The suitability of Polish law for M&A transactions

INTRODUCTION

The European M&A market is significantly shaped by Anglo-American standards originating from common law, as evidenced by the widespread use of clauses typical of M&A transactions across most EU countries. This occurs despite the fact that the legal systems of continental Europe are rooted in statutory law, rendering common law-derived patterns a foreign construct within these jurisdictions. The incorporation of contractual clauses based on assumptions and frameworks from external legal traditions poses a considerable challenge for legal practitioners. They are tasked with adapting standard M&A provisions originating from common law to agreements governed by legal systems that operate under fundamentally different principles.

These circumstances raise critical questions regarding the compatibility of specific contractual provisions with domestic legal frameworks and their practical enforceability in accordance with the expectations of business participants. Furthermore, practitioners in statutory law jurisdictions must grapple with how national courts – deeply embedded in local legal traditions – will interpret and apply these foreign-inspired contractual arrangements

With reference to the above, the Polish legal order and Polish trading practice may be a particularly interesting and useful example of how state law systems adopt and implement standard M&A transaction patterns derived from the common law tradition. Indeed, it should be borne in mind that in Poland, Western transactional standards found particularly fertile and receptive ground, since it was only after the change of the political system in 1989 that the Polish economy opened up to Western investors. Before that - in the second half of the 20th century - the Polish economy was closed to the West, due to the socialist paradigms in place, and there was no space to develop its own transactional practice. Hence, the contractual standards of M&A transactions derived from the common law tradition took root in uncharted territory and were particularly readily adapted by business participants in Poland.

The Polish legal system and the business trading practice operating here seems to be a particularly interesting example of the phenomenon discussed in this article, of how state law systems adopt contractual patterns derived from common law, and may allow us to answer the question of whether Polish law (as a state law system) is suitable for standard M&A transaction patterns.

ORIGIN MEANING OF REPRESENTATIONS AND WARRANTIES AND INDEMNITY CLAUSES

In transactional practice, the allocation of investment risk associated with the acquired business is a particularly important issue. Of significance are clauses that are intended to protect the buyer from possible improper valuation of the acquired business. It is natural that an important element of whether an investment will be profitable is that a proper valuation should be made. Companies are also valued taking into account data from extensive due diligence. Nonetheless, in a certain general assumption it can be stated that, the role of lawyers and properly structured M&A agreements is to ensure that the parties' agreed price is adequate to the data they had at their disposal during negotiations.

For this purpose, in addition to other legal instruments, various types of representations and warranties and indemnification clauses are used. In the laws that are the source of such transactional patterns, i.e. the law that originated form common law systems, each of such clauses could have a different meaning assigned to it. For the sake of clarity in this article, the above clauses can be described based on the original assumptions as follows.

Representations are of particular importance at the pre-contractual stage, their importance generally lies in the fact that if it can be established that the buyer entered into the contract while being under

the influence of a false assurance, then tort liability (or the statutory liability - e.g. on the basis of the Misrepresentation Act 1967 in the UK) arises on the part of the seller and the buyer can even get out of the contract. This is based on the general principle of caveat emptor, which states that it is the buyer's responsibility to inspect the item being purchased and, if necessary, seek relevant representations about it. (see A. Szlęzak, P. Mazur, Wybrane umowy w transakcjach mergers & acquisitions (share deals) w świetle KC i KSH, Warsaw 2022, s. 175 and following)

Warranties, on the other hand, are an element of the contract, hence if they turn out to be untrue or misleading, there is a breach of contract and the buyer can exercise his remedies and, in particular, claim damages, with a feature of Anglo-American systems being that liability for damages does not depend on the fault of the liable party. That is, in these legal orders the premise is strict liability, whereby liability arises regardless of whether the party in question exercised due diligence in the performance of the contract.

The above distinction with respect to specific legal orders (e.g., the legal orders of specific US states) may be more or less clear, Sometimes the difference between these institutions will be so insignificant that one can even speak of a homogeneous clause on representations and warranties. Nevertheless, as a general assumption of the common law systems from which the standard M&A clauses originate is that, as a general rule, in case of breach of representations and warranties the liability is strict and independent of the fault or exercising due diligence of the liable party. The liable party can only defend against a claim with specific allegations consisting of, among other things, that the connection between the breach of contract and the damage is too remote (remoteness), or that the injured party has not exercised diligence to limit the losses incurred (duty to mitigate loss). (the characteristics above were prepared based on A. Szlęzak, P. Mazur, Wybrane umowy (…), s. 175 and following; J. Jastrzębski, Umowa gwarancyjna, Warsaw 2021, chapter 2, § 5)

Further clauses for the proper allocation of risk within the contract are contractual indemnity clauses expressed in various ways, such as through formulas: to "indemnify", "hold harmless", "keep harmless", "keep indemnified" or "keep free from harm". They are intended to further protect the party acquiring certain good, and consist in stipulate that the obligated party is required to pay specific compensation in the event of certain circumstances, while it will not be a liability for breach of contract, so the aforementioned objections available to the liable party (such as "remoteness" and duty to mitigate) will no longer be accessible to them. These types of clauses are called "redress-loss indemnities". Alternatively, "prevent-loss indemnities" can be constructed, which impose on the debtor firstly the obligation to prevent damage (i.e. to act in such way that will a way that the actual state of affairs will be consistent with the reserved clause), and in the event that this is impossible or ineffective, the debtor will have to pay the agreed compensation. (A. Szlęzak, P. Mazur, Wybrane umowy (…), s. 176 and following; J. Jastrzębski, Umowa (…), chapter 2, § 5; R. Zakrzewski, The Nature of Claim on an Indemnity, Journal of Contract Law 2006, no. 22, s. 54–66.)

GENERAL REMEDIES FOR BREACH OF REPRESENTATIONS AND WARRANTIES

Polish and European contract practice was therefore faced with the question of whether existing legal instruments in national systems offer the possibility of mapping the above standard M&A clauses using national legal institutions.

Turning to the analysis of the individual clauses of M&A contracts, it is worth first referring to classically understood representations (i.e., those representations whose falsity in the common law leads to tort liability), it should be noted that theoretically such a construction is possible in Polish law, but in practice such cases based on breach of representations are not often encountered. It can be assumed that this is due to the fact that although Polish law provides a broad and ambiguous defined basis for tort claims,

this is a type of liability in which the plaintiff has the burden of proving all the prerequisites of the claim, which is often difficult in practice. In particular, a Claimant asserting such a claim must prove the fault of the party that committed the misrepresentation, and proving this particular circumstance may be notably difficult. In addition, the reason why parties in the Polish legal order do not use tort claims in case of misrepresentations is also that representations are treated as terms of contract and parties have access to contractual claims, in which the allocation of the burden of proof is much more favorable to the plaintiff, because the fault of the breaching party is presumed. The effect of tort and contract claims is basically the same, so the use of tort claims is very rare. It could be assumed that asserting such claims makes sense in cases that are almost criminal in nature, because in such cases the validity of the contract may be questionable.

Another legal remedy that can be used in cases of misrepresentation in contracts governed by the Polish law is the ability to evade the legal effects of one's declaration of intent (article 84 of the Polish Civil Code). The effect of such action is similar to withdrawal from the contract, however is a general right that parties have by law (does not have to be written into the contract), and it is reserved for cases when a party entered into a contract under the influence of an error that the other party caused or knew of the error or could easily notice it or the other party induced the error by acting deceitfully. This legal remedy also tends to be used in exceptional situations, as often the parties are interested in pursuing other types of claims, and not just in bringing about the non-existence of the contract. Nevertheless, it is worth noting that the filing of a declaration of evasion of the legal effects of a declaration of intent (conclusion of a contract) is allowed within a strict and non-exceedable period of one year until the discovery of the error (misrepresentation).

Therefore, much more useful in the Polish legal order are legal measures that treat representations and warranties as terms of the contract. There is no doubt that by writing representations and warranties into the contract they become its terms and have legal significance, because they co-shape the content of the obligations linking the parties.

This means that in the Polish legal order, as a rule, there is no difference between a representations and warranties, since both clauses are treated as terms of the contract. In other words, in the Polish legal order, they are clauses similar to the originally understood warranties (which also constituting terms of the contract). Nevertheless, it should be borne in mind that the consequences of entering only representations and warranties in contracts may be different depending on whether the law of any of the Anglo-American systems or, for example, the Polish law system (as an example of the system of state law) will be applied to the contract.

The key difference lies in the type of liability for breach of warranties. As it was mentioned above, in Anglo-American systems, if it turns out that the representation was inaccurate, it may result in strict contractual liability. (i.e. to the liability in which the fault of the responsible party is irrelevant). Meanwhile, in the Polish legal system, the mere inclusion of representation and warranties in the contract, without further specification of the meaning of these statements, can cause liability under the statutory warranty of non-compliance of the goods sold with the contract. This form of liability is considered risk-based, that is, it is independent of the fault or diligence of the obligated party. This makes it appear similar to strict liability for breach of contract in Anglo-American law. However, it is not always the legal instrument that is most optimal for the parties. This is due to the fact that the application of the provisions of the statutory warranty for non-compliance of goods with the contract can be a complicated process and not particularly well-suited to the complexity of M&A transaction.

It is worth noting that, in the Polish Civil Code, the statute warranty provisions are regulated explicitly with reference to the sale of movables and real estate, but not to sale other rights (such as shares) or to the sale of enterprise. This may raise doubts concerning the applicability of statute warranty liability. In other words, doubt may arise as to whether a statutory warranty can adequately protect the buyer

in a share acquisition transaction ("SPA"). After all, it should be borne in mind that the object of the SPA in the strict legal sense are the shares, and not the company whose shares are being sold. Hence, if the warranties refer to the shares themselves, for instance, to the validity of issuance of the shares or the unencumbering of the shares by third-party rights, the application of the statutory warranty provisions to such types of warranties seems hardly controversial. Nevertheless, it should be noted that in SPA transactions, the buyer is also interested in obtaining warranties relating to the company's operations and the assets and to the company's legal relationships with third parties.

Thus, in Polish law, there is noticeable difference between the object of the SPA transaction (the shares in the company), and the economic sense of the transaction (purchasing an actively operating business). Therefore, a doubt potentially opens the seller, who gave only warranties that were only a subject to the rigor of statutory warranty, a line of defense against the buyer's claim. In particular the seller could argue that the warranties relating to the company's enterprise are not subject to warranty liability given in the SPA, because they do not relate to what was the subject of the sale, namely the shares.

Nevertheless, it should be noted at this point that in Polish legal doctrine there are considerable opinions, that this kind of defense should not be effective (see Gessel-Kalinowska vel Kalisz B., Wpływ nowej regulacji rękojmi przy sprzedaży (art. 556(1) k.c.) na definicję wady fizycznej prawa udziałowego - uwagi w świetle zmian kodeksu cywilnego wprowadzonych ustawą z 30.05.2014 r. o prawach konsumenta, PPH 2015, nr 12, s. 5-11 and A. Szlęzak, Cywilne prawo, zobowiązania, rękojmia za wady rzeczy sprzedanej, umowa gwarancyjna, odpowiedzialność gwarancyjna, odpowiedzialność odszkodowawcza sprzedawcy, wada fizyczna, wada prawna, odpowiedzialność za niewykonanie lub nienależyte wykonanie zobowiązania. Glosa do wyroku SN z dnia 31 maja 2017 r., V CSK 506/16, OSP 2018, nr 12, s. 119.). Firstly, it is pointed out, that the catalog of what can be covered by warranties (in a statute warranty regime) is open, because Article 5561 of the Polish Civil Code, listing the circumstances that can shape liability under warranty, uses the words "in particular" (in Polish "w szczególności"), which is commonly understood as "including but not limited to" and which means that the catalog listed in the law is not exhaustive. Secondly, Article 558 of the Polish Civil Code, clearly states that statute warranty liability can be extended (in a commercial relationship, which do not include customers). Thirdly, it is rightly pointed out that it is indisputable that the value of the shares is derived from the value of the company's enterprise (its operations and its assets), hence assurances made only under the statutory warranty may also apply to the enterprise of the company in which the shares are acquired (see Gessel-Kalinowska vel Kalisz B., Wpływ nowej regulacji rękojmi (…) s. 5-11).

In light of the foregoing, it is generally accepted that effective warranties concerning the company and its enterprise can be made, notwithstanding the fact that the subject of the SPA contract pertains to shares. Nevertheless, the buyer's position in M&A transactions may remain uncertain if the contract, particularly the SPA, relies solely on the statutory warranty regime. Although the buyer could use several remedies arising from the statutory warranty such as: claim damages, claim for the removal of the non-compliance with the contract, demand a reduction in the sales price or even the buyer can withdraw from the contract (if the non-compliance with the contract is material), they could occur ineffective in cases of complex M&A transactions. For instance, if the buyer demands a price reduction, the seller can oppose this claim by removing the non-compliance with the contract (Article 560 of the Polish Civil Code). On the other hand, if buyer claims removal of the non-compliance with the contract, the seller can refuse to satisfy such demand by claiming that bringing the defective thing into conformity with the contract in a manner chosen by the buyer would require excessive costs (Article 561 of the Polish Civil Code). Naturally, these types of situations can be modified in the contract; however, as a general rule, the statutory warranty regime can be difficult to apply and may not be particularly effective in M&A transactions.

Moreover, insufficiency of the statutory warranty regime for M&A transactions may occur in other areas of seeking redress. For example, the buyer can demand a reduction in the sales price. The Polish Civil

Code stipulates only, the reduced price should be in such proportion to the contract price as the value of the object with the defect (non-compliance with the contract) remains to the value of the object without the defect. However, it does not indicate the method of business valuation to be used, and as is well known, the valuation of actively operating businesses is a complicated issue, and depending on the method of valuation adopted, the values determined may vary.

Therefore, despite the common opinion that contracts governed by the law of countries belonging to the statutory law systems may be simpler than those governed by the law derived from common law, because they may be limited to indicating the subject matter of the contract and possible modifications of the rules resulting from the statutory acts, in the case of complex M&A contracts such a procedure may be insufficient. This could be also the reason why in the M&A transactions governed by the Polish law, it is commonly recommended to use additional contractual provisions, which enhance and clarify situation of parties involved in M&A transaction.

GUARANTEE CLAUSE - ENHANCEMENT OF THE LIABILITY FOR BREACH OF REPRESENTATIONS, WARRANTIES AND INDEMNITY CLAUSE

A way of shaping warranties in a form that is close to their function in Anglo-American law, is enrich the warranties given with an additional contractual stipulation on how the provider of the warranty is to behave in the event that it proves to be inaccurate. Such provisions can therefore be regarded as additional guarantee agreements included in the body of the M&A agreement. Their most important effect is that a breach of representations and warranties (finding them untrue, inaccurate etc.) ceases to be treated as a breach of contract, but becomes a condition embodied in the contract that actualizes the guarantor's obligation to act in a certain way. This construction changes the type of claim that the beneficiary of the guarantee may pursue. He can simply demand from the guarantor the performance of the contract (fulfillment of the stipulated performance resulting from it), and does not have to pursue claims for breach of the contract. This approach places the buyer in a similar situation to the one he would be in if the contract were governed by Anglo-American law, i.e. in such a situation, if indemnity clause, for instance, "hold harmless" etc. were applied. A similar effect in Polish law can also be achieved by a contractual change of the contractual liability regime, changing the statutory premise of fault to a premise of risk, which can be considered close to strict liability in Anglo-American law. However, the formation of representations and warranties as separate guarantee agreements embodied into the M&A agreement allows better protection of the interests of the parties, by clearly defining what claims they are entitled to and in what amount.

Although the aforementioned guaranty clauses are commonly applied in contracts governed by the Polish law, it should be emphasized that this type of guaranty clause is not explicitly and unambiguously regulated in the Polish legal order. This means that they are stipulated within the limits of the principle of freedom of contract and within the limits allowed by law, the principles of community life and the nature of the contractual relationship in question (Article 3531 of the Polish Civil Code). This situation may lead to uncertainties regarding the permissibility of a given warranty clause within the Polish legal order in specific cases. An example of such doubts is the judgment of the Supreme Court of October 9, 2014 in case number IV CSK 29/14 (LEX No. 1544570), according to which: "[T]he principle of freedom of contract, which is expressed in Article 3531 of the Civil Code, due to the limitations arising therefrom, does not allow the acceptance of the defendant's liability for the behavior of third parties. (...) The purpose of the obligation arising from the contract entered into by the parties was to create a guarantee liability of the defendant for the behavior of third parties without the existence of an obligation relationship between these parties and the debtor or creditor. The purpose of this obligation was therefore contrary to the nature of the obligation, which follows from the wording of Article 391 of the Civil Code. An obligation should be characterized by rationality and utility. A contract that obligates the

debtor to cause a certain state of affairs over which he has no control should be considered contrary to these characteristics". In conclusion, in the cited judgment, the Supreme Court stated that in the Polish legal order it is impermissible to give warranties that third parties affiliated with the seller will not engage in competitive activities, unless the seller has influence over the actions of third parties who were not involved in the contract.

The above judgement is widely criticized in the doctrine (see J. Jastrzębski, Swoboda zawierania i kształtowania umów gwarancyjnych. Glosa do wyroku SN z dnia 9 października 2014 r., IV CSK 29/14, Glosa 2015, nr 2, s. 19-26; A. Szlęzak, O umownej odpowiedzialności gwarancyjnej „na zasadzie ryzyka" – słów kilka, in: M. Jagielska, M. Pazdan, E. Rott-Pietrzyk, M. Szpunar (ed.), Rozprawy z prawa prywatnego. Księga jubileuszowa dedykowana Profesorowi Wojciechowi Popiołkowi, Warsaw 2017, s. 809; M. Kocur, Fuzje i przejęcia: wyrok Sądu Najwyższego komplikuje praktykę M&A, RP, Warsaw 2015 r. The opposite position is taken by J. Krauss, Niedopuszczalność stosowania przepisów umowy o świadczenie przez osobę trzecią (art. 391 k.c.) do zachowania niewynikającego z istniejącego stosunku prawnego, polegającego na powstrzymaniu się od działalności konkurencyjnej. Glosa do wyroku SN z dnia 9 października 2014 r., IV CSK 29/14, Glosa 2015, nr 3, s. 47-54). It is pointed out that that the perspective presented therein does not align with economic realities and requirements of business participants. It can be summarized that the criticism of the above judgement can be reduced to the statement that both parties to the contract may have an interest in such allocation of the economic risk of a particular transaction, and, for example, the buyer decided to take on a particular risk, because thanks to this it would possibly not be reflected in full in the sales price by reducing it. This perspective and the permissibility of the use of such guarantee clauses is permitted in many decisions of the Supreme Court, for instance, in the judgment of the Supreme Court of September 17, 2021, ref. V CSKP 166/21 (OSNC 2022, no. 2, item 22), it was stated that: "However, in the literature nor in the case law, there is definitely a predominant view that allows for the possibility of entering into guarantee agreements also outside the cases expressly provided for by the legislator." In turn, the Supreme Court's judgment of September 6, 20218, ref. V CSK 440/17 (LEX No. 2540990) held that: "within the limits of contractual freedom it is also within the limits of contractual freedom to accept guarantee liability for the behavior of third parties without the existence of a contractual relationship between those parties and the guarantor or creditor."

In conclusion, although it is possible to encounter judgments in which the admissibility of the use of guarantee clauses standard for M&A transactions will be questioned, as a rule, the doctrine and case law accepts the valid and effective use of guarantee clauses with regard to the representations and warranties made in the contract. In addition, such warranty clauses shape the seller's obligation to perform in a certain manner upon occurrence of a specific condition. This obligation does not depend on the due diligence of the obliged party, because it is not a matter of liability for breach of contract, but for the performance of the obligation in accordance with its content. This legal framework places the parties to the contract in a position analogous to that which would apply if the contract were governed by Anglo-American law. Moreover, under this framework, it generally does not matter whether the contractual provision is referred to as representations and warranties or as an indemnity clause; in most cases, all such provisions should be regarded as guarantee contracts. This approach ensures that the parties' obligations are clear and comprehensible, while liability remains strict and, typically, independent of the exercise of due diligence by either party in relation to specific actions.

SUMMARY

In summary, Polish legal practice has particularly embraced Anglo-American models of clauses typical for M&A agreements. Although typical contractual provisions used in such transactions (representations and warranties, indemnity clauses) originate from legal systems based on common law, Polish statutory

law allows for a relatively accurate adaptation of the meaning of these types of contractual stipulations. The specificity of these transactions is increasingly recognized in case law, which generally permits strict liability arising from M&A agreements. Therefore, it can be concluded that Polish law is well-suited for M&A transactions. However, when choosing Polish law as the governing law for a particular contract, it is crucial to understand the specifics of Polish law, as the mere inclusion of provisions such as representations and warranties may not always achieve the intended purpose of the parties.

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