Public ownership, benefits and compensation II: Pension funds and employee ownership of water and energy grid companies

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David Hall and Vera Weghmann
halldj@gmail.com , d.j.hall@gre.ac.uk , V.Weghmann@greenwich.ac.uk

David Hall is a Visiting Professor and Vera Weghmann is a Research Fellow at the Public Services International Research Unit (PSIRU), part of the Centre for Research on Employment and Work (CREW), University of Greenwich

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1. Introduction

Since the Labour party announced plans to bring the water companies and the electricity and gas transmission and distribution companies, and Royal Mail, into public ownership, there have been claims by the CBI, the Social Market Foundation (SMF) and others about:

- The cost of compensation
- the impact this would have on pension funds or employees which own shares in these companies, and
- the risk of claims by foreign owners under international treaties, e.g. Bilateral Investment Treaties (BITs).

This paper on pension funds and employees is the second of three reports by PSIRU addressing these issues.

2. Pensioners and employees

This paper presents some results of a comprehensive analysis of the ownership of water and energy grid companies in the UK as at July 2019. This analysis identified all major shareholders of these companies, both listed and non-listed; identifies every investor owning more than 1% of each sector; and calculates what proportion of these companies, and each sector as a whole, is actually owned by five categories of investor: UK pension funds (UK PFs) ; other pension funds (other PFs); employees; sovereign wealth funds (SWFs); and investors eligible to claim under international agreements, including bilateral investment treaties (BITs).

The key results in respect of UK pension funds and employees are as follows:

- UK pension funds own about 8.5% of the water sector and about 2% of the energy grid sector: just over 5% across both sectors. So 95% of these companies are owned by investors who are not UK pension funds.

- the estimated difference between compensation based on book value and a realistic estimate of market value would affect the value of UK pension fund investments by less than 0.1% - less than the normal daily fluctuation in the value of investments, and effectively 'invisible'. This difference would have no impact on the value of actual pensions paid.

- About 0.1% of all water companies and 0.1% of all energy grid companies is held by employees. Legal advice in a recent case says that income from a buyout of employee shares must be treated for taxation purposes as a benefit from employment, so compensation for employees who own shares can and must be treated differently from the investors who own the other 99.9%.
- Variation in compensation paid to shareholders would thus have negligible impact on either employees of water and energy companies or members of funded pension schemes some of whose holdings include some water or energy shares.

Table A. Pension fund and employee ownership of water and energy grids (direct + via shares)

% of sector owned by investors who are:	UK pension funds	Employees	Foreign pension funds
Water	8.5%	0.1%	17.0%
Energy grids: electricity and gas, transmission and distribution)	2.0%	0.1%	7.2%
TOTAL (Water and energy grids)	5.2%	0.1%	12.1%

Sources: see annexes

These results contrast sharply with the assumptions made by commentators without hard information on actual ownership. The CBI for example talks about impact on 'pensioners', but nowhere offers any data on pension funds' ownership. Instead it claims that failure to increase compensation by an arbitrary 30% means that £9billion could be lost to 'UK savers and pensioners', based solely on the assumption that '20% of the shares are held by UK investors'[1]. The implications of these claims are strange: on their own figures, foreign investors will get four times as much benefit than the UK investors, £36billion compared with £9billion, so higher compensation is a very bad way of trying to help UK investors; especially as all the extra £45billion compensation they seek would be paid by UK citizens, who will thus in net terms lose £36billion while the overseas investors would gain the same amount.

A. Pension funds ownership

➢ Water

There are three water companies owned by groups listed on the London Stock Exchange, which between them account for just over a third, by value, of all the water companies: Pennon, Severn Trent, and United Utilities. UK PFs own 3.2% of Pennon, 2.2% of SVT (and an estimated 3.2% of UU). The ownership of these shares of the three listed companies amounts in total to about 1% of the sector. The shares of listed companies held by foreign PFs are slightly greater, at about 1.6% of the sector. These and other figures for ownership of listed companies include 'beneficial' ownership through shares which are nominally held by investor groups. With regard to direct ownership of non-listed companies – about two-thirds of the sector - UK pension funds hold 7.6% of the sector, while overseas pension funds, principally from Canada and Australia, own twice as much in direct holdings, a total of over 15.6% of the sector by value. The combined totals thus show that UK pension funds own about 8.5% of the sector, foreign PFs own about 17.0%.

Table B. Water: pension funds shareholdings as % by value (RCV) of all water cos

WATER			
	Shares in listed (PNN, SVT, UU) as % of all energy grid companies	**Direct holdings as % of all energy grid companies**	**TOTAL**
UK PFs	**1.0%**	**7.6%**	**8.5%**
Other PFs	**1.5%**	**15.6%**	**17.0%**

Source: see annexes

➢ Energy grids

UK listed groups own a higher proportion of the energy grids than in water, with 32% by value owned by National Grid and 11% by SSE. About 1.8% of National Grid shares, and about 2.1 % of SSE shares, are owned by UK PFs, about 0.8% of the sector in total. Larger proportions of the UK listed companies are owned by foreign PFs, (7.3% of NG and 4.9% of SSE), and these shareholdings account for nearly 3% of the energy grid sector as a whole. There is only one significant investment by a UK pension fund in a non-listed energy grid company, worth 1.2% of the sector as a whole, while foreign pension funds' direct holdings amount to over 4% of the sector, mainly due to two Canadian funds holding 25% each of the Scottish and Southern gas distribution networks. Combining the direct holdings with the holdings in the listed companies, UK PFs own 2.0% of the energy grid companies, and foreign PFs just over 7%.

Table C. Energy grids: pension fund shareholders as % of total RAV of all energy grid cos

ENERGY			
	Direct holdings as % of all energy grid companies	**Shares in listed companies (NG/SSE) as % of all energy grid companies**	**TOTAL**
UK PFs	1.2%	0.8%	2.0%
Other PFs	4.3%	2.9%	7.2%

Source: see annexes

[1] CBI 2019 Renationalisation: the cost p.2 This is simply copied from the sameassumption made by Nera consulting in a paper commissioned by the water companies – neither has any information on the actual involvement of pension funds. Nera 2018 The impact of nationalisation of utilities on UK households' savings and pensions https://www.pennon-group.co.uk/sites/default/files/attachments/pdf/180605-nationalisation-savings-nera.pdf

As shown in Table A, above, the combined result across both water and energy is that UK PFs own about 5.2% of the combined sectors, while foreign PFs own just over 12%. The results for the listed companies alone, which show UK PFs owning variously 1.8%, 2.1%, 2.2% and 3.2% are broadly in line with the ONS finding that UK pension funds generally own about 3% of UK listed companies.[2]

- **Impact of compensation calculations on UK pension funds**

There is no set formula under English law for compensation to former private shareholders of companies which are nationalised, rather the compensation has to be laid down in each case by parliament in the relevant nationalisation law.[i] and two approaches which have been most discussed have been the possible use of book value of equity (aka 'net assets') as a starting point, compared with a credible estimate of 'market value', as indicated by the share price of companies listed on a stock exchange. [3] [ii] The choice of method will affect the result for taxpayers on the one hand, and investors on the other hand,

Paying compensation based on will normally be lower than 'market value' as indicated by the share price of companies listed on a stock exchange, and so the difference between these two figures may be used indicate the significance for tax payers, on the one hand, and investors on the other – including pension funds (although companies which are not as profitable as expected may have a market value less than book value of equity, as is the case with Royal Mail plc in October 2019).

In the water sector, compensation based on book value/net assets would be £14.5billion; compensation based on market value as at end May 2019 could be £34.4billion[4] so the difference would be about £20billion in total for all owners of the sector. Of this 8.3% of which would fall on UK pension funds, representing less than 0.8% of fund assets. For the energy grids, the gap is similar: estimated market value of about £37.7bn, vs net assets of £17bn[5], but only 2.0% of this falls on UK pension funds, representing less than 0.02% of total assets.

The combined impact for both sectors of the entire difference between compensation based on full current market value, and compensation based on book value of equity (or net assets) is thus less than 0.1% of pension fund assets. That is of the same order as daily fluctuations in share prices of the listed companies, and can be fairly described as 'invisible' amidst the numerous factors affecting share values.

Such fluctuations in the value of publicly quoted shares occur from time to time and are part of the risk involved in stock market investments: funds are invested in a diversity of shares to diversify this risk, precisely so that the impact of any single factor is minimised. For the 50% of occupational pensioners whose pension is dependent on 'defined benefit' schemes, such factors do not by definition affect their pensions; the minimisation of the impact of individual share valuation ('invisibility') resulting from diversification of asset classes and individual holdings (risk-spreading) means that no actuarial adjustment should (would) result to contributions by current scheme members. The impact on the personal pension 'pots' of the 50% of occupational pensioners who are in 'defined contribution' schemes is, similarly, minimal on total portfolios.

Table D. Potential impact of difference in compensation on pension funds and pensions

	UK PF Assets (£ billions) OECD 2018	UK PF Holdings in water and energy grids as % of total UK PF investments	Potential Diff in compensation between book value vs 'market value'falling on UK PFs as % of UK PF Assets
Total	£2,200 billion	0.17%	0.1%

Sources: company annual reports 2018; OFGEM https://www.ofgem.gov.uk/system/files/docs/2019/03/supporting_data_file_to_regulatory_financial_performance_annex_to_riio-1_annual_reports_-_2017-18.xlsx ; OECD https://www.oecd.org/daf/fin/private-pensions/Pension-Funds-in-Figures-2018.pdf; PSIRU calculations. Market value of investments estimated from listed companies and relative RCVs/RAVs

[2] ONS Ownership of UK Quoted Shares: 2014 https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2015-09-02
[3] or RCV-net debt
[4] the SMF claim of £44bn noted in the FT is simply generated by arbitrarily adding 30% to the market value as estimated above.
[5] Based on RAV-net debt

B. Employee shares

Employee shareholdings have been identified in the formal shareholder lists of three of the five listed water and energy companies – Pennon, Severn Trent and SSE. In both cases these represent less than 1% of the company's shares. These employee shares are estimated to represent about 0.1% of both the water and energy sectors. No major employee shareholders were noted in any non-listed companies. So again, 99.9% of the benefit of increasing compensation would go to all the international private equity funds and banks – a very inefficient way of protecting employee interests.

Table A. Employee shareholdings in listed water and energy companies

						as % of water sector (Pennon+ SVT + UU)	as % of energy grid sector (NG+SSE))
	Pennon	SVT	*UU*	NG	SSE		
Employees	0.0%	0.2%	*0.2%*	0.0%	0.9%	0.1%	0.1%

Source: see annexes

- **Impact of compensation calculation on employees**

In any case, the government has to treat employees differently from other investments, as an employment benefit. The WOC Portsmouth Water was 73% owned by an employee trust until Feb 2018 when the trust, and the other shareholders, agreed to sell to the private equity investor Ancala. This sale led to legal and tax advice from lawyers and HMRC that **the money paid to employees for their shares should be treated as income from employment**, and not only taxed but also subject to N.I. contributions. So the government can and must treat employee-owned shares differently from those of other investors, and compensate them for the full value of their shares by negotiating improvements in pay and conditions, without giving rise to claims for comparable treatment by other investors.

The Portsmouth Water annual report for 2018 states:

> "As a result of this transaction, share options relating to the 73% EBT shareholding were issued to the trust beneficiaries at market value (the majority of current employees and certain former employees). These options were exercised immediately and the shares disposed of as part of the transaction. External tax advice and HMRC clearance indicated that the sales proceeds due to employees, were deemed to have arisen "by virtue of their employment" by the Group. As such these distributions were subject to PAYE and NI contributions. In order to tax effect these sale proceeds due to employees the gross consideration received was paid to the Company and processed through payroll with payments being made net to employees. As such, additional employee PAYE and NIC contributions were settled out of the gross proceeds and were paid during April 2018." Portsmouth Water AR 2018 p.39 and p.76 note 31
> https://www.portsmouthwater.co.uk/wp-content/uploads/2018/06/REPORT-ACCOUNTS-2018.pdf

C. Conclusion

There are at least five fundamental flaws in the idea that pensioners or employees will suffer in some way from lower compensation.

1. Since the case for higher compensation is based on a myth that there is some objective formula for 'true market value', for which the CBI and SMF use a long discredited figure, the payment of compensation based on real net asset value cannot be treated as a 'loss'. The larger figure is larger, but it's just an arbitrary big claim by investors.
2. Only about 5% of shareholders in the water and energy sectors are UK pension funds (8.5% of the water sector, and 2% of the energy grids sector). That means that 95% of the benefit from more generous compensation would go to international investors, private equity funds, and banks. There are much better ways of supporting UK pensioners - for example, the water companies could reverse their policies of closing their own pension schemes and running big deficits in their pension funds.
3. Variations in the market value of investments are entirely normal. The value of shares and bonds varies on a daily and hourly basis for multiple reasons, so pension funds are invested in a wide variety of shares and

debt, in order to minimise the impact of these risks by spreading them. There are many types of risk – from general economic recession, to incompetent management, fall in demand for a product or service – including the risk of changes of government policy as a result of elections or other factors, which is known as political risk. Funds are invested in a diversity of shares to diversify exposure to all these risks, precisely so that the impact of any single factor is minimised.

4. The same applies when funds value individual investments. If a fund invests in oil companies, for example, fund managers will take account of the risk their business will suffer because of decarbonisation policies, as well as other factors. When funds invest in companies which are not listed on a stock exchange, they have to use various methods to estimate their value (though they would never do what the CBI and SMF do, and base this on 'enterprise value'). Sometimes these assessments will turn out to be correct, sometimes not, but it is not for the government, on behalf of taxpayers, to compensate funds for such mistakes.
5. The impact on funds of such a factor is tiny in relation to the investments of each fund as a whole. Even if investors in UK water and energy grids were, in total, notionally 'losing' £40bn short of 'true market value', the 5% of that 'loss' for UK pension funds would total just over £2billion. But this represents less than 0.1% of the £2200billion investments by UK pension funds – much less than the average daily fluctuation in the price of investments. The impact would be invisible.
6. The impact on actual pensions is thus minimal. For the 50% of occupational pensioners whose pension is dependent on 'defined benefit' schemes, such factors do not by definition affect their pensions; and the 'invisibility' resulting from diversification of asset classes and individual holdings means that no actuarial adjustment would result to contributions by current scheme members. The impact on the personal pension 'pots' of the 50% of occupational pensioners who are in 'defined contribution' schemes is minimal on total portfolios for the same reason – and because the variation only amounts to less than 0.1% of PF investments.
7. Employee shareholdings are very small, and are legally treated as employee benefits, so however they are compensated must be different from the bulk of other investors.

Annexe 1 : Companies to be taken into public ownership under plans announced by Labour party

Water:
Anglian Water Services Limited
Northumbrian Water Limited
Severn Trent Water Limited
Southern Water Services Limited
South West Water Limited
Thames Water Utilities Limited
United Utilities Water Limited
Wessex Water Services Limited
Yorkshire Water Services Limited
Affinity Water Limited
Bristol Water plc
Portsmouth Water Limited
South East Water Limited
South Staffordshire Water plc
Sutton and East Surrey Water plc

Energy:
National Grid Gas Plc
National Grid Electricity Transmission Plc
Scottish Hydro Electric Transmission Plc
SP Transmission Plc
Cadent Gas
Scotland Gas Networks
Southern Gas Networks
Wales & West
Electricity North West Limited
Eastern Power Networks Plc
London Power Networks Plc
South Eastern Power Networks Plc
Northern Powergrid (Northeast) Limited
Northern Powergrid (Yorkshire) Plc
Scottish Hydro Electric Power Distribution Plc
Southern Electric Power Distribution Plc
SP Distribution Plc
SP Manweb Plc
Western Power Distribution (East Midlands) Plc
Western Power Distribution (South Wales) Plc
Western Power Distribution (South West) Plc
Western Power Distribution (West Midlands) Plc

Annexe 2: Methodology

The companies examined consist of all those identified for public ownership by the Labour party as at May 2019:
- The water and sewerage companies, and water only companies, licensed by OFWAT
- The electricity and gas transmission and distribution companies licensed by OFGEM

In water, the data on ownership was taken from the latest (2018) annual reports for each company as lodged at Companies House, checked against more recent news reports, and the data in Corporate Watch's December 2018 report. In energy, the ownership of the companies was taken from the latest (2018) annual reports for each company as lodged at Companies House, checked against news reports. The data on book value of equity was taken from company annual reports in all cases.

Market capitalisation values are not available for any of the operating companies, as none of them are listed on a stock exchange. In water, 3 groups listed on the London stock exchange own 3 of the main water and sewerage companies (WASCs) ; in energy, 2 groups listed on the LSE, and one Spanish group listed on the MCE, own a number of transmission and distribution grid companies. Since the current proposals for public ownership do *not* involve buying the entire listed companies, but only the specific UK gas and electricity grid companies owned by them, the market value of the listed companies with businesses other than water or UK energy grids was reduced pro rata to the importance of the water or energy grid businesses to the listed company as a whole, as presented in the companies' segmental analyses: e.g. these represent 44% of the profits of NG, and 42% of SSE. (https://investors.nationalgrid.com/~/media/Files/N/National-Grid-IR-V2/reports/2017-18/annual-report-and-accounts.pdf , https://sse.com/media/522419/sse-28225-ar2018-web-03-july-2018.pdf). In order to assess the proportion of the overall ownership of the industry held by different investors, it was assumed that the **relative** 'value' of the companies is reflected in the relative values of the RCV/RCAs fixed by the regulators – not, it should be emphasised, the **actual** value. The 'market value' of those companies owned by listed groups was then used as a base to estimate a notional 'market value' for the sector.

The beneficial ownership of shares in 4 of the 5 companies listed on the LSE (Pennon, Severn Trent, National Grid, and SSE) was taken from Jan 2017 data on all shareholdings above 0.01%. In producing overall estimates of the shareholdings in listed companies, it was assumed that United Utilities data would be equivalent to the larger of either Pennon or SVT. For each non-listed company the percentage of shares held by individual investors was identified using company reports, media reports, and checked against CW Jan 2019 data. These holdings were then converted into an estimate of the proportion of the industry, by applying the proportion of sectoral RCV held by company. Thus Cheung Kong's 100% ownership of Northumbrian water counts as 6.2% of the sector, as Northumbrian's RCV is 6.2% of the total value of the RCV for the entire sector; Hermes 8.7% holding in Thames Water is equivalent to 1.8% of the sector, as Thames has 20% of the total RCV , while Hermes also holds 21% of Southern, which is equivalent to about 1.5% of the sector, as Southern represents 7.3% of RCV.

Each investor was classified as a pension fund (PF), a sovereign wealth fund (SWF) or other; and their home country was identified. This enabled ownership to be analysed both by type of investor and country of owner, and generate overall estimates as well as individual holdings as a proportion of the sector

Annexe 3: Ownership of English water companies and UK energy grid companies

Table G shows all the major investors who own more than 1% of the water sector. This includes all the investors in the non-listed groups who own 65% of the water companies, as well as shares in the three listed groups shown above. This has been colour coded to show separately the 3 listed companies (pink), UK and foreign pension funds (dark and light green) and Asian and Middle Eastern investors (blue). This table shows that most investments by UK and foreign PFs, and by Asian investors, consists of holdings in non-listed groups, as shown in Table B above.

For non-UK pension funds, Table G shows that holdings by Canadian and Australian pension funds account for 20.6% of the English water companies, mainly in Thames and Anglian. There are additionally other much smaller holdings in the listed companies by other non-UK pension funds, including from the Netherlands, Sweden, state-level USA pension funds, Japanese national pension fund.

Apart from the listed companies and the UK and foreign pension funds, there are a number of Asian investors, led by Cheung Kong Infrastructure (Hong Kong) and YTL (Malaysia), and some sovereign wealth funds, who have holdings of over 1% of the sector. It should be noted that some of the sovereign wealth funds could also be categorised as pension funds.

Only one of the WOCs appears in the table, South East Water, as none of the others is large enough to feature holdings worth close to 1% of the sector or more.

These results are broadly in line with the findings of the Corporate Watch December 2018 report on the water sector https://corporatewatch.org/who-owns-your-water-and-how-theyll-try-to-keep-it/ .

Table B. Largest owners of English water companies

Water companies				**Holding as % of total RCV**	**Anglian**	**North-umbrian**	**Severn Trent**	**Southern**	**South West**	**Thames**	**United Utilities**	**Wessex**	**Yorkshire**	**South East Water**
Water co % of total RCV				**100.0%**	**11.5%**	**6.2%**	**13.0%**	**7.3%**	**5.1%**	**20.4%**	**16.4%**	**4.6%**	**9.6%**	**1.9%**
Groups/investors	**Type**		**Country**											
United Utilities	Listed		ES	**16.4%**							100.0%			
Severn Trent	Listed		UK	**13.0%**			**100.0%**							
Cheung Kong Infrastructure	Listed		HK	**6.9%**		**100.0%**		9.5%						
OMERS/ Borealis	PF		CAN	**6.5%**						31.8%				
Pennon Group	Listed		UK	**5.1%**					100.0%					

YTL	PE		MY	**4.6%**								100.0%		
Canada Pension Plan	PF		CAN	**3.8%**	**32.9%**									
First State Investments	PE		JP	**3.7%**	**32.3%**									
Hermes Investment Management	PF		UK	**3.3%**				21.0%		8.7%				
GIC (SI)	SWF		SG	**3.2%**									33.6%	
Corsair Capital	PE		USA	**2.9%**									30.3%	
JP Morgan Asset Mangt	PE		USA	**2.9%**				39.8%						
University Superannuation Scheme (USS)	PF		UK	**2.3%**						11.0%				
Commonwealth Bank of Australia	PF		AU	**2.3%**	**19.8%**									
Deutsche Asset Management	PE		DE	**2.2%**									23.4%	
Infinity (ADIA, Abu Dhabi)	SWF		UE	**2.0%**						9.9%				
Wren House (KIA)	SWF		KW	**1.8%**						8.8%				
CIC Capital	SWF		CN	**1.8%**						8.7%				
BC IMC	PF		CAN	**1.8%**						8.7%				
UBS Asset Management	PE		CH	**1.6%**				21.9%						
SAS Trustee Corp	PF		AU	**1.2%**									12.8%	
QIC	PE		AU	**1.1%**						5.4%				
Fiera Infrastructure	PE		CAN	**1.0%**						5.0%				
UTA International	PE		AU	**1.0%**										
RBS Pension Fund	PF		UK	**1.0%**										50%
GLIL group of LGPFs	PF		UK	**0.9%**	**11%**									

Table H shows the largest individual shareholders in the energy grids sector by value, including the 43% owned by National Grid and SSE. Unlike water, there is only one direct holding by a UK pension fund in a non-listed energy grid company – Hermes' 8.5% stake in Cadent Gas. As a result, the proportion of the energy sector owned by UK pension funds is smaller than in water.

As in water, Cheung Kong Infrastructure has a significant presence, owning 15.1% of the sector, with a further 6% owned by other Asian and Middle Eastern investors. But 25% of the sector is owned by three European and USA companies – Iberdrola, PPL, and Berkshire Hathaway (Warren Buffet's investment vehicle).

Table C. Largest owners of UK energy grid companies

				GT	ET	ET	ET	GD	GD	GD	GD	ED	ED	ED	ED	ED	ED
			Company	**Nat Grid Gas**	**Nat Grid Elec**	**Scottish Hydro ET**	**SP Tramsmission**	**Cadent Gas**	**NGN**	**SGN**	**Wales & West**	**NWEN**	**UK Power Networks**	**N Powergrid**	**SSEN**	**SPEN**	**WPD**
Owners	Type	Country	%of all grids RAV	8.3%	18.4%	3.0%	3.0%	13.6%	3.1%	7.9%	3.1%	2.8%	9.3%	4.9%	5.4%	5.7%	11.6%
National Grid plc	Listed	UK	**32.0%**	100%	100%			39.0%									
Cheung Kong Infrastructure	PE	HK	**15.1%**						88.4%		100%		100%				
PPL Corp	PE	USA	**11.6%**														100%
SSE	Listed	UK	**11.0%**			100%				33.0%					100%		
Iberdrola	PE	ES	**8.7%**				100%									100%	
Berkshire Hathaway	PE	USA	**4.9%**											100%			
First State Investments	PE	JP	**2.8%**									100%					
OTPP [Ontario Teachers Pension Plan]	PF	CAN	**2.0%**							25.0%							
OMERS/ Borealis	PF	CAN	**2.0%**							25.0%							
Macquarie Infrastructure and Real Assets	PE	AU	**2.0%**					14.5%									
CIC Capital [China Investment Corporation]	SWF	CN	**1.4%**					10.5%									
Allianz Capital Partners	PE	UK	**1.4%**					10.2%									
Abu Dhabi Investment Authority	SWF	AE	**1.3%**							16.7%							
Hermes Investment Management	PF	UK	**1.2%**					8.5%									
Qatar Investment Authority	SWF	QA	**1.2%**					8.5%									

[i] See paper I in this series for a longer discussion of the legal framework.

[ii]