BEFORE THE EXTERNAL REVIEW PANEL OF THE ISDA CREDIT DERIVATIVES DETERMINATIONS COMMITTEE FOR THE AMERICAS

Caesars Entertainment Operating Company, Inc. Credit Event Questions	DC Issues: 2014121901, 2014122202

<u>BRIEF IN SUPPORT OF THE "NO" ANSWER TO THE REVIEWABLE QUESTION</u>

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OVERVIEW[1]

On December 15, 2014, two distinct obligations of Caesars Entertainment Operating Company, Inc. ("CEOC") pertaining to Notes ("Notes") issued under a December 24, 2008 Indenture ("Indenture") were scheduled to come due. The first, which we refer to as the "Redemption," was a partial redemption designed to facilitate advantageous tax treatment for the benefit of CEOC.[2] The Redemption consisted of $17.6 million principal plus accrued interest thereon (in total approximately $18.5 million). CEOC's second obligation was a regularly scheduled semi-annual installment of interest of $41.3 million (the "Interest Installment").[3]

CEOC satisfied the Redemption obligation on December 12, one business day before the due date. In its own words, CEOC:

> deposited funds in an amount equal to the required redemption amount with Delaware Trust Company, as paying agent under the December 2008 Indenture (the "Paying Agent") to fund the payment of the redemption price, and directed the Paying Agent to apply the deposited funds on December 15, 2014 to pay the redemption price. The deposit of the redemption price with the Paying Agent on December 12, 2014 satisfied in full CEOC's obligation to pay the redemption price under the December 2008 Indenture. CEOC is not aware of any legitimate basis to claim that it is in default of its obligations to pay the redemption price under the 2008 Indenture.

Ex. D. These actions complied to the letter with the Indenture provisions governing redemptions, notably Section 3.07 of the Indenture. CEOC, however, made a decision, which CEOC clearly announced to the market, to defer paying the Interest Installment. CEOC did so in reliance on a contractual 30-day grace period for the payment of interest in Section 6.01(a) of the

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[1] Publicly available material submitted as exhibits to this Brief are compiled in the accompanying Appendix.

[2] To prevent the Notes from constituting an "applicable high-yield debt obligation" (AHYDO) under the U.S. tax laws, the terms of the Notes required CEOC to make certain early redemptions of principal. *See* Forms of Note, Exhibits A-1, A-2, B-1, B-2 to Indenture, at ¶ 6 (Ex. B). This feature preserved CEOC's ability to fully deduct the yield on the Notes.

[3] *See* CEOC Form 8-K dated Dec. 16, 2014 (Ex. D); CEOC Form 8-K dated December 15, 2014 (Ex. C); Dec. 16, 2014 Notice from Trustee to Noteholders (Ex. E).

Indenture (*see* Exs. C, E). The question for review is whether this payment immediately generated a Failure to Pay Credit Event.

A Failure to Pay is defined as follows:

> "Failure to Pay" means, ***after the expiration of any applicable Grace Period*** . . ., the failure by the Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement[4] under one or more Obligations, in accordance with the terms of such Obligations at the time of such failure.

2003 ISDA Credit Derivatives Definitions ("Definitions") § 4.5 (emphasis added) (Ex. F).[5] Distinct from the terms related to installments of interest, there is no grace period for principal obligations. *Compare* Indenture § 6.01(b) *with id*. § 6.01(a). It is not disputed that CEOC, one business day before the December 15 due date for the Redemption, deposited funds equal to the amount of the Redemption with instructions to allocate the funds to the Redemption. With respect to the Interest Installment, CEOC made a deliberate decision to rely on the grace period in the Indenture. Based on the plain language of the Indenture, no Event of Default arose on December 15, and that is how market participants—including the Trustee—understood the situation at the time.[6] For example, after December 15, all three rating agencies announced that they were downgrading's CEOC's debt because of the missed interest payment. They all noted

[4] It is undisputed that the Payment Requirement threshold, as relevant here $1 million (*see* Ex. F § 4.8(d)), has been met.

[5] The credit default swaps ("CDS") on CEOC's obligations are governed by the 2003 Definitions, and therefore we cite those, despite the reference in the Reviewable Question and Statement of Facts to the 2014 Definitions, *see* Ex. K at 1 n.1. The definitions of Failure to Pay in the two versions are substantially identical; nor are we aware of any other difference between the Definitions that is material here.

[6] In the days leading up to December 15, Debtwire, citing sources close to the Noteholders, reported that "with no grace period if the company misses a scheduled principal paydown, it would benefit Caesars to make the AHYDO payment even if it opts to enter a 30-day grace period on the coupons." Paunie Samreth, *Caesars 2008 second liens contact trustee, latch on to AHYDO language to force coupon payment*, DEBTWIRE (Dec. 10, 2014) (Ex. L). Similarly, the Trustee, in informing CEOC of the basis for its pro rata distribution, *see* footnote 24 below, cited only the (here irrelevant) October 15 defaults alleged by certain Noteholders—*not* Section 4.01 of the Indenture.

that the missed *interest* payment was subject to a 30-day grace period and made no mention of a supposedly missed principal payment.[7] Similarly, from the perspective of the ISDA Definitions, no Failure to Pay occurred because (a) the Redemption was paid "in accordance with the terms" of the Indenture and Notes, and (b) an "applicable Grace Period" covering the Interest Installment had not yet expired on December 15.

On December 19 and 22, however, ISDA's Credit Derivatives Determinations Committee for the Americas ("DC"), received anonymous submissions (Exs. G, H) (the "Submissions") arguing in relevant part that a single sentence in Section 4.01 of the Indenture transformed CEOC's nonpayment of the Interest Installment on December 15 into a failure to pay the Redemption, resulting in an immediate Event of Default and Failure to Pay. This position has not, to our knowledge, been advanced by any of the actual holders of the Notes in cash form. And the DC did not accept the position advanced by the Submissions: ten of its members voted that no Credit Event had occurred while five voted that a Credit Event had occurred. (*See* Ex. I.) We refer to these camps respectively as the "Majority" and "Minority." Under the DC's Rules ("Rules"), the question was then referred for external review. (*See* Ex. J § 4.1(a); Ex. K (reference to external review panel)).

The panel should decide that no Failure to Pay Credit Event occurred. Unlike the Redemption, a missed interest installment payment could not ripen into a Failure to Pay until 30 days had passed. CEOC had the right under the Indenture and operative New York law to designate its funds as a redemption rather than an installment of interest. Rather than reading the Indenture as a whole and attempting to give meaning to all provisions as New York law requires, the Minority bases its argument on a hypertechnical reading of a single sentence in Section 4.01,

[7] *See, e.g.*, Ex. M (Moodys press release); Ex. N (S&P report); Ex. O (Fitch press release).

erroneously contending that the sentence provides that the 30-day grace period for interest does not exist when an interest installment comes due on the same date as a redemption of principal.

Nothing in Section 4.01 remotely suggests that it was intended to override the 30-day grace period for interest payments expressly afforded to the borrower in Section 6.01(a). Section 4.01 is a covenant to pay, the breach of which results in overdue interest accruing on unpaid amounts. The Minority's position would lead to a commercially irrational outcome. There would have been no sensible rationale for carving out an exception to the grace period for interest installments whenever one happens to come due simultaneously with a principal payment. And, had the parties intended to do so, they would have done so directly, with an express carveout in Section 6.01(a) or an addition to Section 6.01(b), rather than through a single opaque sentence in Section 4.01.

The Minority's narrow, technical reading of the second sentence of Section 4.01 fails for other reasons as well. First, the plain terms of the Indenture (read as a whole) make clear that the Redemption was governed not by Section 4.01, but by Article III, which expressly allowed CEOC to satisfy its redemption obligation in the manner it did here. Second, even if Section 4.01 were to apply, the sentence at issue simply creates a safe harbor—not a prerequisite—for the payment covenant to be deemed satisfied on a given due date. Here the Redemption payment was effectuated by CEOC one business day before the due date. Finally, there is nothing in the public disclosures for this and similar transactions to suggest that the parties intended the bizarre outcome advanced by the Minority.

ARGUMENT

The Indenture and Notes are governed by New York law (*see* Ex. A § 13.09; Ex. B § 20), which the panel is bound to apply. *See* Ex. J (Rules) § 4.6(e). Under New York law, the "fundamental" principle in interpreting a contract such as the Indenture and Notes is that "agreements are construed in accord with the parties' intent." *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 569 (2002).

If a written contract is unambiguous,[8] the intent must be found within its four corners, "giving a ***practical*** interpretation to the language employed and reading the contract ***as a whole***." *E.g.*, *Ellington v. EMI Music, Inc.*, 24 N.Y.3d 239, 244 (2014) (emphases added).[9] Reading a contract as a whole "ensure[s] that undue emphasis is not placed upon particular words and phrases." *Bailey v. Fish & Neave*, 8 N.Y.3d 523, 528 (2007). A contract should be read to give meaning to all of its provisions, and to avoid making part of the contract meaningless. *E.g.*, *Beal Sav. Bank*, 8 N.Y.3d at 324; *God's Battalion of Prayer Pentecostal Church, Inc. v. Miele Assocs., LLP*, 6 N.Y.3d 371, 374 (2006); *Corhill Corp. v. S.D. Plants, Inc.*, 9 N.Y.2d 595, 599 (1961). "Under New York law, 'a specific provision . . . governs the circumstance to which it is directed, even in the face of a more general provision.'" *In re AMR Corp.*, 730 F.3d 88, 99 (2d Cir. 2013) (citation omitted).

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[8] As will be seen below, the Indenture is unambiguous. Generally speaking, a contract is ambiguous only if it is *reasonably* susceptible to more than one interpretation. *See, e.g.*, *Ellington v. EMI Music, Inc.*, 24 N.Y.3d 239, 244 (2014) (emphasis added); *Greenfield*, 98 N.Y.2d at 569-70; *Rosen's Café, LLC v. 51st Madison Gourmet Corp.*, 986 N.Y.S.2d 51, 52 (App. Div. 2014); *Triax Capital Advisors, LLC v. Rutter*, 921 N.Y.S.2d 54, 56 (App. Div. 2011). For purposes of assessing ambiguity, the contract should be read in light of "the customs, practices, usages and terminology" in the particular field. *See, e.g.*, *Chesapeake Energy Corp. v. Bank of N.Y. Mellon Trust Co.*, 773 F.3d 110, 114 (2d Cir. 2014); *Law Debenture Trust Co. v. Maverick Tube Corp.*, 595 F.3d 458, 466 (2d Cir. 2010). Here, the only reasonable interpretation is the Majority's. If, however, the panel were to conclude that the Indenture is ambiguous, then the panel could resort to extrinsic evidence of the parties' intent, including evidence of industry custom and practice. *E.g.*, *Christiana Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268, 274 (2d Cir. 1992); *U.S. Naval Institute v. Charter Commc'ns, Inc.*, 875 F.2d 1044, 1048 (2d Cir. 1989); *see also M&G Polymers USA, LLC v. Tackett*, 2015 WL 303218, at *8 (U.S. Jan. 26, 2015) ("[A] court may look to known customs or usages in a particular industry to determine the meaning of a contract."). As discussed below in Section IV, such evidence favors the Majority's reading.

[9] *Accord Triax Capital*, 921 N.Y.S.2d at 56-57 (contracts should be interpreted to give effect to "the parties' reasonable expectations" (citations and internal quotation marks omitted)); *Slamow v. Delcol*, 571 N.Y.S.2d 335 (App. Div. 1991), *aff'd*, 79 N.Y.2d 1016 (1992); *see also Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318, 324-25 (2007) ("A contract should be read as a whole, and every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose." (internal quotation marks and citation omitted)).

More generally, "[t]he presumption in commercial contracts is that the parties were trying to accomplish something rational. [Thus, c]ommon sense is as much a part of contract interpretation as is the dictionary or the arsenal of canons." *Progress Bulk Carriers v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n*, 939 F. Supp. 2d 422, 428-29 (S.D.N.Y. 2013) (M.J.) (quoting *Dispatch Automation, Inc. v. Richards*, 280 F.3d 1116, 1119 (7th Cir. 2002) (Posner, J.)), *aff'd*, 2 F. Supp. 3d 499 (S.D.N.Y. 2014); *accord Koninklijke Philips Electronics N.V. v. Cinram Int'l, Inc.*, 603 F. Supp. 2d 735, 739 (S.D.N.Y. 2009); *see also Fishman v. LaSalle Nat'l Bank*, 247 F.3d 300, 302 (1st Cir. 2001) (Boudin, J.) (siding with party whose contract reading "makes sense—that is, it carries out what one might imagine to be a plausible objective of parties so situated and is consistent with the usage of trade"); *N. German Lloyd v. Guar. Trust Co.*, 244 U.S. 12, 23 (1917) ("Business contracts must be construed with business sense, as they naturally would be understood by intelligent men of affairs.") (Holmes, J.).

Applying these well settled principles, it is clear that there was no Failure to Pay.

I. CEOC FULLY DISCHARGED ITS REDEMPTION OBLIGATION ON TIME

A. New York Law Gives CEOC the Authority To Designate Its Payments

Section 6.01 of the Indenture, titled "Events of Default," provides in relevant part:

> An "Event of Default" occurs with respect to a series of Notes if:
>
> (a) there is a default in any payment of 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.

Section 6.01 is clear and unambiguous: It provides a 30-day grace period for payments of interest, and no grace period for payments of principal. CEOC made the required Redemption pursuant to Section 3.07 of the Indenture, but delayed the Interest Installment in reliance on the grace period afforded by Section 6.01(a).[10]

Under New York law, CEOC's designation of the funds is controlling. It is axiomatic that where a debt is composed of multiple items, "the debtor may direct the application of his payments." *Snide v. Larrow*, 62 N.Y.2d 633, 634 (1984). Cases so holding, in New York and elsewhere, are legion.[11] Thus, for example, in *Home & City Savings Bank v. Bilinski*, 580 N.Y.S.2d 561 (App. Div. 1992), a borrower had executed multiple promissory notes under a single line of credit. Funds sufficient to cover only some of the outstanding principal and interest had been paid. The proper allocation of remitted funds, according to the Appellate Division, would be a function in the first instance of the borrower's instructions: "It has long been recognized that, in situations such as the one herein involving a debt composed of several items, a debtor can direct to which item of debt a voluntary payment made by him is to be applied." *Id*. at 563.

Similarly, *Central National Bank of Canajoharie v. Paton*, 109 Misc. 2d 42, 439 N.Y.S.2d 619, 620-22 (Sup. Ct. 1981), held that a mortgage lender was not permitted to pay

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[10] As set forth below, in accordance with Section 3.07 of the Indenture, the Redemption had to, and did, include accrued interest on the amount of principal being redeemed.

[11] *E.g.*, *Bank of Cal. v. Webb*, 94 N.Y. 467, 472 (1884) ("A debtor paying money to a creditor to whom he owes several debts may direct the application of the payment . . . ."); *Nat'l Bank of Newburgh v. Bigler*, 83 N.Y. 51, 63 (1880) ("It is the right of a debtor making a payment to dictate, when he does so, upon what distinct and separate liability or demand, held by his creditor, his payment shall be applied."); *Beyer Bros. of L.I. Corp. v. Kowalevich*, 454 N.Y.S.2d 444, 445 (App. Div. 1982) ("As a general rule, the debtor has the right to specify to which debt he wishes a payment to be applied."); *N.Y. Tel. Co. v. State*, 496 N.Y.S.2d 655, 658 (Ct. Cl. 1985); *DiMare Homestead, Inc. v. Alphas Co. of N.Y., Inc.*, 2012 WL 1155133, at *26 (S.D.N.Y. Apr. 5, 2012) ("[A] debtor owing several accounts to a single creditor may designate the account to which a payment is to be applied." (internal quotation marks and citation omitted)); *Lines v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 743 F. Supp. 176, 180 (S.D.N.Y. 1990) ("[I]t is a well-settled rule [in New York law] that a debtor owing more than one debt to a creditor may prescribe the manner in which a payment is applied."); *see also Lehigh & Hudson River Ry. Co. v. Comm'r of Internal Revenue*, 36 F.2d 719, 720 (2d Cir. 1929) (Hand, J.) ("the ordinary rule is that the debtor . . . may allocate the payment at his will").

outstanding taxes using funds received from the borrowers that were clearly designated as monthly payments on the debt: "It is a well-settled principle that a debtor owing on more than one obligation to another has the right to direct the creditor in the application of funds in reduction of any one or more of the debts." *See also Prudence Realization Corp. v. Jackson,* 212 F.2d 362, 368 (2d Cir. 1954) ("It is settled law that a payor may direct application of his payments amongst matured liabilities. The payments in dispute were made in respect of interest, and to interest obligations [as opposed to principal] they must be applied." (citation omitted)).

In this case, CEOC specified exactly how the funds it was remitting were to be applied, as well settled authority entitled it to do. *See* page 2 above (quoting 8-K reporting on CEOC's instructions to Paying Agent). Section 6.10 of the Indenture removes CEOC's discretion and provides for a mandated application of funds *after* an Event of Default.[12] The Indenture contains no such provision, however, in the absence of an Event of Default. Consistent with New York law, therefore, *before* an Event of Default CEOC was free to designate funds as it wished. Because CEOC never triggered the Event of Default provision for a missed principal payment, and a grace period covered the Interest Installment, Ex. F (Definitions) § 4.5, there could have been no Failure to Pay.[13]

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[12] Section 6.10 provides that, "after an Event of Default," funds received from CEOC are to be distributed as follows:

> FIRST: to the Trustee for amounts due under Section 7.07 [relating to compensation of the Trustee]
>
> 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.
>
> THIRD: to the Issuer . . . .

[13] Recall that the Definition of Failure to Pay requires that "any applicable Grace Period have expired," and that there be a failure by CEOC to make a payment "in accordance with the terms" of the Indenture and Notes. A Grace Period, as relevant here, is defined as "the applicable grace period with respect to payments under the relevant Obligation under the terms of such Obligation . . . ." Ex. F. § 1.12(a).

B. There Is No Indication That the Parties Intended To Eliminate the Grace Period for Interest

The Minority's entire case rests on Section 4.01. Here is the provision in full:

> 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.

This provision creates, in the first sentence, a covenant requiring the issuer to pay interest and principal by a certain date, and then *spells out, in the final sentence, the consequences of not doing so*. In particular, overdue interest accrues on unpaid amounts at specified rates.

CEOC's nonpayment of the Interest Installment on December 15 of course violated the first sentence—causing overdue interest to accrue on the Interest Installment. But no one has suggested that the nonpayment of the Interest Installment in isolation would be an Event of Default or Failure to Pay, in light of the 30-day grace period in Section 6.01(a). On the contrary, the drafters clearly distinguished between (i) a missed installment of interest, which would result in interest immediately accruing on the unpaid interest, and (ii) an Event of Default giving the Noteholders the right to accelerate, which would not materialize until *the thirtieth day following the date of the missed interest payment*. Section 4.01 as a covenant and Section 6.01 as the criteria for an Event of Default function entirely separately.

Practically speaking, an ISDA Failure to Pay and an Event of Default under the Indenture are synonymous for present purposes.

The Minority nevertheless relies entirely on the second sentence of Section 4.01, arguing that this text somehow converted the nonpayment of the Interest Installment on December 15 into a failure to make the Redemption (thus triggering Section 6.01(b)).

The practical effect of the Minority view is to eliminate the contractual grace period for any installment of interest that happens to coincide with an AHYDO-related redemption payment. But there is nothing in the Indenture to suggest that that was the parties' "reasonable expectation," *Triax Capital*, 921 N.Y.S.2d at 56 (internal quotations omitted), and plenty to suggest that it was not. If the parties had intended that result, there were much easier and clearer ways to accomplish it, including amending Section 6.01(a) or Section 6.01(b) or both to specify that no grace period would exist for an interest installment due on a date when some kind of redemption of principal was separately due. Moreover, it is difficult to conceive of any commercial rationale for establishing a 30-day grace period for a (relatively large) interest payment and toggling it off whenever a separate (relatively small) AHYDO-related redemption obligation happens to be due the same day.

In sum, the Minority view places "undue emphasis . . . upon particular words and phrases," *Bailey*, 8 N.Y.3d at 528—namely, the second sentence of Section 4.01, and in particular the single word "if" (which does not even mean what the Minority says it means). In so doing, the Minority fails to give the indenture a "practical interpretation" in light of "the contract as a whole," *see Ellington*, 24 N.Y.3d at 244; *Beal Sav. Bank*, 8 N.Y.3d at 324-25, and fails, too, to respect the general presumption that contracting parties "were trying to accomplish something rational," *Koninklijke Philips Electronics N.V.*, 603 F. Supp. 2d at 739. Indeed, the Minority view depends on the bizarre proposition that money that was actually paid should be deemed not to have been paid simply because another payment due that day was not paid. The

Minority view similarly depends on the bizarre proposition that CEOC triggered an immediate Event of Default because of a failure to make a required principal payment, when CEOC, in fact, deposited all funds necessary to make the required principal redemption. This reading has nothing to recommend itself as a matter of contract interpretation, law, or commercial reality.

II. ARTICLE III OF THE INDENTURE, NOT SECTION 4.01, GOVERNS THE REDEMPTION AND EXPRESSLY ALLOWED CEOC TO DO WHAT IT DID HERE

The Minority's construction is inconsistent with the rest of the Indenture. Article III, not Section 4.01, governs when a redemption obligation is satisfied.

The Redemption in this case was required by paragraph 6 of the Notes, titled "Mandatory Redemption." (Note that provisions of the Notes are deemed to be provisions of the Indenture. *See* Indenture § 2.02.) The pertinent portion of paragraph 6 is set forth in the footnote below,[14] and required CEOC to make the AHYDO-related redemption plus accrued interest thereon. Redemptions are expressly governed exclusively by Article III of the Indenture, titled "Redemption." Section 3.02 of that Article provides (emphasis added):

> <u>Applicability of Article</u>. Redemption of Notes at the election of the Issuer or otherwise, as permitted or required by any provision of this Indenture, shall be ***made in accordance with such provision [e.g., paragraph 6 of the Notes] and this Article***.

Section 3.07 in turn governs how a redemption obligation is satisfied (emphases added):

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[14] Paragraph 6 provides:

> If the 2018 Notes would otherwise constitute "applicable high yield discount obligations" within the meaning of 163(i)(1) of the [Internal Revenue] Code, at the end of each accrual period ending after the fifth anniversary of the 2018 Notes' issuance (each, any "AHYDO redemption date"), the Issuer will be required to redeem for cash a portion of each 2018 Note then outstanding equal to the "Mandatory Principal Redemption Amount" (such redemption a "Mandatory Principal Redemption"). The redemption price for the portion of each 2018 Note redeemed pursuant to a Mandatory Principal Redemption will be 100% of the principal amount of such portion *plus* any accrued interest theron on the date of redemption. The "Mandatory Principal Redemption Amount" means the portion of a 2018 Note that must be required to be redeemed to prevent such 2018 Note from being treated as an "applicable high yield discount obligation" . . . .

> 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 . . . *money sufficient to pay the redemption price of and accrued interest on all Notes or portions thereof to be redeemed on that date* . . . . 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.

CEOC fully complied with this provision when it (i) redeemed $17.5 million principal amount of the Notes in accordance with paragraph 6 of the Notes and (ii) deposited $18.6 million with the Paying Agent "prior to 10:00 a.m. . . . on the redemption date." The plain import of Section 3.07 is that "so long as" the Issuer has deposited the requisite funds (*i.e.*, for redeemed principal plus interest thereon), its payment obligations with respect to the portion of the debt being redeemed are satisfied, and interest no longer accrues on the redeemed portion. This feature of Section 3.07 is mirrored in Section 2.09 of the Indenture, titled "Outstanding Notes" (emphasis added):

> If a Paying Agent segregates and holds in trust, in accordance with this Indenture, *on a redemption date* or maturity date ***money sufficient to pay all principal and interest payable on that date with respect to the Notes (or portions thereof) to be redeemed*** or maturing, as the case may be, and no Paying Agent is prohibited from paying such money to the holders on that date pursuant to the terms of this Indenture, *then on and after that date* ***such Notes (or portions thereof) cease to be outstanding and interest on them ceases to accrue***.

Thus, if the Issuer makes a timely redemption payment, then the debt in question is no longer outstanding and interest ceases to accrue.

The Minority reading of Section 4.01 of the Indenture would nullify Sections 2.09, 3.02, and 3.07, which alone is reason enough to reject it. *See, e.g.*, *Beal Sav. Bank*, 8 N.Y.3d at 324; *Corhill Corp.*, 9 N.Y.2d at 599. The Minority view is that, even though CEOC did precisely what Sections 3.07 and 2.09 say is necessary to retire the redeemed portion of the debt, nevertheless the Redemption should not be counted as having been made at all (meaning that the principal in question was not retired and interest would continue to accrue on it) merely because CEOC determined to rely upon its contractual grace period in connection with the altogether separate Interest Installment due the same day. In other words, a payment of principal and accrued interest thereon are *not* effective to redeem debt if a separate installment of interest is due that day and deferred pursuant to a grace period.

But the Indenture contains not one, but two, provisions that expressly provide for a contrary result. Sections 3.07 and 2.09 make plain that a redemption obligation is deemed satisfied provided that the issuer deposits the amount of principal being redeemed plus accrued interest—which is exactly what CEOC did. *Cf. Two Guys from Harrison-N.Y. v. S.F.R. Realty Assocs.*, 63 N.Y.2d 396, 405 (1984) ("'We may not construe the covenant as prohibiting in one subdivision that which it expressly sanctions in another.'" (citation omitted)). Even in the absence of Section 3.02 (which makes express that redemptions are governed by Article III), to the extent there were conflicts between Sections 3.07 and Section 4.01, the more specific redemption provision (Section 3.07) would control over the more general provision governing payment on the Notes (Section 4.01) under well settled principles of New York law.[15]

There are other conflicts, too. Section 3.07 *requires* that a redemption payment be made "*prior to* 10:00 a.m." Section 4.01 uses a 12:00 p.m. cut-off and says nothing about the obligation to make a redemption "prior to" 10:00 a.m. All of these conflicts can be avoided, as New York law instructs, by reading Section 4.01 not to apply to the Redemption at all. Indeed,

[15] As the Second Circuit explained in *Capital Ventures Int'l v. Republic of Argentina*, 652 F.3d 266 (2d Cir. 2011): "New York . . . follows the common (and commonsensical) rule that a specific provision like Section 6.01 governs the circumstance to which it is directed, even in the face of a more general provision like Section 9.05." *Id*. at 271 (citing *Muzak Corp. v. Hotel Taft Corp.*, 1 N.Y.2d 42, 47 (1956)); *accord In re AMR Corp.*, 730 F.3d 88, 99 (2d Cir. 2013).

the second sentence of Section 4.01 by its terms applies to "installments of principal or interest," which are concepts entirely distinct from the redemption at issue here.[16]

III. THE SECOND SENTENCE OF SECTION 4.01, EVEN ASSUMING IT APPLIES TO A REDEMPTION, IS NOTHING MORE THAN A SAFE HARBOR FOR DEEMING PRINCIPAL AND INTEREST PAID ON A CERTAIN DATE

Even assuming for the sake of argument that the second sentence were to apply to a redemption, all it does is set forth conditions that, when satisfied, are sufficient (not necessary) to consider payment made on a particular date.

The Submissions rest on the incorrect premise that "Section 4.01 of the Indenture states 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." Ex. G (Dec. 19 Submission) (emphasis added); *see also* Ex. H (Dec. 22 Submission) at 1 (describing Section 4.01 as "an explicit provision establishing that a payment is deemed made ***only if*** all amounts of principal and interest due on such date are fully funded." (emphasis added)).

That is not what Section 4.01 says. Applying basic principles of logic to the provision as it is written—with the word "if," but not the phrase "only if"— the second sentence establishes a *sufficient* condition for deeming the payment of "an installment of principal or interest" made on a given due date, not a *necessary* condition. Principal or interest will be deemed made on the date in question if the specified conditions are satisfied, but that is very different from saying that

[16] According to *Black's Law Dictionary* 1390 (9th ed. 2009), "redemption" is "the reacquisition of a security by the issuer" and usually "refers to the repurchase of a bond *before maturity*" (emphasis added). *See also IBJ Schroder Bank & Trust Co. v. Fairfield Communities, Inc.*, 178 F.3d 78, 81-82 (2d Cir. 1999) (distinguishing between an Indenture provision that governs "partial and complete redemption of the Notes *prior* to maturity" and "other requirements for payment *upon* maturity"); *Chem. Bank & Trust Co. v. Prudence-Bonds Corp.*, 207 F.2d 67, 72 (2d Cir. 1953) (distinguishing between "*redemption*," which could happen only "before maturity," and "final *payment* at maturity" in order to avoid a "pointless and confusing redundancy"). The Indenture and prospectus for this offering are generally sensitive to the distinction between redemptions and repayments of principal at maturity. *See, e.g.*, Ex. A §§ 8.01(a)(i), 8.02(a)(i) (distinguishing between payment on the Notes "at maturity" and "redemption"); Ex. P at 132, 222 (distinguishing between CEOC making payment by way of "principal" and "redemption").

these conditions *must* be satisfied in order for principal or interest to be timely paid. Judge Easterbrook discussed this logical distinction in *Alden Mgmt. Servs., Inc. v. Chao*, 532 F.3d 578, 581 (7th Cir. 2008), explaining: "'If A then B' . . . differs from 'only if A, then B' . . . [Plaintiff] confuses necessary and sufficient conditions. An aggrieved party's protest is sufficient to require an investigation but is not necessary." *See also Twp. of Tinicum v. U.S. Dep't of Transp.*, 582 F.3d 482, 488-89 (3d Cir. 2009) ("The phrase "only if" describes a necessary condition, not a sufficient condition. . . . A necessary condition describes a prerequisite. . . . The word "if" describes a sufficient condition. . . . A sufficient condition is a guarantee.").[17]

Put differently, the sentence creates a safe harbor: So long as the Issuer, by 12:00 p.m. on the relevant date, deposits the requisite funds with the Trustee, the Issuer avoids any claim that it did not make all payments due on that specific date—as well as the imposition of overdue interest specified in Section 4.01 as the consequences of such a failure. The Issuer would not be responsible if, for example, the Trustee for some reason failed to distribute the funds to the Noteholders, or distributed them improperly, for example by incorrectly allocating as between principal and interest. The sentence does *not* say that, if the Issuer deposits funds for one but not both payment obligations due on a given day, then neither can be deemed made unless both are. Here, the safe harbor is unnecessary to consider because CEOC fulfilled the Redemption obligation.

If the sentence meant what the Submissions say it means ("considered paid *only* if . . . ."), then the following would be an Event of Default: On a date when an installment of principal and interest are both due, the Issuer deposits sufficient funds for principal, but elects to *mail a check*

[17] The Minority commits what is known in logic as the fallacy of denying the antecedent. "If P, then Q" does not mean "If not P, then not Q." *See, e.g.*, T. EDWARD DAMER, ATTACKING FAULTY REASONING 77-78 (6th ed. 2009). An illustration of this fallacy: If Newt is a dog, then Newt must be an animal. Newt is not a dog. Therefore Newt is not an animal. *Id*.

for the interest to the Noteholders. If the second sentence really meant that either everything is deposited with the Trustee or nothing is, then this fact pattern would constitute non-payment of principal pursuant to Section 6.01(b). But the Notes (which as noted above are incorporated into the Indenture) *expressly allow the Issuer to mail checks for Interest*.[18] Under New York law a contract must be read as a whole and in a way that avoids making provisions meaningless. *E.g.*, *Beal Sav. Bank*, 8 N.Y.3d at 324. The Minority position fails to do that.

In any event, the Minority cannot have it both ways. It cannot on the one hand argue for a technical, literal interpretation of the second sentence of Section 4.01 that leads to a commercially unreasonable result, while at the same time sweeping under the rug the sentence's use of the word "if" (and not "only if"), which fails to support the Minority's interpretation.

IV. EVIDENCE OF MARKET UNDERSTANDING UNDERMINES THE MINORITY POSITION

In light of the analysis set forth above, the Majority submits that the Indenture is not ambiguous. However, if the Indenture were deemed ambiguous, then under New York law a court would ascertain the parties' intent by looking to extrinsic evidence, including evidence of custom and practice in the industry. *See* footnote 8 above. Particularly relevant here are the registration statement and prospectus filed with the Securities and Exchange Commission ("Disclosures") for the Notes, and the Disclosures for *other* bond issues with an AHYDO-related redemption feature. These documents are far more useful for discerning the intent of the parties to this transaction than the American Bar Association's Commentaries to the Revised Model Simplified Indenture ("Commentaries" to the "Model"), which deal with different indenture

[18] *See* Ex. B § 2 ("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.").

provisions with different language at a different time (without reference to actual contracting parties).

If the Section 6.01(a) grace period for interest payments were indeed contingent on a separate redemption payment not being due the same day, this would be a material term of the Notes and a significant enough feature that one would expect to see mention of it in the Disclosures. *See* SEC Regulation S-K, Item 202, 17 C.F.R. § 229.202 (requiring disclosure of "[t]he general type of event that constitutes a default"). There is no such mention. On the contrary, the "Description of Exchange Notes" section of the prospectus for the Notes (excerpted in Ex. P) states, without qualification, that an Event of Default includes "a default in any payment of interest on any Note . . . when due, continued for 30 days." Ex. P at 218. The absence of any suggestion that, in light of Section 4.01, this grace period might disappear just because interest is due the same day as a tax-related redemption obligation, is powerful evidence that the transaction participants and the marketplace did not understand the Indenture to mean what the Minority would like it to mean.

In a similar vein, we have attempted to locate the Disclosures for all other debt issuances containing an AHYDO-related redemption feature of the kind at issue here.[19] We found twenty-two such issuances. All of them had 30-day grace periods for missed interest payments. But there was no suggestion in any of the SEC Disclosures that the grace period was qualified by anything in Section 4.01. *See* Exhibit Q for pertinent excerpts. What is more, in a number of those cases, Section 4.01 adopted a different formulation, which made clear that the "all principal and interest then due" language relates only to the specific installment at issue and not

[19] Specifically, we searched a database of EDGAR filings for any S-4 registration statement or associated prospectus containing the phrase "AHYDO Redemption".

to all other items that might be due that same day.[20] In none of these cases was there any suggestion in the Disclosures that the different language used was of any significance to the substantive rights of the parties. To the contrary, regardless of the precise language used in Section 4.01, the disclosure about the application of the grace period was exactly the same, reflecting that any difference in language between indentures was not intended to effect any change in the clear, unambiguous 30-day grace period for installments of interest expressly provided for in the Indenture.[21]

As for the Commentaries, the Minority has in the past claimed to draw support from a single sentence referring to the Model's Section 4.01. *See* Ex. H at 2. This sentence, which is set forth in the footnote below,[22] does not provide the support the Minority claims. As the Second Circuit has noted, the Commentaries "do not, of course, provide authoritative guidance on New York law." *NML Capital v. Republic of Arg.*, 621 F.3d 230, 241-42 (2d Cir. 2010) (referring to the American Bar Foundation's Commentaries on Model Debenture Indenture Provisions). More fundamentally, the sentence in question does not address the issue of a grace period at all. The Commentaries say nothing at all about the relationship between Section 4.01 and the Event of Default provisions, much less whether Section 4.01 somehow overrides the

[20] For example, in indentures for American Apparel and Interline Brands transactions, the drafters replaced "sufficient to pay all principal and interest then due" with "sufficient to pay the installment in full" and "sufficient to pay the installment then due." *See* Ex. Q at Q-1, Q-5, Q-20, Q-100.

[21] In addition, we are aware of no cases in which Section 4.01 was modified the other way, that is, to make it explicit that a failure to pay interest subject to a grace period but due the same day as a redemption would constitute an Event of Default. If the Minority contends that no indentures have been modified in the other direction because the operative language on its face clearly goes their way, we note that under New York law, there is no warrant for consulting extrinsic evidence like this *unless* the Indenture is ambiguous. The Minority cannot have it both ways: either the language at issue is ambiguous or it is not, but if it is ambiguous, then the panelists should accord significance to the fact that the ambiguity has only ever been clarified in one direction—the Majority's.

[22] "This Section makes clear that the Company must deposit an amount sufficient to pay all principal and interest due on the particular date, not (for example) just enough to pay principal and interest on Securities called for redemption if other amounts are due on the same date." Ex. R § 4.01 cmt. 2.

traditional grace period for interest in Section 6.01(a). Nor do the Commentaries even remotely suggest that Section 4.01 is intended to limit a borrower's traditional right to allocate its payments.

At most, the Commentaries clarify that compliance with the requirements to satisfy a redemption obligation in the Model's Section 3.05 (the counterpart to the CEOC Indenture's Section 3.07) does not somehow eliminate the issuer's obligation to make other interest payments due that same date.[23] Confirmation that the interest payments remain due, however, is quite a different thing from eliminating the 30-day grace period for them. Nothing in the Commentaries suggests the latter result.

Beyond that, there are significant differences between this Indenture and the Model. For example, the Model has no Section 3.02 expressly providing that redemptions are to be governed by "this Article," *i.e.*, Article III; this Indenture does. *See* Ex. R art. III. Model Section 4.01 does not use the word "installment," *id*. § 4.01; this Section 4.01 does. And as noted, parties have sometimes revised Section 4.01 in ways that slam the door shut on the Minority's position. So even if the Commentaries meant what the Minority says (and they do not), it would still beg the question whether *this* Indenture was intended to reflect the Minority understanding, given that the Indenture actually *departs* from a Model that supposedly accords with the Minority view. *Cf. Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 397 (Del. 1996) ("Such models are an aid to drafting and construction. . . . but interpretation may become problematic if the drafter excludes key language from the model provision.").

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[23] Model Section 3.05 contemplates that in some circumstances the Paying Agent will return funds deposited for, but in excess of, what is needed for a redemption. Ex. R § 3.05 ("The Paying Agent shall return to the Company any money not required for that purpose"—redemption—"because of conversion of Securities."). This of course does not mean that the issuer is entitled to return of funds corresponding to installments of interest due the same day as a redemption. The Commentaries to Section 4.01 clarify that.

CONCLUSION

CDS are intended to hedge against bona fide defaults that are reasonably clear to market participants—not as a kind of "gotcha" product that rewards an opportunistic position advanced by no party to the underlying instrument. The panel's role here is to predict how a New York court would actually adjudicate the question whether CEOC experienced an Event of Default on December 15. Consider how a court would react had CEOC paid the Redemption on December 15, and then paid the outstanding Interest Installment on January 14. In New York law, "[e]quity will often intervene to prevent a substantial forfeiture occasioned by a trivial or technical breach." *Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc.*, 46 N.Y.2d 573, 76-77 (1979). Here, even setting aside the many doctrinal points on which the Majority has the better of the argument, it is highly unlikely that a court would read the Indenture to have accelerated the Notes, causing CEOC to collapse (a "substantial forfeiture"), purely because of the "[hyper]technical" reading of a single sentence offered by the Minority.

For all the reasons set forth above, the External Review Panel should answer the Reviewable Question in the negative.[24]

[24] The Submissions also advanced as a basis for a Failure to Pay the fact that the Trustee chose to distribute the proceeds from the Redemption not in accordance with CEOC's instructions, but pro rata to principal and interest as contemplated by Section 6.10 of the Indenture after an Event of Default. *See* Exs. G, H. The DC unanimously rejected that argument. *See* Ex. I. The reason for the Trustee's pro rata distribution was that a subset of Noteholders had alleged (although CEOC disputed it) that a default had taken place on October 15, and instructed the Trustee to distribute any funds collected on a pro rata basis. *See* Exs. D, E. The question whether a default in fact took place on October 15 is not before this panel. To the extent the Minority may attempt to confuse matters by arguing that a Failure to Pay Credit Event occurred as a result of supposedly "required pro rata application by the Trustee" (*see* Ex. H at 2), their argument is purely circular. It would appear to go like this: (i) no principal redemption occurred on December 15 because CEOC did not pay "all principal and interest then due"; (ii) therefore, an Event of Default occurred on December 15 pursuant to Section 6.01(b) of the Indenture; (iii) therefore the Trustee was correct to allocate pro rata; (iv) since the Trustee allocated pro rata, the Noteholders received less than the full amount of principal due; and (v) there was therefore an Event of Default or Failure to Pay. But if we are correct that there was no Event of Default stemming from CEOC paying the Redemption and deferring the Interest Installment, then there was no basis for the pro rata distribution because pro rata distribution is permitted only if there is an Event of Default. *See* Indenture § 6.10.

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Respectfully submitted,

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