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Utilizing and Interpreting Make Whole Provisions, including Practical Lessons for Deal Structure

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38th Annual Jay L. Westbrook Bankruptcy Conference
November 14-15, 2019

What is a make-whole?

1. **A make-whole the different between 'par' and the contractual commitment to compensate an investor for early redemption**

2. **Initially included in long term debt instruments as a mechanism to compensate investors for lost interest where the issuer repays them early** - *i.e. to 'make whole' an investor as though the early repayment had not occurred*

3. **It was designed to be incurred *at the Issuers option*** - *The cost to be released from their contractual commitment*

4. **While not (as) controversial in a standard repayment scenario, recent rulings in bankruptcy court have been heavily debating the question on whether a make-whole is payable on an event of acceleration**

Why do investors sometimes have a contractual right to a 'make whole'?

- *Investors put aside their capital for the duration of the loan*
- *And agreed an interest rate to compensate them for that risk – their interest rate bargain*
- *If market conditions have changed, such that cheaper financing is now available – the investor has negotiated a contractual right to still be compensated for their bargain*

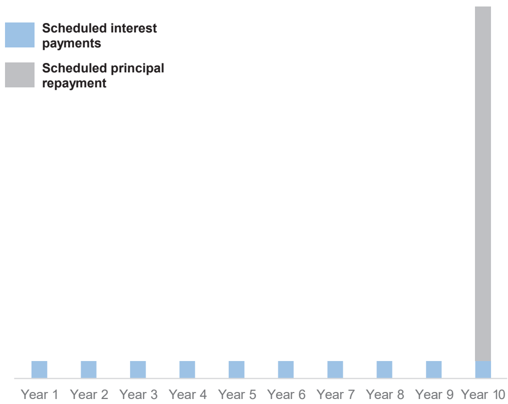
Sample make-whole language

"Make-Whole Amount" means… the excess, if any, of
(a) the present value at such time of
(i) the redemption price… plus
(ii) any required interest payment… computed using a discount rate equal to the Treasury Rate plus 50 basis points, discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months),
over (b) the principal amount of such Note…

How is a make-whole calculated?

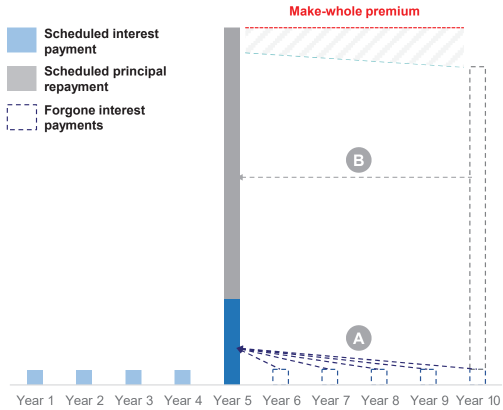
Illustrative stream of payments of a high-yield bond

No early redemption



- *A borrower of high-yield bond will pay coupon payments (typically semi-annually) at the contracted rate in the indenture*
- *At the bond's maturity, the borrower will pay out the then outstanding principal amount of the bond*

Early redemption



A *Discounted value of all future coupon payments*

B *Discounted value of principal payment at maturity*

A + B − = **Make-whole premium**

Key determinants of the make-whole calc.

1	**Debt document definitions**	*Definition of optional redemption and make-whole in the debt documents*	› Defines triggering event for the make-whole provision and calculation of the make-whole premium › Sometime the definitions don't have the rigor are not designed to survive a bankruptcy…
2	**Trigger of make-whole**	*Event of Default ("EoD")* *Voluntary petition of chapter 11* *Repayment of debt*	› Impacts the date to which future payment streams are discounted, and therefore impacts the ultimate value of the make-whole claim › Has a trigger even occurred? See definitions…
3	**Discount rate**	*Treasury yield* *Margin*	› Depending on the date of make-whole calculation, treasury yield of different maturities at such date will impact the discount rate › Margin to treasury yield also impacts the all-in discount rate
4	**Impact of post-petition / EoD payments**	*Adequate protection payments* *Accrued interest on make-whole*	› Contract rate vs. default rate when calculating the make-whole claim amount › What happens if you also get post petition interest payments?
5	**Validity of claim**	*Is the make-whole claim allowed* *Enforcibility of make-whole claim*	› Case law varies by jurisdictions, sometimes even across courthouses › … too many to list here …

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Also available as part of the eCourse
2019 Jay L. Westbrook Bankruptcy eConference

First appeared as part of the conference materials for the
38th Annual Jay L. Westbrook Bankruptcy Conference session
"Utilizing and Interpreting Make Whole Provisions, including Practical Lessons for Deal Structure"