964, when the State Investment Commissioner, pursuant to statute,¹ adopted rules and regulations. These rules and regulations are reprinted here, as they provide valuable and necessary guidelines for Montana’s attorneys, and for all persons interested in financing activities. These rules and regulations, as well as the Montana Securities Law, will be discussed in a series of articles by James E. Newton² which will appear in coming issues of the Montana Law Review.]

STATE OF MONTANA DEPARTMENT OF MONTANA INVESTMENT COMMISSIONER HELENA, MONTANA

RULES AND REGULATIONS

Pursuant to the authority vested in the Investment Commissioner of the State of Montana, under the provisions of Section 15-2024, R.C.M., 1947, the following rules and regulations have been promulgated and adopted, effective March 30, 1964, the Investment Commissioner having found that such action is necessary and appropriate in the public interest and for the protection of investors, and consistent with the purposes fairly intended by the policy and provisions of the Securities Act of Montana.

These rules and regulations do not apply to any exempt securities, or exempt transactions, as set forth under Sections 15-2013 and 15-2014, R.C.M., 1947.

RULE 1. SALES MATERIAL

The Commissioner may require advance approval of all subscription agreements or receipts, and literature and advertising (such as written, printed, radio, television, etc.) proposed to be used in connection with the sale of securities in Montana and that they be filed with the Commissioner at least five days prior to their proposed use.

RULE 2. DEFINITION OF PROMOTIONAL SECURITIES

Securities issued, or to be issued, within three years from the date of registration for services rendered, patents, copyrights, or other in-

¹REVISED CODES OF MONTANA, 1947, § 15-2024. Hereinafter REVISED CODES OF MONTANA will be cited R.C.M.

²Regional Administrator of Securities and Exchange Commission in Seattle. Member of the Seattle Bar. A.B., University of Michigan, 1926; LL.B., Harvard Law School, 1929.

tangibles, together with all property, either real or personal, the actual value of which has not been established to the satisfaction of the Commissioner, or which are issued for a monetary consideration substantially lower than the consideration for which shares are sold for principal financing purposes, may be treated as promotional securities.

RULE 3. ESCROW OF PROMOTIONAL SHARES

Promotional shares may be required to be placed in escrow with an escrow holder first to be approved by the Commissioner. Shares so escrowed, or any interest therein, or any portion thereof, shall not be sold, or transferred, until the written consent of the Commissioner shall have been first obtained.

RULE 4.

WAIVERS IN CONNECTION WITH PROMOTIONAL SHARES

Promotional shares shall carry a waiver of dividend rights and rights to participate in the distribution of assets in the event of liquidation, or dissolution, in favor of the shareholders, who have paid cash, or its equivalent, for their shares. Such waivers shall remain in effect so long as the Commissioner requires.

RULE 5. NEW VENTURE FINANCING

Financing of a new venture by the sale of shares, or securities, which are non-participating, or which have a fixed return, or are redeemable (unless convertible on an equitable basis) shall be considered with disfavor even though sold in units together with common shares.

RULE 6. FILING FOR REGISTRATION

Registration statements by notification, coordination, or qualification, shall not be deemed filed with the Commissioner within the meaning of Sections 8, 9, and 10, of this Act, unless, and until, such registration statements contain all information required by the pertinent provisions of this Act, or requested by the Commissioner, and are accompanied by all required exhibits, except as to such information, or exhibits, the filing of which has been waived by the Commissioner.

RULE 7. NOTICE OF TERMINATION OF OFFERING — CHANGE OF OFFICERS

An issuer which has completed, or discontinued, the sale of securities registered with the Commissioner, shall notify the Commissioner, in writing, to that effect. Until such notice has been given, notices of all changes of officers, directors, trustees, partners, or other principal members of registrants, shall be made to the Commissioner as soon as possible, but within 15 days after such change in personnel of such organization shall become effective.

RULE 8. FILING BY BROKERS, DEALERS, AND SALESMEN

Applications by broker-dealers, salesmen, and investment advisers shall not be deemed filed with the Investment Department, within the meaning of the Securities Act of Montana, unless and until such applications contain all information required by the Commissioner and are accompanied by all required exhibits, except as to such information, or exhibits, the filing of which has been waived by the Commissioner.

RULE 9. BASIS OF SELLING EXPENSES

In the sale of securities, other than those of Investment Companies, as defined in the Investment Company Act of 1940, and securities listed on a national securities exchange, commissions to broker-dealers, or salesmen, as well as all other expenses of selling, chargeable to purchaser, shall be based only on cash actually paid by such purchaser, and not upon the amount of securities sold, or subscriptions taken, and there shall be no default, or penalty provisions, in any stock purchase agreement, or stock subscription agreement.

RULE 10. WARRANTS AND OPTIONS

Warrants or stock purchase options to those other than the purchasers of securities will be looked upon with disfavor and will be considered as a basis for denial of the application, except that:

- (1) Options to management in the nature of restricted stock options for incentive purposes, if reasonable in number and method of exercise, generally will be looked upon favorably.
- (2) Options to employees, or their nominees, pursuant to stock purchase plans or profit sharing plans, if reasonable in number and method of exercise, generally will be looked upon favorably.
- (3) Options or warrants issued to underwriters in connection with a public offering generally will be looked upon favorably if:
 - (a) They are issued to the managing underwriter under a firm underwriting agreement and are not assignable or transferable, except among partners of the underwriter when the underwriter is a partnership;
 - (b) The number of shares covered by the warrants or options do not exceed ten percent of the securities to be outstanding at the completion of the offering, such percentage including warrants to employees;
 - (c) The initial exercise price of the options is at least equal to the public offering price with a "step-up" of at least seven percent of the exercise price each year they are outstanding.
 - (d) The options or warrants do not exceed three years in duration and are exercisable no sooner than eleven months after issuance; and
 - (e) The options or warrants are issued by a relatively small company in the promotional stage where it appears from all

of the facts and circumstances that the issuance of such options is necessary to obtain competent investment banking service, provided that the direct commissions to the underwriters are lower than the usual and customary commissions would be in the absence of such options or warrants.

Options or warrants which do not meet the conditions specified in section 3 may be viewed favorably in unusual instances; but the burden shall always rest on the applicant to justify their issuance. The number of warrants sought to be issued, the exercisable price, the term in which they are exercisable and the absence or adequacy of a step-up rate in the exercisable price will all be taken into consideration.

RULE 11. BROKER-DEALER RECORDS

Every broker-dealer shall make and keep current the following books and records relating to his business:

1. Blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records shall show the account for which each such transaction was effected, the name and amount of securities, the unit and aggregate purchase or sale price (if any), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered.

2. Ledgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts.

3. Ledger accounts (or other records) itemizing separately as to each cash and margin account of every customer and of such member, broker or dealer, and partners thereof, all purchases, sales, receipts, and deliveries of securities and commodities for such account, and all other debits and credits to such account.

4. Ledgers (or other records) reflecting monies borrowed and monies loaned (together with a record of the collateral therefor and any substitutions in such collateral).

5. A memorandum of each brokerage order and of any other instruction given or received for the purchase or sale of securities, whether executed or unexecuted. Such memorandum shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof, the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation. Orders entered pursuant to the exercise of discretionary power by such member, broker, or dealer, or any employee thereof, shall be so designated. The term "instruction" shall be deemed to include instructions between partners and employees of a member, broker, or dealer. The term "time of entry" shall be deemed to mean the time when such member, broker, or dealer transmits the order or instruction for execution or, if it is not so transmitted, the time when it is received.

6. A memorandum of each purchase and sale of securities for the account of such member, broker, or dealer showing the price and, to the extent feasible, the time of execution.

7. Copies of confirmations of all purchases and sales of securities, and copies of notices of all other debits and credits for securities, cash, and other items for the account of customers and partners of such member, broker, or dealer.

8. A record in respect of each cash and margin account with such member, broker, or dealer containing the name and address of the beneficial owner of such account and, in the case of a margin account, the signature of such owner; provided that, in the case of a joint account or an account of a corporation, such records are required only in respect of the person or persons authorized to transact business for such account.

9. A record of the proof of money balances of all ledger accounts in the form of trial balances. Such trial balances shall be prepared currently at least once a month.

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