

Disclosure Schedule Updating for COVID-19 Effects

April 8, 2020

The COVID-19 virus has ushered in unprecedented and challenging times for our country and our global community. From the deeply personal pain and suffering caused by the virus as a health pandemic, to behavioral adjustments in the consumer population at large ("social distancing," etc.), to the everyday, but very real, burdens created by business closures and shelter in place orders, the full force and impact of the virus on our society won't be known for a long time. Apart from these personal and social consequences, of course, the economic downturn is almost certainly just beginning to be seen.

And yet businesses move forward, even in a very different and challenging environment. Businesses now confront practical, real world decisions, with economic and human impact. How do I keep my workforce safe? How do I run my business without travel or face-to-face meetings? How do I deal with current contracts that I know my business can't perform? Do I have any rights for rent abatement under my leases? Is my business exempt from government closures as an essential business?

Certainly, the COVID-19 virus is impacting the way M&A transactions are being looked at, papered and implemented.

Buyers (and rep and warranty insurers) are focusing more aspects of their due diligence on virus-related matters. Transaction parties are negotiating expanded or new representations to address the effect of COVID-19 on the target business, as well as the policies and protocols for dealing with those effects. They are also looking whether the pandemic constitutes a "material adverse effect" or "material adverse change" under the terms of their agreement.

At the same time, M&A sellers are seeking to disclose more COVID-19 matters and consequences - - past, present or future - - to buyers, on the sellers' "disclosure schedules." For transactions subject to a signed M&A purchase agreement but which have not yet closed, sellers are looking to their agreements to see how the topic of disclosure schedule updating is addressed. For a seller about to sign an M&A purchase agreement, the question becomes prospective: how should the parties deal with COVID-19 (or other pre-closing developments) through disclosure schedule updates? Sellers may want maximum flexibility to disclose new COVID-19 consequences, through post-signing disclosure schedule updates, as those effects evolve and occur prior to closing. Buyers will want appropriate limitations, controls and/or other rights - -whether as to termination, indemnification or otherwise - - relating to disclosure schedule updates, depending on the type, materiality and timing of the new disclosures, among other factors.

This article looks at disclosure schedule updating options most commonly negotiated in M&A purchase agreements. Also reviewed are the more typical buyer rights to be considered with respect to, and in response to, disclosure schedule updating. Of course, every M&A purchase agreement is different from the next, and a seller's rights to update disclosures to reflect COVID-19 will depend upon how the agreement has addressed the topic - - whether or not the agreement itself implements any of the typical approaches discussed herein.

What are Disclosure Schedules?

Disclosure schedules are a common component of M&A purchase agreements. A seller's disclosure schedules provide fact-specific disclosures (or exceptions to specific statements) relating to the seller's representations and warranties.^[1] As such, disclosure schedules are an integral part of the seller's representations and warranties. Disclosures made in the disclosure schedules generally fall within two different categories:

- **"Affirmative" Disclosures:** These are disclosures in which the seller must affirmatively disclose certain information as required under the corresponding representations and warranties. It is typical for an M&A purchase agreement to include seller representations and warranties ***requiring that the disclosure schedule list*** certain material contracts, employees and employee benefit plans, current litigation, company policies, etc.
- **"Negative" Disclosures:** These are disclosures "against," or as exceptions or qualifiers to, the seller's representations and warranties. As an example, an M&A purchase agreement may include a representation by the seller that the target business has complied with all applicable laws, ***except as set forth on the disclosure schedules***.

Primary Implications of Disclosure Schedule Updating

Generally, three different, but related, aspects of the M&A purchase agreement (and the resulting relationship between seller and buyer) impact the seller's ability to update disclosure schedules, between the time the M&A purchase agreement is signed and the closing.

- **Closing Conditions:** Most M&A purchase agreements include a condition to the buyer's obligation to close the transaction, that the seller's representations and warranties continue to be true and correct (or materially true and correct) as of the closing. If the seller is allowed to update unilaterally these disclosure schedules, and therefore "amend" its representations and warranties to "make them true," this closing condition would be of no real benefit to the buyer.
- **Termination Rights:** If the seller is allowed to update disclosure schedules, should the buyer, if nothing else, have the right to terminate the M&A purchase agreement if unhappy with the newly disclosed facts or circumstances?
- **Liability for Breach:** Similarly, even if the seller is permitted to provide disclosure schedule updates, should the updates absolve the seller of responsibility under that representation or warranty? Put another way, should a seller be able to ***cure*** a breach of a representation or warranty existing at the time of signing by updating the disclosure schedules and therefore amending the seller's representations and warranties?

Other Relevant Factors

Other factors can come in to play when negotiating an appropriate disclosure schedule updating structure for an M&A purchase agreement.

- **Affirmative v. Negative Disclosures.** As noted above, seller disclosures in the disclosure schedules generally can be characterized as either affirmative disclosures—disclosures of contracts or other items affirmative called out in the relevant representation—or negative disclosures—disclosures that provide exceptions to affirmative statements within the relevant representations. This distinction can be important. Buyers may be more amenable to disclosure schedule updates with respect to affirmative, rather than negative, disclosures. For example, if a seller, post-signing, adopted reasonable and prudent technology policies for its employees working remotely in response to COVID-19, and that business policy would have been disclosed if it had been in place at the time of signing, it is difficult to argue **against** allowing the seller to amend the disclosure schedules to reflect the new COVID-19-centric policy. This is especially true if adopting the new policy was in compliance with the seller’s covenants regarding operation of the target business prior to closing.
- **Retroactive vs New Disclosures.** Similarly, whether or not an update relates to new information or facts, as opposed to those existing at the time of signing, can be relevant. A seller may have a more compelling case to update disclosure schedules for events occurring after the signing of the agreement, than to add facts which were in place or occurring at or prior to signing, but were not disclosed at that time (whether by mistake, lack of knowledge, etc.). Depending upon the timing of the M&A purchase agreement signing, the speed at which COVID-19 has hit the US business environment, and the continuing, evolving effects of the virus, all suggest that some COVID-related circumstances are likely to be considered “new” for these purposes.
- **Materiality of Updates.** Finally, the materiality of the new disclosure can be relevant for determining the effect of disclosure schedule updating. Logic suggests that a buyer should have more input and rights with respect to a matter newly disclosed, based on the materiality of that matter, whether materiality is measured in terms of financial implications or business operations.

Common Alternatives for Disclosure Schedule Updating Provisions

The matrix below summarizes the typical pro-seller and pro-buyer positions with respect to the updating factors and issues described above, as well as example compromise positions on each of the structural elements:

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|------------------|-----------------|----------------|------------------|------------------|-----------------|-----------------------|
| | Closing | Termina | | Affirmati | Retro/ | |
| Orientati | Conditio | tion | Seller | ve/ | New | Materiality of |
| on | ns | Rights | Liability | Negative | Disclosu | Updates |
| | | | | Disclosu | res | |
| | | | | res | | |

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|------------------------------|---|---|--|--|---|---|
| | | Buyer | | Seller | Seller | |
| | Updates | cannot | Seller | may | may | |
| | amend | terminate | may cure | update | update as | |
| Pro-Seller | reps for closing condition purposes. | M&A purchase agreement due to update. | existing breaches via update. | either affirmative or negative disclosure s. | current, new or retroactive information. | Materiality of seller updates irrelevant. |
| | | | Seller | | | |
| | Updates | Buyer can terminate | may not cure | Seller | Seller | |
| | do not amend | M&A purchase agreement | existing breaches via update, | may not update | may not update as | |
| Pro-Buyer | reps for closing condition purposes. | t due to an update of which it does not approve. | and is liable for breach regardless of any update. | against either affirmative or negative disclosure s. | to current, new or retroactive information. | Materiality of seller updates irrelevant, since no updates are allowed. |
| | | | | | | |
| Potential Compro mise | Updates will amend reps for closing condition purposes, subject to termination rights | If the update discloses something material, buyer can terminate . | Seller cannot update so as to cure breaches in effect at signing, but may update for | Seller may update against affirmative but not negative disclosure s. | Seller may update as to current, new, but not retroactive, information. | If a material update is made it would cause a closing condition failure and allow buyer to terminate. |

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Disclosure schedules are an integral part of the seller’s representations and warranties. Updating of disclosure schedules directly impacts risk allocation as between buyer and seller. As reflected in the matrix above, the parties have a wide range of alternatives that they can use to address disclosure schedule updating within an M&A purchase agreement. These current and common options can likely be tailored to reflect a reasonable, negotiated allocation as to COVID-19 developments.

[1] Disclosure schedules are typically more detailed and extensive with respect to the seller’s representations, although there may be disclosure schedules with respect to a buyer’s representations and warranties, depending upon the transaction.