UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

TRILOGY PORTFOLIO COMPANY, LLC, *et al.*, Plaintiffs, v. CAESARS ENTERTAINMENT CORPORATION, *et al.*, Defendants.	:	Case No. 1:14-cv-07091 (JSR)
FREDERICK BARTON DANNER, Individually and On Behalf of All Others Similarly Situated, Plaintiff, v. CAESARS ENTERTAINMENT CORPORATION, *et al.*, Defendants.	:	Case No. 1:14-cv-07973 (JSR) [Rel. Case No. 1:14-cv-07091 (JSR)]

MEMORANDUM OF LAW IN SUPPORT OF
PLAINTIFFS' JOINT MOTION FOR PARTIAL SUMMARY JUDGMENT

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Plaintiffs Trilogy Portfolio Company, LLC and Relative Value-Long/Short Debt, A Series of Underlying Funds Trust (the "Trilogy Plaintiffs" or "Trilogy"), together with Plaintiff Frederick Barton Danner ("Danner," and with the Trilogy Plaintiffs, "Plaintiffs"), respectfully submit this memorandum of law in support of their joint motion pursuant to Fed. R. Civ. P. 56 for summary judgment against Defendant Caesars Entertainment Corporation ("CEC"). Based on the material undisputed facts, the Trilogy Plaintiffs are entitled to summary judgment on Counts One, Two, Three, Four, Eight, and Nine of their Amended Complaint, and Danner is entitled to summary judgment on Counts One, Two, Three, and Six of his Amended Complaint.

PRELIMINARY STATEMENT

There is little if any disagreement between the parties regarding the facts underlying Plaintiffs' claims. Rather, the dispute turns on a few key questions of law, all of which this Court can and should resolve on summary judgment.

The first question presented is whether CEC violated the Trust Indenture Act (the "TIA") and parallel provisions of the indenture governing Plaintiffs' bonds[1] (the "Indenture") when, without obtaining Plaintiffs' consent, CEC purported to amend the Indenture to remove CEC's "irrevocabl[e]" and "unconditional" guarantee of the Notes (the "Guarantee"). The answer to this question is clearly yes. Section 316(b) of the TIA and Section 508 of the Indenture each expressly prohibited CEC from, without Plaintiffs' consent, "impair[ing]" Plaintiffs' right to recover "principal and interest" on any "indenture security," or to "institute suit for the enforcement of any such payment." But that is precisely what CEC did in August 2014, when it paid off funds holding a majority of the Notes (the "Favored Noteholders") in exchange for their consent to the removal of CEC's Guarantee from the Indenture (the "August Transaction").

[1] Plaintiffs hold 6.5% senior unsecured notes due 2016 (the "Notes") issued by CEC's operating subsidiary, Caesars Entertainment Operating Company ("CEOC," and with CEC, "Caesars").

CEC purported to strip its Guarantee from the Indenture approximately five months prior to CEOC's bankruptcy, leaving Plaintiffs and CEOC's other minority holders without any meaningful ability to recover on their Notes.

Although CEC contends that the removal of the Guarantee from the Indenture did not violate the TIA because the Guarantee was not a "core term" of the Indenture, that argument fails for at least two reasons. First, the TIA and the Securities Act of 1933 make clear that the Guarantee is itself an "indenture security" under the TIA. Because Section 316(b) of the TIA expressly prohibits the "impairment" of a holder's right to principal and interest on any "indenture security," this fact moots CEC's "core term" argument in its entirety.[2] And second, even if the Guarantee were not an "indenture security," the Guarantee must necessarily be deemed a core term of the Indenture with respect to the Notes, since it directly affects Plaintiffs' right to sue for the recovery of principal and interest on their loan. For all of these reasons, the August Transaction violated both the TIA and Section 508 of the Indenture.[3] (*See infra* Sections I.A.–C.)

The second question before the Court is whether, as CEC contends, any violation of the TIA in August 2014 was irrelevant because the Guarantee had been released as a result of transactions CEC and its principal equity sponsors (Apollo Global Management LLC and TPG Capital, LP) orchestrated in May 2014 (the "May Transactions"). Those transactions included CEC's sale of 5% of CEOC's stock to [REDACTED], and CEC's transfer of

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[2] Likewise, the Guarantee is defined as a "Security" in the Indenture.

[3] The August Transaction violated the Section 316(b) of the TIA for the additional reason that it was an impermissible out-of-court restructuring that impaired Plaintiffs' practical ability to recover on their Notes. Plaintiffs incorporate by reference the summary judgment arguments made by BOKF, N.A. ("BOKF") and UMB Bank, N.A. ("UMB") concerning this claim. *See* BOKF/UMB Brief Section I.

another 6% of CEOC's shares to various Caesars executives and employees in connection with a hastily-adopted "performance incentive plan." CEC claims that these transactions triggered the Indenture's Guarantee release provision, which provides that CEC will be released from its Guarantee obligations if CEOC ceases to be a "'wholly owned subsidiary' of [CEC] (as such term is defined in Rule 1-02(z) of the Regulation S-X promulgated by the [Securities and Exchange Commission ("SEC")])." As CEC concedes, however, Regulation S-X ("Reg. S-X") defines a subsidiary as "wholly owned" so long as the parent owns "substantially all" of the subsidiary's voting shares. Even after the May Transactions, CEC continues to own at least 89% of CEOC's common stock—an amount that, based on the plain meaning of the word "substantially" ("to a great or significant extent"; "for the most part; essentially"), on its face constitutes "substantially all" of CEOC's voting shares.[4] Based on this fact, as well as CEC's strategic decision to transfer [REDACTED] and that were unable to interfere with CEC's de facto control of CEOC and its assets, CEC's affirmative defense fails as a matter of law under the plain language of the Indenture and Reg. S-X, as well as authoritative guidance issued by the Financial Standards Accounting Board (the "FASB") and SEC Staff. (*See infra* Section I.D.)

Plaintiffs' remaining claims are also based on undisputed facts. For example, CEC does not and cannot dispute that at the point when the Favored Noteholders' consents to the amendment of the Indenture became effective, the Favored Noteholders had been paid for their Notes and the Notes had been delivered to CEC for cancellation. As a result, CEC's reliance on those consents was in violation of Section 316(a) of the TIA and Section 902 of the Indenture.

[4] As detailed in the BOKF/UMB SUMF, a material portion of the stock transfers contemplated by the Performance Incentive Plan still had not occurred as of August 2014. *See* BOKF/UMB Brief Section I.

(*See infra* Section II.) CEC also does not dispute that it failed to offer the minority holders an opportunity to participate in the August Transaction—a transaction in which it sought "exit consents" intended to strip the rights of holders that did not participate in the exchange. This constitutes a plain breach of CEC's duty of good faith and fair dealing. (*See infra* Section III.)

Based on all of the foregoing, Plaintiffs are entitled to summary judgment.

STATEMENT OF FACTS

A. Caesars

CEC, through its various subsidiaries, is one of the largest gaming companies in the world. Statement of Undisputed Facts ("SUMF"), ¶ 6. CEC's principal operating subsidiary is CEOC. *Id.*, ¶ 7. In 2008, CEC was acquired in a $30 billion leveraged buyout transaction (the "2008 LBO") sponsored by Apollo Global Management LLC ("Apollo") and TPG Capital, LP ("TPG"). *Id.*, ¶ 163. In connection with that transaction, CEOC borrowed approximately $24 billion dollars that was used by Apollo and TPG to acquire CEC's publicly traded shares. *Id.*, ¶ 164. As of December 31, 2013 (prior to the transactions at issue in this case), CEOC owed a total of approximately $ 13.5 billion in bond debt, governed by at least eight separate indenture agreements. *Id.*, ¶ 169.

B. The Indenture

Plaintiffs are holders of the Notes. *Id.*, ¶¶ 1-3. The Notes were sold pursuant to a registered public offering in 2006 (prior to the 2008 LBO) and are governed by the Indenture, which is qualified under the TIA. *Id.*, ¶¶ 8-9; 14.

In Section 1501 of the Indenture, CEC agreed to "irrevocably and unconditionally" guarantee the payment of all principal and interest due on the Notes, and that its guarantee obligations would be "unconditional, irrespective of . . . any waiver or consent by any Holder." *Id.*, ¶ 32. In Section 508 of the Indenture, CEC further agreed that, "[n]otwithstanding any other

provision of th[e] Indenture," each holder's right "to receive payment of the principal of and any premium and . . . interest on" any "Security" and "to institute suit for the enforcement of any such payment" is "absolute and unconditional" and "shall not be impaired without the consent of such Holder." *Id.*, ¶ 24. Like the TIA, the Indenture expressly includes CEC's Guarantee in its definition of "Securities." *Id.*, ¶¶ 15-16. Similarly, Section 902 of the Indenture states that while supplemental indentures may be entered into with the consent of a majority of holders, "no such supplemental indenture shall, without the consent of the Holder of each Outstanding Security affected thereby," alter the "principal" or "interest" on any "Security" or "impair the right to institute suit for the enforcement of any such payment . . . ." *Id.*, ¶ 29.

Section 1503 of the Indenture states that the Guarantee may be released under certain limited circumstances, including if CEOC is no longer a "wholly owned subsidiary" of CEC as "defined in Rule 1-02(z) of the Regulation S-X promulgated by the SEC." *Id.*, ¶ 33.[5] This is in contrast with CEOC's indentures following the 2008 LBO, which do not incorporate Reg. S-X's definition of wholly owned subsidiary into their guarantee release provisions. *Id.*, ¶ 41.

C. The May Transactions

In May 2014, facing a mountain of debt and continuing cash flow losses at CEOC, CEC sought to protect its equity holders (*i.e.*, Apollo and TPG) by unilaterally releasing CEC's guarantee of CEOC's bonds through the sale of 5% of CEOC's stock (the "5% Stock Sale"). *Id.*, ¶¶ 86-87; 96-97. The purchasers in this transaction were three investment funds,

Id., ¶¶ 90; 106; 108; 110-111;

[5] The definition of "wholly owned subsidiary" is currently located at Rule 1-02(aa) of Regulation S-X. *See* 17 C.F.R. § 210.1-02(aa).

117-121. There is no dispute that [REDACTED]

[REDACTED] *Id.*, ¶ 91. CEC also admits that, prior to the sale, it was advised by its financial advisor Blackstone Advisory Partners L.P. ("Blackstone") that [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] *Id.*, ¶¶ 100-101. Immediately following the 5% Stock Sale, CEC issued a press release stating generally that, because CEOC was no longer a "wholly owned subsidiary" of CEC, CEC's guarantee obligations had been terminated under CEOC's bond indentures. *Id.*, ¶¶ 44; 116. CEC's press release did not address Reg. S-X's definition of "wholly owned subsidiary," which appears only in the pre-2008 LBO indentures. *Id.*

Approximately three weeks after the 5% Stock Sale, CEC allocated for distribution another 6% of CEOC's common stock to various Caesars employees [REDACTED]

[REDACTED] as part of a hastily-adopted "performance incentive plan" (the "PIP"). *Id.*, ¶¶ 124-131, 135. Because the shares were [REDACTED]

[REDACTED]

[REDACTED] *Id.*, ¶¶ 142; 154. Following the PIP, CEC publicly repeated its statement that its guarantee obligations for CEOC's bonds had been terminated as a result of the 5% Stock Sale. *Id.*, ¶¶ 116; 138. Once again, this statement did not address the definition of "wholly owned subsidiary" in Reg. S-X. *Id.*

D. The August Transaction

On May 15, 2014, CEC received a letter sent by Sullivan & Cromwell LLP ("S&C") on behalf of the Favored Noteholders, who together held a greater than 51% majority of both the Notes and CEOC's 2017 unsecured notes. *Id.*, ¶¶ 47-48. In the letter, Sullivan & Cromwell asserted that, contrary to CEC's press release, the guarantee for the Notes and the 2017 notes

remained in place notwithstanding the effect the 5% Stock Sale may have had on CEOC's other indentures. *Id.*, ¶¶ 48-50.

After receiving the letter, CEC and the Favored Noteholders (through S&C) negotiated the August Transaction, pursuant to which CEOC and CEC together agreed to pay the Favored Noteholders approximately $160 million for certain of their Notes and the 2017 notes. *Id.*, ¶¶ 51; 59; 62. This purchase price covered principal and interest due on the repurchased Notes [redacted] [redacted]. *Id.*, ¶¶ 62; 69; 70. In exchange, the Favored Noteholders consented to amendments that would remove CEC's guarantee from the Indenture and the indenture for the 2017 notes. *Id.*, ¶ 60.

The parties memorialized their deal in a Note Purchase and Support Agreement dated August 12, 2014 (the "NPSA"), and the transaction closed on August 22, 2014. *Id.*, ¶¶ 51; 75. Under Section 5.1 of the NPSA, the Favored Noteholders' consents to the amendments did not "become effective until the consummation of the Closing" of the transaction. *Id.*, ¶ 61.[6] The Favored Noteholders also agreed "not [to] transfer[] any interest in the Notes (including any right to exercise voting power. . ." until the consents were effective or the agreement was validly terminated. Ex. D (NPSA), § 5.1. On the day the transaction closed, CEC, CEOC, and the indenture trustee executed supplemental indentures that purported to remove from the indentures all provisions relating to the CEC's guarantee. SUMF, ¶¶ 37; 60. Plaintiffs did not consent to the Indenture amendments. *Id.*, ¶¶ 66; 68. Nor were they ever offered the opportunity to participate in the August Transaction. *Id.*, ¶¶ 67; 84.

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[6] The NPSA defines "Closing" in Section 2.1 as "[t]he closing of the purchase and sale of the Notes and the Proposed Consent contemplated by this Agreement . . . ." Declaration of Clay J. Pierce in Support of Plaintiffs' Joint Motion for Partial Summary Judgment ("Pierce Decl."), Ex. D (NPSA), § 2.1. Exhibits to the Pierce Decl. are hereinafter referred to as "Ex. __."

E. CEOC's Bankruptcy

CEOC filed for bankruptcy on January 15, 2015, which constituted an "Event of Default" under the Indenture and immediately triggered CEC's Guarantee obligation. *Id.*, ¶¶ 229-232. Upon the filing, any efforts to recover from CEOC directly were halted by the automatic stay under the Bankruptcy Code. 11 U.S.C. § 362(a). CEC has refused Plaintiffs' demand for payment on the Guarantee. SUMF, ¶ 43.

ARGUMENT

I. CEC BREACHED THE TRUST INDENTURE ACT AND THE INDENTURE WHEN IT PURPORTED TO REMOVE ITS GUARANTEE FROM THE INDENTURE WITHOUT PLAINTIFFS' CONSENT

A. Both the TIA and the Indenture Prohibit the Impairment of a Holder's Right to Recover Principal and Interest Without Such Holder's Consent

The TIA was "designed to vindicate a federal policy of protecting investors." *BOKF, N.A. v. Caesars Entm't Corp.*, Nos. 15-cv-1561 (SAS), 15-cv-4634 (SAS), 2015 WL 5076785, at *3 (S.D.N.Y. Aug. 27, 2015) (quoting *Bluebird Partners, L.P. v. First Fid. Bank, N.A.*, 85 F.3d 970, 974 (2d Cir. 1996)) (internal quotation marks omitted). Congress enacted the TIA in response to a 1936 report from the SEC documenting abuses of minority bond holders by issuers and majority holders. *See id.* at *9 (citing SEC Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Prospective and Reorganization Committees, Part VI: Trustees Under Indentures 63-64, 150 (1936) (the "1936 SEC Report")); *see also* 15 U.S.C. § 77bbb(a) (citing SEC reports as a basis for the Act). The 1936 SEC Report found that majority control provisions in indentures, allowing majority amendment of indentures' security and payment obligations, "give rise to abuses and problems which must be faced if the interests of security holders are not to be made subordinate to the desires and conveniences of the dominant group." 1936 SEC Report at 150. Of particular concern was the possibility that, "[b]y buying up

or otherwise controlling a majority of a distressed company's bonds[,] . . . equity owners could vote to suspend or reduce payments on the bonds, thus allowing value to move down the corporate chain to the equity holders." Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1328 (2002). Such an outcome would be "an inversion of the normal priorities in a corporate bankruptcy by which a company's debt holders are paid off before the equity holders." *Id.*

Section 316(b) of the TIA provides in relevant part:

> (b) Prohibition of impairment of holder's right to payment
>
> Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder . . . .

15 U.S.C. § 77ppp(b). Although the amendment as part of the August Transaction impaired the holders' "legal right" to receive payment and institute suit for such payment, a number of courts in this District have found that Section 316(b) also protects a bondholder's "practical ability" to recover payment. *BOKF, N.A.*, 2015 WL 5076785, at *4 (citing *Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 111 F. Supp. 3d 542, 547-54 (S.D.N.Y. 2015)); *see also Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 75 F. Supp. 3d 592, 611-15 (S.D.N.Y. 2014); *Federated Strategic Income Fund v. Mechala Grp. Jamaica Ltd.*, No. 99 CIV 10517-HB, 1999 WL 993648, at *7 (S.D.N.Y. Nov. 2, 1999). "[T]o prove an impairment under section 316(b), plaintiffs must prove either an amendment to a core term of the debt instrument, or an out-of-court debt reorganization. The alleged impairment . . . must be evaluated as of the date that payment becomes due, because it is only then that the bondholders' right to payment has been affected by

certain actions and/or transactions undertaken by issuers or guarantors." *BOKF, N.A.*, 2015 WL 5075785, at *5.

Section 508 of the Indenture parallels TIA Section 316(b), providing as follows:

> Notwithstanding any other provision in this Indenture, the Holder of any Security shall have the right, which is absolute and unconditional, to receive payment of the principal and any premium and . . . interest on such Security on the respective Stated Maturities expressed in such Security . . . and to institute suit for the enforcement of any such payment, and such rights shall not be impaired without the consent of such Holder.

SUMF, ¶ 24 (quoting Indenture, § 508). As noted above, the Indenture expressly includes CEC's Guarantee in the definition of "Securities." *Id.*, ¶¶ 15-16.

B. CEC Violated the TIA and the Indenture by Purporting to Amend the Indenture to Remove the Guarantee, an Indenture Security, Without Plaintiffs' Consent

Because the August Transaction resulted in the removal of CEC's Guarantee obligations from the Indenture without the consent of Plaintiffs, it constitutes a "straightforward" violation of Section 316(b). *See BOKF, N.A.*, 2015 WL 5076785 at *9 ("[R]enegotiating a debt obligation with a majority of noteholders to the detriment of a nonconsenting minority *under the same indenture* would be an impairment" and a "straightforward violation[] of section 316(b) . . . ." (emphasis in original)).

According to CEC, the August Transaction did not violate the TIA or the Indenture because the Guarantee is not a "core term" of the Indenture. As set forth below, that argument is contrary to the governing case law and ignores the obvious impact CEC's Guarantee has on Plaintiffs' ability to recover principal and interest. More importantly, however, CEC's argument ignores the fact that the Guarantee is an "indenture security" under the TIA. The TIA defines an "indenture security" as "any security issued or issuable under the indenture to be qualified." *See* 15 U.S.C. § 77ccc(11). Although the TIA does not specifically define the term "security," TIA

Section 303 instructs that "[a]ny term defined in section 2 of the Securities Act of 1933 [15 U.S.C. § 77b, the "Securities Act"] and not otherwise defined in this section shall have the meaning assigned to such term in section 2 [of the Securities Act]." *See* 15 U.S.C. § 77ccc(1). Section 2 of the Securities Act defines the term "security" to "mean[] any *note*, . . . bond, debenture, evidence of indebtedness . . . or . . . *guarantee* of . . . any of the foregoing." 15 U.S.C. § 77b(a)(1) (emphasis added); *see also Ret. Bd. of the Policemen's Annuity and Ben. Fund of the City of Chicago v. Bank of New York Mellon*, 775 F.3d 154, 168 (2d Cir. 2014) (indicating that the TIA adopts the definition of "security" provided in the Securities Act). Notably, while the TIA exempts particular categories of securities from its protection, it explicitly *includes* guarantees of notes.[7] The TIA also specifically includes a guarantor in the definition of "obligor."[8] Thus, as CEC's own accounting staff has acknowledged, the Guarantee is an "indenture security" under the plain language of the TIA and the Securities Act.[9] *See* SUMF,

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[7] "The provisions of the [Trust Indentures] subchapter shall not apply to any of the following securities: (1) any security *other than* (A) a note, bond, debenture, or evidence of indebtedness, whether or not secured. . . or (C) a temporary certificate for, *or guarantee of, any such note*, bond, debenture, evidence of indebtedness, or certificate . . . ." 15 U.S.C. § 77ddd(a)(1) (emphasis added).

[8] *See* 15 U.S.C. § 77ccc(12) ("The term 'obligor,' when used with respect to any indenture security, means every person (including a guarantor) who is liable thereon . . . ."). Section 303 of the TIA was amended in 1987 expressly to confirm that guarantors are covered by the Act. *See* S. Rep. No. 100-105 at 33 (1987).

[9] In its prior briefing on summary judgment, CEC cited three cases for the proposition that guarantees are not securities. CEC's Opp'n to Pls.' Mots. for Summ. J., Nov. 13, 2015 [*Trilogy* ECF No. 75] at 28. None of these cases are on point. To the contrary, they hold simply that a guarantee is not a "security" if the underlying obligation is not a "security." *See Coan v. Bell Atl. Sys. Leasing Int'l, Inc.*, 813 F. Supp. 929, 935-40 (D. Conn 1990) (finding that a sale/leaseback arrangement with a single investor was not a security; thus, the guarantee of the arrangement was not a security); *Haberman v. Wash. Public Power Supply Sys.*, 744 P.2d 1032, 1048 (Wash. 1987), *amended*, 750 P.2d 254 (Wash. 1988) (underlying public bonds were exempted from the Securities Act's definition of security); *Woods v. Homes and Structures of Pittsburgh, Kansas, Inc.*, 489 F. Supp. 1270, 1294 (D. Kan. 1980) (concluding that guarantees of

¶ 17; CEC–NOTEHOLDER_00002704; *see also Banco de La Republica de Colombia v. Bank of New York Mellon*, No. 10 Civ. 536(AKH), 2013 WL 3871419, at *6 (S.D.N.Y. July 26, 2013) (stating that a guarantee can be a security, "particularly if 'incorporated in securities distributed to investors,'" (quoting H.R. Rep. No. 73-1838, at 39 (1934)).[10]

Because the Guarantee is an "indenture security" under the TIA (and because CEC is an "obligor"), when CEC purported to remove the Guarantee from the Indenture via the August Transaction, it by definition impaired Plaintiffs' "legal right" to recover principal and interest on an "indenture security" (the Guarantee) in violation of Section 316(b). For this reason, Plaintiffs would be entitled to judgment even if the Court were to adopt the interpretation of the TIA advocated by CEC—*i.e.*, that the TIA only protects a holder's "legal right" to recovery, not its "practical ability" to recover.

The removal of the Guarantee also impaired Plaintiffs' "practical ability" to recover on the Notes when due. CEOC declared bankruptcy five months after the August Transaction (an Event of Default under the Indenture), as a result of which it was unable to pay principal and interest on the Notes when due on January 15, 2015. SUMF, ¶¶ 229-232. Because CEC's Guarantee obligations were purportedly stripped from the Indenture by the August Transaction, Plaintiffs had no "practical ability" to recover against either CEOC (the issuer) or CEC (the guarantor) when payment on the Notes became due. *See BOKF, N.A.*, 2015 WL 5076785, at *17

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municipal bonds were "not separately subject to the registration and antifraud provisions of the 1933 Act," but only after explicitly acknowledging that guarantees *can* be securities).

[10] "Guarantees of securities are securities themselves for purposes of the Securities Act of 1933." Financial Statements and Periodic Reports for Related Issuers and Guarantors, SEC Release No. 33-7878 (effective Sept. 30, 2000), https://sec.gov/rules/final/33-7878.htm#P124_6773.

("The alleged impairment . . . must be evaluated as of the date that payment becomes due . . . ."); *see also Federated*, 1999 WL 993648, at *7.

Finally, the August Transaction violated the terms of the Indenture. Section 508 expressly prohibited CEC from "impairing" Plaintiffs' right to principal and interest on any "Security," a term defined to include the Guarantee,[11] or to institute suit for the enforcement of such payment. SUMF, ¶¶ 15-16; 24. Similarly, Section 902 of the Indenture barred CEC from amending the Indenture to remove Plaintiffs' rights to principal and interest on any "Security" without Plaintiffs' consent. *Id.*, ¶ 29. CEC breached both of these provisions when it removed the Guarantee without Plaintiffs' consent pursuant to the August Transaction. Based on the foregoing, Plaintiffs are entitled to judgment as a matter of law.

C. The Guarantee is a Core Term of the Indenture

If the Court agrees that the Guarantee is an "indenture security," the Court need never reach CEC's argument that the Guarantee is not a "core term" of the Indenture. That said, CEC's suggestion that its irrevocable and unconditional guarantee of Plaintiffs' right to recover principal and interest is *not* a core term of the Indenture is directly at odds with the applicable law and facts.

A core term is "one affecting a securityholder's right to receive payment of the principal of or interest on the indenture security on the due dates for such payments . . . ." *Upic & Co. v. Kinder-Care Learning Ctrs., Inc.*, 793 F. Supp. 448, 452 (S.D.N.Y. 1992). In *Marblegate*, Judge

[11] The Indenture defines the term "Securities" in two places—the recitals and Section 101. The recitals state that CEOC and CEC "have duly authorized the execution and delivery of this Indenture to provide for the issuance from time to time of unsecured debentures, notes or other evidences of indebtedness (together with the related guarantees provided by the Guarantor, the "Securities"), to be issued in one or more series as provided for in this Indenture." Ex. A (Indenture), Recitals. Section 101 of the Indenture states that "'Securities' has the meaning stated in the first recital of this Indenture and more particularly means any Securities authenticated and delivered under this Indenture." *Id.*, § 101.

Failla advocated a "contextual" determination of what constitutes a "core term." *Marblegate Asset Mgmt*, 75 F. Supp. 3d at 612 n.14. The court found that if the right to payment, to interest, and to sue are substantive rights, then the parties must look to the "overall structure" to determine whether a change to a term of the indenture "affects that right in the context of [the] particular structure and thus whether or not it is a 'core term.'" *Id.* at 612 & n.14 (referring to a "contextual understanding of the core/non-core distinction"). In *Federated*, the court held that removal of a guarantee and the simultaneous disposition of all meaningful assets would eliminate the noteholders' ability to recover and remove their "safety net" of a guarantee. The court stated that the guarantee "was obviously an investment consideration from the outset."[12] *Federated*, 1999 WL 993648, at *7.

Here, CEC's Guarantee was an inducement to Noteholders to loan CEOC money because it provides a second source of recovery of principal and interest due to Plaintiffs. Because it constituted a safety net for the "right to receive payment of the principal of or interest on the [note] on the due dates for such payment," *UPIC*, 793 F. Supp. at 452, the only logical conclusion is that the Guarantee is a core term. Indeed, the Guarantee's obvious impact on Plaintiffs' substantive right to payment is what drove the court's opinion denying CEC's prior motion to dismiss these cases (in which the court found that the allegation that "the August 2014 Transaction stripped plaintiffs of the valuable CEC Guarantees leaving them with an empty right to assert a payment default from an insolvent issuer" stated a claim for violation of the TIA[13]) as well as the court's finding in the BOKF litigation that CEC's guarantee "unambiguously"

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[12] Particularly here, where the word "Guarantee" appeared on the cover of the Prospectus. SUMF, ¶ 8.

[13] *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.*, 80 F. Supp. 3d 507, 516 (S.D.N.Y. 2015).

provided credit support for the CEOC's Noteholders.[14] CEC's argument that the Guarantee is not a core term of the Indenture cannot be reconciled with these decisions.

Where, as here, an issuer suffers serious financial difficulties and faces present or imminent bankruptcy, the elimination of the obligation of the only other source of payment constitutes an amendment of a term "affecting a securityholder's right to receive payment." *Upic*, 793 F. Supp. at 452. For this reason, CEC's argument that the Guarantee is not a core term of the Indenture fails as a matter of law.[15]

D. The May Transactions did not Release CEC's Guarantee

CEC contends that any violation of the TIA or the Indenture in August 2014 is irrelevant because CEC released the Guarantee in May 2014 through the 5% Stock Sale and the PIP. According to CEC, its transfer of CEOC's shares to [redacted] [redacted] caused CEOC to cease to be a "wholly owned subsidiary" under SEC Reg. S-X, as a result of which CEC's Guarantee was released under Section 1503 of the Indenture.

CEC bears the burden of proving this affirmative defense. *See Barton Grp., Inc. v. NCR Corp.*, 796 F. Supp. 2d 473, 498 (S.D.N.Y. 2011) ("[A] defendant asserting an affirmative defense bears the burden of proof with respect to that defense."). As set forth below, CEC's defense fails as a matter of law because: (i) under the express language of Reg. S-X, a subsidiary is "wholly owned" when the parent owns "substantially all" of the subsidiary's voting shares,[16] a definition that easily encompasses CEC's ownership of 89% of CEOC stock, pursuant to which CEC has at all relevant times exerted unchecked control over CEOC and its assets; and (ii) under

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[14] *BOKF, N.A.*, 2015 WL 5076785 at *8.

[15] It is undisputed that Plaintiffs have not consented to any termination of the Guarantee.

[16] Rule 1-02(z) of Regulation S-X defines "voting shares" to mean "the sum of all rights, other than as affected by events of default, to vote for election of directors and/or the sum of all interests in an unincorporated person." 17 C.F.R. § 210.1-02(z).

guidance issued by the FASB and the SEC Staff, the [redacted] involved in the 5% Stock Sale and the employees who participated the PIP should together be deemed a "collaborative" investor group with CEC, pursuant to which the minority holders' shares may be aggregated with those of CEC for the purposes of the "wholly owned subsidiary" analysis.

1. CEC Continues to Hold "Substantially All" of CEOC's Voting Shares

Section 1503(3) of the Indenture provides that the "Guarantor [*i.e.*, CEC] shall be released from all of its obligations under the Guarantee with respect to Securities . . . if . . . the Corporation ceases for any reason to be a 'wholly owned subsidiary' of the Guarantor (as such term is defined in Rule 1-02(z) of the Regulation S-X promulgated by the SEC)." SUMF, ¶ 33. Under Reg. S-X, a subsidiary is "wholly owned" if "substantially all of [its] outstanding voting shares are owned by its parent and/or the parent's other wholly owned subsidiaries." 17 C.F.R. § 210.1-02(aa). Thus, so long as CEC owns "substantially all" of CEOC's voting shares, the Guarantee will not be released under the terms of the Indenture.

As Judge Scheindlin previously ruled, "[t]he question under Regulation S-X and the Indenture is whether, for purposes of determining whether CEOC is a *wholly owned* subsidiary, CEC owns *substantially all* of the voting shares of CEOC." *Meehancombs Global Credit Opportunities Master Fund, LP v. Caesars Entm't Corp.*, Nos. 14-cv-7091 (SAS), 14-cv-7973 (SAS), 2015 WL 9478240, at *9 n.83 (S.D.N.Y. Dec. 29, 2015). CEC's undisputed 89% ownership interest easily falls with the plain meaning of "substantially all." Statutory construction begins "by focusing on the words that the drafters have chosen." *Holloway v. United States*, 526 U.S. 1, 6 (1999); *United States v. Ali*, 561 F. Supp. 2d 269, 274 (E.D.N.Y. 2008) ("It is elementary that interpretation begins with an examination of the language of the statute or regulation itself; where it is unambiguous, the interpretive process also ends there. The process of ascertaining the 'plain meaning' of a statute or regulation includes an analysis of the

particular language at issue, as well as the language and design of the statute or regulation as a whole." (internal citations omitted)). Here, the word "substantially" means "to a great or significant extent" or "for the most part; essentially." Oxford English Dictionary (3d ed. online version Apr. 2016). Owning nearly 9 out of every 10 CEOC shares, CEC cannot reasonably dispute that, "for the most part," it owns all of CEOC's equity interests. SUMF, ¶ 160.

This conclusion is reinforced when one considers Reg. S-X's definition of "wholly owned subsidiary" in context of the overall statutory and regulatory scheme. *See* 17 C.F.R. § 210.1-02(aa); *Saks v. Franklin Covey Co.*, 316 F.3d 337, 345 (2d Cir. 2003) ("The text's plain meaning can best be understood by looking to the statutory scheme as a whole and placing the particular provision within the context of that statute. . . . [T]he preferred meaning of a statutory provision is one that is consonant with the rest of the statute.") (quotation marks and citations omitted). First and foremost, Reg. S-X uses a specific defined term—"100% owned"—to describe situations where the parent owns, directly or indirectly, "*all* of [the subsidiary's] outstanding voting shares." 17 C.F.R. § 210.3-10 (emphasis added). This provision confirms that the "substantially all" standard encompasses amounts of ownership less than 100%. Second, guidance issued by the FASB and SEC Staff[17] relating to push-down accounting issue shows that a parent can own "substantially all" of a subsidiary's voting shares even when it owns as little as 80% of the subsidiary's common stock. At the time the Indenture was signed, the SEC Staff required companies to use push down accounting for the assets of acquired subsidiaries in their financial statements if the subsidiary constituted a "'wholly owned subsidiary' as defined in Rule 1-02(aa) of Regulation S-X)"—*i.e.*, the same provision of Reg. S-X referenced in Section 1503

[17] *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 163 (2d Cir. 2000) ("[B]ecause SEC staff accounting bulletins 'constitute a body of experience and informed judgment,' and SAB No. 99 is thoroughly reasoned and consistent with existing law . . . we find it persuasive guidance . . .").

of the Indenture.[18] SEC Staff Accounting Bulletin ("SAB") No. 112, Topic 5.J, 74 Fed. Reg. 27427 (Jun. 4, 2009). The SEC Staff originally addressed this topic in SAB No. 54 (published November 3, 1983), in which the Staff advised that, for the purposes of push-down accounting, Reg. S-X distinguishes between a "substantially wholly owned subsidiary," where "the form of ownership is within the control of the parent," and a subsidiary with "a significant noncontrolling interest" which "might impact the parent's ability to control the form of ownership." SEC Staff Accounting Bulletin No. 54, 48 Fed. Reg. 51769 (Nov. 3, 1983). In a related publication, FASB Emerging Issues Task Force Topic No. D-97: Push Down Accounting, Apr. 18-19, 2001 ("EITF D-97"), http://www.fasb.org/pdf/appd-97.pdf, the FASB assigned specific parameters to the percentage ownership associated with a subsidiary becoming "substantially wholly owned," stating that push-down accounting would generally be required if 95% or more of the subsidiary has been acquired, permitted if 80% to 95% has been acquired, and prohibited if less than 80% of the company is acquired. EITF D-97, at 1. Consistent with SAB No. 54, EITF D-97 states that the controlling factor is whether, in light of the "facts and circumstances" of each individual case, the parent's ownership interest was sufficient to "control the form of ownership" of the subsidiary. *Id.* at 2.[19]

[18] While Rule 1-02(aa) of Regulation S-X refers to the term "wholly owned subsidiary," SAB No. 112 (although specifically referencing that definition) uses the term "substantially wholly owned subsidiary." Although CEC may suggest otherwise, there is no reason to believe that the SEC Staff's use of the term "substantially wholly owned subsidiary" was intended to refer to a definition different from "wholly owned subsidiary."

[19] CEC seeks to make much of the fact that Topic 5.J. was rescinded by SAB No. 115, effective November 18, 2014. Their reliance on that provision is misguided: SAB No. 54/Topic 5.J. was in effect when the Indenture was drafted, when the bonds thereunder were issued, when Plaintiffs purchased their bonds, when the May and August Transactions were consummated, and when these actions were filed. A subsequent change in Staff guidance does not affect the interpretation of "wholly owned subsidiary" for purposes of the Indenture. Perhaps more to the point, SAB No. 115 relaxed the ownership threshold used in in Topic 5.J, permitting push-down accounting

Here, CEC's ownership of at least 89% percent of CEOC's equity is well above the 80% threshold under which the SEC prohibits a parent from using push down accounting. In addition, the undisputed facts show that, notwithstanding its sale and transfers of shares to third parties in May 2014, CEC had, and continued to exercise, complete control over CEOC and its assets up until the time of CEOC's actual January 15, 2015 bankruptcy, [REDACTED]

[REDACTED]

Immediately prior to the May Transactions, CEC amended CEOC's Certificate of Incorporation to give CEC (as the majority holder) the right to unilaterally execute through written consent "any action to be taken at any annual or special meeting of the stockholders . . . *without a meeting, without prior notice and with a vote*." SUMF, ¶ 200 (emphasis added). CEC is only required to provide notice that it has taken action pursuant to this provision within 60 days *after* the election (by written consent) has taken place. Del. Code Ann., tit. 8, § 228(e). The amended Certificate of Incorporation provides that this right applies only "[f]or so long as [CEC] and/or any of its affiliates owns or controls a majority in voting power of the outstanding capital stock of [CEOC] entitled to vote." SUMF, ¶ 200. In other words, if and when CEC ceases to be the majority shareholder, the majority holder's ability to act by written consent will immediately terminate. CEC also retains the sole power to ratify any action by CEOC, with the same effect "as though ratified by every stockholder of the Corporation." *Id.*, ¶ 208; 219. Taken together, the above provisions give CEC the unilateral power to put in the directorship role any person of its choosing whenever there is a vacancy on the board, without prior notice to the 11% minority stockholders, without a meeting, and without a vote. *See* SUMF, ¶¶ 184; 200; 208;

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to be used so long as the parent company obtains "control" of the acquired entity. There is no dispute that CEC "controls" CEOC. Thus, were this definition to apply, CEC would necessarily lose on this issue.

215; 219. As a result, following the May Transactions, CEC still retained substantially all of the shareholder voting power, with the ability to block CEOC's minority shareholders from participating in any board elections.

Consistent with the foregoing, none of the minority holders of CEOC's shares requested or received any rights that would allow them to check CEC's control of CEOC. *Id.*, ¶¶ 215-216; 219-226. The PIP participants were simply given their shares, without negotiation or any rights intended to protect minority stockholders. *Id.*, ¶ 131; 224-226. Similarly, none of the 5% Stock Sale purchasers, all of whom were sophisticated investors, required CEC to sign a shareholder agreement in connection with the sale.[20] *Id.*, ¶ 90. As a result, the purchasers did not obtain any of the protections commonly put in place for minority holders—e.g., the right to elect directors, and veto and/or approval rights over extraordinary actions, such as asset sales, mergers, acquisitions, charter amendments, securities offerings, stock repurchases, or incurrence of debt. *Id.*, ¶¶ 215-216; 220-223. CEOC's minority holders did not even have the right to call a special meeting of the shareholders of CEOC. *Id.*, ¶ 223. In fact, the only meaningful protection obtained by the 5% purchasers was CEC's agreement to indemnify them, without limit, for all out-of-pocket expenses arising out of any third-party claim suffered by such purchaser relating the purchased shares or transactions contemplated by the stock purchase agreement. *Id.*, ¶ 115.

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[20] Typically, such agreements provide protections to minority holders by addressing the election of directors, the right of significant minority holders to designate a member of the board (or, in the alternative, board observer rights), information rights, preemptive rights on new issuances by the company, rights of first offer or rights of refusal on transfers by other holders, tag-along or co-sale rights on sales by the majority, and/or protective provisions or blocking rights that prohibit certain extraordinary actions without supermajority approval or the approval of some percentage of the investor group. *See generally* The Corporation Law Committee of the Association of the Bar of the City of New York, *The Enforceability and Effectiveness of Typical Shareholders Agreement Provisions*, 65 Bus. Law. 1153 (Aug. 2010). Such agreements also typically restrict or prohibit transfers by minority holders or require such holders to comply with specified procedures prior to any third party sale. *Id.* at 1172.

The scope of indemnification (covering any third-party claim relating to either "the purchased shares" or "the transactions") is unusually broad, underscoring the fact that the transaction primarily benefitted CEC as seller. *Id.*

Although CEC expanded CEOC's board of directors following the May Transactions, [redacted] SUMF, ¶¶ 195; 210; 220; 224. All but two of the new board members were Apollo, TPG, or CEC employees, including specifically: David Bonderman, founding partner of TPG; Kelvin Davis, senior partner at TPG; Marc Rowan, co-founder and senior managing director of Apollo; David Sambur, partner at Apollo; Eric Press, senior partner at Apollo; Jeffrey Benjamin, consultant to Apollo and senior advisor to Apollo from 2002 to 2008. *Id.*, ¶¶ 172-181. The other two directors (whom CEC designated as the "independent directors" and members of a newly formed Governance Committee) were also both chosen by Apollo, based on their participation in prior Apollo transactions. *Id.*, ¶ 217.

CEC relied on all of the above measures when, on August 12, 2014, CEOC's "independent" board members approved the payment of $77 million to the Favored Noteholders at par plus accrued interest, even though the bonds were trading at a significant discount at that time, and despite the fact that the stated purpose of the transaction was to release CEC's guarantee of CEOC's debt. *Id.*, ¶¶ 57-58; 62; 83. [redacted] *Id.*, ¶¶ 222; 225. Moreover, despite the fact that CEOC's officers had no involvement in negotiating the August Transaction, CEOC's independent board members (again, all hand-picked by CEC and Apollo) approved the deal on less than a day's notice. *Id.*, ¶ 57. This was not an isolated incident. Just

seven days earlier, the CEOC board authorized CEOC to sue certain of its Second Lien bondholders based on derivative liability claims asserted by those noteholders on behalf of CEOC. *Id.*, ¶ 222. Again, [redacted] *Id.*, ¶¶ 222; 225. Last but not least, [redacted] *Id.*

Based on all of these facts, CEC has no basis to argue that CEC's minority stockholders constitute "a significant noncontrolling interest" that "might impact the [CEC's] ability to control the form of ownership." *Cf.* SAB No. 54, 48 Fed. Reg. 51769 (Nov. 3, 1983). As such, the Court should find that CEC owns "substantially all" of CEOC's voting shares and, as a result, CEOC continues to be a "wholly owned subsidiary" of CEC as defined in Reg. S-X.

2. CEOC's Minority Stockholders Should be Deemed a "Collaborative Group" with CEC

Even if the Court were to find that CEC's 89% shareholder interest does not, standing on its own, constitute "substantially all" of CEOC's voting shares, CEOC still should be deemed a "wholly owned subsidiary" of CEC based on the undisputed alignment of interests between CEC and CEOC's minority holders.[21]

In addressing the push down accounting issue, the SEC Staff has stated that the holdings of investors who effectively act as a "collaborative group" should be aggregated in determining

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[21] *See* EITF D-97, at 2. The standards of the Financial Accounting Standards Board ("FASB") are deemed "authoritative" by the SEC. EITF D-97 is, thus, competent evidence of the SEC's approach to interpreting the term "wholly owned subsidiary" under Regulation S-X. *See* Securities and Exchange Commission Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Apr. 25, 2003, Release No. 33-8221, *available at* https://www.sec.gov/rules/policy/33-8221.htm.

whether an acquired company is a wholly owned subsidiary. EITF D-97, at 2. The SEC Staff has identified a number of factors that would indicate an investor is ***not*** part of a collaborative group, including "independence," "risk of ownership," "promotion," and "lack of collaboration." EITF D-97, at 3-4. Although these factors are addressed to the acquisition of a subsidiary (not the transfer of shares by the parent to minority stockholders), they underscore the fact that where (as here) the relationship between different stockholders gives them a unified interest in controlling the subsidiary, the shares of those holders should be aggregated for the purposes of determining whether the subsidiary is "wholly owned" under Reg. S-X.

For example, the SEC Staff regards an investor as "independent" when "the investor is independent of and unaffiliated with all other investors," and where "the investor does not have other relationships with any other investor that are material to either investor." *See* EITF D-97, at 3. Here, neither the 5% Stock Sale purchasers nor the PIP participants could possibly be deemed independent under this standard, since [REDACTED] SUMF, ¶¶ 106; 108; 111; 131; 135.

The SEC Staff regards an investor as bearing the "risk of ownership" of purchased shares where "the investor is investing at fair value," "the investor fully shares with all of other investors in the risks and reward of ownership," and the "[t]he funds invested by the investor are not directly or indirectly provided or guaranteed by any other investor." *See* EITF D-97, at 3. Here, the PIP participants cannot be deemed "investors" of any kind, since none of them "invested" personal funds in the CEOC shares they received. SUMF, ¶ 131. As for the 5% Stock Sale purchasers, [REDACTED]

[REDACTED].

SUMF, ¶¶ 92; 107-112. In addition, [REDACTED]

[REDACTED].[22] *Id.*, ¶¶ 102-105; 143-146.

The SEC Staff deems an investor not to have engaged in the "promotion" of an acquisition where "the investor did not solicit other parties to invest in the investee." *See* EITF D-97, at 4. Here, there is no dispute [REDACTED]

[REDACTED] *Id.*, ¶ 91. Likewise, CEC and Apollo hand-picked the Caesars employees who ultimately received shares as part of the PIP—[REDACTED]

[REDACTED]

[REDACTED] SUMF, ¶¶ 126-127; 222.

Factors determining whether an investor engaged in "subsequent collaboration" include whether "the investor is free to exercise its voting rights in any and all shareholder votes," and "the investor's ability to sell its investee shares is not restricted." *See* EITF D-97, at 4. As noted above, prior to transferring CEOC's shares, CEC amended the CEOC Certificate of Incorporation to effectively do away with shareholder votes, giving itself the sole power to take action via consents that only CEC need sign, without any prior notice to the minority shareholders. SUMF, ¶¶ 196; 200; 215; 219. The undisputed record also shows that [REDACTED]

[REDACTED]

[REDACTED] *Id.*, ¶¶ 139-140.

Having exercised complete control over when, how, and to whom CEOC's minority shares were transferred, CEC's suggestion that it does not control the form of ownership of

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[22] Again, CEC's own advisors and employees valued the CEOC stock as worthless. *See, supra,* at 3, n.4.

CEOC is simply not credible. Thus, consistent with the SEC Staff's guidance, the shareholdings of the 5% Stock Sale purchasers and the PIP participants should be aggregated with those of CEC in determining whether CEOC remains a "wholly owned subsidiary." [23]

II. CEC'S RELIANCE ON CONSENTS FROM THE FAVORED NOTEHOLDERS VIOLATED TIA SECTION 316(a) AND SECTION 902 OF THE INDENTURE[24]

TIA Section 316(a) and Indenture Section 902 each effectively prohibit the amendment of the Indenture based on consents obtained for Notes held by CEC, its affiliates, or Noteholders "controlled" by CEC. As set forth below, based on the undisputed structure of the August Transaction, CEC violated both of these provisions when it amended the Indenture in August 2014.

Section 316(a) of the TIA requires that, when considering a direction to act from a majority of noteholders, an indenture trustee must disregard consents provided "by any person directly or indirectly controlling or controlled by or under direct or indirect common control" of the issuer (here, CEOC). 15 U.S.C. § 77ppp(a). Under the terms of the NPSA, the Favored Noteholders' consents did not "become effective until the consummation of the Closing" of the August Transaction (on August 22, 2014). SUMF, ¶ 61; Ex. D (NPSA), § 5.1. The NPSA defines "Closing" as "[t]he closing of the purchase and sale of the Notes and the Proposed Consent contemplated by this Agreement . . . ." Ex. D (NPSA), § 2.1. Under Section 2.2 of the NPSA, the Closing by definition included: (i) the payment of $155 million to the Favored Noteholders by CEOC and CEC; and (ii) the transfer of the "Purchased Notes" to CEC or

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[23] If the Court determines that CEC's Guarantee remains in place, Plaintiffs are entitled to the immediate payment of all principal and interest owed on the Notes for the reasons set forth in Argument Section III of the Brief submitted by BOKF and UMB.

[24] Although Danner does not join in this portion of Plaintiffs' joint motion for summary judgment, he does rely on the underlying facts in Counts One, Two, and Five of his Amended Complaint. Danner Amended Compl. [ECF No. 28] ¶¶ 72, 75(d), 76, 99, 103(a), 104, 105, 107.

CEOC, as applicable, followed by the transfer of the Notes to the Trustee for cancellation. *Id.*, § 2.2; SUMF, ¶ 62. Thus, under the undisputed terms of the NPSA, at the point when the consents became effective, CEC and CEOC had actual ownership of the Notes. SUMF, ¶ 70. In light of that fact, the Purchased Notes should not have been counted towards any majority required for the direction of the Trustee.[25]

In addition, because the terms of the NPSA expressly prohibited the Favored Noteholders from disposing of or voting on their Notes except as directed by CEOC and CEC, CEC and CEOC also had beneficial ownership of the Notes when the August Transaction closed. Under Section 5.1 of the NPSA, the Favored Noteholders were required "not [to] transfer[] any interest in the Notes (including any right to exercise voting power with respect thereto or delivering any proxy with respect to such Notes or entering into any voting agreement relating to the Notes) from the date hereof to the earlier of (i) the effective time of the Proposed Consents and (ii) the valid termination of this Agreement . . . ." SUMF, ¶ 61; Ex. D (NPSA), § 5.1. Under applicable SEC guidance, these restrictions gave CEOC and CEC beneficial ownership of the Notes. *See* Rule 13d-3 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.13d-3(a) ("For the purposes of sections 13(d) and 13(g) of the Act a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) Investment power which includes the power to dispose, or to direct the disposition of, such security."). Accordingly, because CEOC and CEC

[25] There is no dispute that, without the consents from the Favored Noteholders, CEC lacked the majority necessary for the amendment of the Indenture. SUMF, ¶¶ 29; 46; 52.

had both actual and beneficial ownership of the Favored Noteholders' Notes at the time the consents became effective, the August Transaction violated Section 316(a).

The foregoing undisputed facts also resulted in CEC's violation of Section 902(1) of the Indenture. That section provides as follows:

> The Corporation, the Guarantor and the Trustee may enter into a supplemental indenture with the written consent of the Holders of at least a majority in principal amount of the Outstanding Securities of each series affected by such supplemental indenture (including consents obtained in connection with a tender offer or exchange offer for the Securities of such series) . . . provided, however, that no such supplemental indenture shall, without the consent of the Holder of each Outstanding Security affected thereby . . . impair the right to institute suit for the enforcement of any such payment on or after the Stated Maturity thereof (or, in the case of redemption, on or after the Redemption Date)[.]

SUMF, ¶ 29; Ex. A (Indenture), § 902(1). Here, CEC violated Section 902 because the Notes for which they had consents (*i.e.*, the Notes of the Favored Noteholders) did not constitute "Outstanding Securities" at the time those consents became effective and the Supplemental Indenture was signed. The Indenture specifically defines "Outstanding Securities " to exclude "Securities for whose payment or redemption the necessary amount of money or money's worth has been theretofore deposited with the Trustee or any Paying Agent . . . for the Holders of such Securities" on the date of determination. Ex. A (Indenture), § 101. Because CEC and CEOC had already paid the Favored Noteholders at the time their consents became effective, those Notes were no longer "Outstanding" under the above definition and could not be counted for purposes of determining whether a majority had consented to the Supplemental Indentures. Notably, this is the case even if the Court were to find that CEC did not have actual or beneficial ownership of the Notes for the purposes of TIA Section 316(a).

Accordingly, because the Supplemental Indentures were obtained in violation of both TIA Section 316(a) and Indenture Section 902, the Supplemental Indentures are invalid as a matter of law.

III. CEC BREACHED ITS DUTY OF GOOD FAITH AND FAIR DEALING BY FAILING TO GIVE THE MINORITY HOLDERS THE OPPORTUNITY TO PARTICIPATE IN THE AUGUST TRANSACTION

Finally, the undisputed facts show that CEC breached its duty of good faith and fair dealing by denying Plaintiffs the opportunity to participate in the August Transaction.[26] SUMF, ¶¶ 67; 84. There is no dispute that CEC did not provide Plaintiffs or any other minority holders the opportunity to redeem their Notes in exchange for providing the consents requested by CEC. Nor is there any dispute that as a result of this preferential treatment, the non-participating noteholders' rights in their investment were severely compromised.[27]

Under New York law, all contracts contain an implied covenant of good faith and fair dealing that prohibits a party to a contract from taking actions to "destroy or injure the right of another party to receive the benefits of the contract." *See Chase Manhattan Bank, N.A. v. Keystone Distribs., Inc.*, 873 F. Supp. 808, 816 (S.D.N.Y. 1994) (citing *Carvel Corp. v. Diversified Mgmt. Grp., Inc.*, 930 F.2d 228, 230 (2d Cir. 1991)). The implied duty of good faith and fair dealing applies when a party to a contract acts in a way that is intended to deprive the

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[26] An additional basis for breach of the implied covenant that Plaintiffs will pursue in the event the Trilogy and Danner cases go to trial is that the 5% Stock Sale and the PIP deprived Plaintiffs of the benefit of their bargain under the Indenture.

[27] Plaintiffs' claim for breach of good faith and fair dealing does not rely on an express provision in the Indenture but is consistent with the Indenture's contemplation that noteholders be treated equally and fairly. *See e.g.*, SUMF, ¶¶ 23; 31; Ex. A (Indenture), § 507 ("it being understood and intended that no one or more of such Holders shall have any right . . . to obtain or to seek to obtain priority or preference over any other of such Holders . . . ."); Ex. A (Indenture), § 1103("If less than all the Securities of any series are to be redeemed . . . the particular Securities to be redeemed shall be selected . . . by such method as the Trustee shall deem fair and appropriate.")

other party of the benefit of its bargain. *See Dalton v. Educ. Testing Serv.*, 639 N.Y.S.2d 977, 979 (1995). The critical inquiry is whether CEC acted "in a way that is inconsistent with the justified expectations of the other party." *See Rus, Inc. v. Bay Indus., Inc.*, 322 F. Supp. 2d 302, 315 (S.D.N.Y. 2003).

Courts in New York and Delaware have found that in order to comply with the duty of good faith and fair dealing, an issuer soliciting exit consents must offer the transaction to *all* noteholders if those that reject the offer are to lose rights. *See, e.g.*, *Whitebox Convertible Arbitrage Partners, L.P. v. World Airways, Inc.*, No. Civ.A. 1:04-cv-1350, 2006 WL 358270, at *3 (N.D. Ga. Feb. 15, 2006) (noting that the duty of good faith and fair dealing prohibits a defendant from manipulating the process by which certain bondholders are given preferential treatment in having their bonds exchanged or redeemed); *Kass v. E. Air Lines*, 12 Del. J. Corp. L. 1074, 1080 (Del. Ch. 1986) ("The fact that the offer in this case is one made publicly to all voters on the same terms—that each bondholder is free to accept or reject it—precludes, in my opinion, a conclusion that it disenfranchises any voter or group of voters (although the same could not perhaps be said were the offer of consideration in exchange for a bondholder's vote not made to all bondholders on the same terms)."); *Katz v. Oak Indus.*, 508 A.2d 873, 881 (Del. Ch. 1986) (permitting exit consents because "the incentive to consent is equally available to all members of each class of bondholders").

Here, although the Indenture does not expressly require exit consents to be offered to all bondholders, the Indenture's language clearly contemplates that holders will be treated equally, and that certain holders will not be given "priority or preference over any other of such Holders." SUMF, ¶¶ 23, 31; Ex. A (Indenture), § 507 ("it being understood and intended that no one or more of such Holders shall have any right . . . to obtain or to seek to obtain priority or preference

over any other of such Holders . . . ."); *see also* Ex. A (Indenture), § 1103("If less than all the Securities of any series are to be redeemed . . . the particular Securities to be redeemed shall be selected . . . by such method as the Trustee shall deem fair and appropriate.") Based on this language, there was no reason for Plaintiffs to expect that CEC would attempt to amend the Indenture by making preferential offers to some holders and not others. This is precisely the kind of fact pattern that the good faith and fair dealing claim is meant to address. *See Rus, Inc.*, 322 F. Supp. 2d at 315 (breach of duty of good faith and fair dealing meritorious when defendant acted "in a way that is inconsistent with the justified expectations of the other party").

CONCLUSION

For all of the foregoing reasons, the Court should grant summary judgment against CEC on Counts One, Two, Three, Four, Eight, and Nine of the Trilogy Plaintiffs' Amended Complaint, and Counts One, Two, Three, and Six of the Danner Amended Complaint.

Dated: New York, New York
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