



COMMENTARY
MARCH 2019

Windstream: When a Credit Derivatives Determinations Committee and a Court Disagree

IN SHORT

The Situation: Following a recent court decision holding that Windstream Services, LLC ("Windstream") failed to pay hundreds of millions of dollars in accelerated debt in 2017, the Credit Derivatives Determinations Committee ("DC") was asked to determine whether a Failure to Pay Credit Event had occurred on Windstream credit default swaps ("CDS").

The Result: Apparently locked in by its own prior decision in 2017, and the amount of time that had elapsed since bondholders had purported to accelerate Windstream's debt, the DC concluded that no Failure to Pay Credit Event had occurred under Windstream CDS.

Looking Ahead: Windstream's bankruptcy filing should allow holders of current CDS protection to collect on their contracts after the upcoming Bankruptcy Credit Event CDS auction, but buyers whose credit protection expired prior to the occurrence of that Credit Event are unlikely to be helped by it.

In January 2013, Windstream issued \$700 million of senior unsecured notes ("Notes"). The [indenture](#) for the Notes ("Indenture") prohibited Windstream and its subsidiaries from entering into a "Sale and Leaseback Transaction" (as defined in the Indenture). After issuing the Notes, Windstream formed a new parent holding company ("Holdings") and a real estate investment trust it planned to spin off as a separate publicly traded company ("Uniti"). In 2015, Windstream sold assets to Uniti, and Holdings entered into a master lease with Uniti subsidiaries ("2015 Transaction").

Following the 2015 Transaction, Aurelius Capital Master, Ltd. ("Aurelius") built up a substantial position in the Notes and in September 2017 it delivered a default notice claiming the 2015 Transaction constituted an impermissible Sale and Leaseback Transaction. In October 2017, the trustee for the Notes ("Trustee"), at the direction of Aurelius, sued Windstream in the Southern District of New York ("Court") in connection with the alleged Indenture violation, and Windstream filed counterclaims against the Trustee and Aurelius the following day. Windstream also engaged in a series of exchange offers and consent solicitations in October and November that were aimed at obtaining the requisite consents to waive the alleged default. Notwithstanding Windstream's efforts, upon expiration of the cure period for the alleged default, Aurelius delivered a [notice of acceleration](#) which purported to declare the Notes immediately due and payable on December 7, 2017.

On December 15, 2017, an anonymous CDS market participant [submitted a request](#) to the DC asking it to either: (i) find that a Failure to Pay Credit Event had occurred based on Windstream's failure to pay the Notes upon the purported acceleration; or (ii) toll its decision, leaving current CDS contracts outstanding, pending the outcome of the litigation. The DC did neither. Based on the information available to it, the [DC unanimously determined](#) that no Failure to Pay Credit Event had occurred.

Following a July 2018 trial, the Court issued a [decision](#) on February 15 ("Court Decision") finding that: (i) the 2015 Transaction constituted a default under the Indenture, (ii)



This situation highlights the unique role the DC plays in the CDS market. The DC, which is made up of 10 dealer and five buy-side representatives (who

the notices of default and acceleration were valid and effective; and (iii) all principal and accrued and unpaid interest on the Notes became immediately due and payable on December 7, 2017.

On February 20, two anonymous [CDS market participants](#) again [requested](#) that the DC determine whether a Failure to Pay Credit Event had occurred in light of the Court Decision. The DC [unanimously resolved](#) six days later that "on the basis of the Publicly Available Information submitted ... no Failure to Pay Credit Event has occurred." This may seem like a counter-intuitive outcome but, while the DC did not elaborate on its rationale, the outcome is consistent with the concept of the Credit Event Backstop under the CDS Definitions. This "backstop" increases fungibility among CDS by "erasing" alleged Credit Events that occur prior to a 60-day lookback period from the date of any given DC request, irrespective of the trade date for individual transactions. The Court Decision held that the Notes became due and payable in December 2017, about a year prior to the Credit Event Backstop Date for the February 2019 requests.

The DC also rejected another Failure to Pay Credit Event [request](#) it received on February 26 which asked the DC to reverse its December 2017 resolution. Fortunately for current CDS protection holders, the [DC did find](#) that a Credit Event occurred when Windstream filed a chapter 11 bankruptcy petition on February 25. But the Bankruptcy Credit Event will do nothing to help those whose credit protection expired worthless prior to the bankruptcy filing date.

This situation highlights the unique role the DC plays in the CDS market. The DC, which is made up of 10 dealer and five buy-side representatives (who may have their own positions that will be impacted by the determinations they make) are charged with making quick decisions based on limited information in order to aid the efficient functioning of the market. Litigations, on the other hand, can play out over years and involve fulsome discovery. Whenever a party enters into a CDS it is effectively putting its faith in the hands of the DC, which will ultimately decide whether or not a Credit Event has occurred, regardless of whether a court later decides the DC's determination was wrong.

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THREE KEY TAKEAWAYS

1. The DC and the Court have issued seemingly contradictory decisions regarding whether Windstream failed to make an accelerated debt payment in December 2017.
2. While current holders of Windstream credit protection should get paid on their CDS based on Windstream's recent bankruptcy filing, those parties whose CDS protection expired prior to the bankruptcy filing are unable to collect on their contracts.
3. The situation illustrates the unique role the DC plays and the faith that parties place in it every time they enter into a CDS.



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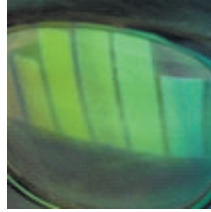
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