Eye of the storm

On 7 September 2006 the front page of the *Financial Times* ran a substantial piece with the headline “GUS in war of words after funds and banks corner debt”. Had it not been competing with the story of a concerted effort by a group of Labour MPs to topple the Prime Minister it might even have been the lead item. It was just the high point in a series of substantial articles on the subject in the *FT*, the *Daily Telegraph*, Breaking Views, Bloomberg and specialist financial publications over several months. The casual reader might have assumed that billions were at stake or that something completely unprecedented was happening. Neither was the case, but the story may still be interesting to corporate treasurers, credit investors and other players in the corporate bond and credit default swap (CDS) markets.

BREAKING UP GUS announced in May 2005 that it intended to demerge its remaining 66% stake in Burberry and in due course to separate its two remaining businesses – Experian, which provides information solutions, and Home Retail Group (Argos and Homebase). A number of investment banks talked about the potential for this to trigger an event of default under the terms of GUS’s outstanding bonds. Some proprietary trading desks and hedge funds started to build positions, principally in the 2013 bond, presumably in anticipation of extracting substantial compensation from the company.

The clause in the bonds giving rise to this anticipation was one of the definitions of an insolvency event: “the Issuer or any Material Subsidiary ceases or threatens to cease to carry on all or any substantial part of its business…”. Similar language exists in many UK issuers’ bonds and its implications have been debated in other demergers; there have been no court cases on the point and leading QCs have given varying opinions. We knew from the outset that this issue would have to be addressed.

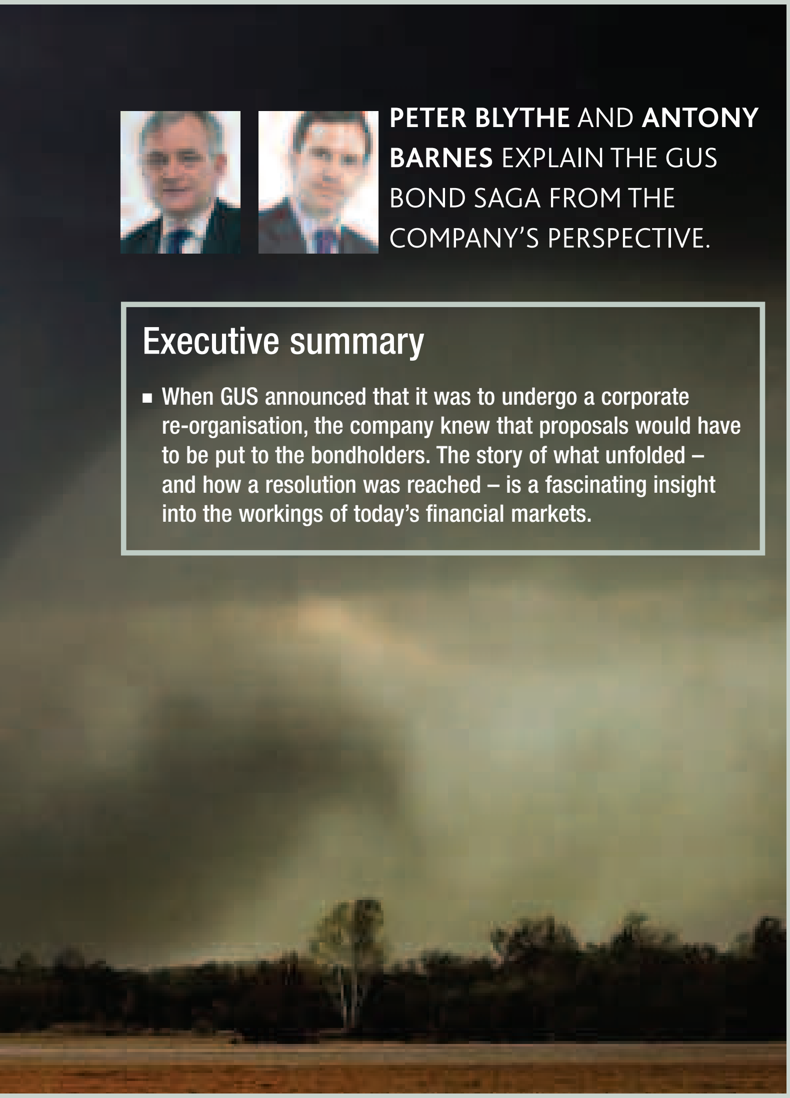
In March 2006 GUS announced that the separation would be effected by a demerger, accompanied by a substantial equity issue by Experian. We also announced that we would put proposals to bondholders.

Almost immediately we started getting calls from a hedge fund which said it spoke on behalf of the large majority of the holders of the 2013 bonds. This hedge fund identified itself and one other fund (although not the size of their individual holdings), but none of the other holders was even prepared to be named. Although always willing to talk, GUS felt it reasonable that the principal holders should identify themselves first if they wanted to negotiate with us.

SEEKING AGREEMENT In the absence of such talks GUS decided in May to publish proposals to bondholders. In return for bondholders agreeing that the demerger was not an event of default, the company proposed to:

- pay a one-off consent fee of 0.25% for the 2007 bonds and 0.50% for the 2009 and 2013 bonds; and
- add a clause to say that, if a change of control was accompanied by a credit rating downgrade to sub-investment grade, the bondholders would have the right to have their bonds redeemed at par plus accrued interest.

The proposals also said that the bonds would remain obligations of GUS plc rather than being transferred to the new Experian Group parent company, of which GUS plc would become a subsidiary. As the proposal document explained, this point was designed to address the concerns of those bondholders who also held CDS protection on



PETER BLYTHE AND **ANTONY BARNES** EXPLAIN THE GUS BOND SAGA FROM THE COMPANY'S PERSPECTIVE.

Executive summary

- When GUS announced that it was to undergo a corporate re-organisation, the company knew that proposals would have to be put to the bondholders. The story of what unfolded – and how a resolution was reached – is a fascinating insight into the workings of today's financial markets.

the GUS name, since the CDS protection would become invalid and worthless if GUS ceased to have any outstanding debt. This was probably the first time a proposal to corporate bondholders had explicitly acknowledged CDS concerns. The proposals were accepted by over 90% of the holders of the 2007 and 2009 bonds who voted, but were rejected by the 2013 holders.

At the beginning of August the bond trustee announced that leading counsel had advised it that shareholder approval of the demerger, due at the end of August, would be an event of default. GUS had been advised that, despite this, the bondholders had no ability to disrupt the demerger (and no attempt was ever made to do so) and that their only remedy if there was an event of default was to accelerate – in other words, to require immediate payment of par plus accrued interest.

Under the terms of our bonds (and most others) the occurrence of an event of default does not lead automatically to acceleration – the trustee or 25% of the bondholders have to call for it. The trust deed was silent on how long this right to accelerate would last, and there was debate on how long a court would allow if asked: just a reasonable period after demerger, or the full life of the bonds? GUS was advised that it would very probably be the former, and that the bondholders' right to accelerate would probably be lost if not exercised promptly.

OUR 2013 BOND BUY-BACK OFFER WAS ACCEPTED BY ONLY 5% OF THE HOLDERS AND THERE WAS NO CALL FOR ACCELERATION, WHICH SUGGESTED THERE WERE NO REAL CONCERNS ABOUT A DETERIORATION IN OUR CREDITWORTHINESS.

Therefore, to put each bondholder in much the same position (that is, grant them a temporary ability to receive par plus accrued interest) without their having to go through the formalities of calling for acceleration of the entire issue, GUS put forward another proposal to the 2013 holders, offering to buy back any bonds tendered at par plus accrued interest. At this time the bonds were priced at around par. This offered an exit route, at a fair price, for any bondholders concerned that the demerger would adversely affect the security of their investment.

We also said that, while reserving our position on whether the demerger was an event of default, we would not contest a call for acceleration, provided it was done promptly. We went on to say that if neither of these things happened GUS reserved the right to contest any attempt to accelerate at a later date. The offer to buy back the bonds was timed to remain open until a week after shareholder approval of the demerger (the event which the trustee had been advised triggered default). It was accepted by only 5% of the holders and there was no call for acceleration, which suggested there were no real concerns about a deterioration in our creditworthiness.

TAKING STOCK Despite the default announcement GUS felt that it continued to have a strong position, economically, legally and "morally". Insolvency events of default are intended to protect bondholders when an issuer's creditworthiness deteriorates drastically. This was clearly not the case here; GUS was rated BBB+/Baa1 before the demerger and had announced that it wished Experian to retain this rating and was undertaking a substantial equity issue to ensure this. The rating agencies, after considering carefully the very unusual situation of an outstanding event of default on a bond issued by an investment-grade company which had demonstrated it was willing and able to repay if required, concluded that the ratings should remain unchanged. The company had, at an early stage and modest cost, put in place a bank credit line specifically to fund repayment of the bonds if called for. We had also arranged carve-outs, in our other bonds, our bank facilities and our ISDA (International Swaps and Derivatives Association) agreements, from any cross-default arising from the demerger.

We had offered bondholders what they would receive on acceleration, first as a protective option following a change of control and rating downgrade, and then as an immediate option. The 2013 bondholders argued that they now had a put option, allowing them to accelerate at any subsequent date of their choosing – for example, if interest rates fell to a level which made acceleration attractive. We had already been advised that the right to accelerate would probably be lost if not exercised promptly and in October the bond trustee obtained and published leading counsel's advice that the right to accelerate "may not be available after a reasonable period of time following the occurrence of such Events of Default".

RESOLUTION Given all this, GUS did not feel it should offer any substantial improvement on its previous proposals but the issue continued to take up management time and incur legal fees, so when approached again by the hedge fund representing the bondholders we were willing to talk – a few more holders had identified themselves, although many remained shy. In November, a few weeks after the demerger was completed, a mutually satisfactory deal was struck, under which the one-off consent fee was raised to 0.75% and the change of control clause was modified to provide that, following a change of control combined with a rating downgrade to sub-investment grade, bondholders would have the choice between redemption at par plus accrued interest, as previously offered, or an increase in the coupon of 2% a year. As explained, the option to keep the bond outstanding was important for the holders of CDS protection.

CONTINUING DISCUSSION POINTS The sums involved in this long and high-profile debate were not large. The opening suggestion was that there should be improvements in the bond terms equivalent to 'Spens' (that is, to make whole at the gilt rate), which would have cost around £20m for the 2013 bonds. The value of the eventual outcome was considerably less than this – a £2.5m consent fee, plus whatever value one ascribes to the change of control clause.

Other demergers have led to event of default discussions and other corporate activity has raised CDS concerns, although this was probably the first to combine the two. There is much discussion about the extent to which the CDS market is driving the corporate bond market, including issuers. Our view as an issuer is that, since we have no direct relationship with the CDS market, we have no obligations to it. However, we do have a relationship with bondholders and if many of them also hold CDS positions one cannot ignore the impact of these.

We still find it surprising that some of the large bondholders refused throughout to disclose their identities to us, communicating with us only via the hedge fund, but eventually we were able to have constructive discussions with the hedge fund, which enabled a sensible resolution to be reached.

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