February 20, 2019

TO: ISDA Determinations Committee

RE: Windstream Services, LLC – Failure to Pay Credit Events

I. Introduction

Two Failure to Pay Credit Events have occurred with respect to the outstanding credit default swaps referencing Windstream Services, LLC (the "**Company**"). Those two events are:

- **Credit Event #1**: The Company's failure to pay the principal amount of its 6.375% Senior Notes due 2023 with CUSIP 97381WAZ7 (the "**Notes**") on or prior to February 21, 2019, three business days after the determination on February 15, 2019 by the U.S. District Court for the Southern District of New York (the "**Court**") that the entire principal amount thereof (which exceeds $1 million) has become due and payable as a result of an acceleration.[1]
- **Credit Event #2:** The Company's ongoing failure to pay the accelerated principal amount of the Notes (which exceeds $1 million) since the Notes were accelerated, which constitutes an additional Failure to Pay Credit Event each day it continues and is not cured within three business days.

II. Credit Event #1

A. Facts

On February 15, 2019, the Court issued its Findings of Fact and Conclusions of Law (the "**Decision**") in the civil litigation known as U.S. Bank National Association v. Windstream Services, LLC v. Aurelius Capital Master, Ltd. (Case No. 17 Civ. 7857 (JMF)) (the "**Litigation**").[2]

The Litigation was brought on October 12, 2017 by U.S. Bank National Association, as indenture trustee for the Notes (the "**Trustee**"), against the Company, seeking a judicial determination that the Company had violated a covenant in the indenture governing the Notes (the "**Indenture**").

From the outset, the Company disputed the Trustee's assertion that a covenant default had occurred. Even so, on October 18, 2017, the Company launched exchange offers and a consent solicitation for the purpose of procuring a waiver of that default. On November 13, 2017, the Company announced that this waiver had purportedly taken effect on November 6, 2017. The Litigation was thereupon expanded to address whether that waiver was valid, and whether a

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[1] This Credit Event has not occurred as of the date hereof, but this submission assumes that the Company will fail to repay the amounts due under the Notes on or prior to tomorrow's deadline.

[2] All documents cited herein are publicly available. The Decision is document #245 on the public docket for the Litigation, which is publicly available via the PACER system (https://www.pacer.gov/), as well as the Electronic Case Filing system for the Southern District of New York (http://www.nysd.uscourts.gov/ecf.php).

December 7, 2017 notice of acceleration issued by Aurelius Capital Master, Ltd. ("**Aurelius**") was valid.

While the Litigation was pending, the Company repeatedly and publicly disputed as "meritless," "baseless" or the like the assertions by the Trustee and/or Aurelius that a covenant default had occurred and not been waived, and that the Notes had been accelerated as a result. For example, on December 7, 2017, the Company announced that Aurelius's notice of acceleration:

> "is baseless and of no effect. No Event of Default has occurred, or is occurring under the [Indenture] …, because the alleged defaults … are without merit. Furthermore, all such alleged defaults have been validly waived …."[3]

The trial in the Litigation was held in July 2018. The Decision just issued is the Court's ruling setting forth the outcome of the Litigation.

The central issue in the Litigation was whether the maturity of the Notes had been accelerated, with the result that the entire principal amount thereof had become due and payable. The Court ruled on this issue in the affirmative, stating on page 54 that "the December 7, 2017 Notice of Acceleration sent by Aurelius to Services with respect to those Events of Default was valid and effective, and all principal together with all accrued and unpaid interest on the Notes became immediately due and payable as of that date".

The principal amount outstanding of the Notes is now $465 million.[4] Thus, according to the Decision, the entire principal amount of the Notes ($465 million) has become immediately due and payable.[5] That principal has not been repaid.[6]

Under the Indenture, there is no grace period for the failure to pay principal. According to Section 6.01(a) of the Indenture:[7]

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[3] Exhibit 99(a) to the Company's Form 8-K dated December 7, 2017, available at https://www.sec.gov/Archives/edgar/data/1282266/000156761917002436/s001990x2_ex-99a.htm. To like effect, see the Company's 2017 Form 10-K at pp. 16, 27, F-29, F-79 and F-102, available at https://www.sec.gov/Archives/edgar/data/1282266/000128226618000016/a201710k.htm , the Company's March 31, 2018 Form 10-Q at pp. 50 and 85, available at https://www.sec.gov/Archives/edgar/data/1282266/000128226618000026/a20180331form10q.htm, and the Company's June 30, 2018 Form 10-Q at pp. 53 and 90, available at https://www.sec.gov/Archives/edgar/data/1282266/000128226618000046/a2018063010q.htm.

[4] Bloomberg DES function for the Notes.

[5] The Notes as defined herein are those that were issued before the November 2017 exchange offer (CUSIP 97381WAZ7). The Decision ruled on the acceleration only of those Notes, not the similarly named notes (CUSIP 97381LAA6) that Windstream purported to issue in November 2017 pursuant to an exchange offer.

[6] Bloomberg DES function for the Notes.

[7] The Indenture is available at https://www.sec.gov/Archives/edgar/data/1282266/000119312513020891/d472206dex41.htm. The various supplemental indentures entered into with respect thereto are publicly available but do not amend any of the provisions pertinent to this submission.

"Each of the following is an 'Event of Default' with respect to the Notes:

…

"(ii) default in payment when due (whether at maturity, upon acceleration, redemption, required repurchase or otherwise) of the principal of … the Notes …."

B. Failure to Pay Analysis

Plainly, a "Failure to Pay" has occurred under Section 4.5 of ISDA's 2014 Credit Derivatives Definitions (the "**Definitions**")[8]:

- The Company (the Reference Entity) has failed to pay when due the principal amount of the Notes (an Obligation of the Reference Entity), in accordance with the terms of the Notes at the time of such failure.
- The amount of this failure exceeds $1 million.
- The failure to pay that principal has continued for at least three business days (the period prescribed by Definitions Section 1.46 where, as here, the Obligation itself prescribes no grace period).

A Failure to Pay occurred on February 22, 2019, three business days after the Decision was entered. Until the Decision was entered, there was no means for the Determinations Committee and market participants to reach a reliable conclusion that the principal had in fact been accelerated. Indeed, that very question was contested between the Company on the one hand and Aurelius and the Trustee on the other. The parties to the Litigation having submitted their dispute to the Court, the Decision now resolving the dispute must be viewed as an independent event crystallizing the payment obligation for market purposes.

This approach is completely consonant with the Determination Committee's prior ruling concerning this very dispute. Based on Aurelius's December 7, 2017 notice of acceleration, a market participant asked the Determinations Committee on December 15, 2017 either to determine that a Failure to Pay Credit Event had occurred or to defer that determination and toll the expiration of all then-currently outstanding CDS contracts until the Determinations Committee had sufficient publicly available information to reach a determination. The Determinations Committee did neither. Instead, it determined that a Credit Event had not yet occurred.

At that time, there were was good reason for the Determinations Committee not to determine that a Credit Event had occurred. This reason is primarily rooted in the Reference Entity's dispute of the assertions underlying the Litigation and the lack of judicial resolution thereof. The Decision now resolves the dispute and creates the basis for a determination that a Failure to Pay has occurred.

The Determinations Committee could not have determined that a Credit Event had occurred without, in effect, ruling against the Reference Entity on the very dispute at the heart of the Litigation, 14 months before the Court did. Back in December 2017, most pre-trial discovery had

[8] The facts and analysis herein also apply to the 2003 Credit Derivatives Definitions.

not occurred (let alone been made public), the amendments and answers to the counterclaims had not all been filed, and no trial had been held.

It would have been entirely different if the Court had ruled on the matter prior to the December 2017 Determinations Committee submission, since that would have provided a public judicial determination on which the Determinations Committee could have relied. But as of December 2017, the trial in the Litigation was not expected to occur for many months, and the timing for the Court to issue its decision was also uncertain.

That left the Determinations Committee only one prudent course in December 2017, which was to determine that the Credit Event had not yet occurred. That did not mean the Determinations Committee was picking sides in the Litigation. Rather, it simply meant that for the purposes of the CDS contracts, the Determinations Committee had an insufficient basis to determine that the Credit Event had occurred, so it was premature to trigger the CDS.

The Decision provides the Determinations Committee what it was theretofore lacking – a public and official determination on which the Determinations Committee can and should rely in concluding that the Notes have been accelerated, which, together with the Company's failure to pay within three business days after the Decision's entry, constitutes a Failure to Pay Credit Event.

It is irrelevant that the Company might decide to appeal the Decision. The Decision represents the final word by a United States court, the U.S. District Court for the Southern District of New York. Whatever small chance there may be that the Company would eventually succeed on appeal does not alter the fact that the Decision provides the Determinations Committee with a reliable and official basis to find that Credit Event #1 (as well as Credit Event #2) has occurred.

Our analysis of Credit Event #1 is squarely supported by the Definitions since the Determinations Committee is in possession of adequate Publicly Available Information under Section 1.35(a):

> "Publicly Available Information" is defined to mean "information that ***reasonably*** confirms any of the facts relevant to the determination that the Credit Event … have [sic] occurred …."

The term "Publicly Available Information" specifically includes "(iii) information contained in any … order [or] decree … of … a court …." Conspicuously absent from this passage is a requirement that the order or decree be non-appealable.

Furthermore, the definition of Credit Event in Section 4.1 of the Definitions provides in relevant parts:

> "If an occurrence would otherwise constitute a Credit Event, such occurrence will constitute a Credit Event whether or not such occurrence … is subject to a defense based upon … (c) any applicable … order [or] decree …, or any change in [] the interpretation by any court … of any applicable … order [or] decree …."

Thus, a Credit Event should be found here even if the Company appeals.

III. Credit Event #2

A. Continuing Payment Default Constitutes a Series of Daily Credit Events

The acceleration of the Notes should also be regarded as resulting in a series of daily Credit Events by virtue of the Company's continuing failure to pay the principal amount of the Notes ever since Aurelius gave its notice of acceleration on December 7, 2017.[9] On each day that the Company does not pay the overdue principal, it is failing to make a payment that is due in respect of the Notes. A Failure to Pay has therefore occurred every day since three business days after December 7, 2017, including yesterday.[10]

This "continuing default" approach is entirely consonant with the definition of Failure to Pay in Section 4.5 of the Definitions:

> "'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 the aggregate amount not less than the Payment Requirement under one or more Obligations …." (Emphasis added.)

These words make clear that the expiry of the Grace Period *per se* does not amount to a Failure To Pay. Rather, only the Reference Entity's failure to pay the relevant amount can constitute a Failure to Pay and such failure continues at any point in time after the expiration of the applicable grace period until the amount is paid.

No language in the Definitions provides that an ongoing failure to pay can give rise to only one Failure to Pay. To the contrary, while the Definitions make clear that a payment curing the failure after the expiration of the Grace Period would not undo the Failure to Pay that has already occurred, the Definitions do not suggest the converse: that the absence of that tardy payment (i.e., the continuation of the default after the Grace Period) cannot result in additional daily Failures to Pay (each with its own grace period).

This concept of a series of Failures to Pay arising from an ongoing payment default has no practical relevance in the vanilla situation where the Reference Entity is publicly known to have missed a scheduled installment of principal or interest. In that scenario, the default will rapidly be brought to the attention of the Determinations Committee, which will easily be able to determine that a Failure to Pay has occurred.

In contrast, the concept of a series of Failures to Pay is essential to the practical and orderly operation of CDS where a payment default is outstanding for 60 or more days before a court can rule on any dispute about whether the default has occurred. It surely cannot be that CDS provides

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[9] Page 54 of the Decision.

[10] The difference between Credit Event #1 and Credit Event #2 is that Credit Event #1 regards the entry of the Decision itself (when coupled with the Company's failure to cure within three business days thereafter) as a Failure to Pay, whereas Credit Event #2 regards the Company's ongoing failure to pay the accelerated principal as a series of daily Credit Events. Even under the latter approach, it was only upon entry of the Decision that the Determinations Committee had a public and official determination on which it should rely to determine that the Notes had accelerated and that a Failure to Pay Credit Event occurred.

no protection against an uncured payment default simply because the basis for the payment obligation is challenged by the Reference Entity. How long it takes for a trial court to rule should only determine when the Determinations Committee can find that the payment default has occurred, but surely it should not determine whether the default (if uncured in the interim) is a Credit Event at the time of that ruling. The same reasoning applies to Credit Event #1 above.

B. This Continuing-Default Approach is Consonant With (Indeed Essential to) the 60-Day Lookback

This concept of a series of daily Failures to Pay arising from a continuing payment default is easily harmonized with the "60-day lookback" embedded in the definition of "Credit Event Backstop Date" (Definitions Section 1.39). The purpose of the 60-day lookback is to ensure fungibility as among CDS contracts with a common Reference Entity and expiry. Prior to the adoption of the 60-day lookback, such otherwise similar CDS contracts were not fungible, because each contract took into account all Credit Events occurring after the contract was entered into, and CDS contracts varied greatly as to when they were entered into. The 60-day lookback fixed this by providing that all contracts looked back the same 60 days, regardless when the contracts were entered into.[11]

The concept of a series of daily Failures to Pay described above honors this objective. No matter which daily Failure to Pay one picks, all outstanding CDS contracts are treated the same regardless when they were entered into. If the pertinent payment default was cured more than 60 days before the matter is submitted to the Determinations Committee, none of the CDS contracts would be

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[11] The above description of the sole purpose of the 60-day lookback is consistently presented through multiple sources. For example, ISDA's counsel provided the following explanation on ISDA's Conference Call held on March 3, 2009*:*

> "And the purpose of these provisions is to assist with achieving fungibility of transactions that otherwise have identical terms …. And so what we want to ensure, is that any transaction that has the same scheduled termination date and that references the same terms, are truly fungible in terms of the credit profile and so we have instituted a change to the definition such that rather than permitting any credit event that occurs between the effective date and scheduled termination date to be a credit event that will be triggerable, instead we require that the particular event must have occurred within the 60 calendar days prior to the date that the committee is asked to consider whether or not the event is a credit event or not." (available at https://www.isda.org/a/JS6EE/88439136.mp3)

To like effect, see page 14 of "The CDS Big Bang" by Markit dated March 13, 2009:

> "This change ensures fungibility as far as protection is concerned. A CDS trade with the same characteristics done under the new contract will have the same effective date as a trade done one week later. This allows for the trades to be netted easily and avoid residual stub risk between trades with the same entity/maturity/currency/restructuring done on different dates."

The same rationale is provided in the FAQ to the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement CDS Protocol (Big Bang Protocol) (available at FAQ tab of https://www.isda.org/traditional-protocol/big-bang-protocol/).

triggered. If the pertinent payment default either remains uncured or was cured 60 or fewer days before the matter is submitted to the Determinations Committee, all the CDS contracts that have not expired more than 14 calendar days after the date of the Determinations Committee submission would be triggered.

This continuing-default approach would also not place an unviable burden on writers of CDS to protect themselves, whether through due diligence or market positioning. Indeed, the opposite will more commonly be true. Writers of CDS are always at risk of being blindsided and poorly positioned by an unexpected payment default. The chance of this occurring is far less (if not zero) with an uncured payment default that has been publicly in dispute for a long time than with a payment default that has just arisen or has just been disclosed.

This is well illustrated by the present situation. The market has known of the Litigation since October 2017 and known of Aurelius's Notice of Acceleration since December 7, 2017. The Litigation has been transparent and widely followed. The trial was held in July, in a courtroom packed with market participants and the media. Buyers and sellers of Windstream's CDS have long known of the risk at hand, have had abundant opportunity to assess it, and have undoubtedly reflected their assessments in their positioning and the price of the CDS.

While the Determination Committee's recognition of Credit Event #2 would thus be entirely consonant with the purpose of the 60-day lookback, its refusal to recognize Credit Event #2 would create a gaping and commercially absurd hole in the protection provided by CDS. Surely the failure to pay principal or interest has always been the most central risk protected by CDS – regardless whether the payment default arises on a scheduled payment date, upon the occurrence of some contingency, or upon acceleration. It would thus be shocking to market participants globally to be informed that uncured payment defaults are permanently excluded from that protection if disputes as to their existence cannot be resolved within 60 days.

It is one thing to decide that such a delay should be relevant to the application of CDS expiration dates; but it is an entirely different matter (having nothing to do with fungibility) to decide that those delays should cause an uncured payment default to be permanently exempted from protection under all CDS contracts, regardless of expiry. The latter step would be a radical up-ending of the scope of protection afforded by CDS. It would also allow the availability of protection for a particular default to be permanently determined by arbitrary or manipulable factors – like the court's calendar, the Reference Entity's choice about how to pace the litigation, or even the Reference Entity disputing the most straightforward acceleration notice at the urging of sellers of protection. Surely, a change of such profundity would have deserved very prominent mention when the 60-day lookback provision was being introduced to the market during the 2009 "Big Bang", but ISDA provided no disclosure to this effect.

In sum, not only is the logic of Credit Default #2 consonant with the consistently stated purpose of the 60-day lookback; it is essential to ensuring that the lookback does not lead to a result that would be globally shocking, and that would inflict severe damage to the integrity of CDS.

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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.