

## Trends in M&A Provisions: Disclosure Schedule Updating

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### *What are Disclosure Schedules?*

Disclosure schedules are a common component of a 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 representations and warranties in the purchase agreement.<sup>1</sup> As such, disclosure schedules are an integral part of the seller's representations and warranties, and directly impact the scope of those representations and warranties (and, therefore, the seller's responsibility for the same). The disclosures within disclosure schedules generally fall within two different categories, as follows:

1. "Affirmative" Disclosures. These are disclosures that are affirmatively required to be disclosed by the seller's representations and warranties. It is typical for a purchase agreement to include seller representations and warranties requiring the disclosure schedules to list, for example, material contracts, employees and employee benefit plans, current litigation, and the like. The disclosure schedules would provide this information.
2. "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 need to be met for closing of the transaction to occur.

Since the disclosure schedules are typically attached to and part of the purchase agreement, they usually speak as of the date of signing (or periods prior to that date). However, during the pre-closing business, the seller will continue to enter into contracts, hire and fire employees, deal with liabilities and claims as they arise, and otherwise continue operations of the target business.<sup>2</sup> A seller, therefore, will want to update its disclosure schedules to reflect facts or information coming to light after signing and prior to closing.

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## *Primary Implications of Disclosure Schedule Updating*

Generally, the issue as to whether, and how, the seller may update the disclosure schedules will impact three different—but related—aspects of the purchase agreement (and the resulting relationship between seller and buyer), as follows:

1. Closing Conditions. Most 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 the disclosure schedules, and therefore "amend" its representations and warranties, this closing condition could be of reduced utility to the buyer.
2. 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?
3. Liability for Breach. Similarly, even if the seller is permitted to provide disclosure schedule updates, should it always be free of liability? 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 within disclosure schedules generally can be characterized as either affirmative disclosures—disclosures of contracts or other items affirmatively called out in the relevant representations—or negative disclosures or exceptions—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, as opposed to 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, especially 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 described above, 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—even a new claim or lawsuit—than to add facts that were in place or occurring at or prior to signing, but that for whatever reason were not disclosed then (whether by mistake, lack of knowledge or otherwise).

Finally, the materiality of the new disclosure can be relevant to 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 if that matter is material, 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
<b>Pro-Seller</b>	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.
<b>Pro-Buyer</b>	Updates do not amend reps for closing condition purposes.	Buyer can terminate purchase agreement due to update that it does not approve.	Seller may not cure existing breaches via update, and is liable for breach notwithstanding update.	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.
<b>Potential Compromise</b>	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 any update is of a material item, it would cause closing condition failure and buyer termination rights.

## Conclusion

As reflected in the matrix above, there is a wide range of alternative possible options to address the issue of disclosure schedule updating within a purchase agreement. 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. Updating of disclosure schedules directly impacts risk allocation as between buyer and seller, so practitioners should tailor the disclosure schedule updating structure to the specific aspects of their particular transaction.

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<sup>1</sup> 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 as well, 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 related disclosures—may be a very important aspect of the transaction for the seller.

<sup>2</sup> Most purchase agreements have covenants requiring the target business to be operated in the ordinary course prior to closing. As a related point, purchase agreements often also require the seller to notify the buyer if it becomes aware prior to closing of any facts or circumstances that constitute a breach of the seller's representations and warranties.