SULLIVAN & CROMWELL LLP

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Delayed SEC Filings

Recent Decisions Have Held That an Issuer's Delayed SEC Filing Does Not Breach Its Indenture

SUMMARY

Three federal district courts have now ruled that a company's delay in filing its Form 10-Q or 10-K with the SEC does not violate either (1) a widely used indenture provision that requires issuers to deliver copies of such reports to an indenture trustee within a specified time after their filing with the SEC or (2) the federal Trust Indenture Act. *See UnitedHealth Group, Inc.* v. *Cede & Co.*, No. 06-cv-4307 (D. Minn. Mar. 10, 2008); *Affiliated Computer Services, Inc.* v. *Wilmington Trust Co.*, No. 06-cv-1770, 2008 WL 373162 (N.D. Tex. Feb. 12, 2008); *Cyberonics, Inc.* v. *Wells Fargo Bank N.A.*, No. H-07-121, 2007 WL 1729977 (S.D. Tex. June 13, 2007). S&C represented UnitedHealth Group, Inc. in this litigation.

Applying New York contract law, these courts rejected the reasoning of a New York trial court decision finding that an issuer with similar language in its indenture was obligated to file such reports with the trustee within the time limit for their filing with the SEC. *See Bank of New York* v. *BearingPoint, Inc.*, 824 N.Y.S.2d 752 (N.Y. Sup. Ct. Sept. 18, 2006). The *Cyberonics* decision is currently on appeal to the Fifth Circuit, and dispositive motions are pending in at least two similar cases in federal courts. *See Beazer Homes USA, Inc.* v. *U.S. Bank N.A.*, No. 07-cv-2006 (N.D. Ga.); *Am. Stock Transfer & Trust Co.* v. *Par Pharm. Cos., Inc.*, No. 06-cv-13283 (S.D.N.Y.).

BEARINGPOINT AND THE THREE DECISIONS REJECTING ITS REASONING

BACKGROUND

During 2005, BearingPoint, Inc. delayed filing one Form 10-K and two Form 10-Qs beyond the deadlines for such filings under SEC rules. Debtholders purportedly declared certain of BearingPoint's debt securities in default under a reporting obligation similar to those involved in *Cyberonics*, *ACS* and *UHG* as a result of this filing delay, and sued to accelerate the repayment of principal.

On March 18, 2006, the Wall Street Journal published a story entitled "The Perfect Payday," questioning whether several public companies had "backdated" grants of employee stock options. Dozens of large companies reportedly delayed filing one or more Form 10-Qs or 10-Ks while investigating their past option grants. In July and August of 2006, debtholders served notices of default on several of these companies, including Affiliated Computer Services, Inc. ("ACS"), Cyberonics, Inc. ("Cyberonics") and UnitedHealth Group, Inc. ("UHG"), and sought to accelerate debt securities issued by these companies. ACS, Cyberonics and UHG each sought declaratory judgments that the companies were not in breach.

The indentures governing the debt issued by BearingPoint, ACS, Cyberonics and UHG each contained a covenant based on a "Model Simplified Indenture," published by the American Bar Association in 1983. This "1983 model covenant" required that SEC filings (such as Form 10-Qs and 10-Ks) be delivered to the indenture trustee within "*15 days after [the issuer] files them* with the SEC." The indentures did not use the language set forth in the American Bar Foundation's Model Debenture Indenture Provisions (1971), which required that Form 10-Qs and 10-Ks be delivered to the indenture trustee "within *15 days after the Company is required to file* the same with the SEC." Both the 1971 and 1983 model indenture provisions are widely used in the corporate debt market today.[1]

THE *BEARINGPOINT* DECISION

On September 18, 2006, the New York Supreme Court ruled that BearingPoint's delay in filing its Form 10-K and 10-Qs had breached its indenture covenant and violated the Trust Indenture Act of 1939 ("TIA"), reasoning that making timely "SEC filings optional under the terms of the Indenture vitiates the clear purpose of the Indenture to provide information to the investors so that they may protect their investment." Alternatively, the *BearingPoint* court held that the company had repudiated its contractual obligation to deliver its SEC filings to the indenture trustee by failing timely to file those reports. The *BearingPoint* court ordered that BearingPoint's notes be accelerated, the remedy called for by the indenture. The *BearingPoint* court agreed to reconsider its ruling, but the case settled before rehearing or trial.

THE *ACS*, *CYBERONICS* AND *UHG* DECISIONS REJECTING *BEARINGPOINT'S* REASONING

Three federal district courts have now rejected *BearingPoint*'s reasoning, two of which decisions have been issued very recently. Each of the *ACS*, *Cyberonics* and *UHG* courts held that the plain language of the indenture and Section 314 of the TIA required only that the companies deliver to the indenture trustee reports that were actually filed with the SEC, and did not contractually incorporate any requirement that such filings be "timely" made with the SEC in accordance with SEC rules.

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[1] Each indenture also incorporated Section 314(a) of the Trust Indenture Act, which requires that issuers file with the indenture trustee copies of SEC filings such as Form 10-Qs and 10-Ks. This Act does not specify any deadline for when such reports must be filed with the SEC or the indenture trustee.

Each of these cases noted approvingly that the issuers had provided investors with the best available (albeit preliminary) information regarding the issuer's financial situation. *Cyberonics* held that the purpose of the indenture's "delivery" covenant was "not to obligate the company to file in accordance with the [Securities Exchange Act of 1934 ("Exchange Act")], but to keep the trustee informed of company developments," which obligation could be "satisfied . . . through 8-K filings." Similarly, both *ACS* and *UHG* acknowledged that the issuer had provided timely financial information in notifications of delayed filings under Rule 12b-25, press releases and Form 8-Ks.

The *UHG* court examined more closely the equities than the *Cyberonics* and *ACS* courts: "If the principle that one who seeks equity must do equity means anything, the Noteholders' suggestion that they should reap a windfall profit from UHG under these circumstances should turn to stone in their mouths." Thus, the implied covenant of good faith and fair dealing could not be "used as a sword to skewer" an issuer that, like UHG, "timely made each and all payments on the Notes," did not "violate the Indenture's plain language," and "complied with its statutory reporting duties" under the Exchange Act. The *UHG* court recognized that companies routinely and legitimately delay their Form 10-Q and 10-K filings, "because a company is prohibited by law from filing a Form 10-Q which it knows to be inaccurate or misleading," and noted that the SEC retains the power "to sanction companies which might abuse this protection."

IMPLICATIONS

These decisions demonstrate the need to consider carefully the language of new indentures relating to the delivery of SEC reports to the indenture trustee. Under the *Cyberonics*, *ACS* and *UHG* decisions, the "1983 model covenant" allows issuers to delay their SEC filings, because such reports must be delivered to the indenture trustee only "within 15 days after [the issuer] files them with the SEC." While these cases provide useful guidance, it is important to bear in mind that because they are federal district court decisions, they are not binding precedent for other federal courts or state courts. On the other hand, the "1971 model covenant," which was not addressed in the recent decisions, provides that SEC filings are to be delivered to the indenture trustee within "15 days after the Company is required to file … with the SEC." Accordingly, we recommend that for new indentures, the parties to the transaction carefully consider, and clearly state in the indenture, the implications of a breach of the covenant. If the parties agree that the covenant is not intended to impose an independent timely filing requirement, the indenture should so state. Alternatively, the parties may wish to consider excluding a breach of this covenant from the defaults giving rise to a right of acceleration, specifying a period longer than 15 days when failure to file an SEC report becomes a default or, in lieu of a default, providing for an increase in the interest rate while the issuer is in noncompliance with SEC reporting requirements.

Companies that already have either formulation and must delay an SEC filing may reduce the risk that those debt securities will be effectively accelerated by timely publishing the best available financial information, using a notification under Exchange Act Rule 12b-25 and Current Reports on Form 8-K, and promptly furnishing them to the trustee. We also note that New York law recognizes an equitable defense

to the remedy of acceleration where the breach is technical in nature and does not harm the other party. This equitable defense was briefed in each of *ACS*, *Cyberonics* and *UHG*, but was not reached by any court.

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