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Trends in M&A Provisions: Disclosure Schedule Updating

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What are Disclosure Schedules?

Disclosure schedules are a common component of an M&A purchase agreement (whether a stock purchase agreement, asset purchase agreement, or merger agreement). The disclosure schedules provide fact-specific disclosures (or exceptions to specific statements) relating to the representations and warranties. [2] As such, disclosure schedules are an integral part of the seller's representations and warranties, and directly impact the scope of and seller's responsibility under those representations and warranties. Disclosures made in the disclosure schedules generally fall within two different categories:

- **"Affirmative" Disclosures**: These are disclosures in which seller must affirmatively disclose certain information as required under the corresponding representations and warranties. It is typical for 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, etc.
- **"Negative" Disclosures**: These are disclosures "against," or as exceptions or qualifiers to, the seller's representations and warranties. As an example, 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.

Seller and Buyer Perspectives on Disclosure Schedule Updating

Unless the purchase agreement contemplates a simultaneous signing and closing, where the transaction is completed at the time the purchase agreement is signed, there will be some period of time between signing and closing. The period of time between signing and closing can run from days to months, depending on the conditions that must be met prior to the closing.

Because the disclosure schedules are typically attached to and part of the purchase agreement, the disclosures usually are made as of the signing date (or periods prior to that date). However, in the interim period between signing and closing, the seller will continue to enter into contracts, hire and fire employees, address liabilities and claims as they arise, and otherwise continue operations of

the target business. [3] A seller's disclosure schedules provided at the signing of the purchase agreement would not, therefore - - absent some type of updating mechanism – reflect facts or information coming to light after signing and prior to closing. This can be problematic, particularly if (and as is often the case) a seller's representations and warranties are made to the buyer as of the signing of the purchase agreement and as of the closing.

Primary Implications of Disclosure Schedule Updating

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

- **Closing Conditions**: Most purchase agreements include a condition to the buyer's obligation to close the transaction requiring 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 the disclosure schedules, and therefore "amend" its representations and warranties, this closing condition could be of reduced value 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 purchase agreement?
- **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 amending the disclosure schedules and therefore the seller's representations and warranties?

Other Relevant Factors

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 as buyers may be more amenable to disclosure schedule updates with respect to affirmative, rather than negative, disclosures. For example, if a seller enters into a new material contract prior to closing, and that contract 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 that new contract. This is especially true if entering into the contract was in compliance with the seller's covenants regarding operation of the target business prior to closing.

Similarly, and related to the issues of termination rights and seller liability, 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 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.).

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.

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 common compromise positions:

Orientation	***Closing Conditions***	***Termination Rights***	***Seller Liability***	***Affirmative/ Negative Disclosures***	***Retro/ Current Disclosures***	***Materiality of Updates***
Pro-Seller	Updates amend reps for closing condition purposes.	Buyer cannot terminate purchase agreement due to update.	Seller may cure existing breaches via update.	Seller may update against either affirmative or negative disclosures.	Seller may update as to current, new or retroactive information.	Materiality of seller updates irrelevant.
Pro-Buyer	Updates do not amend reps for closing condition purposes.	Buyer can terminate purchase agreement due to an update of which it does not approve.	Seller may not cure existing breaches via update, and is liable for breach	Seller may not update against either affirmative or negative disclosures.	Seller may not update as to current, new or retroactive information.	Materiality of seller updates irrelevant, since no updates are allowed.

			regardless update.			
Potential Compromise	Updates will amend reps for closing condition purposes, subject to termination rights and materiality provisions.	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 new matters.	Seller may update against affirmative but not negative disclosures.	Seller may update as to current or new, but not retroactive, information.	If a material update is made it would cause a closing condition failure and allow buyer to terminate.

Trends Regarding Disclosure Schedule Updates

Every other year since 2005 the American Bar Association ("ABA") has released its Private Target Mergers and Acquisitions Deal Point Studies (the "ABA studies"). The ABA studies examine purchase agreements of publicly available transactions involving private companies that occurred in the year prior to each study (and in the case of the 2017 study, including the first half of 2017). These transactions range in size but are generally considered as within the "middle market" for M&A transactions; the average transaction value within the 2017 study was $176.3 million.

The most recent four ABA studies have looked at whether the reported deals: (1) allowed or required disclosure schedule updates; (2) prohibited such updates; or (3) were silent on the topic.

Where updating was permitted or required, the studies also looked at whether: (1) the information eligible for updating was limited to post-signing information; and (2) the buyer's right to indemnification was limited with respect to the updated information. [4] As a practical matter, if an agreement is silent as to disclosure schedule updating, the likely result is that the seller would not be able to unilaterally effect such an update (the same result as a prohibiting updates).

Conclusion

The ABA studies generally show that: (1) allowing or requiring disclosure schedule updates is permitted in only about one-third of the reported deals (i.e., a minority position); (2) in deals permitting disclosure schedule updating (a) about half of reported deals limit the updates to post-signing info and (b) between 40 and 60 percent place limitations on the buyer's indemnification rights with respect to updated matters.

Though often set forth in a separate document attached to the purchase agreement, disclosure schedules are an integral part of the seller's representations and warranties. Further, 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 a purchase agreement. Because of the impact, practitioners should tailor the disclosure schedule updating structure to the specific aspects of their particular transaction.

[1] Daniel Avery is a Director in the Business Law Group at Goulston & Storrs, in Boston, Massachusetts. Mr. Avery is a member of the ABA's working group which published the 2017 ABA private company M&A deal points study. This article is based on, and updates, the article of the same name co-authored by Mr. Avery and Daniel H. Weintraub, Managing Director and General Counsel of Audax Group, published in the Volume 5, No. 13 Edition of the Bloomberg Law Reports —Corporate and M&A Law (2011). This article is one of a series of over 20 articles co-authored by Mr. Avery looking at trends in private company M&A deal points. The series is currently being updated to reflect the 2017 ABA private company study and will be published throughout 2018. The articles can be found on Goulston & Storrs' "What's Market" web page at https://www.goulstonstorrs.com/whats-market/ and on Bloomberg Law at https://www.bloomberglaw.com/page/infocus_dealpoints.

[2] 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. For example, in a merger of equals, or a transaction where the seller is receiving securities of the buyer as part of the transaction consideration, buyer representations and the related disclosures may be a very important aspect of the transaction for the seller.

[3] Most purchase agreements have covenants requiring the target business to be operated in the ordinary course prior to closing. Purchase agreements often also require the seller to notify the buyer if it becomes aware prior to closing of any facts or circumstances which constitute a breach of the seller's representations and warranties.

[4] The 2017, 2015, 2013 and 2011 ABA Studies looked at these variables. Although the 2009 ABA study looked at disclosure schedule updating, it used different wording than the subsequent studies. As result, we have not referenced the 2009 study information.