Company Migrations to Other Jurisdictions

As high-growth early stage companies begin to seek opportunities offshore, it is likely to become desirable for those companies to establish a physical and legal presence in countries other than New Zealand. Several SCIF investee companies have already done this, or are in the process of doing so.

There are three main ways in which a company's legal presence can be migrated offshore:

- a share swap, which involves existing shareholders swapping their shares in the New Zealand company for shares in the overseas company;
- a sale of the New Zealand business to the overseas company, with the shareholders subscribing for shares in the overseas company at the same time; and
- a change in the domicile of the New Zealand company to an overseas domicile.

We outline the steps which are taken for each option, together with some specific points to consider. However, there is no "standard" approach; any decision about moving offshore is usually driven by tax and other commercial considerations (and, depending on the context of the migration, existing New Zealand based shareholders or overseas investors may influence the ultimate decision).

Share Swap

The process of a share swap (also sometimes referred to as a flip up) is as follows:

- a new company (**NewCo**) is incorporated in the target country (eg USA); and
- the shareholders of the New Zealand company (**OldCo**) sell their shares in OldCo to NewCo in exchange for new shares in NewCo (generally in the same proportion/carrying the same rights as their shareholdings in OldCo).

The result is that, following the share swap, the former shareholders of OldCo hold shares in NewCo instead, and OldCo becomes a wholly-owned subsidiary of NewCo. Under this structure, OldCo remains the operating company, but NewCo is the company in which new investors can invest, incorporated in the new jurisdiction.

This structure is often used where a new investor wishes to invest in a company which is domiciled in that investor's own jurisdiction (for tax and other reasons).

The assets of OldCo will continue to be owned by OldCo and any legal arrangements with OldCo (eg customer, supplier, employee and contractor arrangements) will remain with OldCo and will not be automatically transferred to NewCo.

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As part of the restructuring transaction, inter-company arrangements between OldCo and NewCo are usually entered into, covering matters such as the ownership and use of OldCo's intellectual property and provision of services between the entities.

Sale of Business

Under this option, OldCo sells its business to NewCo, with the sale price being satisfied by NewCo issuing shares to OldCo. OldCo can then be liquidated, with the existing shareholders in OldCo receiving shares in NewCo as part of the distribution of OldCo's assets on liquidation.

This option will require either an assignment or re-documenting of the existing business arrangements of OldCo, which may give rise to issues if existing customers or suppliers have concerns with contracting with a company based in a new jurisdiction (in particular, if NewCo wishes to have its contractual arrangements subject to the governing law of that new jurisdiction).

Re-Domicile

The New Zealand Companies Act provides for overseas companies to register on the New Zealand Companies Register, which enables those overseas companies to carry on business in New Zealand. A similar regime may be available in the relevant overseas jurisdiction, which may be sufficient to achieve the local presence required by investors and customers in that jurisdiction.

The Companies Act provides for the re-domicile of New Zealand companies to overseas jurisdictions.

Legal Issues

In considering the most appropriate migration approach, a number of legal issues will arise, depending on how the associated restructure is carried out, including the following:

- The restructure may give rise to termination or other rights under supplier or customer contracts, due to a change of control of OldCo, or may require the consent to assignment of agreements to NewCo;

- As part of the restructure, steps may be taken to split the ownership of the key intellectual property away from the operating company (OldCo). This may in turn require intra-company licensing agreements if OldCo wishes to continue to use the intellectual property.

- In general, each option will require the consent of the shareholders in OldCo (a special resolution would be required for the sale of its business to NewCo and for a re-domicile; each shareholder would be required to agree to any share swap). Subject to any specific provisions in the constitution of OldCo or any shareholders' agreement relating to OldCo, a level of shareholder support will be required in order to give effect to any such transaction.

Tax Issues

There are likely to be significant tax implications, both for OldCo and its shareholders, arising from the way in which a migration is structured and carried out. These may include:

- a change in the currency in which the company's sales and revenues are recorded, and dividends paid out;

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- a change in shareholdings in OldCo may result in OldCo losing accrued tax losses or imputation credits;

- the sale of intellectual property from one entity to another may give rise to deemed income arising from the valuation of that intellectual property as part of that sale; and

- individual shareholders may face adverse tax implications due to moving from holding New Zealand-domiciled shares to overseas-domiciled shares (in New Zealand, capital gains on share sales are generally tax-free, but this position may be different in other countries).

Documentation

Depending on the approach thatis taken in order to achieve migration of a company to another jurisdiction, existing shareholding documentation will need to be amended or potentially replaced. New shareholder arrangements in relation to NewCo may need to be subject to the local law of the jurisdiction in which NewCo is incorporated, in order to properly be able to replicate the shareholder rights that applied in respect of OldCo.

Where there are specific shareholder rights in the constitution of OldCo, these may need to be reflected in the constitution (or equivalent constitutional document) of NewCo. As NewCo will be subject to a different companies legislative regime, those rights may not be able to be exactly replicated in that new document.

Where the investors in OldCo have invested in OldCo by way of convertible loans, there are two approaches:

- convert the loans to shares in OldCo and exchange such shares for shares in NewCo as part of a share swap; or

- transfer the debt, any security interests and conversion obligations to NewCo, such that the debt is owed by NewCo rather than OldCo, the lenders hold security over the assets of NewCo and shares in NewCo are issued on conversion of the loans.

The first approach is simpler and therefore generally preferable, since it avoids the need to transfer the debt, security and conversion obligations.

It crucial that shareholders in OldCo turn their minds to how their rights as shareholders in OldCo will be reflected in respect of NewCo. A key challenge is that, as alluded to above, the approach to documenting shareholder rights and terminology used differs between jurisdictions (not to mention views about what is considered "standard" practice), and relevant securities and company laws will differ across jurisdictions, so it may not be possible to exactly replicate all existing shareholder rights.

Migrations are also often prompted by, and timed to coincide with, investment in NewCo by new investors (such as VC funds), who are based in the new jurisdiction. OldCo shareholders need to be particularly vigilant that they are not being marginalised by the new investors as shareholders in NewCo (for example, where the new investors will seek preferential rights in relation to NewCo and a valuation of NewCo which results in OldCo shareholders being unfairly diluted as shareholders in NewCo, in particular where existing shareholders are not able to participate in the new funding round).

Regardless of the approach taken to migration, the process is complex and time-consuming (particularly where there are numerous shareholders in OldCo whose written approval is required). Companies should

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typically allow at least a month for completion of a migration, and potentially much longer where there are a number of practical steps that need to be taken (for example, obtaining consent of a number of minority shareholders, obtaining key customer or supplier consents).

We recommend that OldCo shareholders instruct legal advisors (in New Zealand and in the country to which the business is migrating) as soon as it becomes apparent that a migration is expected to take place, particularly where the migration is expected to coincide with additional investment by new investors in NewCo. That way, OldCo shareholders can ensure that their interests as shareholders in NewCo will be represented and, to the extent possible in the circumstances, their rights in relation to the business as a whole can be appropriately preserved and protected.

Please feel free to contact us if you would like to discuss any of the issues we have touched on above.

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