Milbank

MEMORANDUM

VIA EMAIL

TO	DC Secretary
FROM	Barclays Bank plc and certain other Eligible Market Participants
DATE	September 17, 2024
SUBJECT	The Initial List of Deliverable Obligations for the Avon Products, Inc. Auction

Background

The Initial List of Deliverable Obligations for the Avon Products, Inc. ("**Avon**" or the "**Reference Entity**") Auction was published on September 12, 2024, and excluded the USD 405,000,000 promissory note dated May 17, 2022 and payable by Avon to Natura (the "**Promissory Note**"). On the same date, the Americas DC published a meeting statement (the "**Meeting Statement**") regarding its decision to exclude the Promissory Note from the Avon Initial List.

Pursuant to Rule 3.3(d) of the ISDA Credit Derivatives Determinations Committee Rules (September 28, 2018 version, as amended from time to time, the "**DC Rules**"), we hereby challenge the exclusion of the Promissory Note. Capitalized terms used but not defined herein have the meanings ascribed to them in the Meeting Statement and/or the 2014 Credit Derivatives Definitions and DC Rules (the "**Definitions**").

Milbank LLP, acting as counsel for the U.S. special situations trading desk of Barclays Bank plc and certain other Eligible Market Participants, submits this memorandum in support of this challenge.

Summary of Argument

The Promissory Note should be included on the Final List of Deliverable Obligations for the Avon Auction because it falls within the Deliverable Obligation Category "Bond or Loan." There is sufficient evidence to conclude that the Promissory Note is *either* a "Bond" or a "Loan," and there is no evidence that it includes any features that make it different from other Bonds and Loans that would be included in this Deliverable Obligation Category.

For the purposes of determining whether an Obligation falls with the Deliverable Obligation Category of "Bond or Loan," it is not necessary for members of the Americas DC to decide that it is necessarily one or the other. When applying the Definitions, the Americas DC

should consider the objectives that animated the drafting of the Definitions and the purpose of the Deliverable Obligation Characteristics in a Credit Derivatives Transaction. In order not to frustrate the reasonable commercial expectations of Credit Derivative market participants, the DC should interpret the "Bond or Loan" Deliverable Obligation Characteristic in a flexible manner, informed by the business purpose sought to be achieved by the drafters of the ISDA standard documentation, so that it can be used to include financial instruments that market participants consider to be similar in relevant ways (*e.g.*, clarity of the amount owed, ease of transferability) to other instruments that satisfy the "Bond or Loan" Deliverable Obligation Category. Such an approach is consistent with that followed in the December 21, 2018 Decision and Analysis of the External Review Panel of the U.S. Determinations Committee in connection with the Sears Credit Event (DC issue 2018101502) (the "**Sears ER Decision**").

That said, there is a sufficient basis upon which to conclude that the Promissory Note is a "Bond" or a "Loan":

- In its current form, the Promissory Note satisfies the definition of "Bond". Specifically, a "note" is *per se* included in the definition of "Bond" in the Definitions, and it is not necessary to find that the Promissory Note is a security to meet the definition of "Bond." At the same time, the Promissory Note in fact *does* satisfy the definition of "security" under New York State's Uniform Commercial Code ("**NYUCC**") and relevant case law from the New York State Court of Appeals, both of which govern here.

- Alternatively, it is also reasonable to conclude that the Promissory Note is a "Loan" as defined in the Definitions, based on statements by the Reference Entity, the content of the Promissory Note, and relevant New York case law.

We note that, if this question were to be addressed through External Review, the decision-makers would be charged with finding the "better answer" as to how the Definitions should be applied to facts and circumstances here. *See* DC Rules, Section 4.6(d). So, in making this determination, the members of the Americas DC should not allocate a burden of proof to either side of the question. Members who believe the Promissory Note should be included on the Final List do not have an added burden to prove that it qualifies as a "Bond or Loan" (or that it necessarily fits within one or the other component of the category) any more than the members who believe it does not qualify have any burden to prove the opposite. Instead, when considering whether the Promissory Note fits within the definition of "Bond" or "Loan" (and whether the distinction even matters if in fact it has elements of each), members of the DC should consider which outcome would best align with the reasonable expectations of Credit Derivatives market participants. By construing the Definitions in a general and flexible manner, consistent with the expectation of market participants, we believe the Americas DC will conclude, for the reasons set forth below, that the "better answer" in this instance is that the Promissory Note falls within the "Bond or Loan" Deliverable Obligation Category.

Summary of the Promissory Note

The Promissory Note is a medium-term, fixed rate instrument. Avon "unconditionally promise[d] to pay to" Natura (the "**Noteholder**") "the principal amount of USD 405,000,000 together with all accrued interest thereon" in exchange "FOR VALUE RECEIVED," with a maturity date of May 17, 2029. Promissory Note ¶ 1, §§ 2.1, 1.1(j), 2.2.

The Promissory Note contains an express obligation that Natura effectuate the transfer of $405 million to Avon no later than May 20, 2022. §5.1(b) ("the Noteholder shall be required to effectuate such transfer between May 17, 2022 and May 20, 2022"). In addition, the Promissory Note specifies the interest rate on the principal amount (6.71% per annum), that interest is payable annually, and the maturity date. §§ 1.1(j) & 3.1. The Note also sets out various covenants of Avon, including a "Restricted Payments" covenant and a "Fundamental Change" covenant, §7.1, and specifies various customary events of default, §8.1, and the rights of Natura in the event of such default, §8.2. Conditions precedent to the parties' rights and obligations are Natura's written acknowledgement that it received the executed Promissory Note and Avon's receipt of the principal amount from Natura. §5.1.

The Promissory Note does not permit the Issuer to assign the Promissory Note without the consent of the Noteholder, but the Noteholder "shall be entitled to assign any of its rights or obligations hereunder without prior consent of the Issuer." §12.2. Finally, the Promissory Note itself describes the transaction between Natura and Avon as a "loan." §§ 1.1(i), 2.1, 2.2, 3.1, 4.1, 4.2, 8.1(d) (using the term "loan" eleven times). And Avon repeatedly characterized the Promissory Note as a "loan" in public filings.[1]

The Promissory Note Qualifies as a "Bond"

As noted in the Meeting Statement, a "Bond" is defined to include "any obligation of a type included in the 'Borrowed Money' Obligations Category that is in the form of, or represented by, a bond, note (other than notes deliverable pursuant to Loans), certificated debt security or other debt security and shall not include any other type of Borrowed Money." Meeting Statement, p. 2. The Americas DC concluded that the definition of "Bond" is "limited to types of 'debt security'", and determined that the Promissory Note was not a Bond because it did not qualify as a security under the framework set forth in *Reves v. Ernst & Young*, 494 U.S. 56 (1990). *See* Meeting Statement, pp. 3-5.

We submit that it was incorrect to interpret the "Bond" definition to require that the instrument in question be a security to qualify as a "Bond." It was also incorrect to rely primarily upon *Reves* in determining whether the Promissory Note was a "debt security" or "security."

[1] *See* Avon Form 10-Q, August 12, 2022, p. 13; Avon Form 10-Q, November 10, 2022, p. 16; Avon Form 10-K, March 14, 2023, pp. F-6, F-25; Avon Form 10-Q, May 15, 2023, p. 11.

An Instrument Need Not Be a Security to Meet the Definition of "Bond."

Citing *In re Falvey*, 15 A.D. 2d 415, 420 (1962), the Americas DC invoked the cannon of construction *ejusdem generis* to conclude that the use of the phrase "or other debt security" in the definition of Bond means that the "items listed ahead of that phrase in the definition, namely a 'bond, note . . . certificated debt security' should be read as limited to types of 'debt security'." Meeting Statement p. 3 & p. 3, n. 8.

The Americas DC incorrectly applied that cannon. As the New York Court of Appeals has clearly held, *ejusdem generis* "imposes the understanding that ***general phraseology*** will be taken to have been ***limited by the specific words that precede it***." *Manhattan Pizza Hut v. NYS Human Rights Appeal Board*, 51 N.Y.2d 506, 512 (1980). *In re Falvey* itself articulates that same principal. *See* Meeting Statement, p. 3, n. 8 (quoting *In re Falvey*). Properly applied, the cannon would suggest that the general phrase "other debt security" may be limited by the more specific words "bond", "note" and "certificated debt security," not that "other debt security" may be interpreted to qualify the words "bond", "note" and "certificated debt security." The Americas DC application of the doctrine was precisely the opposite of the way the doctrine is intended to work.

In any event, the definition of "Bond" is in no need of interpretation through cannons of construction as it is plain on its face: a "note" is *per se* included in the definition of "Bond."

New York Law—not Reves—Should Have Been Applied to Determine Whether the Promissory Note Was a Security.

Second, it was incorrect to rely primarily upon *Reves* in determining whether the Promissory Note was a "debt security" or "security." In *Reves*, the Supreme Court created a framework for determining whether an instrument was a security "within the meaning of . . . the Securities Exchange Act of 1934," 494 U.S. at 58—the question presented had nothing to do with an interpretation of ISDA's Definitions. The Americas DC should have relied primarily on New York Law in evaluating whether the Promissory Note is a security. In particular, the choice of law in relevant ISDA Master Agreements and the choice of law in the DC Rules both point to New York law. DC Rules, §4.6(e).[2]

As detailed below, the Promissory Note qualifies as a security under New York law.

In *Highland Capital Management LP v. Schneider*, 8 N.Y.3d 406 (2007), the New York Court of appeals determined that the promissory notes at issue in that case were securities within the meaning of New York law, specifically Section 8-102 (a)(15) of the NYUCC. In doing so,

[2] The Americas DC did invoke New York law in certain aspects of its analysis. Meeting Statement, p. 4. We acknowledge, of course, that the Americas DC noted that it also considered Article 8 of the NYUCC, but the analysis in the Meeting Statement focuses exclusively on the Reves framework.

the *Highland* Court held that, to qualify as a security, a promissory note "must fulfill the requirements of subparagraphs (i) (the transferability test), (ii) (the divisibility test) and (iii) (the functional test) of section 8–102(a)(15)." 8 N.Y.3d at 412. The Promissory Note meets all three requirements.

- **Transferability**. This requirement involves several layers. To begin, the note must be "a paper embodying the underlying intangible interest." *Id.* at 413. This exists where a note "embod[ies] and evidence[s] the underlying intangible obligation of" one party to another. *Id.* The Promissory Note is clearly a paper that embodies and evidences underlying intangible obligations of Avon to Natura—most notably the obligation of Avon to repay the Principal Amount reflected in the Promissory Note (with interest). *See* Promissory Note, ¶ 1 (Avon "unconditionally promises to pay. . ."); §2.1 ("the issuer shall be obligated to pay the Noteholder the amount of USD 405,000,000 (together with any accrued but unpaid interest . . . ."); §7.1 (setting forth covenants of the Issuer); *see also Highland*, 8 N.Y.3d at 413.

  Next, the note must be in bearer or registered form. *Id.* at 413. The Promissory Note is not in bearer form. A note is in registered form where it (1) "'specifies a person entitled to the security'" and (2) "'a transfer of the security *may* be registered upon books maintained for that purpose by or on behalf of the issuer . . . .'" *Id*. at 413 (quoting NYUCC, Section 8-102(a)(13)) (emphasis added). The Promissory Note satisfies requirement (1) since it specifies that Natura is entitled to the security. *See id*. at 413 ("Each of the notes specifies one of the four Schneiders as the 'person entitled to the security,' which satisfies section 8-102(a)(13(i).").

  The Promissory Note also satisfies requirement (2). Here, the "proper inquiry is whether the notes *could have been* registered on transfer books for this purpose at the time it issued notes, not whether they were registered on transfer books at the time of the litigation." *Id*. at 414 (quotations and citations omitted; emphasis in original). In *Highland*, the court held that the notes satisfied requirement (2) because, "as a practical matter, [the note issuer] would have to have recorded any transfer of [the] notes in order to protect itself and the senior debt holders." *Id*. The same logic applies here.

- **Divisibility**. A single instrument meets the divisibility test where it is "divisible into at least one additional instrument." *Id.* at 415. The Promissory Note specifically authorizes Natura to assign "*any* of its rights or obligations [there]under" without the consent of Avon. Promissory Note, §12.2 (emphasis added). This language grants the Noteholder the unilateral right to partially assign the Promissory note—to one or more persons—rendering it divisible into a series of participations and interest. Additionally, the definition of "Noteholder" in the Promissory Note includes Natura's "assigns," indicating the intent for the term "Noteholder" within the agreement to pick up any assignees of any of Natura's rights under the Promissory Note.

- **Functionality**. The *Highland* court explained that an instrument meets the functional test when it is "*of a type*, dealt in or traded on securities exchanges or securities markets." *Id.* at 415. Instruments like the Promissory Note are traded over-the-counter.[3]

The Promissory Note meets the Reves Test When Properly Applied.

Even if the Americas DC believes *Reves* should be considered, the Promissory Note satisfies the *Reves* test.

Under *Reves*, "we begin with a presumption that every note is a security." 494 U.S. at 65. Moreover, if the purpose of the instrument is "to raise money for the general use of a business enterprise" the "instrument is likely to be a 'security." *Id*. at 66. The purpose and terms of the promissory note confirm that it was used to raise money for general use of a business enterprise: it was used to refinance another debt security and, in return, the noteholder received an expected profit through a fixed rate of interest negotiated with the issuer at the time of issuance.[4] Thus, under *Reves*, the Promissory Note is "likely a 'security.'"

The Americas DC suggested that the absence of a plan of distribution and the fact that the Promissory Note was issued by an affiliate would offset the presumption that the Promissory Note is a security. *See* Meeting Statement, p. 5. But while an active plan of distribution to investors might cause an instrument to be deemed a security, the absence of such a plan does not insulate an investment product—such as this medium-term, fixed rate instrument—from the securities laws. Indeed, investors would reasonably expect that any assignment of an instrument such as the Promissory Note—an unsecured fixed rate note—in the secondary market would require compliance with private resale restrictions under the securities laws. The reasonable expectations of investors therefore confirm—rather than rebut—the presumption that the Promissory Note is a security under *Reves*.

Finally, as in *Reves*, there is "no risk-reducing factor to suggest that these instruments [here, the Promissory Note] are not in fact securities. The notes are uncollateralized and uninsured…[and]…would escape federal regulation entirely if the [securities laws] were held not to apply." 494 U.S. at 69.

[3] In determining that the promissory notes at issue were securities under the NYUCC, the *Highland Capital* court also noted that its decision was "consistent with existing case law . . . ." 8 N.Y.3d at 416 (citing *Vigilant Ins. Co. of Am. v. Hous. Auth. Of City of El Paso, Tex*., 87 N.Y.2d 36, 43 (1995) (stating broadly that "article 8 of the [UCC] . . . governs stocks, bonds and other evidences of indebtedness")) and also relied upon commentary that "the definition [of security] will cover anything which securities markets, including not only the organized exchanges but as well the 'over-the-counter' markets, are likely to regard as suitable for trading." 8 Lawrence's Anderson on the Uniform Commercial Code, Section 8-102:1, at 29 (3d ed. 2005); *see also Bentley v. ASM Commc'ns, Inc*., No. 91 CIV. 0086 (MBM), 1991 WL 105220, at *2 (S.D.N.Y. June 11, 1991) (stating that it is clear in the comments to § 8–102 "that the intended definition of security for purposes of this statute is broad"). That same reasoning applies here.

[4] *See* Avon 8-K, May 17, 2022, p. 2; Promissory Note, §§ 2.1, 1.1(j), 2.2, 3.1.

As demonstrated above, three of four *Reves* factors confirm the presumption that the Promissory Note is a security for purposes of the federal securities laws. This conclusion is further demonstrated by the absence of any resemblance between the Promissory Note and the following types of instruments, all of which are *not* securities under the "family resemblance" test endorsed by *Reves*: "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized." *Id*. at 66 (citations and quotations omitted); *see also Tannebaum v. Clark*, 1991 WL 39671, at *5 (N.D. Ill., March 18, 1991) (*rejecting* the argument that a promissory note is not a security: "Overall, we find that under every aspect of the 'family resemblance' test laid out in *Reves*, the promissory note sold to Tannebaum is a security covered by the 1933 and 1934 Securities Acts.").

The Promissory Note is Very Similar to Avon's Unsecured Bonds

Finally, the below comparison of the key terms of the Promissory Note with the key terms of the form of note representing the unsecured bonds of the Reference Entity (Appendix A to the Avon Eighth Supplemental Indenture dated March 12, 2013), demonstrates that they are functionally equivalent:

Provision	**Form of Note for 6.95% Notes due 3/15/2043**	**Promissory Note**
Principal Sum/Amount	p. 1 ¶ 3.	¶ 1, Sec. 2.1
Maturity Date	p. 1 ¶ 3	Sec. 1.1(j), Sec. 2.2
Interest Rate	p. 1 ¶ 3	Sec. 3.1
Interest Calculation Method	p. 1 ¶ 3	Sec. 3.1
Interest Due Date	p. 1 ¶ 3	Sec. 3.1
Restricted Payments	p. 5 ¶ 3	Sec. 4.1
No Fundamental Changes	p. 7 ¶ 3	Sec. 7.1
Events of Default	p. 8 ¶ 9	Sec. 8.1, Sec. 8.2
Amendment	p. 8 ¶ 11	Sec. 12.5
Assignment	p. 9 ¶ 3	Sec. 12.2

The Promissory Note Qualifies as a Loan

In the alternative, it is reasonable to conclude based on available facts that the Promissory Note meets the definition of a "Loan." We also believe that, given the parallel function of the terms "Bond" and "Loan" in the Definitions, if a DC member believes that the Promissory

Note fails to qualify as a "Bond" only because it is a "note deliverable pursuant to Loan", then it should conclude that the Promissory Note qualifies as a "Loan".

A "Loan" is defined in the Definitions as "any obligation of a type included in the 'Borrowed Money' Obligation Category that is documented by a term loan agreement, revolving loan agreement or other similar credit agreement and shall not include any other type of Borrowed Money." Meeting Statement, p. 2.

The Americas DC decided that the Promissory Note was not a "Loan" because it was not "**documented by** a term loan agreement", in that it was not bilaterally executed, does not contain "mechanics for effecting a borrowing" and "presupposes, but does not itself represent, an obligation of Natura to provide an extension of credit . . ." Meeting Statement, p. 3 (emphasis in original). This determination should be reconsidered because it does not account for all available facts that bear upon the question or applicable New York law:

- First, the Promissory Note did, in fact, call for Natura to extend credit to Avon, and contains "mechanics for effectuating" a borrowing. *See* Promissory Note, Section 5.1(b) ("the Noteholder *shall be required* to effectuate such transfer [of the Principal Amount] between May 17, 2022 and May 20, 2028.") (emphasis added). Furthermore, the Promissory Note contains representations and warranties that are customarily found in a loan agreement. (See § 6).[5] In any event, it is evident from the terms of the Promissory Note and Avon's public filings with the SEC that Natura did, in fact, provide an extension of credit in the amount of $405 million to Avon, a key element of any loan.[6]

- Second, Avon itself repeatedly described the Promissory Note as a loan—both in the note itself and its SEC filings.[7]

[5] While the Meeting Statement states that the covenants in the Promissory Note are "minimal" and "not in line with what would typically be seen in a credit facility," and therefore weigh against treating the Promissory Note as a "Loan," it should be noted that the covenants are as restrictive, or perhaps more restrictive, than are typically found in credit agreements. In particular, the flat prohibition on fundamental changes (without any exceptions other than transactions with Affiliates) is at least as restrictive as is found in many credit agreements. The prohibition on the transfer of "a substantial part" of the business assets of Avon to any person other than an Affiliate, again, without any other exceptions, is also stricter, in many respects, than many credit agreements. In any event, we would suggest that the Americas DC should not concern itself with this aspect of the analysis—whether the covenants in an instrument are "typical" or "minimal" should not serve to create market uncertainty as to whether the instrument is a Deliverable Obligation.

[6] *See In re Grand Union Co.*, 219 F. 353, 356 (2d Cir. 1914) (A "loan" is simply "a contract by which one delivers a sum of money to another and the latter agrees to return at a figure time a sum equivalent to that which he borrows.").

[7] *See* Avon Form 10-Q, August 12, 2022, p. 13; Avon Form 10-Q, November 10, 2022, p. 16; Avon Form 10-K, March 14, 2023, pp. F-6, F-25; Avon Form 10-Q, May 15, 2023, p. 11.

- Third, numerous New York courts have recognized that a written promissory note "documents" a loan and constitutes direct "evidence" thereof.[8] Moreover, the Promissory Note contains all of the key terms of the loan to Avon: principal, interest rate, and the duration of the loan.[9]

- Finally, promissory notes are considered "agreements" even though executed by the issuer only. Failure to meet the terms of a promissory note can be redressed via lawsuit for breach of contract.[10]

The Promissory Note Satisfies the Other Relevant Deliverable Obligation Characteristics

Although we are not aware of any market participants having raised any concerns about the other Deliverable Obligation Characteristics, the Promissory Note satisfies each of them as set forth in the below table (for completeness):

Deliverable Obligation Characteristic	**Yes/No**	**Section Reference**
Not Subordinated	Yes	The Promissory Note does not contain any terms that subordinate it to any other obligation.

[8] *See CB & F Interamerica, Inc. v. Agro Industrias M&M S.R.L.*, 675 F. Supp. 179, 179, n. 1 (S.D.N.Y. 1987) ("The loans are documented by promissory notes signed by defendants . . . ."); *Excelsior Capital, LLC v. Superior Broadcasting Co., Inc*., 82 A.D.3d 696, 697 (2d Dep't 2011) ("Each loan was evidenced by a promissory note."); *United States v. Castine,* 259 A.D.2d 873, 873 (3rd Dep't 1999) ("The loan was evidenced by a promissory note, to be repaid in 20 annual installments . . . ."); *Barrett v. N.Y. Republican State Committee*, 238 A.D.2d 960, 960 (4th Dep't 1997) ("The loans were evidenced by three promissory notes executed by the Committee Treasurer."); *People's Nat'l Bank of Rockland County v. Kogan*, 120 A.D.2d 718, 718 (2d Dep't 1986) ("proof of a loan at 15% interest" was "evidenced by a promissory note").

[9] *See Barshay v. Naithani*, 2022 WL 170599, at *6 (S.D.N.Y., Jan. 18, 2022) ("Essential terms of a loan agreement include an interest rate, a maturity date, and a schedule for payments."); *L.K. Station Group, LLC v. Quantek Media, LLC*, 62 A.D.3d 487, 491 (1st Dep't 2009) (no loan contract where documents did "not contain some of the essential terms of a loan, such as the interest rate or maturity date . . . .").

[10] *See Nimkoff v. Drabinsky*, 2020 WL 3806146, at *5 (E.D.N.Y. June 9, 2020) ("A promissory note is a contract and is thus construed according to the general rules of contract interpretation."); In re Canal Asphalt, Inc., 2017 WL 1956849, * 5 (Bankr., S.D.N.Y., May 10, 2017) ("A promissory note is a contract for the payment of a debt . . . ."); *Kieran v. Sinetos*, 145 A.D.3d 987, 988 (2d Dep't 2016) ("promissory note was enforceable contract governing the terms of the transaction"); *Hogan & Co., Inc. v. Saturn Management, Inc*., 78 A.D. 837, 837 (1st Dep't 1980) ("proceeding brought upon a promissory note evidencing a loan in the amount of $80,000.00 from plaintiff . . . to defendant . . . , payable on one-hundred and twenty days after execution . . . .").

Deliverable Obligation Characteristic	Yes/No	Section Reference
Specified Currency	Yes	Pursuant to Section 2.1 of the Promissory Note, the Promissory Note is denominated in U.S. dollars.
Assignable Loan or Transferable (as applicable)	Yes	Pursuant to Section 12.2 of the Promissory Note, the noteholder "shall be entitled to assign any of its rights or obligations hereunder without prior consent of the Issuer."
Maximum Maturity: 30 years	Yes	The Promissory Note has a stated maturity date of May 17, 2029.
Not Bearer	Yes	The terms of the Promissory Note do not provide that it is a bearer instrument.

The Americas DC Should Apply the Definitions in a Flexible Manner to Support the Commercial Purpose of the Definitions

The Americas DC is perhaps confronted – for the first time – with the question of whether an instrument that is a "Bond" in its current form but also may have been intended by the parties to be a "Loan" can be considered to satisfy the "Bond or Loan" Deliverable Obligation Category. As noted above, there is ample evidence for the Americas DC to conclude that the Promissory Note meets the definition of a "Bond" in its current form. At the same time, the Promissory Note also has features of a Loan and has always been described as such by the borrower and noteholder. Regardless of whether it is a "Bond" or a "Loan," there is no evidence that it is different in any material way from the full category of instruments intended to be captured by the "Bond or Loan" Deliverable Obligation Category. DC Members should approach this DC Question, like all others, in a manner that will give effect to the intent of the drafters of the Definitions. So, if members believe the Promissory Note falls between "Bond" and "Loan," they should not prevent it from being considered a Deliverable Obligation like all other "Bonds" and "Loans" that satisfy the other Deliverable Obligation Characteristics. As noted in the Sears ER Decision, "[i]t is the nature of a relational contract, like the ISDA Master and the transactional confirmations and the terms incorporated by them, that it will include language that is general to accommodate the variety of fact patterns to which such language will apply. In order to ascertain the meaning of [the relevant term], therefore, the business purpose sought to be achieved by the drafters of the ISDA standard documentation is

relevant." Sears ER Decision, p. 3, ¶ 3. After noting that the goal of the drafters of the CDS Definitions was to expand the scope and usefulness of the CDS product, the Sears ER Decision explained that "the commercial objective was to cast a wide net to ensure greater liquidity through greater deliverability in order to avoid situations where no deliverables were available and, therefore, a CDS protection buyer could not receive the benefit of its contract, and also to reflect a more complete view of the recovery rate of credit instruments issued by a particular borrower when settling the related CDS contracts." Sears ER Decision, p. 3, ¶ 3.

We believe that it would be inconsistent with the Sears ER Decision to apply the "Bond or Loan" requirement in such a way that an instrument would fail to meet this Deliverable Obligation Category merely because the DC cannot determine whether it is one or the other. It is true that the "Bond or Loan" Deliverable Obligation Category is defined as "either a Bond or Loan", but we believe this should be interpreted to encompass any instrument that is a "Bond" or "Loan" or anything in between. Therefore, in seeking to apply the facts of the Promissory Note here, any argument that the instrument is a "Bond" should not be burdened by the possibility that it might be a "Loan" and vice versa. It is also true that the terms "Bond" and "Loan" include the language "…shall not include any other form of Borrowed Money." But relying on this language to exclude from the Final List any Obligation that a DC member believes falls between the two definitions would be inconsistent with the commercial intent of the Definitions.

Interpreting the Definitions to exclude the Promissory Note from the "Bond or Loan" category would frustrate the ability of market participants to diligence the fundamental creditworthiness of a Reference Entity, thereby harming the efficiency of the CDS market. Given the public disclosures of the Reference Entity with respect to the Promissory Note in its various periodic reports to the SEC, CDS market participants would expect such an instrument to be a Deliverable Obligation without worrying about whether it is specifically a "Bond" or a "Loan." In evaluating a CDS position, market participants focus instead on whether an instrument fundamentally embodies a transferable obligation of a Reference Entity to pay the relevant currency at a stated maturity date and is not burdened by any other limitation that would prevent it from being delivered in settlement of a CDS. The Promissory Note fulfills all of those requirements. Consonant with the expectations of market participants, the Americas DC should seek to enhance the scope, functionality and liquidity of the market for credit derivatives, by enlarging the universe of Deliverable Obligations rather than narrowing it.

Such an approach would not defeat any other purpose of the Definitions. First, a flexible reading of the Definitions in this manner would not erode the clearly contemplated distinction between "Borrowed Money" and "Bond or Loan". We believe the drafters of the Definitions (and CDS market participants) found this difference useful because there are certain types of debt obligations for which a default (*e.g.*, a payment default) could be meaningful enough as a credit matter to warrant the declaration of a Credit Event while at the same time being potentially unworkable as an instrument that can or should be physically delivered to settle a CDS contract. Examples of such instruments include deposits (of many types) and inter-

affiliate advances memorialized only on internal books and records and not in the form of a promissory note. Such instruments, were they to be considered Deliverable Obligations, would greatly complicate (and possibly defeat) any effort to rationally predict the value of a CDS Contract. But such infirmities plainly do not apply to the Promissory Note. Interpreting the Deliverable Obligation Category in this flexible manner does not require extending it to bond- or loan-like instruments with features that contradict or materially limit the essential attributes of obligations that could be deliverable under the "Bond or Loan" Deliverable Obligation Category in the CDS contract. Such essential elements likely would principally include (in addition to the fact that the instrument must be Borrowed Money): (a) the fact that the claim is a clearly articulated debt claim, (b) the validity of the claim in a bankruptcy proceeding, and (c) the ability to transfer the claim. The Promissory Note contains all these elements.

This is not to suggest that the Americas DC should not be guided by the language of the Definitions themselves. As noted above, New York case law provides ample support for concluding that the Promissory Note meets the definition of "Bond," and we believe the factual record also supports treating it as a "Loan". We believe the guidance from the Sears ER Decision clearly directs the DC members to interpret the Definitions flexibly and here, such an approach supports a finding that the Promissory Note should qualify as a Deliverable Obligation.