DECISION AND ANALYSIS OF THE
EXTERNAL REVIEW PANEL
OF THE
DETERMINATIONS COMMITTEE
OF THE
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.
DC ISSUES: 2014-121901 and 2014-122202

The External Review Panel of the Determinations Committee of the International Swaps and Derivatives Association, Inc. considered the question (the "Reviewable Question") presented to it on Thursday, January 22, 2015:

> "Has a Failure to Pay Credit Event occurred with respect to Caesars Entertainment Operating Company, Inc.?"

On February 9, 2015, in accordance with the timetable provided in the DC Rules, we first announced the unanimous decision of the External Review Panel that "No" is the better answer to the Reviewable Question, and we set out then the principal reasons for that decision and certain facts and assumptions upon which it was based. Our answer followed our review of Publicly Available Information, including briefs and supplemental materials presented to the External Review Panel by the "Yes" and "No" advocates (and also available on ISDA's website under the "Determinations Committee and Credit Events" link on the home page). Our decision was also informed by a hearing on February 5th that was held in accordance with the DC Rules, the arguments made to us by counsel then, the responses to the questions that we put to them and our understanding of applicable law.

As we said we would at the time of that initial announcement, we are re-publishing the answer that we gave yesterday, and, insofar as it may be helpful, we now include in the text below several key provisions from the underlying documentation at issue and a fuller analysis of such provisions and other considerations we thought relevant to our conclusion.

Facts and Assumptions

The Reviewable Question relates to payments due on December 15, 2014, in relation to the 10% Second-Priority Senior Secured Notes due 2015 and 10% Second-Priority Senior Secured Notes due 2018 (together, the "Notes" and sometimes also referred to as the "Obligations") of Caesars Entertainment Operating Company, Inc. ("CEOC" and sometimes also referred to as the "Reference Entity").

The Notes were issued under an Indenture, dated as of December 24, 2008 (the "Indenture"). Under the Notes' terms, beginning after the fifth anniversary of the Notes' issuance, CEOC was obligated to redeem for cash a portion of the outstanding Notes necessary to prevent them from being treated as "applicable high yield discount obligations" under U.S. tax law, in addition to making the Notes' semi-annual interest payments. Accordingly, on December 15, 2014, CEOC was obligated to (i) make a mandatory principal redemption of $17,631,000, plus accrued interest, totaling $18,513,390, and (ii) pay interest on the Notes equal to $41,271,000. On December 12, 2014, CEOC deposited $18,513,390 with the paying agent under the Indenture (the "Paying Agent") and directed the Paying Agent to apply the deposited funds on December 15 to the principal redemption payment. CEOC did not

deposit any other funds with the Paying Agent in connection with its December 15 payment obligations. We have been directed not to consider whether an Event of Default on the Notes existed on or prior to December 15 in relation to payments owed on October 15 or otherwise other than any arising solely from the facts set forth above.

Capitalized terms used in this decision, unless otherwise defined in it, shall have the respective meanings as set forth in the 2003 ISDA Credit Derivatives Definitions and the 2014 ISDA Credit Derivatives Definitions (together, the "Definitions").

Principal Reasons for the External Review Panel's Determination

1. **The "Yes" advocates' reliance on Section 4.01 of the Indenture to eliminate an otherwise applicable Grace Period for the interest payments due from the Reference Entity on December 15, 2014, is misplaced. Section 4.01 was not intended to be an "application of proceeds" provision, neither was it intended to define "principal" for purposes of whether an Event of Default (as defined in the Indenture) had occurred.**

2. **The language in Section 4.01 is general, and the particular sentence in it that gives rise to this dispute is poorly drafted. However, other provisions of the Indenture deal with redemption procedures, grace periods and application of proceeds clearly and in an unqualified way; there is no reference or deference in these to Section 4.01.**

3. **The Notes and the Indenture also contemplate a measure of issuer discretion in matters relating to payments and redemption prior to an Event of Default; the direction by the Reference Entity in this case, if not expressly contemplated or provided for, is neither expressly prohibited nor precluded by the Indenture's terms.**

4. **The situation in the instant case is very different from one that might arise, and the priorities that the Indenture prescribes, after an Event of Default has occurred.**

5. **Insofar as it may be relevant, we believe that our interpretation of the Indenture comports with both market practice (both as we know it and as reported to us regarding market reaction to the facts in this case) and legal practice relating to the disclosure of material terms of material contracts, and nothing that counsel have shown us, given its proper reading, appears to us to be contradictory or authority for a different view on the facts before us.**

6. **We have been unable to identify any compelling commercial reason from the point of view of either the Reference Entity or the holders of the Obligations at the time that documentation for the Obligations was agreed that would have justified, let alone compel, the reading that the "Yes" advocates would ascribe to the Notes and the Indenture. We can, however, contemplate commercial reasons both for the distinction between principal and interest when assessing grace periods in the first instance and for preserving that distinction throughout the term of the Notes even in the absence of scheduled "interest only" payment dates.**

Key Provisions

Section 4.5 of the Definitions

> "**Failure to Pay.** "Failure to Pay" means, after the expiration of any applicable Grace Period (after the satisfaction of any conditions precedent to the commencement of such Grace Period), the failure by [a (*2003*)/the (*2014*)] Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement under one or more Obligations, in accordance with the terms of such Obligations at the time of such failure."

Form of the Notes

> "Method of Payment
> The Issuer shall pay interest on the Notes (except defaulted interest) to the Persons who are registered holders at the close of business on June 1 or December 1 (each a "Record Date") next preceding the interest payment date even if Notes are canceled after the record date and on or before the interest payment date (whether or not a Business Day). Holders must surrender Notes to the Paying Agent to collect principal payments. The Issuer shall pay principal, premium, if any, and interest in money of the United States of America that at the time of payment is legal tender for payment of public and private debts. Payments in respect of the Notes represented by a Global Note (including principal, premium, if any, and interest) shall be made by wire transfer of immediately available funds to the accounts specified by The Depository Trust Issuer (*sic*) or any successor depositary. The Issuer shall make all payments in respect of a certificated Note (including principal, premium, if any, and interest) at the office of the Paying Agent, except that, at the option of the Issuer, payment of interest may be made by mailing a check to the registered address of each holder thereof; *provided, however*, that payments on the Notes may also be made, in the case of a holder of at least $1,000,000 aggregate principal amount of Notes, by wire transfer to a U.S. dollar account maintained by the payee with a bank in the United States if such holder elects payment by wire transfer by giving written notice to the Trustee or Paying Agent to such effect designating such account no later than 30 days immediately preceding the relevant due date for payment (or such other date as the Trustee may accept in its discretion)."

Section 3.07 of the Indenture (Article III Redemption)

> "Deposit of Redemption Price. With respect to any Notes, prior to 10:00 a.m., New York City time, on the redemption date, the Issuer shall deposit with the Paying Agent (or, if the Issuer or a Wholly Owned Subsidiary is the Paying Agent, shall segregate and hold in trust) money sufficient to pay the redemption price of and accrued interest on all Notes or portions thereof to be redeemed on that date other than Notes or portions of Notes called for redemption that have been delivered by the Issuer to the Trustee for cancellation. On and after the redemption date, interest shall cease to accrue on Notes or portions thereof called for redemption so long as the Issuer has deposited with the Paying Agent funds sufficient to pay the principal of, *plus* accrued and unpaid interest on, the Notes to be redeemed, unless the Paying Agent is prohibited from making such payment pursuant to the terms of this Indenture."

Section 4.01 of the Indenture (Article IV Covenants)

"Payment of Notes. The Issuer shall promptly pay the principal of and interest on the Notes on the dates and in the manner provided in the Notes and in this Indenture. An installment of principal of (*sic*) or interest shall be considered paid on the date due if on such date the Trustee or the Paying Agent holds as of 12:00 p.m. Eastern time money sufficient to pay all principal and interest then due and the Trustee or the Paying Agent, as the case may be, is not prohibited from paying such money to the holders on that date pursuant to the terms of this Indenture.
The Issuer shall pay interest on overdue principal at the rate specified therefor in the Notes, and it shall pay interest on overdue installments of interest at the same rate borne by the Notes to the extent lawful."

Section 6.01 of the Indenture (Article VI Defaults and Remedies)

"Events of Default. An "Event of Default" occurs with respect to a series of Notes if:
(a) there is a default in any payment of interest (including any additional interest) on any Note of such series when the same becomes due and payable, and such default continues for a period of 30 days,
(b) there is a default in the payment of principal or premium, if any, of any Note of such series when due at its Stated Maturity, upon optional redemption, upon required repurchase, upon declaration or otherwise,
(c) the failure by the Issuer or any Restricted Subsidiary to comply for 60 days after notice with its other agreements contained in the Notes of such series or this Indenture,
(d) . . . ."

Section 6.10 of the Indenture (Article VI Defaults and Remedies)

"Priorities. Subject to the terms of the Intercreditor Agreement and the Security Documents, any money or property collected by the Trustee pursuant to this Article VI and any other money or property distributable in respect of the Issuer's or the Parent Guarantor's obligations under this Indenture after an Event of Default shall be applied in the following order:
FIRST: to the Trustee for amounts due under Section 7.07;
SECOND: to the holders for amounts due and unpaid on the Notes for principal, premium, if any, and interest, ratably, without preference or priority of any kind, according to the amounts due and payable on the Notes for principal and interest, respectively; and
THIRD: to the Issuer or, to the extent the Trustee collects any amount for the Parent Guarantor, to the Parent Guarantor.
. . . ."

Analysis

1. *Section 4.01 of the Indenture.* The "Failure to Pay" credit event trigger set out in the Definitions (Section 4.5) makes reference, and the trigger is subject, to "the expiration of any applicable Grace Period" that benefits any relevant payment contemplated by the Obligations.

It is a widely accepted market expectation that a failure to make principal payments when due on publicly traded note issues like the Obligations is an event of default with no grace period. It is similarly the market's expectation that a failure to make interest payments due on such notes is subject to a 30-day (or at least some) grace period before an event of default occurs.

To deviate from such standard market practice would, in our view, be a material departure from market expectation and would require more specific language directing more clearly a different outcome than does the language in Section 4.01 on which the "Yes" advocates rely. (*See* discussion at 2 below.) It would also be expected that such a material change, or the possibility of it arising in the natural term of a publicly traded issue, would be disclosed by an issuer, for example, in filings with the US Securities and Exchange Commission (the "SEC"), but we see no such disclosure (or even any *mention* of Section 4.01) in the Reference Entity's S-4 registration statement filing with the SEC for the Obligations in 2008. We think that is because Section 4.01 was intended by its drafters to have more modest ambitions.

Similarly, it would be reasonable for the market to expect to see the actual mechanism by which an otherwise applicable grace period was to be eliminated to be prominent in the Notes, or in the section of the Indenture that deals with grace periods or redemptions of principal, or at least cross-referenced there. It seems to the External Review Panel too subtle to bury an appropriation of grace periods and payments provision in the Covenants section of the Indenture without any consistent referral to its relevance elsewhere. We note that there are otherwise no shortage of cross-references throughout the Indenture.

We prefer the view that sees the covenants set out in Section 4.01 as serving the limited purpose of preserving (a) a separate promise running to the Trustee to enable it to enforce payment on behalf of the holders of the Obligations and (b) a potential safe harbor for the issuer for payments deemed to be made (whether or not funds have by then reached the holders).

2. *Interpreting the second sentence of Section 4.01.* We set out above the language of Section 4.01. Much of this dispute has focussed in particular on the second sentence of that Section. Having preferred the more modest view of the drafters' intent for the covenants contained in Section 4.01, we think that some of the arguments advanced to support a "Yes" answer have read too much into this sentence.

   For example, in a December 14, 2014, submission to the Determinations Committee, Section 4.01 of the Indenture was said to state, presumably in reliance on that second sentence, "that an installment of principal or interest is considered paid *only if* the Trustee or Paying Agent holds funds sufficient to pay all principal and interest then due." (*emphasis added*) We do not see the words "only if" in the second sentence of Section 4.01. And in the "Yes" advocates' brief it is stated that the Indenture "provides that an installment of principal or interest is *not deemed paid unless* "***all*** principal ***and*** interest then due" is paid. (*non-bold emphasis added*) Similarly, we cannot see where the Indenture expressly provides that conclusion in Section 4.01. Indeed, the External Review Panel reads the language of Section 4.01 quite differently.

Interestingly, both the "Yes" advocates and the "No" advocates argue that the language of Section 4.01 is clear and unambiguous. However, each derives a very different and conflicting meaning from the same wording.

Further to questioning from the External Review Panel in the hearing, counsel for the answer "Yes" accepted that his reading of the second sentence of Section 4.01 would be better supported or at least clearer if, without changing any words in that sentence, the words here in **bold** were added:

> "An installment of principal of or interest shall be considered paid on the date due if**, but only if,** on such date the Trustee or the Paying Agent holds as of 12:00 p.m. Eastern time money sufficient to pay all principal and interest then due **on that and any other installment . . ."**

Counsel also did not deny that, for such purpose, it would be even more clear if added at the end of the sentence (borrowing the language from Section 6.10 of the Indenture) were the words:

> "and, for the avoidance of doubt, **any money . . . collected by the Trustee pursuant to this Article . . . shall be applied . . . to . . . principal . . . and interest, ratably, without preference or priority of any kind".**

And counsel for the answer "No" accepted that his reading of that same second sentence would be better supported if, without changing any words in that sentence, the words here in **bold** were added:

> "**One way [a]**n installment of principal of or interest shall be considered paid on the date due **is** if on such date the Trustee or the Paying Agent holds as of 12:00 p.m. Eastern time money sufficient to pay all principal and interest then due **on that installment . . ."**

What is clear (in addition to the extraneous "of" that appears after the word "principal") is that the word "installment" was consciously added, which, for example, distinguishes the formulation in the Indenture from others that appear as Section 4.01 in the model forms and commentaries that we were shown.

Yet the reading advocated by the "Yes" vote would view installments as irrelevant to the method of payment. It would cancel the contractually agreed distinction between the grace period for interest payments and the absence of any grace period for principal whenever payments for both principal and interest fell due on the same date even where those payments related to different installments or contractual duties to pay. By this reading too, once any amount of an interest payment remains outstanding, it becomes impossible to settle interest separately from principal. Likewise, it becomes impossible to *preserve* an already established grace period for a previously missed interest payment as soon as a principal payment arises.

It then ignores the commercial rationale for the distinction being made in the first place (between monies advanced and monies earned), including the fact that, since interest payments are often made without presentation of a note, there may be a

greater likelihood that it may take more time to confirm all interest payments and with a greater likelihood of technical or inadvertent failure.

An example based on different facts that could arise under the Obligations illustrates the fallacy of the reading given by the "Yes" advocates. As the brief in support of the "No" answer points out, the Notes expressly allow the Reference Entity to mail checks for interest. Thus, the Reference Entity could fully pay interest on the Notes, but according to the reading of Section 4.01 given by the "Yes" advocates, such interest would not be deemed to be paid or effectively so. We do not think that was the drafters' intent. In fact, we see from the method of payment provision in the Notes that there are a number of ways in which the Reference Entity can pay interest and principal without all funds being first deposited with the Trustee.

3. *The redemption provisions of the Indenture.* In addition to Section 4.01, there are several other provisions in the Notes and Sections in the Indenture where the issuer's payment obligations are described. The provision we highlight giving the Reference Entity the option to make payments of interest by check is one of these. Section 3.07, which is entitled "Deposit of the Purchase Price" and sets out provisions governing Note redemptions, is another. It is the contention of the "No" advocates that it should be Article III of the Indenture, including Section 3.07, and paragraph 6 of the Notes themselves which govern satisfaction of the principal obligation relevant to the Reviewable Question, and not Section 4.01. It is the position of the "Yes" advocates that "Section 3.07 addresses only the Reference Entity's duty to deposit funds for redemption with the Paying Agent, not the Reference Entity's duty to satisfy its payment obligations." We think that the view of the "No" advocates that under the Indenture, as drafted, the payment obligations for a redemption are to be found in Article III (Redemption) rather than Article IV (Covenants) is the better answer.

4. *The issuer's right to direct payments.* We were unpersuaded by the arguments and the authorities cited for the proposition that the debtor's right to allocate payments as between interest and principal in the ordinary course were necessarily limited by language in the Notes or the Indenture. While we were shown alternative formulations of the language in Section 4.01 that more clearly contemplated such direction, we saw these more as drafting efforts to clarify and confirm that right rather than efforts to create a power to direct otherwise prohibited at law or at odds with more established indenture practice. We preferred the formulation of relevant law provided by the Restatement (Second) that where a debtor owes money on several accounts or for more than one matured contractual duty and makes a payment of less than the total amount due that payment will be applied in accordance with the debtor's intention unless otherwise agreed.

   Since in oral argument at the hearing counsel advocating the "No" answer cited authorities for this view, not reflected in the parties' briefs, we invited both sides to submit additional authority on the question of whether or not an issuer can direct how funds are allocated as between principal and interest on redeemed notes and regular note interest payments. Each side chose to do so, and we appreciate the extensive work of both under very tight time constraints. On balance, we see nothing in the authority provided to us that compels a different conclusion than the one we reach today and much that supports it. The position codified in the Restatement (Second) and acknowledged in several cases from New York (and other jurisdictions) also

comports with our view of the market's understanding of practice pre-insolvency or in the absence of the application of contractually provided for remedies following the occurrence of an event of default.

5. *Post-default priorities.* The External Review Panel accepts that the availability of any Grace Period and therefore the outcome could be quite different following the occurrence of an Event of Default as defined in Section 6.01 of the Indenture. In that case, the priorities would be established by Section 6.10 of the Indenture, and *any* monies received by the Trustee would have to be applied, after satisfying reimbursement claims of the Trustee, to debts for principal and interest "ratably, without preference or priority of any kind".

   However, the Determinations Committee previously voted unanimously that a Failure to Pay Credit Event had not occurred because of the pro-rata application by the Trustee of amounts received from the Reference Entity in accordance with Section 6.10 following receipt of a notice of event of default relating to alleged, but disputed, October 15 defaults. *See* DC Issue 2014-122202, Second Question for vote. We had no evidence of any such notice or allegation in respect of the events of December 15, and we understood that our instructions were to consider the Reviewable Question with the assumption that Section 6.10 was then not applicable as a result of the October 15 events. That understanding was confirmed by counsel for both sides at our hearing on February 5th. In reaching our reported decision, the External Review Panel acted accordingly.

6. *Market reaction and practice.* We were advised by the "No" advocates that, when the Reference Entity publicly announced its intention and strategy to rely on the 30-day interest grace period, market participants, press coverage and the leading rating agencies all understood the missed interest payment to be subject to a 30-day grace period. *See* Brief in Support of the "No" Answer to the Reviewable Question at notes 6 and 7 and accompanying text. This position was not refuted by counsel for the "Yes" vote, and thus we have assumed, insofar as it may be relevant, that contemporaneous market commentary appears to have been uniformly that (a) the Reference Entity was executing a reasonable strategy to delay payments of interest during its consideration of potential restructuring and (b) the relevant portion of Notes called for redemption had been successfully redeemed by the payments which were made by the Reference Entity on December 15th. We also do not believe that this reaction would in any way reflect a departure from market understanding or practice at the time that the Indenture was drafted and the Notes first issued.

7. *Commercial considerations.* If the parties specifically contemplated or had intended to provide for a different outcome, namely the removal of a grace period for interest payments on dates on which principal installments were also due, then it is reasonable to assume that there would be, at the time the terms of the issuance were agreed, a commercial, economic rationale to do so. However, no such suitable commercial rationale has been provided, either in the briefs or oral argument, to the External Review Panel. There would, for example, be no loss of interest earnings in the instant case since the Indenture provides for interest on outstanding interest at the same rate as interest accrues on principal. This suggests to us that the parties are unlikely to have even contemplated the situation during their negotiations at the time the Indenture was drafted.

> We have been shown by each set of advocates examples of language from other indentures where it appears more certain that the parties did contemplate facts similar to ours and expressly sought to deal with installments severally for purposes of Section 4.01. The "Yes" advocates advanced the argument that these other precedents demonstrate that indeed others in the market intended to take a different approach than in the Notes, and therefore the Reference Entity was differently positioned. However, in our hearing, and in response to our questions, they could offer no economic rationale (*e.g.,* that it might impact the pricing or investor attractiveness of the issue) that might motivate different issuers to position themselves differently in this way from the outset. And if there was a good reason for the intended difference, it was unclear why issuers or the Reference Entity had failed to describe it in their disclosures (which were uniformly silent on the subject).

The language that we have been asked to consider in the **Failure to Pay Credit Event** that appears in the Definitions is general. It does not expressly contemplate or provide for the situation before us. This is not surprising. It is in the nature of a relational contract like the ISDA Master and the transactional confirmations and the terms incorporated by them that they will include language that is general to accommodate the variety of fact patterns to which they may apply. The covenant in Section 4.01, on which the "Yes" advocates rely, similarly serves a general purpose, and while we have seen that the language in parallel provisions has varied from indenture to indenture (there being no international body like ISDA to regularly review and standardize that language), it is the view of the External Review Panel that its purpose is more limited than to provide priorities for the application of payments and proceeds. In this decision we have tried to interpret the relevant language in a commercially reasonable manner. Accordingly, and for the reasons set out more fully above, we have determined that "No" is the better answer to the Reviewable Question.

The External Review Panel is cognizant of the possible effect its decision may have with respect to any future questions presented to the Determination Committee, and by expanding in this way on our initial decision we mean to give a better understanding of the scope of our review but do not mean necessarily to set any precedent. We also wish to emphasize that, while we make reference to wider market practice in our analysis, our decision should be limited to DC Issues 2014-121901 and 2014-122202.

February 10, 2015

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