THE PRIVATE EQUITY REVIEW

NINTH EDITION

Editor
Stephen L Ritchie

THE LAWREVIEWS

THE PRIVATE EQUITY REVIEW

NINTH EDITION

Reproduced with permission from Law Business Research Ltd
This article was first published in April 2020
For further information please contact Nick.Barette@thelawreviews.co.uk

Editor
Stephen L Ritchie

THE LAWREVIEWS

PUBLISHER
Tom Barnes

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGER
Joel Woods

SENIOR ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall

ACCOUNT MANAGERS
Olivia Budd, Katie Hodgetts, Reece Whelan

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Gavin Jordan

PRODUCTION AND OPERATIONS DIRECTOR
Adam Myers

PRODUCTION EDITOR
Katrina McKenzie

SUBEDITOR
Robbie Kelly

CHIEF EXECUTIVE OFFICER
Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk

ISBN 978-1-83862-487-3

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

A&L GOODBODY

ALLEN & OVERY

BAHR

BONELLI EREDE

CAMPOS MELLO ADVOGADOS IN COOPERATION WITH DLA PIPER

CUATRECASAS

FASKEN MARTINEAU DUMOULIN LLP

JINGTIAN & GONGCHENG

KIRKLAND & ELLIS

KRAMER LEVIN NAFTALIS & FRANKEL LLP

LEGANCE – AVVOCATI ASSOCIATI

LENZ & STAEHELIN

LUIZ GOMES & ASSOCIADOS – SOCIEDADE DE ADVOGADOS SP, RL

MAPLES GROUP

MARVAL O'FARRELL & MAIRAL

MORI HAMADA & MATSUMOTO

NADER, HAYAUX Y GOEBEL, SC

NOERR LLP

PWC

SCHINDLER ATTORNEYS

SHARDUL AMARCHAND MANGALDAS & CO

SHEARMAN & STERLING

SHIN & KIM

SOŁTYSIŃSKI KAWECKI & SZLĘZAK

VON WOBESER Y SIERRA, SC

WONGPARTNERSHIP LLP

CONTENTS

PREFACE

The ninth edition of *The Private Equity Review* follows another extremely active year for dealmakers in 2019. While the number and value of global private equity deals completed declined slightly from 2018, deal activity was still robust, weighted towards the upper end of the market, and included several large take-private transactions. Fundraising activity was also strong with aggregate capital raised just slightly below 2018's record levels, as institutional investors remained extremely interested in private equity as an asset class because of its continued strong performance. That, combined with some caution due to an uncertain market environment, has resulted in private equity funds having significant amounts of available capital, or dry powder. This dry powder, together with competition from non-traditional dealmakers, such as sovereign wealth funds, family offices and pension funds, led to very competitive transactions being completed at increasing purchase price multiples. This has caused private equity firms to become even more creative as they seek opportunities in less competitive markets or in industries where they have unique expertise. Given private equity funds' dry powder and creativity, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less established geographical markets to continue.

While there are potential headwinds – including trade tensions, the upcoming US election and an eventual end to one of the longest-running recoveries in US history – on the horizon for 2020 and beyond, we are confident that private equity will continue to play an important role in the global economy, and is likely to further expand its reach and influence.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. *The Private Equity Review* has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 22 different countries, with observations and advice on private equity dealmaking and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this ninth edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2020

Part I

Fundraising

Chapter 13

NORWAY

Peter Hammerich and Markus Heistad[1]

I GENERAL OVERVIEW

During the past 25 years, the Norwegian private equity market has matured and become more internationalised. Several factors seem to have contributed to the development of the sector. One factor has no doubt been the establishment of Argentum Fondsinvesteringer AS in 2001. Argentum is a government-owned investment company established to make private equity investments. It has committed substantial amounts in funds managed by Norwegian and Nordic managers since its inception, and had a portfolio valued at 7.6 billion Norwegian kroner at the end of 2018.[2] Another factor may have been the advent of the Alternative Investment Fund Managers Directive (AIFMD). Before this, the Norwegian private equity sector was wholly unregulated. The AIFMD has introduced regulation, and resulted in work towards the standardisation and institutionalisation of the actors in this sector.

The size of the Norwegian fundraising market may be viewed from the perspective of the sponsors (in terms of potential for committed capital), and from the perspective of the amount of funds raised by Norwegian sponsors.

There are no statistics concerning the size of the Norwegian market in terms of potential for committed capital. The Norwegian economy is, however, relatively small, meaning that the fundraising market is small and therefore sensitive to vintage years.

With respect to the amount of capital raised by Norwegian sponsors,[3] 2018 saw the low total of 4.5 billion Norwegian kroner, up from 0.9 billion Norwegian kroner the year before.[4] Illustrating the volatility between different vintage years, 2016 saw record high fundraisings, amounting to 22 billion Norwegian kroner.[5] The figure for 2007 was 4.8 billion Norwegian kroner.[6]

A notable fundraising by Norwegian sponsors in 2019 was Explore Equity I (€840 million).

Notwithstanding this, globally the trend has been towards larger fundraisings, with firms having established their track record and a more international investor base. Further, more firms have come to market than in previous years. Although the barrier to entry for new

1 Peter Hammerich is a partner and Markus Heistad is a senior lawyer at BAHR.

2 Source: Argentum 2018 annual report.

3 Defined as capital raised through funds advised or managed by a firm with its head office established in Norway (Norwegian Venture Capital and Private Equity Association (NVCA)).

4 NVCA 2018 activity report.

5 NVCA 2017 activity report.

6 NVCA 2016 activity report.

sponsors is low from a purely regulatory point of view, significant fundraisings by newcomers are the exception rather than the rule, as they will rarely be able to demonstrate any track record, unless they are spin-offs from previous sponsors or internal asset management departments.

The duration of fundraisings varies quite significantly, from a handful of weeks until almost a year, depending on whether the sponsor provides an offering that corresponds to investor demand.

We expect the local market to grow somewhat in the coming years. Since 1 January 2019, Norwegian pension funds have been subject to new solvency rules based on a simplified version of the EU Solvency II rules, including investment freedom. This means that both Norwegian insurers and pension funds now are free to increase their allocation to private equity, where previously statutory investment restrictions held these at low levels, and perhaps lower than an optimal portfolio allocation and asset liability management should suggest.

II LEGAL FRAMEWORK FOR FUNDRAISING

Norway is a Member State of the European Economic Area (EEA). As such, the main body of legislation regulating the financial sector consists of EU legislation transposed into Norwegian law. Management and marketing of private equity fund managers are regulated under the Norwegian Alternative Investment Fund (AIF) Act, transposing the AIFMD.

At the fund level, private equity funds are unregulated in Norway. Closed-ended funds, and open-ended funds investing in asset classes other than financial instruments and bank deposits (e.g., real property, commodities (directly, and not in derivatives)), generally fall outside the scope of the Norwegian Investment Fund Act. Although it is expected that the EU-regulated fund types European Venture Capital Funds (EuVECAs), European Social Entrepreneurship Funds (EuSEFs) and European Long-Term Investment Funds (ELTIFs) will be introduced into Norwegian law, these regulations are not yet incorporated into the EEA Agreement or implemented into Norwegian law. Consequently, legal form and key legal terms for private equity funds are primarily shaped by investor expectations and based on international market standards.

The preferred jurisdictions for the establishment of funds by Norwegian firms have traditionally been Norway for smaller funds, and the Channel Islands for larger funds by sponsors that also target non-Norwegian investors.

In terms of legal form, the preference has been for companies that are tax-transparent for the purposes of Norwegian tax law, namely limited partnerships, with a general partner having invested an amount into the partnership directly. In the past, smaller Norwegian private equity funds were also established as limited companies.

Following Brexit, several fund managers are assessing whether to move new funds to within the EEA or to establish parallel structures inside and outside the EEA. Luxembourg is likely to be the most natural jurisdiction for such funds, and some fund sponsors have made this choice for their most recent funds (e.g., Explore Equity, Norvestor VIII).

Key legal terms for private equity funds correspond to those of market standard private equity funds established as limited partnerships. Outside commercial considerations such as a team's potential for deal sourcing, prospective investors may be expected to be primarily concerned with the correlation between total fund size and management fee, risk alignment or carried interest investment by the team, key man provisions, length of investment or commitment period and of term, and conditions for extending the investment period or term. Fundraisings in the institutional market typically see extensive negotiations over key terms.

It is standard market practice and a clear investor expectation for funds to include a most-favoured-nations clause with respect to side letters. For authorised managers, this is also likely to be required under the AIF Act, as is the obligation of fair treatment of investors, whereby any preferential treatment accorded to one or more investors shall not result in an overall material disadvantage to other investors. Side letters have begun to represent a major compliance burden for managers as these bespoke demands are becoming more extensive and may often include more discretionary elements, such as environmental, social and governance (ESG) reporting. It remains to be seen whether cost-saving measures and an increased compliance burden in general will force a larger degree of standardisation and reduce the current willingness of sponsors to negotiate side-letter regulation.

Following the entry into force of the Norwegian transposition of the AIFMD, authorised managers are subject to statutory disclosure requirements to both investors and to competent authorities, both with respect to pre-investment disclosures and ongoing disclosures. Disclosures are, however, primarily market-driven, and investors typically require more extensive disclosures than those required by law alone.

The trend for increased disclosure requirements is mainly driven by institutional investors such as insurers and pension funds, which typically require more extensive ESG reporting, as well as financial reporting, making insurers capable of employing the Solvency II 'look-through' approach for calculating capital requirements. Good quality financial reporting is also required by fund-of-funds investors that have become large investors in private equity funds.

The AIF Act imposes certain requirements with respect to ongoing reporting to investors, and requires periodic reporting to the competent authorities. Institutional investors will typically have specific reporting requirements, such as insurance companies (and, going forward, Norwegian pension funds – see Section I) subject to Solvency II capital requirements, and be obliged to adopt the look-through approach to the underlying investments of a private equity fund.

Following entry into force of the AIF Act, marketing of interests in private equity funds is regulated under the AIF Act. The AIF Act and its marketing rules have had a substantial impact in the Norwegian market. While marketing of unregulated funds previously could be made without specific restrictions (other than prospectus rules, general marketing law and rules regulating investment services), the AIF Act introduced common marketing rules for all types of alternative investment funds.

The marketing rules differ depending on the jurisdiction of the manager and the fund, whether the manager is authorised or registered, and the jurisdiction of target investors.

The AIF Act and the implementation of the AIFMD in Norway are to a large extent based on a copy-out approach, with little or no 'gold-plating'. Norway has implemented the AIFMD thresholds, allowing for light-touch regulation of managers of smaller funds that are not mutual funds (in simple terms, less than €500 million for closed-ended funds and less than €100 million for open-ended funds).

For private equity managers, that threshold will typically be €500 million, as funds as a rule are unleveraged at the fund level. In practice, the authorisation requirement will be triggered by the fact that the manager wishes to manage a fund established outside Norway, or to market fund interests to investors that are not professional according to the definition in the AIFMD. Norwegian rules concerning marketing of interests in AIFs to non-professional investors require that the manager is authorised under the AIFMD.

Whether or not the fund sponsor corresponds to the fund manager (on which the onus of regulation of the AIFMD lies) will vary depending on how the fund structure has been organised. Norwegian private equity funds will typically be managed by an external manager that is either registered or authorised. Internally managed private equity funds are rare. Certain larger sponsors with funds established outside Norway and the EEA, typically the Channel Islands, may have a structure where the manager (typically the general partner) is also established in the Channel Islands, and any Norwegian entities operate in an advisory function to the general partner. Advice in the context of private equity funds has been viewed by the Financial Supervisory Authority of Norway (FSAN) as being outside the scope of investment advice as defined in the Markets in Financial Instruments Directive (MiFID II). This mode of organisation requires that the actual management of the fund is undertaken outside Norway, and that the advisory company does not engage in investment advice or any other regulated activities.

Marketing of Norwegian unregulated funds by managers falling below the threshold values of the AIFMD and established in Norway are not subject to the specific marketing notification rules under the AIF Act. Managers of sub-threshold funds may opt in to benefit from the marketing passport under the AIFMD.

Norway has implemented the private-placement provisions of the AIFMD with respect to funds and managers established outside the EEA. On this point, however, the rules are somewhat more strict than under the AIFMD, as they require prior authorisation from the FSAN to market, rather than relying on notification only. In addition, for fund managers established outside the EEA, there is a requirement that they are registered with a competent authority and subject to prudential supervision in their home state for the purposes of asset management.

If the interests issued by unregulated investment funds are financial instruments, then services related to those interests (such as arrangement services or second-hand share sales) constitute investment services that fall within the scope of MiFID II, transposed into Norwegian law through the Securities Trading Act (the ST Act). Note that, under Norwegian law, interests in limited partnerships are generally not viewed as financial instruments, but there is a specific extension of the scope of the ST Act to include interests in limited partnerships where those interests represent a commitment of less than 5 million Norwegian kroner or the investors are not professional investors per se according to the definition in MiFID II.

In addition, the offer of interests that are financial instruments may trigger a requirement to publish a prospectus under the public offering rules of the ST Act, unless an appropriate exemption is available.

Marketing of private equity funds to non-professional investors requires a separate authorisation by the FSAN, and is only available to funds managed by an EEA-authorised alternative investment fund manager (AIFM).

There have been few supervisory actions in the private equity segment, largely because the majority of funds have targeted institutional and professional investors. The FSAN has primarily focused on monitoring activities by sub-threshold managers in respect of non-professional investors, and in particular, upon reverse solicitation. The FSAN will typically require firm documentation for reverse solicitation to substantiate that no marketing has been undertaken with respect to non-professional investors without authorisation.

The scope of fiduciary duties that a fund manager owes to the fund investors is different for authorised AIFMs and for registered AIFMs.

Authorised AIFMs are subject to overarching business-conduct rules, as further specified in the AIF Act and the AIFM delegated regulation. Registered AIFMs are only subject to contractual obligations towards fund investors, and general marketing and contract law.

Authorised AIFMs are required to appoint a single depository to each fund under management. This includes unregulated funds not previously subject to such a requirement. Although there are a limited number of available Norwegian service providers in this segment, this has not proven to be a bottleneck for the establishment of new funds. However, the FSAN has proved sceptical of depositaries in the same group as the AIFM. Further, authorised AIFMs are subject to specific requirements concerning internal organisation, including separation of risk management, and valuation and compliance functions, as well as rules limiting their activities to managing alternative investment funds and certain MiFID investment services as ancillary activities subject to prior authorisation. Authorised AIFMs may therefore also offer managed account products provided that the AIFM has the relevant authorisation.

III REGULATORY DEVELOPMENTS

i Regulatory oversight and registration obligations

Following the transposition of the AIFMD into Norwegian law, private equity fund managers and their activity fall under the oversight of the FSAN. Pursuant to the AIF Act, the FSAN is responsible for the oversight of managers – including both registered and authorised managers – and indirectly the funds managed by such managers. The Consumer Authority has oversight of actors in the financial sector providing services to consumers, including investment products such as private equity fund interests offered to consumers, and the marketing of such products and services.

The EU Packaged Retail and Insurance-based Investment Products Regulation (the PRIIPs Regulation), which has a requirement for a key information document (KID) when making interests in private equity funds available to non-professional investors, has not been implemented in Norwegian law. Instead, there are non-EEA-based rules requiring a KID to be drawn up to obtain authorisation to market AIFs to non-professional investors. For asset managers active in the retail markets the impact of the PRIIPs Regulation may introduce increased competition and cost transparency. Higher costs and risks connected to retail products may also lead to reduced competition, if non-Norwegian sponsors do not find the market large enough to warrant the investment. Distribution of private equity interests in the retail segment is also be affected by MiFID II and stronger investor protection rules. The new rules on inducements under MiFID II may affect sponsors in terms of how they can distribute funds in a cost-effective manner. It remains to be seen whether the increased transparency offered by PRIIPs will also affect the marketability of different segment (and higher-cost) funds in the retail markets, and whether this transparency will also affect the approach of institutional investors, especially smaller institutional investors that are not large enough to directly influence costs of management.

The coming year or two will likely see the advent of both statutory ESG requirements and higher investor requirements in that field. The Norwegian Ministry of Finance seems to prioritise implementation of EEA (EU) legal acts in this field, and the FSAN is focused on avoiding adverse effects of 'greenwashing' in the financial markets. For private equity fund managers, the increased focus will likely require them to integrate ESG into their investment and risk management processes to a higher degree than what has been the case to date.

As mentioned above, private equity funds are not regulated at the fund level in Norway. The EU regulations concerning the EuVECA, EuSEF and ELTIF regulated fund types have not been incorporated into the EEA Agreement or implemented into Norwegian law. There are therefore no specific regulatory requirements concerning the funds themselves. However, the rules of the AIF Act, which apply to fund managers, require that the funds are registered with the FSAN as being managed by the manager, irrespective of whether the manager is a registered or authorised AIFM. Further, certain provisions of the AIF Act, such as those concerning valuation, will have some bearing on the terms of the fund. In June 2019, the FSAN issued a circular concerning project finance companies and the scope of the AIF Act. Project finance companies that are single asset funds have been widely distributed in both the professional and retail spaces, as it has been the market view that these were outside the scope of the AIF Act. Pursuant to the FSAN circular, the FSAN holds that most such undertakings constitute AIFs subject to the AIF Act, unless they are joint ventures or the investors otherwise have day-to-day discretion or control.

Registered and authorised AIFMs are equally subject to the Norwegian anti-money laundering act (transposing the EU Fourth Anti-Money Laundering Directive into Norwegian law) and the General Data Protection Regulation (GDPR), as well as to requirements under tax reporting legislation implementing the Foreign Account Tax Compliance Act (FATCA) and the Organisation for Economic Co-operation and Development Common Reporting Standard (CRS).

ii Taxation of Norwegian funds and investors

With respect to taxation of Norwegian private equity funds and investors, Norwegian taxation broadly depends on whether a Norwegian fund is transparent (typically a limited partnership) or opaque (typically a limited liability company) for Norwegian tax purposes.

iii Taxation of transparent Norwegian funds and their investors

A transparent fund is not subject to Norwegian taxation. Instead, the income, gains, costs and losses of the fund are calculated at the level of the fund and taxed at the hands of its investors on a current basis (irrespective of whether the fund makes any distributions).

An investor (Norwegian or foreign) is taxable for its share of the fund's net income and gains at the ordinary tax rate of 22 per cent (25 per cent if the investor is subject to the financial tax rate; see Section III.vi). However, any gains deriving from the fund's qualifying equity investments (see Section III.v) are tax-exempt, while any dividends from such investments are subject to effective taxation (3 per cent of dividends taxable at the ordinary tax rate) of 0.66 per cent (0.75 per cent if the investor is subject to the financial tax rate).

An individual investor is further subject to an effective tax rate of 31.68 per cent on distributions from the fund to the extent they are not treated as tax-free repayments of paid-in capital, as well as on gains upon disposal of interests in the fund. The individual investor is, however, allowed a deduction in the distributions or gains for any taxes paid by the investor on the income and gains of the fund, and is further allowed a minor shielding deduction.

A corporate investor is subject to 0.66 (0.75) per cent effective taxation on distributions from the fund (3 per cent of distributions taxable at the ordinary tax rate), to the extent they are not tax-free repayments of paid-in capital. The corporate investor is tax-exempt on any gain upon disposal of interests in the fund, provided at least 90 per cent of all equity

investments held by the fund have been qualifying equity investments (see Section III.v) for a consecutive period of at least two years immediately prior to the investor's disposal. Otherwise, the gain would be subject to the ordinary tax rate of 22 (25) per cent.

An investor may generally deduct costs, although a corporate investor may not deduct acquisition or realisation costs related to qualifying equity investments. Losses are generally deductible to the extent corresponding gains would be taxable, but with certain limitations that are not dealt with further in this chapter.

The above generally applies to both Norwegian and foreign investors, but the foreign investors may, for example, be exempt from Norwegian taxation under an applicable double-tax treaty, and certain other deviations may apply.

iv Taxation of opaque Norwegian funds and their investors

An opaque fund in the form of a limited liability company is subject to the ordinary tax rate of 22 per cent on its income and gains. The rate is 25 per cent if subject to the financial tax rate (see Section III.vi). However, any gains deriving from the fund's qualifying equity investments (see Section III.v) are tax-exempt, while any dividends from such investments are subject to effective taxation (3 per cent of dividends taxable at the ordinary tax rate) of 0.66 per cent (0.75 per cent if the investor is subject to the financial tax rate). Such dividends are fully exempt from taxation if they are paid by an EU or EEA-resident company in which the fund holds more than 90 per cent of both share capital and votes (subject to certain conditions). The fund may generally deduct costs to the extent that they are not acquisition or realisation costs related to qualifying equity investments. Losses are generally deductible to the extent that corresponding gains would be taxable, but with certain limitations that are not dealt with further in this chapter.

A Norwegian individual investor is subject to an effective tax rate of 31.68 per cent, minus a minor shielding deduction, on gains and dividends from the fund, and is entitled to deductions for associated costs and losses.

A Norwegian corporate investor is tax-exempt on any gains from the fund and is subject to effective taxation (3 per cent of dividends taxable at the ordinary tax rate) of 0.66 (0.75) per cent on any dividends from the fund. Correspondingly, losses are not deductible.

A foreign investor is in general subject to 25 per cent Norwegian withholding tax on dividends from the fund, while any gain upon disposal of interests in the fund is not subject to Norwegian taxation unless the shares are connected to a permanent establishment maintained by the foreign investor in Norway. The foreign investor may be entitled to a reduced withholding tax rate under an applicable double-tax treaty. Foreign corporate investors that are genuinely established and carrying on genuine economic activities within the EEA are normally exempt from withholding tax. Further, individual investors resident within the EEA may claim a reduced withholding tax if the withholding tax exceeds the net taxation that would have been borne by a Norwegian individual investor. Certain documentation requirements for the right to reduced withholding tax at source were introduced on 1 January 2019.

v Qualifying equity investments

Norway has a tax-exemption method that applies to qualifying equity investments. Qualifying equity investments include (1) shares in Norwegian limited liability companies and similar opaque entities, (2) shares in corresponding EEA limited liability companies, provided the

EEA company in question is not a wholly artificial arrangement established in a low-tax country, and (3) shares in corresponding non-EEA limited liability companies, provided the non-EEA company is not resident in a low-tax country, and further provided the fund holds at least 10 per cent of the share capital and votes of the non-EEA company for at least two consecutive years. Qualifying equity investments further include investments in tax-transparent entities, provided that at least 90 per cent of all equity investments held by the transparent entity have been qualifying equity investments for a consecutive period of at least two years.

vi Financial tax rate

Since income year 2017, a specific finance tax has applied to Norwegian asset managers (and Norwegian branches of foreign asset managers). The tax is composed of two elements; a 5 per cent tax on the aggregate payroll expenses and a 25 per cent tax on net income (compared to 22 per cent, which is the ordinary tax rate for 2020).

vii Carried interest

For funds sponsored by Norwegian managers, the right to carried interest normally depends upon the investors having received payment for the entire contributed amount, in addition to a minimum return (typically 8 per cent). The excess proceeds are normally divided (usually 80:20) between the investors and those who have the right to carried interest.

The year 2013 saw the first court case on taxation of carried interest, involving the management company Herkules Capital and three partners. The case concerned the validity of a reassessment of income for 2007 by the tax authorities against Herkules Capital and the three partners, who had received amounts under carried interest. The tax authorities had concluded that the amounts – which had accrued to the partners' personal wholly owned investment companies – constituted ordinary income (salary) for the relevant persons, and that the amounts received by the general partner were taxable as business income in the hands of Herkules Capital.

After an annulment of the tax authorities' reclassification in the court of first instance (district court) and a full win for the tax authorities in the court of appeal, the Supreme Court rendered its judgment on 12 November 2015. The Supreme Court found that the amount of carried interest received by the partners' investment companies was not taxable as ordinary income (salary) for those persons. Further, the court found that the part of the carried interest amount received by the general partner corresponding to the partners' share could not be reallocated to Hercules Capital as business income. In coming to its conclusion, the Supreme Court emphasised that the taxation of carried interest must be based on the agreed allocation of income between the parties (unless the agreed allocation constitutes a tax avoidance in breach of the general anti-abuse rule or is not based on the arm's-length principle). Further, the Supreme Court emphasised that even though the contribution by the partners was an important factor for the achievement of carried interest, carried interest was also a result of other factors, such as the persons working in the relevant portfolio companies and market developments.

IV OUTLOOK

The Norwegian private equity sector has gone through significant changes between 2014 and the present. In 2014, the AIFMD was transposed into Norwegian law. Before that, both management and marketing of private equity funds were unregulated. Compliance practices were purely market-driven. On the other hand, the Norwegian investor market was also restricted in that both insurance companies and pension funds were strictly limited in their allocation to private equity investments. These restrictions have now been repealed following the transposition of Solvency II for insurance companies, with similar rules for Norwegian pension funds. Combined with the institutionalisation of the sector under regulation and the low interest rate climate, this may provide continued growth of private equity as an asset class.

The introduction of the AIFMD could be seen as the starting point for a more intensive regulation of the sector. Following the introduction of the AIFMD, Norwegian fund managers have also been subject to the Norwegian implementation of the EU anti-money laundering directive, FATCA/CRS, and the GDPR. Further, investors have become increasingly affected by managers establishing robust ESG policies for their investment activities. Insurers, pension funds and funds-of-funds are drivers behind this development, and managers are increasingly required to meet new ESG diligence and reporting requirements, as well as changing the interaction with portfolio companies to take into account 'non-economic' factors.

Outside market developments, there are three important challenges going forward for the Norwegian private equity sector. First, both in time and likely importance, Brexit may reduce market access for Norwegian fund managers to the UK market, as well as reducing the overall fundraising capability of placement agents currently headquartered in the City. We expect the market to adapt quite quickly, but the outcome is difficult to foresee.

Second, the Norwegian financial sector – and indirectly the investors and clients, both Norwegian and foreign – have been affected by the long and seemingly growing delay in implementing EU financial legislation in Norway. After the entry into force of the EEA Agreement in 1994, Norway generally implemented EU legislation with great assiduity. This changed following the establishment of the EU system of financial supervision in 2011 and the increasing legislative activity of the EU following the financial crisis.

The EU supervisory organisations – the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority – have partially supranational authority, and this conflicts with the principle of the EEA Agreement, whereby no sovereignty shall be relinquished by the EEA Member States. An agreement concerning the incorporation of the EU regulations establishing the European Supervisory Authorities into the EEA Agreement and integration into the EU system of financial supervision was concluded on 14 October 2014[7] and approved by the Norwegian parliament in June 2016. This led to a delay in implementation of EU law passed during that time. Further, it seems the legal mechanism of the relevant agreement concerning financial supervision is labour intensive, whereas the number of legal acts and delegated legal acts adopted in the EU is inflating, even with the respite afforded on this point by Brexit diverting resources within the EU. The backlog of outstanding legislation does not seem to decrease in any significant way and it is difficult to see any clear prioritisation other than capital requirements.

7 www.efta.int/about-efta/news/eea-efta-and-eu-ministers-reach-agreement-european-supervisory-authorities-3211.

In the asset management area, the regulations concerning EuVECA, EuSEF and ELTIF funds have not yet been implemented in Norway. Although these fund types do not seem to have had any resounding success in other EU countries, they may provide specific advantages under Norwegian law, as providing loans is a regulated activity in Norway. These fund types could, therefore, provide managers with greater flexibility and market opportunities in their investment activity in the unlisted markets in Norway. On 15 January 2018, the Ministry of Finance initiated a public consultation on the implementation of amendments to EU EuVECAs and EuSEFs and the delegated regulation under the ELTIF Regulation. None of the main regulations have entered into effect in Norway yet, and these will require an amendment to the Financial Undertakings Act to allow these funds to provide loans.

Lastly, the review of the AIFMD is expected later in 2020, after having been delayed because of Brexit. Legal reform brings an element of uncertainty. It is to be expected that Brexit and the position of third countries under the rules will affect the review. Private equity managers that have established or plan to establish funds in the Channel Islands, for example, would be sensitive to changes in this respect.

Appendix 1

ABOUT THE AUTHORS

PETER HAMMERICH

BAHR

Peter Hammerich is a partner at BAHR law firm, and head of BAHR's asset management and private equity group. Having practised within asset management, investment funds and private equity for more than 22 years (14 as a partner), Mr Hammerich represents hedge funds, private equity funds, open-ended investment companies and other asset management vehicles, as well as their sponsors, managers, service providers, portfolio companies and institutional investors. Mr Hammerich serves in various capacities in the Norwegian Venture Capital & Private Equity Association and is a board member of several leading Norwegian asset managers. He is the author of several publications within his field of expertise.

MARKUS HEISTAD

BAHR

Markus Heistad is a senior lawyer in BAHR's asset management practice group, having practised within asset management for more than 10 years. Before joining BAHR, Mr Heistad held a position with the financial markets department of the Norwegian Ministry of Finance, working with financial services regulation. Mr Heistad's practice focuses on asset management, banking and insurance regulation, as well as transactions within those fields.

BAHR

Tjuvholmen allé 16
PO Box 1524 Vika
0117 Oslo
Norway
Tel: +47 21 00 0050
Fax: +47 21 00 0051
ph@bahr.no
marhe@bahr.no
www.bahr.no

an LBR business

ISBN 978-1-83862-487-3