

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

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What is a make-whole?

- 1 A **make-whole** is the difference 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'?

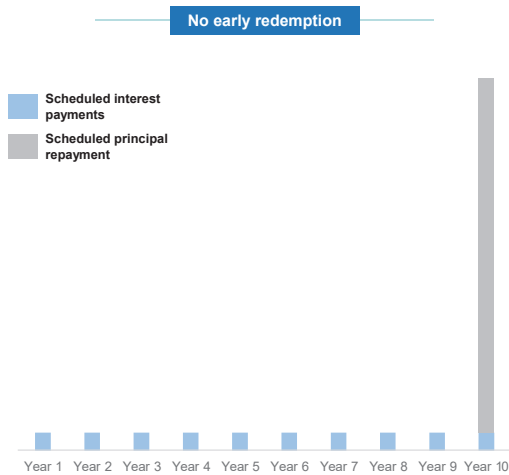
- Investors put aside their capital for the duration of the loan
- And agreed an interest rate to compensate them for that risk - their interest rate bargain
- If market conditions have changed, such that cheaper financing is now available - the investor has negotiated a contractual right to still be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

Sample make-whole language

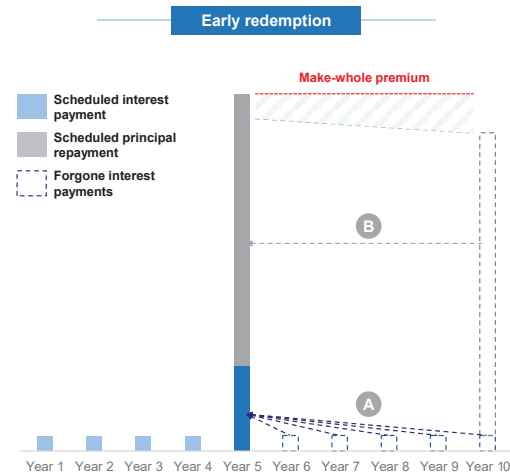
"Make-Whole Amount" means... the excess, if any, of
 (a) the present value at such time of
 (i) the redemption price... plus
 (ii) any required interest payment... computed using a discount rate equal to the Treasury Rate plus 50 basis points, discounted to the redemption date on a semi-annual basis (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



- > 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



- A Discounted value of all future coupon payments
- B Discounted value of principal payment at maturity

$$A + B = \text{Make-whole premium}$$

Key determinants of the make-whole calc.

1	Debt document definitions	Definition of optional redemption and make-whole in the debt documents	<ul style="list-style-type: none"> > 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	<ul style="list-style-type: none"> > 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	<ul style="list-style-type: none"> > 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	<ul style="list-style-type: none"> > 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	<ul style="list-style-type: none"> > Case law varies by jurisdictions, sometimes even across courthouses > ... too many to list here ...

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