Lessons from Punch Taverns restructure

A debt-for-equity swap marks the end of marathon discussions and disagreements

Danielle Myles, editor

Three years of acrimonious negotiations needed to restructure Punch Taverns could have been shortened if the UK made use of some French insolvency concepts, deal counsel have said.

The iconic British pub operator's restructure, considered Europe's most complex since Eurotunnel in 2007, finalised last month.

The out-of-court deal followed three rejected proposals and ended a stalemate between senior creditors, Punch's board and its shareholders – many of which were also junior noteholders.

Once agreed, it took under six months to complete the agreed debt-for-equity swap, which reduced Punch's debt levels from £2.2 billion ($3.45 billion) to £1.6 billion. But the saga preceding that agreement suggests a need to pause and reflect on how England's insolvency framework can be improved.

"We like to think that the UK restructuring process is one of the best in the world," said John Houghton, partner at Latham & Watkins, which advised the senior creditors. "But maybe we could take a lesson from the French and their *mandataire judiciaire* moderator role," he added.

A *mandataire judiciaire* is an independent arbiter appointed by the court to facilitate discussions between the parties. Their aim is to broker a compromise before the company hits insolvency.

Much of the difficulty in Punch's reorganisation stemmed from the fact hedge funds that owned shares in the company had also acquired junior notes in the two securitisation vehicles through which Punch was funded.

According to some involved in the deal, this meant that the three reorganisation proposals put forward by Punch between late 2012 and late 2013 were based on the interests of out-of-the-money shareholders and junior noteholders.

Approval required a majority of 75% of each of the 16 creditor classes, and the senior creditors' coordination committee (CoCom) held a blocking stake.

Key takeaways

- On October 8 Punch Taverns completed a debt-for-equity swap that reduced its debt from £2.2 billion to £1.6 billion;
- It has been described as Europe's most complex restructure since Eurotunnel in 2007;
- The agreement came after three years of acrimonious negotiations between senior creditors, Punch, and hedge funds which were junior noteholders and shareholders;
- Deal counsel said the deal could have been shortened by one year if the UK insolvency regime introduced a mandataire judiciaire-type role seen in France;
- The deal was complicated by the pub operator being financed via a whole business securitisation, meaning there was no intercreditor, pledges or cross-collateralisation.

This created the standoff that, if a third party was involved, could have ended a lot earlier.

"If we had something [like the *mandataire judiciaire*], where someone could have sat in the middle of the parties with a view to facilitating a restructuring discussion, this deal could perhaps have been truncated by maybe a year or more," Houghton said

The success of UK schemes of arrangement and pre-packed administrations has cemented its rivalry with the US as a global restructuring hub. But the Punch restructuring has revealed room for improvement in out of court deals.

Punch's restructuring timeline

2011
Punch's debt levels approach £3 billion. Senior creditors, including the Association of British Insurers, discuss the possibility of a restructure.

Late 2012
Punch and different stakeholders start discussions on a consensual restructure.

February 2013
Senior creditors reject Punch's first restructuring proposal

June 2013
Senior creditors reject Punch's second proposal

January 2014
Senior creditors reject Punch's third proposal

February 2014
Rothschild, senior bondholders' financial adviser, proposes a debt-for-equity swap to Punch. They accept a revised version

June 2014
Senior creditors approve restructuring plan

September 2014
Shareholders approve the plan

October 2014
Restructuring completes

A stronger WBS structure

The debt-for-equity swap that saved Punch was proposed by Rothschild, the CoCom's financial adviser, shortly after the senior creditors rejected the company's third restructuring proposal.

It involved the exchange of junior notes in Punch's two securitisation vehicles for new junior notes, cash, and shares amounting to 85% of the subsequent corporate structure. The CoCom continues to hold their senior notes.

The deal involved the redrafting of 18,000 pages of whole business securitisation (WBS) documentation, including some unprecedented amends to create a more robust corporate structure and stronger senior noteholder rights.

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As a result, it's now easier for the securitisation noteholders to obtain information from the business. The company is also no longer allowed to buy back junior notes out of priority.

Perhaps the most notable changes are the securitisation vehicles' new pledges over the shares of Punch. If there is a default and the pledge is exercised, all the group's debts are released, which would greatly ease any enforcement process.

"As far as we know, there is no other whole business securitisation that has this clause in it," said Latham's Mark Nicolaides, who also worked on the deal.

The pledge agreement, and parallel release clauses included in the security documents, are a WBS market first. It's hoped they may be incorporated into future deals, to facilitate any subsequent restructuring discussions.

Preparing plan B

As in most restructures, the CoCom – as the in-the-money creditors – prepared an enforcement strategy to demonstrate to the company and junior noteholders that it could get hold of the assets if it wanted.

This is usually eased by an intercreditor agreement, which sets out the waterfall and security trustee's ability to release other claims.

However as Punch is structured as a WBS, there was no cross-collateralisation and no intercreditor, making it impossible to cramdown the junior noteholders through a court process.

"A comprehensive release clause is standard in leveraged finance, but not in securitisations," said Nicolaides. "So you couldn't leave the out-of-the-money creditors behind with a classic share pledge enforcement and pre-pack, which meant we had to go about it in a slightly more complicated way."

In the absence of the pledge subsequently introduced into the WBS structure, the CoCom had to work with the security trustee to demonstrate to Punch and its shareholders that if the notes defaulted, the CoCom could get access to the underlying assets.

"We had to unpick a series of locks to make sure the junior noteholders and out-of-the-money shareholders realised that if there was a default, they would lose everything," said Nicolaides. "That was the key to getting the deal done."

Slaughter and May, Skadden Arps Slate Meagher & Flom and Cravath Swaine & Moore were unable to comment for this article.

TEAR SHEET

The £2.2 billion restructure of two of Punch Taverns' securitisation vehicles completed on October 8. A debt-for-equity swap reduced the company's debt by £600 million. The stakeholders agreed on the plan in June, two-and-a-half years after senior creditors first discussed the possibility of a restructure.

The restructure leaves the junior noteholders in the two Punch securitisation vehicles holding 85% of the equity in Punch

Latham & Watkins advised the CoCom, Slaughter and May advised Punch, Freshfields Bruckhaus Deringer advised Deutsche Bank as security trustee, and Allen & Overy acted for Citi bank as liquidity provider.Clifford Chance acted for RBS as another liquidity provider, Cadwalader Wickersham & Taft was counsel to MBIA, Linklaters advised mezzanine creditors, and Ashurst advised the issuer and borrower of Punch's securitisation subsidiaries. Skadden Arps Slate Meagher & Flom and Cravath Swaine & Moore also had roles.