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The “Delivery Covenant” Controversy Divergent Court Opinions Raise Questions Over Boilerplate

It is relatively rare that the interpretation of a covenant contained within a bond indenture becomes the subject of a reported court opinion. It is even rarer that two courts, examining the same type of covenant, arrive at differing conclusions. And now a third court has been requested to join the fray.

At the heart of the issue is a covenant included in an overwhelming majority of bond indentures and often regarded as a “boilerplate.” The covenant, sometimes known as the “Delivery Covenant,” requires the issuer of the bonds to deliver to the bond trustee under the indenture the quarterly and annual reports and other information required to be filed with the Securities and Exchange Commission (the “SEC”) pursuant to Sections 13 and 15(d) of the Securities Exchange Act of 1934 (the “Act”). The specific legal issue with which the courts are now wrestling is whether such a covenant requires the issuer to timely file all such Act reports with the SEC — essentially incorporating into the bond covenants by reference the filing deadlines under the Act — or whether it requires the issuer to deliver such reports to the bond trustee substantially contemporaneously with the filing of such reports with the SEC, regardless of whether such filings are timely made under SEC rules.

In *Bank of New York v. BearingPoint, Inc.*, No. 600169106, 2006 N.Y. Misc. LEXIS 2448 (N.Y. Sup. Ct. Sept. 18, 2006), a New York supreme court held that BearingPoint, Inc., which had two series of outstanding debentures under its indenture, had violated the reporting provisions in the BearingPoint indenture. *Id.* at *2-4, 7-9. Further, the court held that BearingPoint had also violated Section 314(a) of the Trust Indenture Act of 1939 (the “TIA”) by failing to timely file its SEC reports and, consequently, failing to provide its SEC reports to the indenture trustee. *Id.*

The court addressed two issues. First, whether BearingPoint was unconditionally required to timely file reports with the SEC and, pursuant to its indenture, provide the filed SEC reports to the indenture trustee within 15 days thereafter. *Id.* at *3-4. Second, whether BearingPoint was merely required to provide SEC reports to the indenture trustee if, and only if, such reports were filed with the SEC. *Id.* at *4-5. The court noted “The provision, which is denominated ‘SEC and other Reports,’ provides ‘[T]he Company **shall** file with the Trustee...copies of its annual report and ... other reports ... which the Company is required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act.’” *Id.* (emphasis added).

Additionally, the court noted that the BearingPoint indenture stated: “The Company shall comply with the other provisions of TIA Section 314(a).” *Id.*

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Given the language in the BearingPoint indenture, the court found that BearingPoint had an affirmative obligation to timely file its SEC reports under both the indenture and Section 314 (a) of the TIA. *Id.* at *7-9. Thus, BearingPoint's obligation to provide SEC reports to the indenture trustee was not dependent upon its filing of those reports with the SEC. Given that BearingPoint was unwilling to provide any information to bondholders when it became delinquent in filing its SEC reports, the court stated that to rule otherwise would "vitiating the clear purpose of the Indenture to provide information to the investors so that they may protect their investment." *Id.* at *7.

However, in June 2007, the United States District Court for the Southern District of Texas took the opposite view of the court in *BearingPoint*. In *Cyberonics Inc. v. Wells Fargo Bank National Ass'n.*, No. H-070121, 2007 U.S. Dist. LEXIS 42779 (S.D. Tex. June 13, 2007), the court held that the Delivery Covenant in the Cyberonics indenture only required the bond issuer to file SEC reports with the indenture trustee within 15 days of **actually** filing the SEC reports with the SEC. *Id.* at *9-10. The Court noted the relevant language in the Cyberonics indenture requires Cyberonics to "deliver to the Trustee within 15 days **after** it files them with the SEC copies of the annual reports ... which the Company is required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act." *Id.* (emphasis altered).

Given the language in the Cyberonics indenture, the court determined that the bond issuer does not have an affirmative obligation to timely file SEC reports pursuant to the Delivery Covenant in the indenture. *Id.* at *10-11. In addressing the obligations imposed by Section 314(a) of the TIA, the court in *Cyberonics* reasoned that the language of Section 314(a) of the TIA is less stringent than the reporting covenant itself because the former does not have the deadline imposed by the latter. *Id.* at *11. Thus, Section 314(a) of the TIA does not require the bond issuer to timely file its SEC reports.

Additionally, the court in *Cyberonics* noted that, unlike BearingPoint, Cyberonics kept its bondholders informed of company developments by filing Form 8-Ks containing information about the company's operations with the indenture trustee. *Id.* at *15.

Recently, this issue has worked its way into the Eleventh Circuit. In September 2007, U.S. Bank National Association sent purported default notices to Beazer Homes USA, Inc., threatening to accelerate \$1.3 billion in debt because Beazer Homes failed to timely file its Form 10-Q for the quarter ending June 30, 2007. Beazer Homes delayed the filing of its Form 10-Q because it uncovered some potential misstatements in certain accounting entries that needed to be reviewed prior to filing its Form 10-Q with the SEC.

Given that the Delivery Covenant contained in the Beazer Homes' indenture reads similarly to Cyberonics indenture, Beazer Homes is seeking declaratory relief because its covenant does not incorporate SEC timing requirements for filing but rather that it must contemporaneously deliver to the bond trustee those filings made with the SEC when those filings are, in fact, made. Also, and again similar to Cyberonics, Beazer Homes argues that the court should grant declaratory relief because it has never missed a payment to the bondholders and it has kept the bondholders informed of its operations and financial condition by filing Form 8-Ks, including unaudited financial statements, with the indenture trustee.

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Every borrower or issuer should carefully consider the effects of the failure to deliver quarterly and annual financial statements in a timely manner under its bank debt and bond covenants. And, in an effort to avert a negative reaction by creditors to delinquent SEC reporting, borrowers and issuers should consult with their respective administrative agents and bond trustees before missing a filing deadline and ensure that the various creditor groups are kept abreast of the business operations and financial condition of the company. These steps will demonstrate that the company is using its best efforts to provide its creditors with the requisite information to aid in the protection of their investment and may help avert costly litigation.

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