

Should the CDS Auction be delayed until the resolution by the bankruptcy court of certain issues directly affecting the liquidity of deliverable obligations therefore reducing the risk of technical squeeze?

We hereby refer to the Determinations Committee's (the "DC") January 7th, 2019 decision to set the Auction Date on January 17, 2019 with respect to the Sears Roebuck Acceptance Corp's Credit Event.

In light of the unique situation presented by SRAC where a CDS seller controls the majority of the Deliverable Obligations, the continued elevated risk of a squeeze, and accusations of market manipulation by a CDS seller, we respectfully request that the DC considers a delay of the Auction until a date which would not be earlier than the Final Sale Hearing⁽¹⁾ of the "Go Forward Stores" (as defined in Docket 816⁽²⁾). The Final Sale Hearing is currently scheduled on February 1, 2019. If the Auction is delayed to post the Sale Hearing, the outcome would better reflect market expectations – the purported goals of the Auction.

The Risk of a Squeeze Remains High

As it has been widely publicized, of all outstanding SRAC Deliverable Obligations currently on the Supplemental List of Deliverable Obligations, the vast majority are owned or otherwise directly or indirectly controlled by the largest seller of SRAC CDS, a hedge fund controlled by Eddie Lampert/ESL (holder of \$525 million loan obligations), and affiliates of the Debtors which are not permitted to sell their \$1.3 billion holding⁽³⁾, leaving only a small fraction of Deliverable Obligations being held or otherwise freely accessible or purchasable by the remainder of market participants ("Available Deliverable Obligations").

Even though the Net Open Interest has significantly reduced over the past month, the risk of a squeeze of the SRAC Auction remains high⁽⁴⁾ if measured by the very thin trading of the Available Deliverable Obligations (less than \$1 million a day in aggregate) and their clearing price which is by far exceeding their implied market value (these unsecured obligations are trading 40 points above second lien notes technically not deliverable in the CDS auction).

Additionally, as per the Auction Terms, the DC requires at least eight (8) Valid Initial Market Submissions of Initial Market Quotation Amount of USD 1 million in order to commence the Auction. In other words, in order to participate in the Auction, dealers need to source at least 8 million of illiquid scarce bonds in the market which will lead to further price dislocation.

Additional Deliverables could Start Trading Post the Final Sale Hearing

As it has been widely publicized, Eddie Lampert and ESL have attempted to bid for Sears' assets^(5,6) and could use his loan holdings in a credit bid package. As a result, ESL is unlikely to be a seller of its loan holding until the conclusion of the asset sale process. The final court sale hearing ("the Final Sale Hearing") is currently scheduled on February 1, 2019.

ESL is the sole holder of the \$525 million second lien loan (BBG00DX35360), which has been approved as a Deliverable Obligation at the CDS Auction. Waiting until the resolution of the auction of the Sears assets (or the Go Forward Stores) could open up to \$525 million of deliverable into the CDS Auction, reducing the risk of a technical squeeze and preserving the integrity of the CDS market.

As articulated by the DC, Auction Settlement Terms should broadly reflect the outcomes available to market participants which would have been available if Physical Settlement had been the applicable Settlement Method, consistent with 3.2(d) of the DC Rules.

To ensure that broadest set of Deliverables remain available for the CDS Auction to satisfy any demand from market participants requesting participation in the Auction (specifically 525mm 2nd lien Loans FIGI: BBG00DX35360), we request that the DC considers a delay of the Auction to a date following the settlement of the "Sale Hearing".

We confirm that a copy of this statement may be provided to the members of any Credit Derivatives Determinations Committee convened under the DC Rules in connection with the General Interest Question to consider the issues discussed herein, and that it may be made publicly available on the ISDA Credit Derivatives Determinations Committee website. We accept no responsibility or legal liability in relation to its contents.

⁽¹⁾ Sears Global Bidding Procedures Timeline: <https://restructuring.primeclerk.com/sears/Home-Index>

Global Sale Process

On November 11, 2018, the Court entered the Order Approving Global Bidding Procedures and Granting Related Relief [Docket No. 816] (the "Global Bidding Procedures Order") for a sale of the Debtors' assets, including the "Go Forward Stores" on a going concern or liquidation basis.

Important Dates and Deadlines Related to the Global Bidding Procedures Order:

- **December 5, 2018:** Deadline to submit Non-Binding Indication of Interest
- **December 15, 2018:** Deadline for the Debtors to designate Stalking Horse Bidder for Go Forward Stores and file a Sale Notice with respect to the Go Forward Stores designating a Stalking Horse Bidder
- **December 28, 2018 (4:00 p.m.):** Bid Deadline
- **December 31, 2018 (4:00 p.m.):** Deadline to object to the designation of a Stalking Horse Bidder and any Stalking Horse Bid Protections
- **The later of (i) fourteen calendar days after service of the Assumption and Assignment Notice and (ii) January 7, 2019:** Deadline to object to (i) proposed Cure Costs for Proposed Assumed Contracts in a Stalking Horse Bid and (ii) Adequate Assurance Information for Stalking Horse Bidder
- **January 4, 2019 (4:00 p.m.):** Deadline for Debtors to notify Prospective Bidders of their status as qualified Bidders and announcement of Auction Packages
- **January 11, 2019 (10:00 a.m.):** Hearing on Stalking Horse Designation Objections and on objections to the qualification of any Credit Bid by affiliate or insider, if necessary
- **January 14, 2019 (10:00 a.m.):** Auction held at Weil offices, if necessary
- **January 16, 2019:** Target date for debtors to file with the Bankruptcy Court the Notice of Auction Results and to provide the applicable Counterparty with Adequate Assurance Information for the Successful Bidder (if different than the Stalking Horse Bidder)
- **The later of (i) January 24, 2019 and (ii) eight days of filing of the Notice of Auction Results and Service of the Adequate Assurance Information:** Deadline to object to (i) the proposed Sale Transaction for a Successful Bidder (including a Stalking Horse Bidder), (ii) Debtors' proposed Cure Costs for Proposed Assumed Contracts not included in any Stalking Horse Bid, (iii) the assumption of and assignment to a Successful Bidder that is not a Stalking Horse Bidder of any Proposed Assumed Contracts or any Contracts or Leases that may later be designated by such Successful Bidder for assumption and assignment, and (iv) conduct of the Auction
- **January 29, 2019 (4:00 p.m.) or two days prior to the Hearing Date:** Debtors' deadline to reply to Sale Objections
- **February 1, 2019 (10:00 a.m.):** Sale Hearing

⁽²⁾ Sears Holdings Corporation bankruptcy Docket #816. <https://restructuring.primeclerk.com/sears/Home-DocketInfo>

⁽³⁾ Sears Holdings Corporation bankruptcy Docket #1369. <https://restructuring.primeclerk.com/sears/Home-DocketInfo>

6. Covenants. The Debtors hereby covenant and agree (i) with respect to clauses (a)-(d), during the period from the date hereof to the conclusion of any auction to be held by ISDA with regard to credit default swaps referencing SRAC and the settlement of all transactions arising out of such auction and (ii) with respect to clause (e), with no date of termination, as follows:

...

(b) Further Action. The Debtors (i) shall not take any steps to cause Sears Re or any other party to list any Sears Re Obligations for inclusion in any auction to be held by ISDA with regard to the credit default swaps referencing SRAC, (ii) shall not disclose, or otherwise facilitate the disclosure of, the terms of any Sears Re Obligation unless otherwise required by the Bankruptcy Court and (iii) shall use commercially reasonable efforts to oppose any such action referenced in the preceding (i) or (ii) by any Bermuda Court Appointed Receiver.

- (4) The mechanics of the squeeze have been well explained in the 201812180 submission <http://dc.isda.org/>
- (5) Sears Holdings 13D/A dated Jan 2 2019 (ESL bid)
- (6) <https://www.wsi.com/articles/auction-for-sears-will-go-ahead-on-january-14-lawyer-11546971475>