WILSON SONSINI

How do I Raise Money from a UK-US Investor Group?

Daniel Glazer
London Office Managing Partner at Wilson Sonsini

Recently, the founder of a US early-stage company (previously London-based) described various problems he experienced in trying to implement a UK-US cross-border equity financing. Ultimately, he gave up on the UK piece of the deal and financed solely in the US.

Early-stage cross-border financings do involve greater challenges than purely domestic transactions, given the need to balance the company's own objectives against investor groups with different expectations and motivations. Cross-border transactions also require legal and tax advice in multiple geographies.

If handled properly, however, combining UK and US investor groups can provide a superior base from which to build a global business. Early-stage investors don't just contribute their capital; they also bring valuable contacts and expertise that help grow the business. An international investor base provides access to advisers with broader and more diverse backgrounds, skills, and networks.

So – how to make this work?

The discussion below is focused on the UK and US, but the base principles have broader applicability to other geographies.

1. Choice of holding company

For reasons we have discussed previously, a UK holding company often provides a better starting point for a global business than a Delaware corporation or other US company. Nonetheless, a cross-border financing can work equally well with a US holding company.

2. Role of founders

Founders need to understand the cross-border financing structure to ensure clear communications with potential investors. A capital structure that works for both UK and US investors will differ from what investors might expect in purely domestic financings. It is important that the respective investor groups not be surprised.

This article does not constitute legal advice and should not be relied upon for business or legal decisions.

3. Legal and tax advisers

The company's lead legal and tax advisers should understand all sides' relevant expectations and motivations, so they can give balanced, sensible advice. Cross-border expertise and a willingness to look beyond a purely national perspective are critical. It is also helpful if all of the company's advisers are in the same geography, or at least within compatible time zones. Finally, the right team will include US-qualified advisers for US issues and UK-qualified advisers for UK issues.

4. Tax differences are critical

Differences between the UK and US tax systems are the key drivers of the need for different approaches.

A. SEIS and EIS investors

Early-stage UK investors may want to take advantage of the very substantial tax incentives offered by the Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) programs. However, these programs have various specific requirements, and UK investors will typically want tax clearance from the UK tax authority (HMRC) before proceeding. If a UK tax-qualified Enterprise Management Incentives (EMI) employee option program is being put in place, an additional clearance may be needed.

Securing the UK tax clearances will take time – it's advisable to allow at least a month, so start planning early.

There also are various substantive requirements. For example, the SEIS and EIS programs have limitations based on the type of business at issue and the nature of the securities being offered. The company will need to comply with certain ongoing restrictions on its business in order to retain SEIS and EIS qualified status. These include, for example, a requirement that the company itself maintain a permanent establishment in the UK for at least three years.

Note, however, that a company does not need to be a UK company in order to qualify for SEIS or EIS, so long as it has a permanent establishment in the UK. For example: a US company with a permanent UK office is potentially eligible for the SEIS and EIS programs.

Investors seeking SEIS or EIS benefits can only hold ordinary shares (common stock), not preference shares (preferred stock) or convertible debt. However, that does not prevent the company from including preference shares, or debt convertible into preference shares, in its capital structure, so long as it is not issued to investors seeking to qualify for SEIS or EIS. That point is critical for the reasons discussed below.

This article does not constitute legal advice and should not be relied upon for business or legal decisions.

B. US and other investors

US investors, in contrast, will expect to acquire convertible preferred stock, or a debt or equity instrument convertible into convertible preferred stock. The preference gives the investor a preferred position in the event of a liquidation, and sometimes other preferences as well. The convertible preferred stock is convertible into common stock.

The terms of these instruments are fairly well established, although there is some limited range for negotiation. An excellent non-technical description of these terms can be found in Brad Feld and Jason Mendelson's book on the mechanics of US venture funding, "Venture Deals: Be Smarter than Your Lawyer and Venture Capitalist."

UK investors who are not seeking SEIS or EIS treatment (as is the case with many venture capitalists, including UK VC's) typically look for comparable terms.

C. Resulting capital structure

The combination of UK investors – often seeking SEIS or EIS treatment – and US and other investors seeking a preferred position, results in the latter having a senior position in the capital structure. SEIS and EIS investors hold the same subordinated equity security as the founders and employees, potentially with some additional rights, such as board representation. This is the price that the SEIS and EIS investors pay to get the SEIS and EIS tax benefits.

D. Tax complexities

There are a few other tax complexities, but they are manageable. For example, US investors may look to avoid adverse treatment under US tax provisions relating to certain kinds of interests in non-US companies. Without appropriate planning, these broad provisions may inadvertently apply to investments in non-US early stage companies.

This article provides more detail on the US tax implications of US investment into a UK or other non-US company.

* * *

This may all sound difficult, but it's actually pretty straightforward. The founders and advisers need to know what they're doing and coordinate appropriately, and the investors need to understand the nature of their investment.

With these cautions and caveats, cross-border financing can be a source of significant additional value for startups and investors alike.

Dan can be reached at daniel.glazer@wsgr.com. This article does not constitute legal advice and should not relied upon for business or legal decisions.

This article does not constitute legal advice and should not be relied upon for business or legal decisions.