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INSIGHTS

Early Warning Reports – When Do I Need to File?

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This insight updates an earlier article posted on [July 11, 2016](#) to clarify the requirements to file an early warning report.

In theory calculating when early warning reports are required to be filed under Canadian securities law sounds simple, but in practice it can be quite complicated. This article attempts to make that task a little less confusing. In any event, if you are close to any reporting thresholds before buying or selling any further shares or convertible securities you should seek legal advice from a legal professional experienced in this area so that all relevant facts can be ascertained and proper legal advice provided.

General Requirements

Generally speaking, the early warning reporting system under Canadian securities laws is designed to inform the marketplace immediately of the following events:

- (a) **10% Ownership:** If a reporting person acquires securities of a reporting issuer such that the reporting person then beneficially owns, directs or controls 10% or more of a reporting issuer's now current outstanding voting or equity securities;
- (b) **2% Increases or Decreases:** If a reporting person that was required to file a report under (a) above, subsequent to the date that the reporting person's last report was filed, increases or decreases that reporting person's ownership, direction or control (through one or more acquisitions or dispositions) by 2% or more of a reporting issuer's now current outstanding voting or equity securities; or
- (c) **Decreases to Less than 10% Ownership:** If a reporting person that was required to file a report under (a) above, subsequent to the date that the reporting person's last report was filed, decreases that reporting person's ownership, direction and control to less than 10% of a reporting issuer's now current outstanding voting or equity securities.

In each of these events, the reporting person must:

- (a) **News Release:** Issue (and file on SEDAR) a news release, with mandated disclosure, by the opening of trading the next day; and
- (b) **Early Warning Report:** File an early warning report, with mandated disclosure, on SEDAR within 2 days.

That sounds pretty simple but in reality there are a series of factors that make the calculations for each of the foregoing events much more complicated in many circumstances.

Calculating the 10% Threshold

Add Convertible Securities and Joint Actors

First, the inputs for determining the percentage of a class of voting or equity securities beneficially owned, controlled or directed by a reporting person include not only shares of that class held by the reporting person but also convertible securities held by the reporting person, plus shares and convertible securities held by persons acting jointly and in concert with the reporting person. Second, the inputs for the numerator and the denominator in this calculation are slightly different. The table below sets for the inputs for determining when the 10% threshold has been reached for any class of shares.

Numerator:

- Reporting Person - The number of shares that the reporting person has beneficial ownership of, or control or direction over.
- + Reporting Person - The number of shares that the reporting person can acquire **at any time** upon the exercise or conversion of any convertible securities (i.e. options, warrants, convertible debentures or any other conversion or subscription right).
- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person has beneficial ownership of, or control or direction over.
- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.

Denominator:

- Reporting Issuer - The number of shares now outstanding,
- + Reporting Person - The number of shares that the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.
- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.

Note that the number of shares that the reporting person can acquire **at any time** upon the exercise or conversion of any convertible securities is added to the numerator whereas only the number of shares that the reporting person can acquire **within the next 60 days** is added to the denominator.

Consider Issuer Actions

Now let's make it a little more complicated. What happens if the number of outstanding shares of the reporting issuer changes over time?

A person is **exempt** from the early warning requirements in connection with an **increase** in the percentage of outstanding shares held by the person that arises without any action being taken by the person and **solely from a reduction in outstanding shares** that occurs as a result of redemptions, retractions or other repurchases by the reporting issuer that affect or are offered to all shareholders of the relevant class.

Similarly, a person is **exempt** from the early warning requirements in connection with a **decrease** in the percentage of outstanding shares held that arises without any action being taken by the person and **solely from an increase in outstanding shares** that occurs as a result of treasury issuances of shares by the reporting issuer.

However, a person may rely upon the aforementioned exemptions only **until the person undertakes any transaction** (i.e. any acquisition or disposition of shares or convertible securities) that changes the shareholding percentage of the person.

The table below provides a short summary of the reporting requirements in a few different circumstances:

<u>Event</u>	<u>Reporting Requirement?</u>
<u>Ownership Exceeding 10% or More</u>	
Acquisition - Person acquires shares resulting in that person's aggregate ownership exceeding 10%.	Report
Issuer Event - Issuer redeems a number of issuer shares from other shareholders. After the redemption, the person's share ownership increases to above 10%.	Report when person makes next acquisition or disposition of shares or convertible securities that changes its shareholding percentage.
<u>Ownership Decreasing Below 10%</u>	
Disposition - Person disposes of shares resulting in that person's aggregate ownership decreasing to below 10%.	Report
Issuer Event - Issuer issues from treasury a number of shares to other persons. After the share issuance, the person's share ownership decreases to below 10%.	Report when person makes next acquisition or disposition of shares or convertible securities that changes its shareholding percentage.

Calculating the 2% Threshold

Two Tests

The 2% threshold calculation is actually two separate calculations, as a reporting person who was previously required to file early warning disclosure upon exceeding the 10% threshold is required to make disclosure each time the reporting person, or any person acting jointly or in concert with the reporting person, acquires or disposes beneficial ownership of, or acquires or ceases to have control or direction over, either of the following:

- (a) Shares in an amount equal to 2% or more of the issuer's outstanding shares; or
- (b) Shares convertible into 2% or more of the issuer's outstanding shares.

Calculating the First Test

For the first test, a person needs to include both shares currently owned and shares that can be acquired **within the next 60 days** upon the exercise or conversion of any convertible securities (in

the latter case these are included in both the numerator and the denominator). It should be noted however that, depending on the terms of the convertible securities, it is likely that the number of shares that the person can acquire upon the exercise or conversion of any convertible securities within the next 60 days will change over time and therefore a reporting requirement may be triggered upon the passage of time. The table below sets for the inputs for this first test.

Numerator:

- Reporting Person - The number of shares that the reporting person has beneficial ownership of, or control or direction over.
- + Reporting Person - The number of shares that the reporting person can acquire **within 60 days** upon the exercise or conversion of any convertible securities that the reporting person has acquired (or disposed) beneficial ownership of, or control or direction over since the reporting person's last report.
- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person has acquired (or disposed) beneficial ownership of, or control or direction over since the reporting person's last report.
- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities that the reporting person has acquired (or disposed) beneficial ownership of, or control or direction over since the reporting person's last report.

Denominator:

- Reporting Issuer - The number of shares now outstanding,
- + Reporting Person - The number of shares that the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.
- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.*

*After calculating the percentage ownership based on this formula, the person will compare its percentage ownership to its percentage ownership when it initially filed its early warning report. If the change in ownership (increase or decrease) is greater than 2%, the person is required to issue a news release and file an early warning report.

*Note that if a reporting person commences acting jointly or in concert with another person after the date of the reporting person's last report, all securities owned by the joint actor should be included in this calculation, not just those acquired since the date of the reporting person's last report.

Calculating the Second Test

For the second test, a person includes in the numerator shares that can be acquired **at any time**, by either the reporting person or any joint actors, upon the exercise or conversion of any convertible securities whereas only the number of shares that can be acquired **within the next 60 days**, by either the reporting person or any joint actors, are added to the denominator. The table below sets forth the inputs for this second test.

Numerator:

- + Reporting Person - The number of shares that the reporting person can acquire **at any time** upon the exercise or conversion of any convertible securities that the reporting person has acquired (or disposed) beneficial ownership of, or control or direction over since the reporting person's last report.

- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person can acquire **at any time** upon the exercise or conversion of any convertible securities that the reporting person has acquired (or disposed) beneficial ownership of, or control or direction over since the reporting person's last report.

Denominator:

- Reporting Issuer - The number of shares now outstanding,

- + Reporting Person - The number of shares that the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.

- + Joint Actors - The number of shares that any person acting jointly or in concert with the reporting person can acquire **within the next 60 days** upon the exercise or conversion of any convertible securities.*

*Again, note that if a reporting person commences acting jointly or in concert with another person after the date of the reporting person's last report, all securities owned by the joint actor should be included in this calculation, not just those acquired since the date of the reporting person's last report.

Consider Issuer Actions

Again, let's make it a little more complicated by considering what happens if the number of outstanding shares of the reporting issuer changes over time. As stated earlier, a person is exempt from reporting changes arising solely by issuer actions until the person makes a further transaction that changes the person's shareholding percentage.

The table below provides a short summary of the reporting requirements in a few different circumstances:

<u>Event</u>	<u>Reporting Requirement?</u>
<u>Ownership Decreasing By 2%</u>	
Acquisition - Shareholder is subject to early warning reporting requirements (owns more than 10% of shares) and, since the date of the last report, acquires a number of additional shares equal to more than 2% of the current outstanding shares.	Report
Issuer Event - Shareholder is subject to early warning reporting requirements (owns more than 10% of shares) and, since the date of the last report, acquires a number of additional shares that at the time of acquisition equaled <u>less than 2%</u> of the then	Report when person makes next acquisition or disposition of shares or convertible securities that changes its shareholding percentage.

current outstanding shares. Subsequently, the issuer redeems a number of issuer shares such that the person's aforementioned acquisitions now equal to more than 2% of the now current outstanding shares.

Ownership Decreasing By 2%

Disposition - Shareholder is subject to early warning reporting requirements (owns more than 10% of shares) and, since the date of the last report, disposes of a number of shares equal to more than 2% of the current outstanding shares.

Report

Issuer Event - Shareholder is subject to early warning reporting requirements (owns more than 10% of shares) and, since the date of the last report, disposes of a number of additional shares that at the time of acquisition equaled less than 2% of the then current outstanding shares. Subsequently, the issuer redeems a number of issuer shares such that the person's aforementioned dispositions now equal to more than 2% of the now current outstanding shares.

Report when person makes next acquisition or disposition of shares or convertible securities that changes its shareholding percentage.

Reliance on Reported Outstanding Shares

In determining its percentage of a class of shares held for the purposes of the early warning requirements, a person may rely upon information most recently provided by the issuer of the shares in a material change report or in its MD&A, whichever contains the most recent relevant information.

Notwithstanding the foregoing, a person may not rely on that information filed by the issuer if the person has knowledge both (i) that the information filed is inaccurate or has changed and (ii) of the correct information.

Who is a Joint Actor?

For these purposes, it is always a question of fact as to whether a person is acting jointly or in concert with another person but, without limiting the generality of the foregoing:

- (a) **Deemed** Joint Actor: A person that, **as a result of any agreement, commitment or understanding** with the first person or with any other person acting jointly or in concert with the first person, **acquires or offers to acquire securities** of the same class as those subject to the acquisition or offer to acquire by the first person is **deemed to be** acting jointly or in concert with the first person; and
- (b) **Presumed** Joint Actor: A person that, **as a result of any agreement, commitment or understanding** with the first person or with any other person acting jointly or in concert with the first person, **intends to exercise jointly or in concert** with the first person or with any

person acting jointly or in concert with the first person **any voting rights** attaching to any securities of the issuer whose securities are the subject of the acquisition or the offer to acquire is **presumed to be** acting jointly or in concert with the first person.

Restrictions on Purchases

During the period commencing on the occurrence of an event in respect of which an early warning report is required and terminating on the expiry of one business day from the date that the early warning report is filed, neither the acquiror of the shares nor any joint actor of the acquiror shall acquire or offer to acquire beneficial ownership of any securities of the class in respect of which the early warning report was required to be filed or any securities convertible into securities of that class. This requirement does not apply to a person that has beneficial ownership of, or control or direction over, securities that, together with that person's joint actors, comprise 20% or more of the outstanding securities of the class.

Sample Calculations:

As you can see, it can be quite complicated to determine when a person must comply with the early warning reporting requirements. Hopefully the foregoing discussions and tables together with the sample calculations in Appendix "A" will make the rules a little easier to follow.

Invitation for Discussion:

If you would like to discuss this article in greater detail, or any other securities law matter, please do not hesitate to contact one of the lawyers in the Business Law group at Shea Nerland LLP.

Disclaimer:

Note that the foregoing is for general discussion purposes only and should not be construed as legal advice to any one person or company. If the issues discussed herein affect you or your company, you are encouraged to seek proper legal advice.

**APPENDIX “A”–
When Do I Need to File My Next Report? – Sample Calculations**

To make the early warning reporting rules a little easier to understand, we have put together below some sample fact patterns and tables to demonstrate how these rules might be applied in certain situations. We caution that the sample fact patterns and tables do not cover every situation nor every fact that might be relevant in each situation. They are intended to be illustrative only and should not be relied upon by any one person. Readers potentially subject to early warning reporting requirements are strongly advised to seek legal advice from a legal professional experienced in this area so that all relevant facts can be ascertained and proper legal advice provided.

Day 1 – Initial Report:

- a. Company has 100 shares outstanding.
- b. Shareholder owns 36 shares and options to acquire 2 additional shares.
- c. Shareholder is not acting jointly or in concert with any person.
- d. As such:

Person	Shares Owned	Convertible Securities Owned	Total Shares and Convertible Securities Owned	% of Outstanding Shares
Shareholder	36	2	38	38%
Joint Actor	-	-	-	-
Joint Actor of Joint Actor	-	-	-	-
Total	36	2	38	38%

Report Required?

Yes - Initial report required on ownership reaching 10% or more of outstanding shares.

Day 100 – Disposition of Some Shares (After Company Offering Diluting Shares):

- a. Between Day 1 and Day 100, Company issued more shares in public offerings or private placements and therefore increased the total outstanding shares to 200.
- b. Per last report filed, Shareholder owned 36 shares and options to acquire 2 additional shares.
- c. Shareholder sells 3 shares (in one or more transactions).
- d. Shareholder is not acting jointly or in concert with any person.
- e. As such:

Person	Shares Owned	Convertible Securities Owned	Total Shares and Convertible Securities Owned	% of Outstanding Shares
Shareholder – Securities on Last Report	36	2	38	19% (36% per last report)
Shareholder – Acquisition (Disposition)	(3)	-	-	(1.5)%
Joint Actor	-	-	-	-
Joint Actor of Joint Actor	-	-	-	-
Total	33	2	35	17.5%
Report Required?				
No - The number of securities disposed of, from the total number held as indicated on the last report filed, only equals 1.5% of the currently outstanding shares. For a report to be required, the Shareholder would have had to have disposed of 4 shares or convertible securities in aggregate (2% of the currently outstanding shares).				

Day 200 - Agreement with Joint Actors That Own More Than 2%:

- Company has 200 shares outstanding.
- Shareholder now owns 33 shares and options to acquire 2 additional shares.
- Shareholder begins acting jointly and in concert with another person that owns 5 shares and has options to acquire 2 additional shares.
- The first joint actor is acting jointly and in concert with another person that owns 2 shares and has options to acquire 1 additional share.
- As such:

Person	Shares Owned	Convertible Securities Owned	Total Shares and Convertible Securities Owned	% of Outstanding Shares
Shareholder – Securities on Last Report	33	2	35	35%
Joint Actor	5	2	7	7%
Joint Actor of Joint Actor	2	0	2	2%
Total	40	4	44	44%
Report Required?				
Yes - The number of securities held by the Shareholder together with those held Joint Actors increased by more than 2% of the currently outstanding shares from the total number of shares reported on Shareholder's last report (i.e. any increase greater than 2% of the currently outstanding shares – or 4 shares - would need to be reported). Note that reports would need to be filed by each of the Shareholder, the Joint Actor and the Joint Actor of the Joint Actor but there is a provision that allows for only one report to be filed by them in the aggregate so long as that report discloses all of them as joint actors along with their respective shareholdings.				

Day 250 – Terminate Agreement with Joint Actors:

- Company has 200 shares outstanding.
- Shareholder now owns 33 shares and options to acquire 2 additional shares.
- Shareholder was acting jointly and in concert with another person that owns 5 shares and has options to acquire 2 additional shares. The first joint actor is acting jointly and in concert with another person that owns 2 shares and has options to acquire 1 additional share.
- Shareholder has terminated his agreement with the first joint actors and is not acting jointly and in concert with any other person.
- As such:

Person	Shares Owned	Convertible Securities Owned	Total Shares and Convertible Securities Owned	% of Outstanding Shares
Shareholder –Shareholder Securities on Last Report	33	2	35	35%
–Joint Actor Securities on Last Report	5	2	7	7%
–Joint Actor Securities on Last Report	2	0	2	2%
Total on Last Report	40	4	44	44%
Joint Actor	0	0	0	0%
Joint Actor of Joint Actor	0	0	0	0%
Total Now	33	2	35	35%
Report Required?				
Yes - The number of securities held by the Shareholder together with those held by current Joint Actors decreases by more than 2% of the currently outstanding shares from the total number of shares reported on Shareholder's last report (i.e. any decrease greater than 2% of the current outstanding shares – or 4 shares - would need to be reported).				