

# Distribution Waterfalls

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## Overview

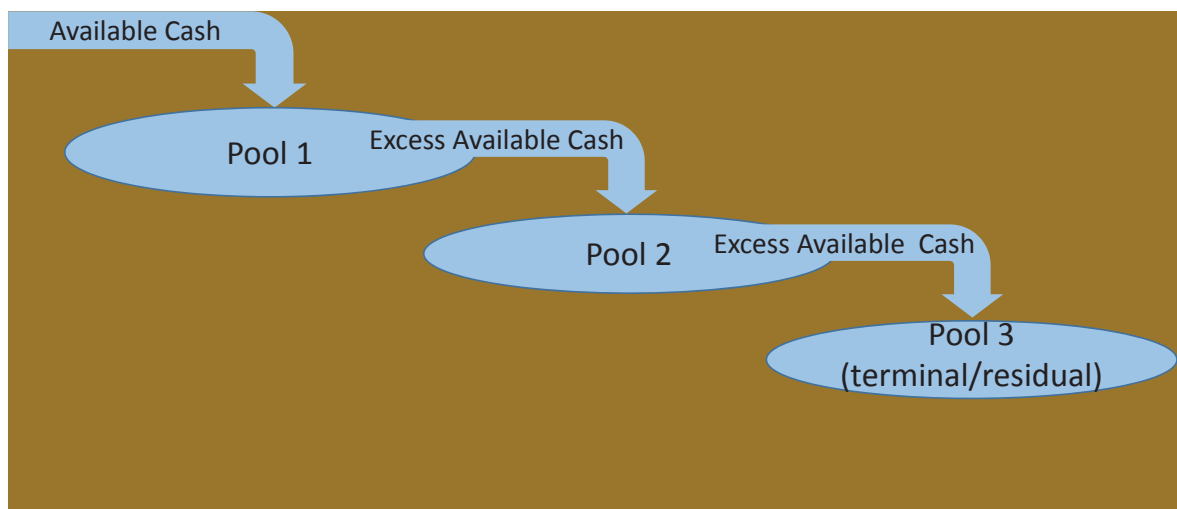
- Present different types of distribution waterfalls.
- Explore IRR waterfalls in depth.
  - Review time value of money basics
  - Consider use of time value of money terms and concepts in entity agreements
  - Explore direct and indirect methods for computing IRR hurdles
- Tax Considerations

# Contract Interpretation

- “Under the prevailing will theory of contract, parties, like Humpty Dumpty, may use words as they please. **If they wish the symbols ‘one Caterpillar D9G tractor’ to mean ‘500 railroad cars full of watermelons’, that's fine-provided parties share this weird meaning.”**
  - Judge Frank Easterbrook, TKO Equip. Co. v. C & G Coal Co., 863 F.2d 541, 545 (7th Cir. 1988).
- Otherwise, interpreting technical terms will most likely require extrinsic evidence in the form of expert testimony.
  - Focus here is on technical meaning and application of terms.

# Types of Distribution Waterfalls

# Distribution Waterfall



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## General Types of Distribution Waterfalls

	(1) Preferred Return Followed by Return of Capital		(2) Return of Capital Followed by Preferred Return		(3) IRR Return	
Priority	Waterfall 1	Waterfall 2	Waterfall 3	Waterfall 4	Waterfall 5	Waterfall 6
Pool 1	Preferred Return. 10% simple interest (based on unreturned capital).	Preferred Return. 10% interest with quarterly compounding (based on unreturned capital and unpaid return).	Return of Capital	Return of Capital	10% IRR with quarterly compounding	<i>Pari passu</i> 95/5 split until 10% IRR with quarterly compounding
Pool 2	Return of Capital	Return of Capital	Preferred Return. 10% simple interest (based on unreturned capital).	Preferred Return. 10% interest with quarterly compounding (based on unreturned capital and unpaid return).	80/20	<i>Pari passu</i> split according to interests until 15% IRR with quarterly compounding
Pool 3	80/20	80/20	80/20	80/20	N/A	80/20

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"Ensuring an Internal Rate of Return (IRR) Distribution Waterfall Flows Correctly"