Company Restructuring Options

Motivation for company restructuring might be to survive, revive or thrive. The focus in this article is on restructuring in order to survive, which essentially requires downsizing in order to realign costs of the business to sunken revenue and/or debt reduction.

Employee Retrenchment

Processes for redundancy in the present environment are reputedly truncated. I have been told of an example where the redundancy process from go to whoa was completed inside a week. Nevertheless, employee protections remain:

a. the employee must be given an opportunity to consult on the effect of the proposed changes on the employer's business (cases establish this must be a reality and not a charade);

b. the redundancy must genuinely reflect the employer's position being superfluous to the employer's needs and must not be a substitute for dismissal for poor performance;

c. the selection process must be unbiased and not based on a prior incident. Nor can it be on discriminating grounds, for example favouring a New Zealand resident employee ahead of a person on a work visa.

Companies wishing to embark on a redundancy must first establish the business case as a prelude to the proposal. Once that is done, relevant information is to be provided to the affected employees to afford them an opportunity to comment on the information before the decision is made. Confidential information (for example in order to protect a person's privacy) must not be supplied.

The employee's agreement to his or her redundancy is not required, so long as there has been proper consultation and correct procedures have been followed.

Pushing out Bank Facilities

Banks have openly invited borrowers to shift to interest only. The debt remains payable and the bank will want reassurance that their customer will have the means to repay the debt. Financial projections, and more particularly, the adequacy of them, will dictate the bank's response to the application to push out facilities. Borrowers should take time to thoroughly prepare them before approaching the bank; including obtaining input from external accountants and, where relevant, legal input. An example of legal input is to consider the effect of bank forbearance on any long term contracts; while it is unlikely to be an event of default, maintaining bank repayment schedules may be a KPI under a long term contract or a term of an IRD instalment arrangement and at the very least the bank will be on watch to see that the borrower has considered all issues.

If a borrower's financial projections do not support full repayment of the debt, a solution may be to enter into a compromise with creditors. I discuss compromises in an earlier newsletter, see the link below.

Hive Downs

These entail sale of all or part of a discrete component of the company's business, involving as a first step the transfer of the business to a newly incorporated sister company (**Newco**). If a full hive down is intended, then the second step will be the offer to sell all the shares in Newco.

Alternatively, only a partial hive down might be intended in which case shares in Newco are issued to investors comprising less than 100% of the company's issued capital. Potentially, the investors might include (and commonly do) suppliers to the business and shares are issued in cancellation of debt to them (subsequent to a novation to transfer the debt to Newco).

Hive downs have become reasonably common place but are somewhat time consuming. Amongst other things, consideration should be given to:

a. tax consequences of sale of assets to Newco;

b. consents needed from secured creditors and parties to long term contracts which contain restrictions on a change of control;

c. lease assignments; and

d. IP assignments and/or a licence to use IP.

A pre-requisite is that the business of Newco is attractive to investors. For that reason, it is usually the more profitable component of the business that is selected for a hive down. Share warranties in such arrangements are quite straight forward; the primary concern will be to ensure that Newco obtains good title to the assets needed for the hive down business and does so free of clawback or encumbrances.

A key (and usually essential) ingredient to the success of a hive down is to shelter investors from debts of the business. Consequently, there should be no transfer of liabilities from the trading company to Newco, as the hive down entity in which shares are offered for sale.

Share Issues

As an alternative to a hive down, it might be easier to simply issue shares in the trading company. I discuss capital raising in an earlier newsletter, see the link below, where this path is chosen:

a. be careful not to forfeit imputation credits or tax losses for breach of shareholder continuity;

b. extensive warranties in a share subscription agreement will be required.

The shareholder continuity rules require 66% continuity in order to retain imputation credits. If this test is going to be breached, the usual course is to declare a pre-completion dividend and attach imputation credits to it. For many companies, cash is not available to support the dividend. A solution is to declare a taxable bonus issue. This increases the company's available subscribed capital (the amount the company can return to shareholders tax free) and ensures the economic benefit of the imputation credits is preserved.

Moves are afoot to substitute the shareholder continuity test with a business continuity test which will make life a little easier in these respects, but present law does not recognise a business continuity test (unlike Australia) for carrying forward tax credits or tax losses.

Flow through Tax Treatment

For a business that anticipates incurring a loss for the foreseeable future, there may be a desire to pass through the loss to the shareholders for their use against their personal income. An ordinary company does not facilitate that. Alternative structures that do are:

a. a look through company (**LTC**);

b. a limited partnership.

Where the LTC eligibility requirements are met (notably 5 or fewer natural person shareholders) the easiest path will be to elect into the LTC regime. If that is not possible, then a transfer of the business to a limited partnership might be contemplated. That is, however, an extensive process and should only be undertaken where the commercial advantages of a limited partnership best suit the business. There are many reasons why that might be the case, for example to escape the administrative rigours of the Companies Act or major transaction provisions prescribed in that Act.

If I can be of assistance in any of these areas, I would be pleased to help and my contact details are below.

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Links

https://www.speakmanlaw.co.nz/all-publications/2020/4/28/strategies-for-companies-in-insolvency

https://www.speakmanlaw.co.nz/all-publications/2020/4/28/protections-for-owner-operated-companies

https://www.speakmanlaw.co.nz/all-publications/2020/4/28/capital-raising-steps