



JONES DAY COMMENTARY

FEDERAL APPEALS COURT FINDS NO DEFAULT UNDER INDENTURE REPORTING COVENANT

The U.S. Court of Appeals for the Eighth Circuit recently held in *UnitedHealth Group Inc. v. Wilmington Trust Co.*¹ that an issuer had not defaulted under the reporting covenant of its bond indenture by failing to timely file a quarterly report with the Securities and Exchange Commission. In so holding, the Eighth Circuit becomes the fourth federal court (and the first appellate court) to reject the decision of the New York State trial court in *Bank of New York v. BearingPoint, Inc.*² This *Commentary* summarizes the *UnitedHealth Group* decision and some common variations of reporting covenants.

THE EIGHTH CIRCUIT'S DECISION

In the *UnitedHealth* indenture, the reporting covenant required the issuer to “cause copies of all current, quarterly and annual financial reports . . . which the Company is then required to file with the [SEC]” to be filed with the trustee and mailed to registered bondholders “within 15 days of filing with the [SEC].” As a

result of an internal investigation into options backdating practices, *UnitedHealth* was unable to timely file a quarterly report with the SEC. A group of investors, which had purchased a substantial number of the bonds in the open market at a discount, alleged that the failure to file a quarterly report with the SEC in a timely manner breached the reporting covenant. As a result, the bondholders requested that the trustee declare *UnitedHealth* in default and accelerate the repayment of the entire principal amount of the bonds.

In concluding that *UnitedHealth* had not defaulted under the indenture, the Eighth Circuit reasoned in part that the text of the reporting covenant “imposes only a relative time constraint” rather than an “independent obligation to comply with the Exchange Act or SEC regulations.”³ According to the court, the company was obligated simply to transmit to the trustee and bondholders what it filed with the SEC after doing so. In light of the “clear and unambiguous language of the indenture,”⁴ the Eighth Circuit declined to follow

the New York court's decision in *BearingPoint*, even though the covenant at issue in that case was virtually the same as the UnitedHealth covenant. The Eighth Circuit found the reasoning of three other federal courts that had rejected the *BearingPoint* decision⁵ more persuasive. Those courts had read similar reporting covenants as "impos[ing] nothing more than the ministerial duty to forward copies of certain reports, identified by reference to the Exchange Act, within fifteen days of actually filing the reports with the SEC."⁶

The Eighth Circuit also rejected the trustee's claims that UnitedHealth had violated Section 314(a) of the Trust Indenture Act (the "TIA") and had breached an implied covenant of good faith and fair dealing. Section 314(a) of the TIA requires every obligor under a trust indenture to "file with the indenture trustee copies of the annual reports and of the information, documents, and other reports . . . which such obligor is required to file with the Commission pursuant to section 13 or section 15(d)" of the Exchange Act.⁷ The Eighth Circuit observed that this language "imposes no time constraints" on filings with the trustee and thus "is actually *less* burdensome than . . . the indenture."⁸ Since the court had already found that UnitedHealth's conduct complied with the indenture, it followed that its conduct also complied with the TIA. As for the implied covenant of good faith and fair dealing, the Eighth Circuit held that UnitedHealth "took all reasonable and necessary steps to provide its noteholders with as much information as possible."⁹ In lieu of filing its Form 10-Q, UnitedHealth had furnished the trustee with comparable data on its financial condition and results of operations, and it regularly updated investors about developments in its backdating investigation.

As the opinions in *BearingPoint*, *UnitedHealth*, and other cases have stressed, courts in this area will consider all the relevant facts and circumstances before determining whether an issuer has complied with its reporting covenants.

THE TEXT OF COMMON REPORTING COVENANTS

With the *BearingPoint* and *UnitedHealth* decisions in mind, we surveyed forms of reporting covenants, as well as actual reporting covenants from recent high-yield and investment-grade offerings. Although many variations may be found in

negotiated indentures, the following sample illustrates some of the more common models and versions in use.

1. **Bar's Model Reporting Covenants.** The American Bar Foundation and the American Bar Association have published a series of model covenants over the years for use by issuers and indenture trustees.
 - a. *ABF Model Debenture Indentures (1965–1967).*¹⁰ As part of the first project to create standardized forms for debt securities, a committee of the American Bar Foundation prepared a model indenture that contains a reporting covenant. The covenant requires the issuer to "file with the Trustee, within 15 days after the Company is required to file the same with the [SEC], copies of the annual reports and of the information, documents and other reports . . . which the Company may be required to file with the [SEC] pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934" Commentary to the model indenture indicates that the American Bar Foundation "expect[ed]" this language to become "commonplace, standardized 'boilerplate.'"¹¹
 - b. *ABA Model Simplified Indenture (1983, revised 2000).*¹² In 1983, and again in 2000, the ABA sought to revise and simplify the prior model indenture. The 1983 and 2000 versions of the covenant are in pertinent part virtually identical. They call for the issuer to "file with the Trustee within 15 days after it files them with the SEC copies of the annual reports and of the information, documents, and other reports . . . which the Company is required to file with the SEC pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934." The reporting covenant in the ABA's model simplified indenture closely resembles UnitedHealth's reporting covenant.¹³ The 2000 commentary indicates that the ABA was aware that many indentures in practice required the issuer to continue filing timely periodic annual and quarterly reports with the trustee even if the issuer ceased to be subject to Exchange Act reporting requirements.¹⁴
 - c. *ABA Model Negotiated Covenants (2006).*¹⁵ In the 2006 model, the ABA shifted its approach by preparing a set of standardized covenants for high-yield

issuers. The reporting covenant included among them requires the issuer to “[{(1)}] file with the SEC . . . and [(2)] provide the Trustee and Securityholders with such annual reports and such information, documents and other reports as are specified in Sections 13 and 15(d) of the Exchange Act . . . , such information, documents and other reports to be so filed and provided at the times specified for the filings of such information, documents and reports under such Sections” In the event that the issuer ceases to be subject to Exchange Act reporting requirements, the 2006 model requires the issuer to continue filing reports with the SEC on a voluntary basis within the same time periods as a reporting company. Finally, the issuer must agree to furnish its investors with “any information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act so long as the [bonds] are not freely transferable under the Securities Act.” The model thus closes the gap in the earlier ABA indentures that allowed an issuer to avoid reporting to its bondholders if it ceased to be subject to Exchange Act reporting requirements. As the commentary notes, “the covenant requires timely filing of SEC reports (vs. providing such reports to Security holders [sic] once the reports have been filed). Companies that have found themselves in restatement situations and thus unable to make their filings on a timely basis have been faced with technical default of this covenant.”¹⁶

2. **Sample High-Yield Covenants.** Most high-yield reporting covenants are based on the standard forms of “Description of Notes” used by the investment banks that participate in the sale of the bonds. As a result, high-yield reporting covenants tend not to vary significantly from offering to offering, and they are generally more restrictive on high-yield issuers than investment-grade reporting covenants are on investment-grade issuers. Many high-yield reporting covenants resemble the ABA’s 2006 model covenant. For example, a reporting covenant from a 2007 high-yield offering required the issuer to “file with the SEC . . . and provide the Trustee and Securityholders with such annual and other reports as are specified in Sections 13 and 15(d) of the Exchange Act . . . , such reports to be so filed and provided at the

times specified for the filings of such reports under such Sections”

3. **Sample Investment-Grade Covenants.** Unlike most high-yield covenants, investment-grade covenants are generally based on the issuer’s own precedents, and a wider range of formulations is found. Some are similar to the high-yield model above. Others require the issuer to “file with the Trustee and transmit to Holders such information, documents and reports as may be required pursuant to the Trust Indenture Act,” provided that an issuer not subject to Exchange Act reporting requirements must furnish its investors with the information required by Rule 144A(d)(4). Still others simply call for the issuer to comply with Section 314(a) of the TIA.
4. **Credit Roundtable “White Paper” for Investment-Grade Bonds.**¹⁷ In 2007, the Credit Roundtable, in association with the Fixed Income Forum, published a set of model covenants designed to improve the protections afforded to investors in offerings of investment-grade bonds. The model reporting covenant requires an issuer (a) to furnish its bondholders with copies of its Exchange Act reports “within the time periods specified in the SEC’s rules and regulations”; (b) in the event that the issuer ceases to be subject to Exchange Act reporting requirements, to publish financial information on its web site “substantially similar to that which would have been required” in Exchange Act reports “within the time periods that would have been applicable to filing such reports with the SEC”; and (c) if the issuer’s bonds are not freely transferable under the Securities Act, to provide investors and others with the information required under Rule 144A(d)(4).

This *Commentary* takes no position on the proper application of the *BearingPoint* and *UnitedHealth* decisions to any of the forms and variations of reporting covenants summarized above. We do not endorse any of the reporting covenants presented herein as appropriate for any particular indenture. The interpretation of any particular reporting covenant or how a court ought to rule when an issuer has not made its SEC filings on a timely basis will depend on a review of all relevant facts and circumstances.

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ENDNOTES

- 1 _____ F.3d _____, No. 08-1904, 2008 WL 5047669 (8th Cir. Dec. 1, 2008).
- 2 No. 600169/06, 2006 WL 2670143 (N.Y. Sup. Ct. Sept. 18, 2006) (unreported opinion).
- 3 *UnitedHealth Group*, 2008 WL 5047669, at *3.
- 4 *Id.* at *5.
- 5 *Finisar Corp. v. U.S. Bank Trust N.A.*, No. C 07-4052, 2008 WL 3916050 (N.D. Cal. Aug. 25, 2008) (unreported opinion); *Affiliated Computer Servs., Inc. v. Wilmington Trust Co.*, No. 3:06-CV-1770-D, 2008 WL 373162 (N.D. Tex. Feb. 12, 2008) (unreported opinion); *Cyberonics, Inc. v. Wells Fargo Bank N.A.*, No. H-07-121, 2007 WL 1729977 (S.D. Tex. June 13, 2007) (unreported opinion).
- 6 *UnitedHealth Group*, 2008 WL 5047669, at *5.
- 7 TIA § 314(a)(1), 15 U.S.C. § 75nnn(a)(1).
- 8 2008 WL 5047669, at *5.
- 9 *Id.* at *7. Under New York law, every contract is deemed to contain an implied covenant of good faith and fair dealing, which "precludes each party from engaging in conduct that will deprive the other party of the benefits of their agreement." *Filner v. Shapiro*, 633 F.2d 139, 143 (2d Cir. 1980) (citing *Kirke LaShelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87 (1933)).
- 10 American Bar Found., Model Debenture Indenture Provisions § 704(1) (1965); American Bar Found., Model Debenture Indenture Provisions—All Registered Issues § 704(1) (1967).
- 11 Introduction to American Bar Found., Sample Incorporating Indenture and Model Debenture Indenture Provisions 1, 1 (1965).
- 12 Comm. on Developments in Bus. Fin., ABA Section of Corp., Banking & Bus. Law, *Model Simplified Indenture* § 4.02, 38 Bus. Law. 741, 755 (1983); Comm. on Trust Indentures & Indenture Trustees, ABA Section of Bus. Law, *Revised Model Simplified Indenture* § 4.02, 55 Bus. Law. 1115, 1134 (2000).
- 13 Cf. *UnitedHealth Group*, 2008 WL 5047669, at *4 ("[T]he language [of UnitedHealth's reporting covenant] is derived from a Model Simplified Indenture drafted by the American Bar Association in 1983.").
- 14 See *Revised Model Simplified Indenture* § 4.02 cmt., 55 Bus. Law. at 1184.
- 15 Comm. on Trust Indentures & Indenture Trustees, ABA Section of Bus. Law, *Model Negotiated Covenants and Related Definitions* § 4.13, 61 Bus. Law. 1439, 1536 (2006). The model negotiated covenants were designed to supplement the 1983 and 2000 model indentures, which had omitted covenants customarily negotiated by the issuer and underwriters.
- 16 *Id.* § 4.13 cmt., 61 Bus. Law. at 1535.
- 17 The Credit Roundtable in Ass'n with the Fixed Income Forum, Improving Covenant Protections in the Investment Grade Bond Market (Dec. 17, 2007), available at http://admin.iimemberships.com/downloads_upload/creditroundtable/Covenant%20White%20Paper%20publication%20copy.pdf. The Credit Roundtable and Fixed Income Forum are trade groups supported by *Institutional Investor* magazine. They represent the views of fixed income investors and senior executives at institutional investors specializing in fixed income.

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