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Global Wealth Chains & Public Utilities

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Introduction

There are many ways to understand the co-ordinating role of lead firms in markets –as transaction cost managers engaged in make-or-buy decisions (Coase 1937), as information brokers building collaboration (Spekman et al 1998) or as strategic pivots and governance agents in increasingly complex markets (Gereffi et al 2005). This chapter argues that these productionist conceptions miss the point that such firms are an integrated financial and productive asset and are thus articulated in global wealth chains, as well as value chains. We note a tendency on behalf of investors to conceive of the firm as an aggregate of separable assets, so that wealth is extracted both from underlying productive activities and also through forms of financial engineering. Taking UK water companies as our case study, this chapter explores how the response to regulatory price-setting has been to innovate around law and accounting arrangements to maximise cash extraction and private wealth appropriation opportunities. In the case of the multinational French firm Veolia, the provision of water and waste services provided the secure income stream through which debt-loaded subsidiaries could remit returns back to the French parent. Asset revaluations, inter-company debt and special dividends were used to immure a greater share of wealth within the corporate network and evict the claims of the UK state.

This case illustrates how the firm has become a conduit between debt markets and investor returns and a source of collateral to back extended chains of financial engineering. The governance of these global wealth chains are a hybrid of captive and hierarchy – the regulator is close during the price setting phase, but kept at a distance as client and supplier co-ordinate tightly to seek extractive opportunities from the new regulatory arrangements and are

separated only by legal boundaries between related corporate entities. Any intervention would therefore require not only changes in domestic regulation but multilateral coordination.

Section 1: Conceptualising Lead Organisation Relations Within A Supply Chain Or Network

How might we begin to conceptualise the relations around lead organisations in the governance of supply chains like water or waste? Since Coase's (1937) seminal work on the role of transaction costs in make or buy decisions, two influential approaches have emerged within academic writing on this issue. The first is the literature on supply chain management (SCM), rooted in operations management and consulting, which emphasises the role of lead firms in embedding co-ordination and trust in supply networks within innovative markets. A second set of literatures which emerges from world systems theory (Bair 2005) is the research on global value chains (GVC), which emphasises the role of firms as strategic pivots and key governance agents. Both emphasise new network forms of co-ordination, but both assume the central governance relations to be productionist. This assumption may not be appropriate in a mundane, financialised business like water.

Supply chain management

According to the SCM approach, lead firms increasingly perform the role of 'information brokers' rather than transaction managers in modern supply chains (Spekman et al 1998). The background to this claim is a broader perception that the sources of competitive advantage have changed fundamentally after globalisation. Specifically lead firms have become central to the organisation of looser networks of firms, allowing for both cost-cutting and value-adding advantages (Miles and Snow 2007). This co-ordinating role has been facilitated by new, sophisticated information systems which improve the efficiency of logistics and other functions and allow for a more modular form of production and service provision (Carter and

Price, 1993). This facilitated lead firms' access to smaller, more specialised firms whose skills would allow them to meet changing, more refined consumer preferences (Dale et al 1994; Harland 1996). Out of necessity this led to alternative modes of contracting, such as outsourcing (Willcocks et al 1995) and the emergence of temporary, project-based organisational forms (MacBeth and Ferguson 1994) to allow for such flexibility.

For SCM authors, lead firms' competitive advantage depended less on their ability to manage their internal processes and more on their ability to manage the performance of the total supply chain (Chen and Pulraj 2004; Harland 1996). According to Stadtler (2015: 10) '…no single organizational unit now is solely responsible for the competitiveness of its products and services in the eyes of the ultimate customer… competition has shifted from single companies to supply chains'. This meant lead firms have had to manage the broader integration and co-ordination processes across organisations (Monczka and Morgan 1997), to foster co-operation, collaboration and partnerships within the whole chain to secure long term competitive advantage for all participants (Azadegan 2011; Balakrishan, 2004; Carr, 1999; Hammer 2001; Hartmann and De Grahl 2011; Paulraj 2011).

The supply chain management literature on the water industry is minimal, and those references which do exist tend to focus on the narrower, though related, concept of sustainable SCM (see Seuring and Muller 2008 for an overview). This work develops the themes of SCM to emphasise, for example, the importance of collaborative benchmarking and transparency (Braadbart 2007) or the forms of information and co-ordination required to meet the challenges of water scarcity (Grant et al 2015) amongst other things. The representation of lead firms as information brokers continues, but the industry's unglamorous character and the perceived absence of innovative capacity within it, means there is scant reference to it within the literature.

Global Value Chains

Whilst accepting some of the contextual background discussed by SCM authors, the GVC approach differs significantly in its view of lead firms - in particular its theorisation of their use of power and the co-ordination and governance of the networks within which they are embedded. GVC authors identify the different governance arrangements of, and the uneven appropriation of value within, a network. This differs markedly from SCM's emphasis on mutual gains, goal congruence and the marginalisation of opportunism (see Storey et al 2006 for an overview).

In terms of power, GVC authors are less inclined to discuss lead firms' 'legitimate power', as is discussed in some SCM analysis (see, for example, Benton and Maloni, 2005) and instead views power as something that is not always exercised consensually. This was central to the original work of Gereffi and Korzeniewicz (1994) on buyer-driven and producer-driven Global Commodity Chains (GCCs), which broke down the financial value embedded in a product and traced its unequal distribution across the supply chain (Dedrick et al 2010). This inequality was linked to firms' structural sources of power (market power) and power over the dominant normative conventions of the network - such as the qualification of specific products - which allowed them to govern supply chains in ways that served their interests (Ponte and Gibbon, 2005).

More recent GVC work has emphasised the technical and economic aspects of governance at the expense of the more political questions around distributional outcomes (Palpacuer 2008). This research centred on how lead firms make strategic selections to optimise gains from new organisational and governance arrangements, against the backdrop of fragmenting market structures and the vertical disintegration of the multi-national firm. For example Gereffi et al

(2005) in their later work move beyond the dichotomy of buyer versus producer driven chains to outline five governance patterns in GVCs: market, modular, relational, captive and hierarchy to better understand the different organisational and governance structures emerging in new technology sectors. Each suggests a different role for lead firms: transaction-based governance in market structures; codification of complex information in modular chains; outsourcing to access core competences in relational networks; locking in suppliers in captive networks; and the exchange of tacit knowledge internally, logistics development and the management of intellectual property in hierarchical systems (Gereffi et al 2005, pp.86-7). This differs from SCM's singular and occasionally prescriptive approach to governance by emphasising the multiple ways lead firms reorganise and govern production in increasingly complex markets. But like SCM, there is very little written about the water industry from a GVC perspective – which is perhaps surprising given the global character of its ownership structures.

Section 2. Financialization And Global Wealth Chains

Both SCM and GVC do provide useful insights into the changing shape of global production and service provision. But the more recent emphasis on complex, innovative goods has tended to ignore important but mundane sectors like water which generate significant employment and provide essential services. Water is an interesting case because the mundane features of its activity contrast with the increasingly international and fund-based character of its ownership (Table 1) and the attendant financial innovations that have facilitated the global movement of wealth within - and out of - the industry. These developments are often not well captured by the activity-focused frame of SCM and GVC which haven't always engaged with the way the corporation has been financialized over the last 25 years, although there are

notable exceptions within the GVC literature in particular (Milberg 2008; Palpacuer 2008; Ponte and Gibbon 2005). The understanding of water as a financialized business changes the way we conceptualise the relevant governance arrangements within which water companies are embedded.

Table 1: UK/Overseas Ownership of UK Water Companies

Water company	UK or Overseas Ownership	Owner
Affinity Water (formerly Veolia Water Central, Veolia Water East, Veolia Water Southeast)	UK & Overseas	Allianz Group, HICL Infrastructure Company Ltd, DIF
Anglian Water (includes Hartlepool Water)	UK & Overseas	Osprey Acquisitions Limited - a consortium of several companies based in the UK, Australia and Canada.
Bristol Water	UK & Overseas	iCON Infrastructure Partners III, L.P., iCON Infrastructure Partners III (Bristol), L.P. and Itochu Corporation of Japan
Cholderton and District Water	UK	Independent water company
Dwr Cymru Welsh Water	UK	UK-based Glas Cymru
Northern Ireland Water	UK	Government-owned company
Northumbrian Water (including Essex & Suffolk Water)	Overseas	Hong Kong-based CK Hutchison Holdings Ltd
Portsmouth Water	UK	UK-based SD Parent Ltd
Scottish Water	UK	Government-owned company

Severn Trent Water (including Dee Valley Water)	UK	Severn Trent Plc
South East Water	UK & Overseas	Utilities Trust of Australia, RBS Pension Trustee Ltd, Desjardins Entities (RRMD, Certasm DFS)
South Staffordshire Water (including Cambridge Water)	Overseas	US-based KKR & Co L.P. and Mitsubishi Corporation
South West Water (including Bournemouth Water)	UK	UK-based Pennon Group PLC
Southern Water	UK & Overseas	UBS Asset Management, JP Morgan Asset Management, Whitehelm Capital, Hermes Infrastructure Funds
Sutton and East Surrey Water	Overseas	Japanese companies Sumitomo Corporation and Osaka Gas
Thames Water	UK & Overseas	Kemble Water Holdings Ltd, a consortium of investors
United Utilities	UK	United Utilities Group PLC
Wessex Water	Overseas	Malaysia-based YTL Power International
Yorkshire Water	Overseas	Kelda Group, which is owned by a consortium, including Deutsche Asset Management and private equity fund Corsair Capital

Source: company accounts

After financialization, firms are as much financial conduits – a relay between debt markets and investor income – as they are productive, value-adding nodes in a supply chain or

network. The role of conduit takes two forms. First, as Fligstein (2005) notes, management's conception of control changed to one which views the corporation as an aggregate of separable assets which can be divested, sold and leased back, secured against debt, securitised and put to many other financialised uses in the interest of maximising shareholder returns[1]. At the same time, the rising value of financial assets relative to total assets gives companies the incentives and capacity to shift these asset-related costs and profits across borders (Morgan 2014). Second, the accounting treatment of assets themselves is now central to wealth creation, illustrating the constructivist character of profit as an accounting artefact, which draws law and accounting expertise into a global corporate assemblage (Mitchell & Sikka 2011; Riles 2011). An explosion of practices like transfer pricing, intellectual property management and the use of special dividends to syphon off income to areas of lowest regulatory costs (Sikka and Wilmott 2010; Shaxson 2010); and an array of complex corporate arrangements, including the use of tax havens, to facilitate other quasi-legal, under-the-radar practices (Palan et al 2010) are the result. This illustrates the Jekyll and Hyde quality of modern governance relations when we move from operations to the financials. Trust, information sharing, collaboration and co-operation may well characterise some systems of governance on the productive side (though this too may be over-stated – see Brooks et al 2017), but on the financial side, opportunism, gaming, obfuscation and non-disclosure characterise relations with national regulators.

Mainstream corporate strategy has therefore become closer to the more exotic practices of alternative investment funds where the goal is levering financial assets for cash extraction as much as levering productive assets for value creation (Erturk et al 2010; Froud et al 2007), and where the firm itself has become a kind of mutable, rehypothecatable asset to be pledged

[1] We should recognise that Fligstein (2005) believed the Enron debacle marked the end of the shareholder value conception of control. Our view is that Fligstein's conclusion was premature.

in the interest of shareholder value creation. And with that move towards alternative investment strategies, capital has become more mobile and assets mutable so that there is a growing disconnect between the location of value creation and the geographical allocation of profits and wealth. If we are to understand this process, we must engage with the organisation of financial flows which shape the geographic footprint of capital. This is the start point for Seabrooke and Wigan's (2017) concept of Global Wealth Chains – a kind of vertical analogue to Gereffi et al's (2005) horizontal Global Value Chain.

The GWC aim is to map the 'transacted forms of capital operating multi-jurisdictionally for the purposes of wealth creation and protection'. This may involve an interactive relation between the organisation of the financial and operating activities – financialised pressures may, as Falcounbridge and Muzio (2009) recognise, feed back into corporate and public organizational forms and discourses, altering systems of governance within, and the geography of, production chains. GWC therefore has the capacity to shed light on the organisation and governance of global financial flows in unfashionable sheltered sectors like utilities. Understanding these sections of the economy is important when activities like water, gas, electricity, public sector operations etc still employ upwards of 10 million people in the UK or approximately 35% of the national workforce (Bowman et al 2014), yet so little is written about the governance of those networks and their financialized character. We will now explore some of these themes with the example of UK water.

Section 3: The Regulation of Water in the UK: Close But Distant

The organisation and governance of global wealth chains are influenced by three key variables: (1) regulatory liability (2) the innovative capacities of product suppliers in wealth chains (3) the complexity of transactions (Seabrooke and Wigan 2017). We will deal with this first concern, before exploring the remaining two variables in subsequent sections.

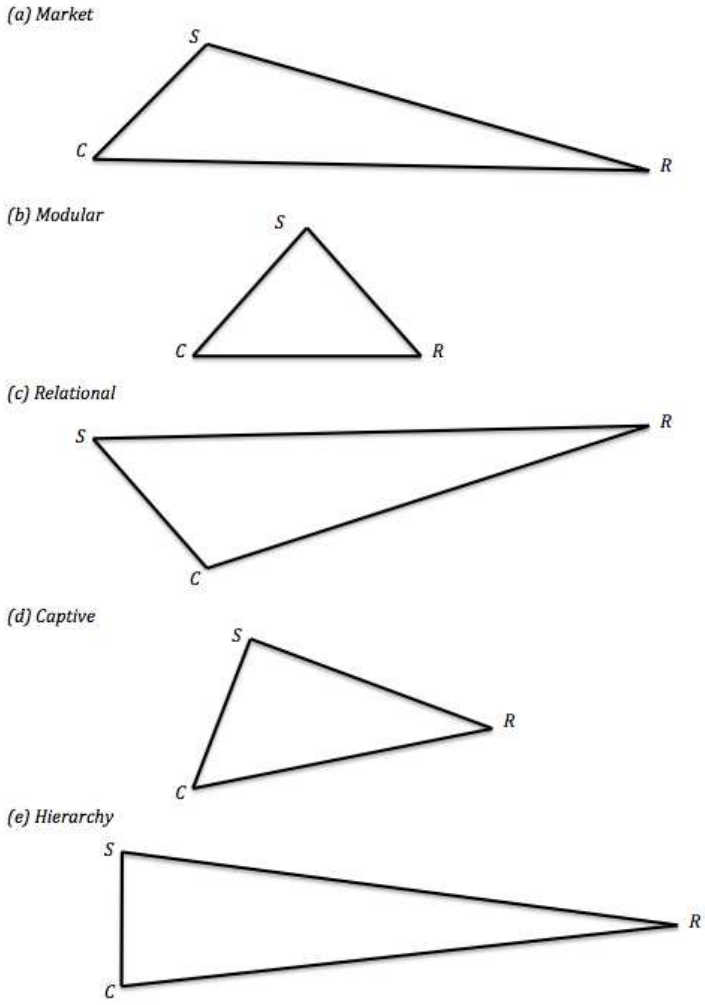
The nature of the relation between the regulator and regulated entities in the UK is temporally contingent. Relations are closer during the price-setting phase, whilst the regulator is held at a distance during the AMP5[2] phase. These relations reflect the relatively unique characteristics of the activity and a very particular regulatory history post-privatisation.

UK water provision was privatised in 1989 under the Thatcher government and the particular regulatory regime that emerged in the UK reflected an ongoing attempt to resolve a central tension evident from the outset: that water provision, due to its requirement for large capital outlays, is a natural monopoly and thus resistant to the kind of market logics envisaged in the privatisation programme. The regulatory framework that therefore emerged was complex and multi-layered in an attempt to simulate market forces in the absence of consumer switching power. The Water Services Regulatory Authority or 'Ofwat' is the economic regulator of the water and sewerage sectors, tasked with promoting competition to protect consumers, monitoring water companies' productive and financial performance against a set of benchmarks and a broader 'sustainable development' remit. The Department for Environment, Food and Rural Affairs (DEFRA) sets the overall water and sewerage policy framework in England, including the setting of core legislation and standards, as well as creating special permits such as drought orders. Much of the same activities are governed by the Welsh Government in Wales. The Environment Agency advise government on the environment and thus have a role in regulating the water and sewerage sector, for example, in seeking to avoid flood risk. There is a Drinking Water Inspectorate who check that water companies meets the standards set in the Water Quality Regulations. The Consumer Council for Water act as consumer advocates and investigate consumer complaints. Whilst Natural England advise government on certain environmental aspects of water supply and

[2] The AMP5 is the Asset Management Plan for the next 5 years.

preservation. In addition to all that there are European water, wastewater and environmental standards set by the European Union.

From a GWC perspective, Ofwat is the most relevant regulatory actor because they deal with economic practice in the sector. But Ofwat has always had a conflicted regulatory role. In the absence of competition Ofwat is tasked with simulating market effects by setting price limits on the wholesale water and sewerage business every five years. But at the heart of this price setting remit lies a balance between the need to incentivise capital investment over the long term and the goal of empowering consumers and stimulating efficiency (Ogden 1997). This manifests in a tension between keeping prices low enough to justify Ofwat's consumer protection remit and preventing them falling so low that they compromise the supplying entities' ability to meet investment and sustainability targets. Ofwat is therefore simultaneously close to the industry in the negotiation of key metrics which feed into the pricing review, with informal, co-operative relations present between regulators and the regulated (Willman et al 2003). But it is also held at a distance by the industry as they draw on law and accounting expertise to aid them in maximising cash extraction from the activity over the five year period once prices are set, ensuring they also meet (or appear to meet) their obligations on service provision, investment and so on. The water industry might therefore be thought of as either a form of captive or hierarchy relations, or a hybrid of both within the GWC schema (see figure 1), depending on the temporal frame of our analysis.



To understand this unusual client-regulator relation it is worth examining the price setting mechanism more closely, to understand how extractive strategies are built in response to it. Ofwat's remit to ensure that water companies can finance their functions means the central goal of the pricing methodology is to guarantee a return on the capital invested in the business, effectively putting a floor under the price (whilst also underwriting water company profits). This is done by imputing a 'regulatory capital value' (RCV), which is remunerated to include the costs of capital and is indexed to inflation, both of which are forecasted for the subsequent 5 years during the price review (Office of Water Services 1992). Adjustments to the RCV are then made, based on the expected capital expenditure required to enhance and

maintain the network, whilst deducting capital grants and other contributions to the cost of the new assets. Current cost depreciation on a current replacement cost basis is also deducted from the RCV (Ofwat 2017). Companies are then encouraged to outperform these regulatory assumptions and are allowed to retain any efficiency gains made on a rolling basis, although the 2015 price review did make some amendments. There are no restrictions on dividend payouts, which were abolished in the 1989 Water Act.

A calculation this complex encourages innovation around accounting categories and the legal form. And the rest of the history of regulation in the sector has been one of cat and mouse as each price-setting review encourages new practice which subverts their sentiment. Gaming goes back to the very first days of privatisation when newly privatised companies set up holding companies with multiple subsidiaries to relocate various activities outside of the realm of Ofwat's reach (Ogden and Glaister 1996). Similarly companies soon realised that 'outperforming' (underspending) early in the price review period allowed them to keep the benefits of their efficiencies for longer, before customers felt the benefit (Ofwat 2017). Firms also discovered ways of bringing in new sources of income not well captured by the RCV calculations – such as the selling of land and other assets, which the 2015 review has now tried to address. With each new regulatory intervention, a new set of practices emerged in response on the blind side of the regulator. But these standard forms of regulatory arbitrage morphed into something much more elaborate as regulation became an input for financial innovation rather than a constraint on it.

4. Innovative Capacities: Firms as Financial Conduits Between Debt Markets And Investor Returns

The GWC emphasis allows us to understand firms like water companies differently - as a kind of conduit between debt markets and equity holders; or alternatively as a portal which alters the temporal allocation of income and costs so that it is entirely possible for investors to take out distributions over and above the firm generated cash residual, whilst leaving the corporate entity with the present costs of the future debt-based liabilities.

Not all firms can be put to this kind of use, but public utilities are particularly attractive as a conduit asset, because of their security and the predictability of their income streams. This may explain their appeal to the more exotic end of the investment spectrum like private equity funds where there is a strong preference for investments with strong and secure cashflows to finance the levered nature of the acquisition. Water companies have little demand risk because they provide an essential service. The income stream is linked to RPI and the return on capital is underwritten by the regulator, so there is no innate inflation or interest rate risk. There is no commodity price risk because water companies do not 'own' the product they distribute and there is minimal competition risk because the activity is a natural monopoly. These characteristics are highly appealing to alternative investment funds because asset-heavy, cashflow positive, secure industries give funds multiple 'outs' and financial innovation opportunities. The firm, when compared to other asset classes, has a mutability rooted in its limited liability status, which makes it amenable to the kind of financialized practices that a simple government bond is not.

In the case of water, the central opportunity has been to increase leverage and pay out dividends – a product of the original 1989 Water Act which lifted restrictions on both (Bailey 2002). Water companies notoriously distribute very high levels of dividends to investors, and in recent years much of this has been funded by debt issue (Financial Times 2015). Ofwat first became aware of the dividend issue in the mid-1990s when companies claimed that they did not need to invest as much in the future network because of their capital efficiency

savings which justified higher dividend payouts (Hall & Lobina 2007). The early 2000s were then characterised by underinvestment as water companies sacrificed capex for distributions: between 2000-2005 the investment underspend was estimated to be around £1.7bn or 9% of Owfat projections, whilst companies paid out £3.4bn in dividends (Ofwat, 2006). This worsened in 2006 when the capital underspend reached £1bn in a single year - 22% lower than the level assumed by Ofwat when setting the price limits (Lobina and Hall 2008). By 2009 the industry paid out almost twice its free cash flow before interest in dividends, funded by debt as gearing ratios rose from 46% in 2000 to 72% by 2009 (Armitage 2011). Ofwat did respond amidst a public backlash against dividend payouts: regulated companies were required to report dividends paid to their parent company and to explain the basis of the dividend; firms were also reminded that dividend payouts should not impair their ability to finance their regulated businesses and that dividends should only reward efficiency and the management of economic risk. But in reality the latter was difficult to measure and thus enforce, and the former was always susceptible to hold-up risk when firms' inability to deliver on their investment promises would be viewed at least in part as an indictment of Ofwat itself given its responsibilities to underwrite the financing of those firms; the temptation to lower expenditure targets[3] or revise pricing arrangements[4] would be high and not unprecedented. By 2013 Cox (2013, p10) found that little had changed: shareholder distributions to parent companies continued so that 'at the top end of the range, companies have been paying out close to 25% of their equity asset base ('equity RAV') to their holding companies in each year'.

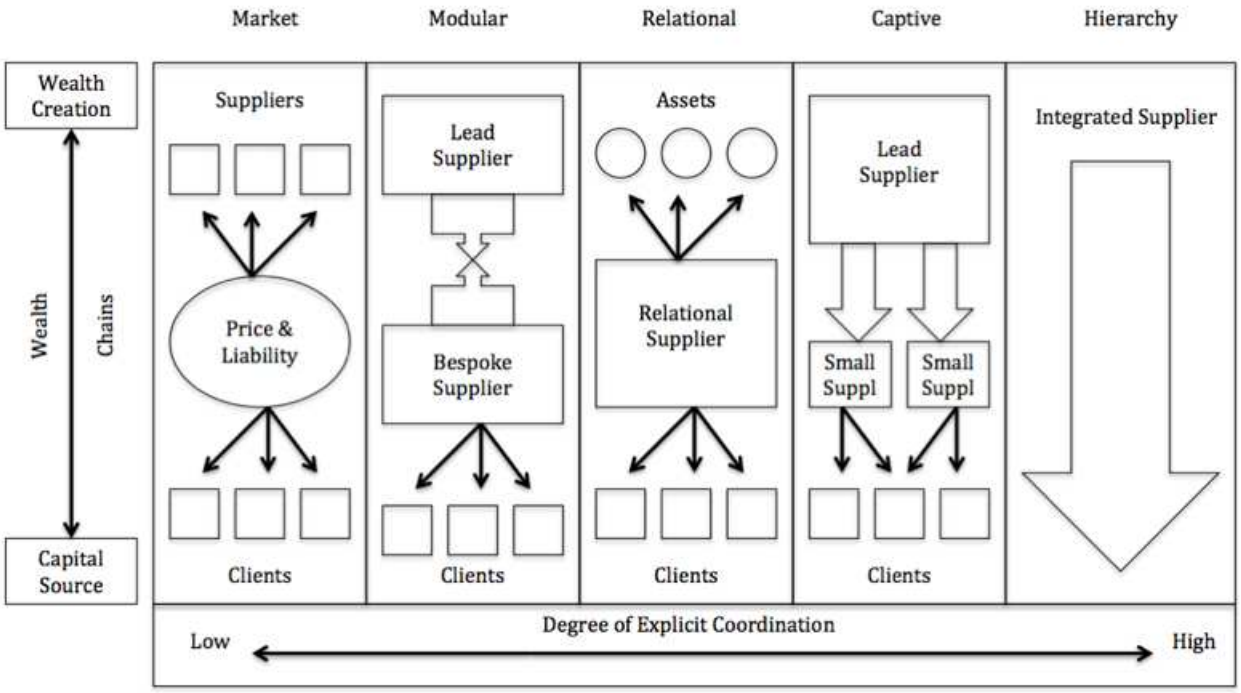
[3] For example in Ofwat's 2004 review it recommended that Thames Water cut its expenditure on fixing leaky pipes by 27% (Armitage 2011).

[4] In some cases shortfalls in revenues are recoverable through the revenue correction mechanism (RCM) at the next price review. The RCM, is designed to compensate water companies for lower-than-anticipated consumption by "tariff basket" (largely household and smaller commercial) customers.

Accounting and law expertise has become central to this process of extraction, where there is a close relation between clients and suppliers to innovate around and occlude practice from the regulator. Authors have already argued that that the costing methodology is flawed and open to too much discretion in the accounting of unit costs (External Stakeholder Survey, 2005: 38). Similarly, others have noted that profits are exceptionally sensitive to the method of valuing the assets and the rules regarding depreciation (Armitage 2011). Below the line innovations to reduce tax costs have also proliferated. Water companies have levered up to depress corporation tax receipts (FT Oct 20th 2015). They have also booked large deferred tax allowances against future investments. Government estimates are that water, electricity and gas companies denied the Treasury of up to £1bn through complex and aggressive forms of tax avoidance (Kavanaugh 2013). Securitisation in the case of Welsh Water's recent deal with RBS and Yorkshire and Southern Water's use of derivatives like index linked swaps show there is also an appetite for more exotic forms of financial innovation.

The GWC governance relations that underpin these extractive strategies are therefore closer to hierarchy (figure 2). They are more likely to be bespoke than off the peg because their goal is something quite specific to water companies - to maximise extractions from the AMP5 period where prices have already been set and there is a certain confidence in a margin positive but low ROCE future. There is also significant divergence in practice and levels of debt across the water companies (Armitage 2011; Ofwat 2015), suggesting the services are firm-specific and work with an integrated supplier-client relation due to the complexity of information and knowledge transfer. This may also be shaped by the specificity of client's requirements, which are always shaped by the different domiciles and thus tax regimes within which parent organisations are based. To explore the role of accounting and law expertise and how it influences practice we shall now look at the instructive case of Veolia Water.

Figure 2: Five Global Wealth Chain Governance Types



Section 5. Veolia And Complex Transactions

Veolia Environnement SA is a French utilities company which had a UK subsidiary, Veolia Water UK PLC/Ltd[i] - then its main operating entity in the UK water utility sector. Veolia Water UK was often held up as an exemplar of good practice in a sector where high gearing ratios and complex corporate structures were the norm (see Allen & Pryke 2013). But whatever its productive achievements, the story of Veolia Water UK is also one of financial engineering, specifically the use of inter-company debt and special dividends to move wealth around within an international corporate structure.

The backdrop to the story is the Eurozone crisis which forced Veolia Environnement SA to assess its position in a number of global markets, including its water businesses (Boxell

2012). This was in part forced upon them due to large losses from their financing activities. Veolia's senior management therefore sought a 5-6bn Euro divestment programme focussing mainly on foreign assets to reduce corporate debt (Veolia Environnement SA 2011). But this accumulation of corporate debt when consolidated at group level must be understood within the context of the relations between French parent and UK subsidiary, where intercompany debt and other forms of financial engineering were significant features.

The financial engineering in this particular example began in 2010 when Veolia Water UK revalued its tangible fixed assets from historic cost methods to fair value methods, following accounting rule FRS15. This had a profound effect on the balance sheet as Veolia Water UK PLC revised the value of some of its tangible assets up by £436.6m, which, through the double entry effect, directly increased shareholder funds on the liability side by the same amount (figure 3). Even though this innocuous accounting exercise had added multiples of millions of pounds to its shareholder funds, this was still only a paper gain. To access that new asset value created there needed to be a way of liquefying those assets and then extracting value from them. To do this Veolia Water UK PLC was loaded with £325.8m of intercompany long term and short term debt. This created an asset (£325.8m cash from the loan) and a liability (the £325.8m which had to be paid back to the parent). The company then paid a virtually equivalent dividend payment of £321m back up the structure to the French parent (figure 4). The £321m disappeared from the asset side and an identical reduction had to be booked to the liability side. The obligation to repay the intergroup debt remained, so shareholder funds were reduced by £321m.

Figure 3

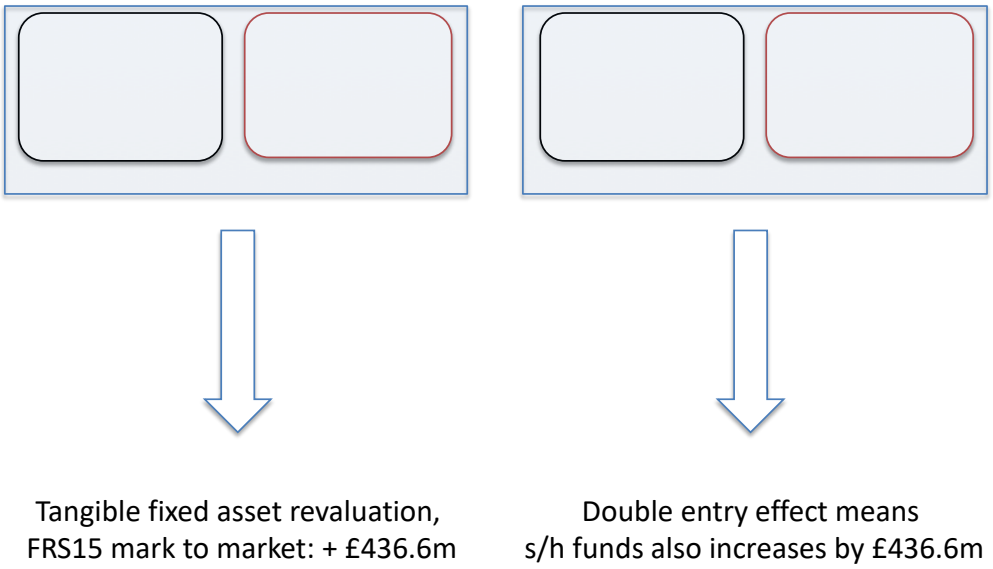
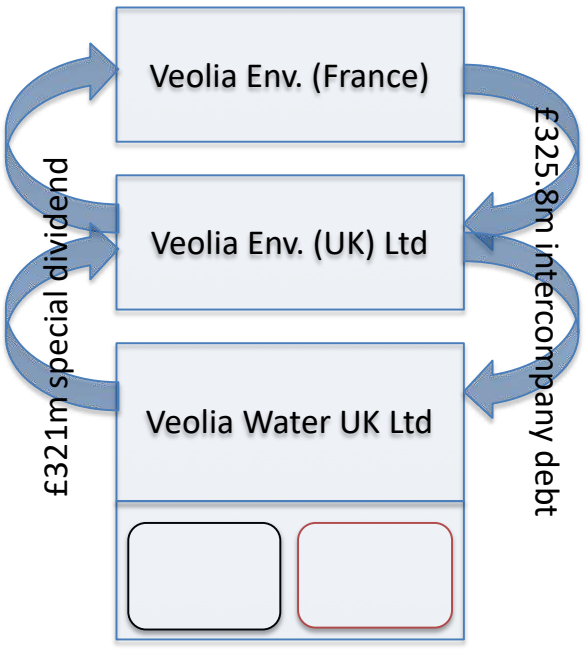

Tangible fixed asset revaluation,
FRS15 mark to market: + £436.6m
Double entry effect means
s/h funds also increases by £436.6m

Figure 4


Veolia Env. (France)
Veolia Env. (UK) Ltd
Veolia Water UK Ltd
£321m special dividend
£325.8m intercompany debt

The use of intercompany debt and special dividends gave Veolia two main benefits: the higher interest payments resulted in a lower post-interest profit, which reduced their tax burden; the inter-group interest then became a second form of extraction from the UK subsidiary to the French parent, allowing the French parent to increase its own dividend payout to 735.6m Euros in 2010 from 434m Euros in 2009 – a sum unerringly similar to the special dividend paid to it by its UK subsidiary. This financial manoeuvre helped limit the claims of the State on the surpluses of this UK subsidiary, surpluses effectively underwritten by the regulator, and which could have been redirected into socially useful capital investment.

At the consolidated level the intercompany debt balances out – its main purpose is to evict the UK state from its claim on the national subsidiaries surplus. But by 2011 the French parent wanted to exit the UK water business (at least in part) to raise money to pay down debt. Veolia Water Ltd was sold in 2012 to a consortium of investors. This was a complex arrangement: the separate licences of Veolia Water Central Ltd (VCE), Veolia Water Southeast Ltd (VSE) and Veolia Water East Ltd (VEA) were unified and held by a holding company: Veolia Water Capital Funds Limited (Ofwat 2012a). Veolia Water Capital Funds Limited was then sold to a consortium led by Infracapital Partners (part of the M&G investment group, Prudential's investment arm), Beryl Datura Investment Ltd (BDIL) Equity and Morgan Stanley Infrastructure Partners. The takeover vehicle was given the moniker of Rift Acquisitions (Investments) Ltd (Ofwat 2012b), but later became Affinity Water Acquisitions (Investments) Ltd. A holdco, midco and another subsidiary were then inserted between it and the bought out Veolia Water Capital Funds Limited.

The financing arrangements were also complicated. On the equity side Veolia Water UK Limited retained a 10% stake in the holdco company, with the remaining 90% stake held by Infracapital, Morgan Stanley Infrastructure Partners and BDIL Equity. The buyout was

financed with shareholder loans and £552m of bank loans (Affinity Water 2013); but within five months the loans were repaid through a new £572.9m intercompany loan, financed by a securitisation through a new Cayman Islands registered vehicle: Affinity Water Programme Finance Limited. A further £200m from an existing bond facility was provided by Affinity Water Finance (2004) to Affinity Water Limited acting as the guarantor (Affinity Water 2014). The complexity of the deal perhaps obscured some sizeable extractions. Veolia paid itself an additional £60m in dividends from the UK subsidiary in July 2012 just as it was sold. Upon handover and in the same financial year, Affinity then paid its investors £95.2m from the operating entity it had just bought (Affinity Water Capital Funds Limited 2013).

Conclusion

The complexity of the strategies above requires persistent rather than periodic engagement between client and supplier. Much of this co-ordination takes place on the blind side of regulators who either become aware or obtain a position to respond to these practices three or four years after they occur at the next price setting review. Water companies therefore operate as a hybrid of captive and hierarchy in global wealth chains: the regulator is close to the client during the price setting phase, but kept at a distance as client and supplier co-ordinate tightly to seek extractive opportunities from the new regulatory arrangements once the pricing criteria has been set.

This emphasis on the governance of wealth rather than production casts an altogether different light on the water industry. Its mundane activity characteristics stand in contrast to the exotic financial manoeuvrings that take place within the corporate network. This might also open up the analysis of global value chains to processes of financialization as water companies become treated increasingly like a conduit or syphon between debt markets and investor returns.

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[i] The subsidiary was named Veolia Water UK PLC until 2012; it became Veolia Water UK Ltd thereafter