Chapter 6
Other Equity Markets for Shipping

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Abstract The Norwegian Market proves to be an attractive source of equity for the international shipping industry, mobilizing substantial amounts of equity. The most common Norwegian private equity investment structures are: Limited partnership (Kommandittselskap, "KS"), Silent partnership (Indre selskap, "IS"), Limited liability company (Aksjeselskaper, "AS"), General partnership (Anvarlig selskap, "ANS"). Recently the Silent partnerships, generally known as ISs, have become the most popular investment vehicle replacing the formerly widely used KSs as ISs are very flexible and tax efficient. A Norwegian Silent partnership is not liable to pay taxes. The silent partners are taxable to their relevant share of a calculated taxable income/loss and net worth according to the tax rules of their domicile. This makes the silent partnership structure attractive for non-Norwegian investors as they are not taxed in Norway whereas Norwegian investors are taxed according to ordinary Norwegian taxation.

6.1 Norway and its Limited Partnership Structures

The Norwegian Market has also proven to be an attractive source of equity for the international shipping industry, appealing to both Norwegian residents and foreign investors. Similar to the German KG structure, the Norwegian market has been able to mobilize substantial amounts of equity due to a certain affinity of investors for the domestic shipping and offshore sector.

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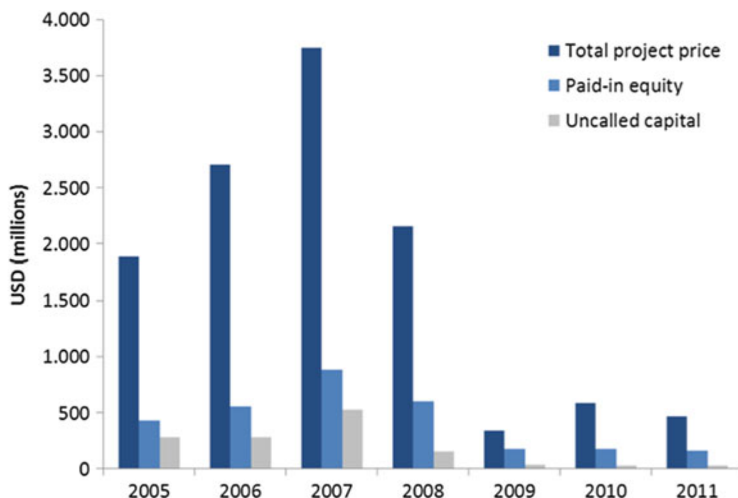

Fig. 6.1 Total project capital invested in Norwegian market (balance is primarily senior debt, however in some cases supplemented by a sellers' credit)

6.1.1 Norwegian Market for Private Equity Investment

Norwegian limited partnerships, generally known as KSs, have been in use since the 1970s and are most commonly used for investments in shipping and commercial property. For shipping, the glory days of the KS were in the late 1980s when several loopholes in the Norwegian tax system allowed for substantial deductions on an individual's tax return as a result of hyper-accelerated depreciation schedules. A similar development could be seen in Germany well into the early years of the new Millennium. Since then, the tax laws have been changed and the latest tax reform in 1996, which addressed the taxation of shipping companies, removed all but a few tax advantages for investors in the KS structure. Nevertheless, a substantial amount of capital has been raised in the heydays of the latest shipping boom culminating in 2007. During the last couple of years, Silent Partnerships, generally known as ISs, have become the most popular investment vehicle replacing the KSs, as they are very flexible and tax-efficient also for investors outside Norway (see Fig. 6.1).

There is a definite advantage by using a specialist underwriter for a shipping KS/IS to secure a liquid second-hand market of the KS stakes. There are a few specialized underwriters of a shipping KS/IS of this type in Norway (see Fig. 6.2).

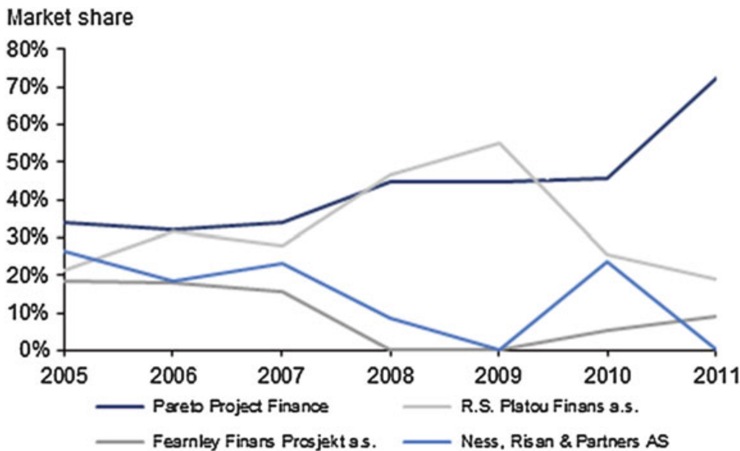

Fig. 6.2 Market shares of different Norwegian corporate finance service providers in shipping

6.2 Types of Structures

The most common Norwegian legal structures used as vehicles for private equity investments are:

- Limited partnership (Kommandittselskap, “KS”)”
- Silent partnership (Indre selskap, “IS”)
- Limited liability company (Aksjeselskaper, “AS”)
- General partnership (Anvarlig selskap, “ANS”)

The silent partnership has the most similarities with an offshore limited partnership and has become the predominant Norwegian legal structure. Both limited partnerships and silent partnerships are referred to as limited partnerships in this chapter which will not cover the AS structure.

6.2.1 Norwegian Limited Partnerships

The Norwegian limited partnership is governed by the Norwegian Partnership Act (“Selskapsloven”) of 23 June 1985 No. 83 (“Partnership Act”). The Partnership Act differentiates between various partnerships such as (a) general partnerships with unlimited liability for all partners (“ANS”), (b) internal partnerships with limited liability for the silent partners (“IS”), and (c) limited liability partnerships with limited liability for the limited partners (“KS”). Limited partnerships are governed not only by the provisions of the Partnership Act but also by the provisions of the limited partnership agreement (the latter only to the extent that there is no conflict with mandatory provisions of the Partnership Act).

6.2.2 The Limited Partnership "KS"

To be considered a single-purpose limited partnership ("KS"), the KS must be established by two or more individuals or legal entities, which may be Norwegian residents or foreigners, and must consist of one general partner ("komplementar") and at least one or several partners with limited liability ("kommandittist"). The general partner must hold a minimum share of 10 % in the KS and has unlimited liability toward the company's creditors to the extent of their personal assets. The limited partners make their contribution to the capital of the company and their obligations are limited to each partner's share of the total committed capital of the KS. However, the limited partners hold a joint liability toward the KS if one of the other limited partners default on their obligations. A limited partnership does not require a minimum capital.

The primary company organ of the KS is the partnership meeting. The partners may choose not to elect a board of directors. In this case, the general partner will have powers and areas of responsibility similar to those of a board of directors. The general partner is always responsible for the supervision of the management of the day-to-day operations of the KS. Moreover, certain powers in principle belonging to the partnership meeting may be transferred to the general manager, depriving the partnership meeting of its right to instruct and set aside certain decisions made by the general partner.

It is required by the Partnership Act that the general partner provides at least 10 % of the committed capital of the KS and holds an interest in the KS similar to at least 10 % of its net assets and to share a part of at least 10 % of the deficits and profits of the KS. Each partner with limited liability must make a capital commitment of at least NOK 20,000 of which no less than 40 % must be paid within 2 years after its incorporation (the minimum amount of called and paid-in capital at the time of incorporation being 20 %). Provisions regarding payment of uncalled capital are left to be governed by the partnership agreement as the Partnership Act does not stipulate further requirements. It is usual that the partnership meeting or the general partner is given powers to demand payment of uncalled capital within a certain time limit. The KS's claim against its partners for uncalled capital may not be transferred to any other party or assigned to any party by way of security (e.g. to a lender providing financing to the KS). Forty percent of the total committed capital shall be "locked-in" capital, meaning that only equity in excess of that amount may be distributed to the partners as long as the KS remains in existence (see Fig. 6.3).

Even though a KS may be made subject to bankruptcy proceedings, the liability of the limited partners will always be limited to payment of their respective portion of the uncalled committed capital. Claims against such partners for payment of uncalled capital must be made by the KS itself (and/or its receiver) and may not be made directly by the KS's creditors.

The KS has been a popular way of organizing business ventures in Norway since the 1980s, especially within the shipping business. Apart from the obvious benefit

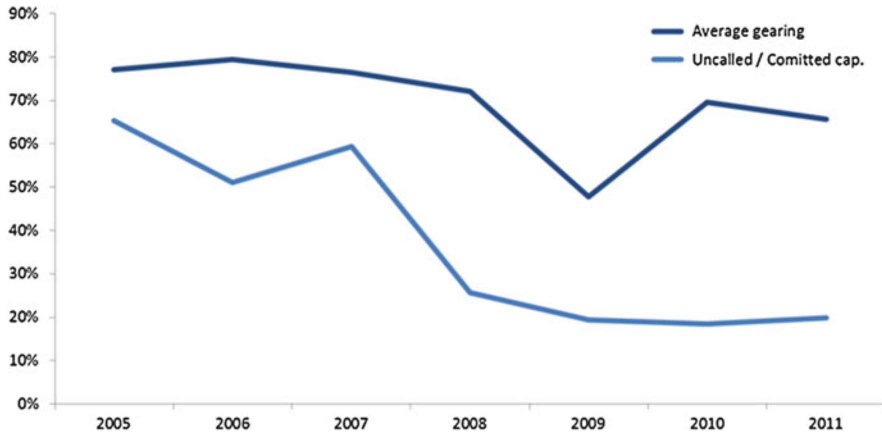

Fig. 6.3 A specialty of Norwegian KS financing is the so-called uncalled capital

of being liable up to a known limit (being the portion of the total partnership capital subscribed for) of the KS's legal liabilities connected to its business operations, there are certain tax advantages in owning assets through a KS. Partners with limited liability will, for tax purposes, be deemed to own a share in the asset(s) (for example, a vessel) directly corresponding to their ownership share in the KS and therefore, when filing their annual tax returns, be entitled to their corresponding share of the annual book value depreciation of the relevant asset(s). However, it should be noted that the tax advantages of owning assets through KSs have been reduced to some extent over the past few years as a result of the introduction of a new tax regime in Norway.

6.2.3 The Silent Partnership "IS"

A silent partnership is a special kind of partnership and as such is also governed by the Partnership Act. A silent partnership consists of a general partner and at least one silent partner ("stille deltaker"). The general partner has an unlimited liability for the partnership's obligations, whereas the silent partners have limited liability. The general partner may, and will normally be, a limited liability company ("AS").

In contrast to an ordinary partnership, the silent partnership does not publicly act or appear as a partnership toward contractual partners and other third parties. The silent partners cannot represent or commit the silent partnership in any way or form.

The general partner of the silent partnership carries out the business of the silent partnership. The general partner acts in its own name and assumes all rights

and obligations toward third parties. Internally, between the general partner and the silent partners, the rights and obligations are normally divided according to a partnership agreement.

The legal basis of a silent partnership is laid down in a partnership agreement. There are no formal requirements that have to be met. Only a limited number of the statutory provisions of the Partnership Act apply to silent partnerships and as a result, the rights and obligations of the partners may have to be set out in greater detail in the partnership agreement of a silent partnership compared to other partnerships.

As opposed to a limited partnership, there are no specific requirements for the capital of a silent partnership. The silent partnership thus gives greater flexibility with regard to the calling of additional capital and the distribution of profits than a limited partnership.

According to the Partnership Act section 2–8 (2) silent partners may not be members of the partnership meeting. Thus, in a silent partnership with one general manager and several silent partners there is no partnership meeting as such. The silent partners may be given a right through meetings to instruct the general manager on certain matters. In addition, the silent partners may be given veto rights with respect to the operations of the partnership.

A silent partnership is not registered in the Norwegian Corporate Registry ("Foretaksregisteret"). The fact that the silent partnership is not registered in the Corporate Registry is attractive to investors wishing discretion regarding their investments.

A shareholders' agreement typically will contain important clauses stipulating the mechanism of triggering a sale or purchase of shares or a mandatory share offer should one partner become the owner of more than 75 % of the partnership shares in accordance with the Norwegian Securities Act 1997 ("Verdipapirhandelloven") section 1–4. 7.

A decision to increase the Partnership Capital may be made by the Partnership Meeting with the prior approval of at least 76 % of the votes cast at the Partnership Council.

6.2.4 The Limited Liability Company "AS"

This is the equivalent of a stock-based company where the owners cannot be held liable beyond each one's contribution to the company's stock capital. The private limited company must provide a minimum capital of 100.000 NOK. The shares of a Norwegian private limited company are registered and cannot be made public or transferred freely.

6.2.5 The General Partnership "ANS"

Norwegian partnerships are regulated by the Partnership Act and each partnership agreement. It can be established by two or more members who have the right to manage the company and are held responsible for the gains and profits of the company, and also the losses. All the partners are active, being general partners. Their liability is unlimited, the partners being liable to the company's debts and obligations. The general partnership does not require a minimum capital.

6.3 Taxation Aspects of Norwegian Limited Partnerships/Silent Partnerships

In general, there are no tax incentive schemes specifically aimed at encouraging investments in unlisted companies.

Typically, these structures are either tax transparent (taxed at the level of the investor) or taxed at the company level. The silent partnership structures are tax transparent, while the limited liability company is taxed at company level. However, this tax liability is generally mitigated by the exemption method. The exemption method applies to all corporate entity investors regardless of their tax residency and commonly exempts foreign investors from taxation in Norway. Under the exemption method, corporate investors in limited partnerships are not liable for tax in Norway on income from shares held by the limited partnership in companies that are tax resident within the European Economic Area (EEA).

A Norwegian limited partnership is considered to have a fixed place of business in Norway. Non-resident investors in a Norwegian limited partnership are normally considered to participate in a business in Norway, and are liable for taxation in Norway in the same way as an individual investor resident in Norway.

A Norwegian silent partnership is not liable to pay taxes (tax-transparent company). The investors (the silent partners) are taxable to their relevant share of a calculated taxable income/loss and net worth according to the tax rules of their domicile. This makes the silent partnership structure attractive for non-Norwegian investors as they are not taxed in Norway whereas Norwegian investors are taxed according to ordinary Norwegian taxation.

Currently, the tax rate in Norway for ordinary income is 28 % and the marginal assets tax rate ("Formueskatt") is 1.1 %. In Norway, the taxable loss allocated to the investors is limited to equity. The Norwegian personal investors are subject to tax (28 %) on dividends from the silent partnership. Total tax on income and dividends thus amounts to 48.16 %. Limited liability companies investing in a silent partnership are not subject to tax on dividends. The realization of shares is taxable for personal investors. Any loss will be subject to deductions in taxable income. For limited liability companies domiciled in Norway, realization of shares is covered by "Tax exemption model". This means that potential gains will be tax-exempt and

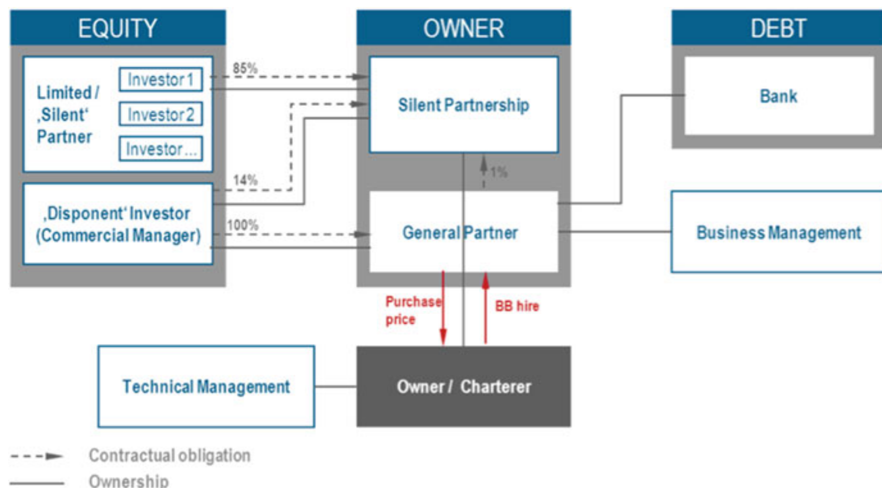

Fig. 6.4 Graphical representation of the structure of the transaction

potential losses will not be tax deductible. However, 3 % of the realization gains will be included in taxable income.

6.4 Example of a Typical Silent Partnership Transaction

The following example is an excerpt from the corresponding Pareto Finance AS Information Memorandum and outlines the acquisition and financing of two anchor handling tug supply vessels arranged by Pareto Project Finance AS, January 2012.[1]

Pareto Project Finance agreed with a Far East owner and certain of its subsidiaries the acquisition of two of the owner's Anchor Handling Tug Supply (AHTS) vessels by a special-purpose IS company for $64 m en bloc.

Post acquisition, the vessels were chartered to a company guaranteed by the owner on a 5-year "hell or high water" bareboat contract at a Bareboat rate of $11,000 per day per vessel. The owner will have the option to buy the vessels back at the end of the third, fourth, and fifth year at a price per vessel of $30.5 m, $29.7 m, and $28 m, respectively. If the purchase options are

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[1]Graphs and investment case courtesy of Pareto Project Finance AS, Dronning Maudsgate 3, P.O. Box 1396 Vika, 0114 Oslo, Norway.

exercised individually, it is the special-purpose company's choice to nominate the vessel.

Over the project's full 5-year lifetime, the average annual dividend is forecast at 15 % of the paid-in equity per year. Valuing the vessels at exit in year 5 at a level equivalent to the depreciated current charter-free market value, equity investors are expected to receive an internal rate of return (IRR) of 26 % per annum. 26 %-annual return is also expected if the owner exercises its option after year 5, while an exercise after years 3 and 4 yield an IRR of 29 and 28 %, respectively.

The vessels are of a high build quality and are suitable for operations in all major offshore fields across the world, including Brazil, Australia, and Asia, with the exception of harsh environments such as the North Sea.

The key investment highlights are summarized below:

- 5-year "hell and high water" bareboat charter to company guaranteed by the owner
- BB rate of $11,000 net/vessel/day
- Expected IRR of 26–29 % if call option is exercised/sale at depreciated values
- Expected annual dividends of 15 % (on average during BB period)
- Residual value equal to last 5-year low gives an IRR of 20 %
- Purchase price: $32 million per vessel-below charter-free market values of $33–36.5 million per vessel at the time of the transaction
- Seller's credit of $12.8 million en bloc as security for the bareboat contract, which implies a net purchase price about 25 % below values at the time of the transaction
- Charterer with diversified balance sheet, book equity of $1.4 billion (52 %) and $477 million in cash and time deposits as per March 31, 2011
- Bareboat contract no technical or market risk during charter party
- Residual value at $17.9 million per vessel gives money back, implying that values can drop by approximately 40 % from level at the time of the transaction
- Key financial data:
  - Project cost: US$66,400,000
  - Paid-in equity: US$11,600,000
  - Uncalled capital: US$6,000,000
  - Min subscription: 1 %: US$116,000
  - Uncalled capital per 1 %: US$60,000

The business manager for the IS single-purpose company is Pareto Business Management AS looking after the company's interests toward shareholders, preparing tax information for the participants and the company,

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preparing annual reports, organizing board meetings and general meetings, besides maintaining a secondary market for the shares. All secondary trading of shares in the IS will be handled through Pareto Business Management AS/the Equity Sales department of Pareto Project Finance AS. A graphical representation of the transaction structure is provided in Fig. 6.4.

Is it really an attractive investment? This type of a Norwegian limited partnership is more of a financial vehicle and the investment carries quantifiable risk factors. As we have seen in the example above, the acquisition and financing of two Anchor Handling Tug Supply Vessels are not very different from a sale-leaseback transaction. In this setup, a special-purpose company buys the vessel and charters it back on a bareboat charter to the seller. By having a long-term charter attached, the main risks to be evaluated from an investor's perspective are the residual value of the vessels and the ability of the owner/charterer to perform their obligations.