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The Reception of Anglo-American Contractual Standards in Selected Droit Civil Systems: German and Polish Examples.

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The Reception of Anglo-American Contractual Standards in Selected *Droit Civil* Systems. German and Polish Examples.

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ABSTRACT

The reception of Anglo-American contractual standards in *droit civil* countries is not as straightforward as it would seem at first glance. The language expressing notions such as "breach of contract," "representations & warranties," or "indemnities" cannot be merely copied into agreements subject to the law of *droit civil* countries. They need to be transposed thereto, i.e., rendered in terms of legal institutions characteristic of the legal systems of such countries, to achieve the same functional results as those achievable in the place of origin of such notions.

The authors discuss the process of such transposition in the examples of Germany and Poland. In particular, they show that due to structural differences between the notions of a breach of contract in Germany and Poland (where it is fault-based) and in the Anglo-American world (where it is strict), a breach of warranty (which in a common law jurisdiction is a form of a breach of contract) is best expressed in German or Polish legal parlance as a guarantee agreement. Under such an agreement, the guarantor would not be able to avoid repairing the damage by proving that the breach of warranty occurred for reasons other than the guarantor's lack of due care (in Poland) or reasons not attributable to the guarantor (in Germany). In short, in Germany or Poland, a claim to redress the damage, i.e., a claim for specific performance under a guarantee contract, would lead to similar functional results as a damages claim for a breach of warranty in common law jurisdictions.

A similar transposition, namely converting an Anglo-American indemnity contract (both prevent loss and redress loss indemnity) into a guarantee agreement, makes it possible to achieve economic results in Germany and Poland comparable to those in common law jurisdictions. In such jurisdictions, the amount of compensation due to the indemnitee is not typically diminished by doctrines characteristic of a damages claim for a breach of contract (such as remoteness, foreseeability, and a duty to mitigate the loss). In Germany, a prevent loss indemnity is still predominantly understood as a best-efforts contract obligating the indemnitor to avert the loss. In Poland, however, a guarantee contract is believed to operate similarly for both types of indemnities, regardless of whether a "hold harmless" or "indemnify" contract is applied.

I. INTRODUCTION

Anglo-American, or simply common law, contractual standards rule the world. It is not our role to speculate why this is so. We can, however, point to several factors: (1) the financial world is, thus far, Anglo-American;[1] (2) Dubai and other Emirates favor English law[2] for their international contracts;[3] (3) Singapore holds a strong position in arbitration, often applying English substantive law;[4] and (4) American and British law firms are usually the first to appear in new jurisdictions, as was the case in Poland when it joined the free world in 1989, ending several decades of Soviet influence. Once these law firms put down roots on foreign soil, they spread their contractual standards, including representations and warranties, indemnity clauses, reliance letters, and the no-fault notion of breach of contract.[5]

Notwithstanding the above, we do not pretend to know why this is so. One thing, though, is certain: a simple explanation in terms of *cuius regio, eius religio* (whose realm, their religion), transformed into "whose money, their legal system," does not fully answer the question. Some Anglo-American legal standards are also abundant in the practice of law in countries with long-standing and rich legal traditions, such as Germany[6] and France.[7] Therefore, the answer may be that these standards better fit the present business reality and are somehow more efficient or more comprehensively address the needs of the contracting parties in a globalized world.[8]

We chose not to show why but how. Sometimes, common law standards are simply copied into contracts subject to German or Polish law without any attempt to express Anglo-American standards through the institutions of local law. This yields surprising, yet obvious, results

1. *See, e.g.*, Martin Arnold, *How US banks took over the financial world*, FINANCIAL TIMES (Sept. 16, 2018), https://www.ft.com/content/6d9ba066-9eee-11e8-85da-eeb7a9ce36e4.

2. References to English law in this paper should be understood as references to the laws of England and Wales.

3. *See* David Russel & Gabor Bognar, *The Application of English Law in the Financial Free Fones of the United Arab Emirates*, 23 TRUSTS & TR. 480, 481 (2017).

4. *See* Warren B. Chik, *The Law of International Commercial Arbitration in Singapore*, TRANSNAT'L DISP. MGMT. 1, 3 (2006).

5. *See* John Flood, *Lawyers as Sanctifiers: The Role of Elite Law Firms in International Business Transactions*, 14 IND. J. GLOB. LEGAL STUD. 35, 64 (2007).

6. *See* Oliver Duys & Kerstin Henrich, *Unternehmenskauvertrag nach anglo-amerikanischem Muster, in* HANDBUCH Unternehmenskauf 1386 (Wolfgang Hölters ed., 2010); TIMO ENGELHARDT, UNETERNEHMENSKAUF IN RECHT UND PRAXIS. RECHTLICHE UND STEUERLICHE ASPEKTE 205 (Hans-Joachim Holzapfel & Reinhard Pöllath eds., 2016).

7. *Id.*; *see* Duys & Henrich, *supra* note 6.

8. *Id.*

for the parties when local courts refuse enforcement, arguing that Polish (or German) law does not recognize the concepts applied and that what the parties wanted to achieve is not attainable with the concepts or words used. Sometimes, however, such standards are not merely copied into a contract but transposed into the local legal parlance, i.e., the drafters attempt to achieve the typical result of common law using *droit civil* structures.[9]

We will show how the mechanics of this transposition work under German and Polish law. The choice of jurisdictions, apart from the obvious nationality factor of the authors, is dictated by the fact that the German jurisdiction is a well-established system of *droit civil*. Germany is the leading European economy with mature institutions, abundant legal writings, and tradition. Conversely, the Polish jurisdiction serves as an example of how a country—whose legal system is also rooted in the *droit civil* family of laws—was able to shed the elements of the "communist heritage" and transform its legal system to fit the requirements of today's transactional world.

It is not our ambition to discuss the reception of all contractual standards developed in common law countries and then widespread overseas (including clauses such as force majeure, severability, entire agreement, or time is of the essence, to name just a few). Our remarks will be confined to the application of warranties[10] and indemnities in contracts governed by Polish and German law. We believe that this choice is not entirely arbitrary because warranties and indemnities have become commonplace in business-to-business transactions in continental Europe, and those clauses are among the most heavily negotiated in most contracts.

Our knowledge of common law is limited. Nonetheless, we are sure that readers will be able to fill in any gaps we have left. This text is not designed to explain common law to common law lawyers. It is, however, meant to show how the common law is understood elsewhere to those familiar with common law, yet not necessarily with the *droit civil* systems. It also aims to show how to avoid the misunderstandings that often happen "between the words" when one is "lost in translation."

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9. *Id.*

10. We will use the term "warranties" and thus follow the standard common law distinction between representations and warranties still present in English law. German and Polish contractual practice follows the American standard and uses the notion of "representations & warranties." *See* Rafal Zakrzewski, Representations and Warranties Distinguished, 28 Buttersworth J. of Int'l Banking & Fin. Law 341, 342 (2013); Kenneth A. Adams, Eliminating the Phrase Representations and Warranties from Contracts, 16 TRANSACTIONS: THE TENN. J. OF BUS. LAW 203, 203 (2015).

This paper is organized as follows:

In Part 2, we briefly discuss how indemnities and warranties work in their place of origin, such as in English and American contract law. Here, we will mention the basic assumptions relating to breach of contract claims and their consequences in common law. While these remarks may seem simplistic and naïve to readers trained in common law, they are necessary to understand the different approaches of common law and *droit civil* to certain issues, which render the application of indemnities and warranties complex on foreign soil.

In Part 3, we describe the application of indemnities and warranties in Germany. We argue that common law-style warranties gained significant popularity, especially in complex M&A transactions, due to the inflexibility of the German statutory regulations on warranty defects (*Gewährleistung*) and the lack of adjustment for the default model of guarantee of quality (*Beschaffenheitsgarantie*) to the requirements of transactions relating to complex business structures. The gap left by statutory law has been filled by parties using their freedom of contract to follow the Anglo-American standards. We also point out that even though it is generally possible to transpose warranties and indemnities to contracts governed by German law, the differences between common law and *droit civil* (e.g., those referring to the notion of breach of contract or calculation of loss) require very precise drafting to give such clauses the same effect as in their places of origin.

In Part 4, we discuss the legal aspects of using warranties and indemnities in contracts governed by Polish law. We argue that the debate on the correct transposition of warranties and indemnities into contracts governed by Polish law (to which one of the authors of this paper has substantially contributed) led to the development of the dogmatic foundations of Polish civil law. This doctrinal debate resulted in a better understanding of the legal nature of so-called guarantee agreements (*umowy gwarancyjne*) that are best suited to replicate the notions discussed herein (common law breach of contract, warranties, and indemnities) in terms of Polish law.

Finally, Part 5 concludes the analysis with a handful of comparative remarks.

II. WARRANTIES AND INDEMNITIES UNDER COMMON LAW

A. Breach of Contract

The discussion on the reception of Anglo-American warranties and indemnities in *droit civil* systems should be preceded by general remarks on a breach of contract and its consequences under common law. As we will show in Parts 2 and 3 of this paper, understanding the different approaches in these two legal traditions is pivotal to correctly applying warranties and indemnities in contracts governed by German or Polish law.

Under common law, a breach of contract claim and the subsequent liability for such breach are not contingent upon demonstrating the fault of the breaching party[11] or identifying the cause of the breach.[12] The breaching party may be held liable even if it exercised due care in performing its promise or if the acts of third parties caused the breach.[13] The legal excuses limiting the scope of liability of the breaching party, such as the doctrines of unconscionability or frustration, are clearly defined and limited.[14] In these circumstances, the liability for a breach of contract has traditionally been referred to as "strict."[15] We make this statement intentionally, risking the oversight of certain nuances described in the bulk of the literature,[16] and note that Anglo-American contract law contains what is sometimes called "pockets of fault-based liability."[17]

A valid breach of contract claim entitles the innocent party to seek remedies. The scope of their remedies depends on the classification of the

11. By "fault," we understand willful, reckless or negligent failure to perform the promise. This understanding of fault corresponds with that adopted in *droit civil* countries, as will be discussed further in this paper. In American literature, the notion of "fault" is also used in other areas of contract law, such as unconscionability, unexpected circumstances, interpretation, and mistake. S*ee* Melvin A. Eisenberg, *The Role of Fault in Contract Law: Unconscionability, Unexpected Circumstances, Interpretation, Mistake, and Nonperformance*, 107 MICH. LAW REV. 1413, 1414 (2009).

12. *See, e.g.*, EWAN MCKENDRICK, CONTRACT LAW: TEXT, CASES AND MATERIALS 739 (9th ed. 2020); Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349, 1349 (2009).

13. Stefan Grundmann, *The Fault Principle as the Chameleon of Contract Law: A Market Function Approach*, 107 MICH. L. REV. 1583, 1589 (2009).

14. MCKENDRICK, *supra* note 12, at 739; Posner, *supra* note 12, at 1351.

15. MELVIN A. EISENBERG, FOUNDATIONAL PRINCIPLES OF CONTRACT LAW 174 (2018); Posner, *supra* note 12, at 1349; Robert A. Hillman, *The Future of Fault in Contract Law*, 1454 CORNELL L. FAC. PUBL'NS, 275, 278–79 (2014).

16. *See* Eric A. Posner, *Fault in Contract Law*, 107 MICH. L. REV. 1431, 1431 (2009); Grundmann, *supra* note 13, at 1583; Eisenberg, *supra* note 11, at 1413; Hillman, *supra* note 15, at 275.

17. Posner, *supra* note 16, at 1431.

infringed term as a condition or warranty.[18] Broadly, a breach of a condition typically entitles the innocent party to terminate further performance of the contract, whereas a breach of warranty entitles the innocent party to a claim for damages in addition to contract performance.[19] Unlike in the *droit civil* jurisdictions, in common law jurisdictions, the role of specific performance in breach of contract cases is very limited and is treated as a last resort remedy if damages turn out to be inadequate.[20]

Our research shows that in contracts governed by German and Polish law, the parties expressly classify certain terms as warranties and do not intend to allow the innocent party to terminate performance of the agreement should the warranty turn out to be untrue or misleading. Therefore, we disregard difficult distinctions between conditions, innominate terms, and warranties and do not discuss the right to terminate a contract in the event of a breach of a condition.[21] For the same reasons, we do not discuss the materiality of the breach and its impact on the innocent party's right to terminate the contract. Instead, we will focus on the description of warranties and the consequences of their breach.

B. Warranties

Like conditions, warranties are simply terms of a contract.[22] Generally, a breach of warranty entitles the innocent party to claim damages based on their expectation interest.[23] In other words, pecuniary compensation awarded to the innocent party places them in the same position they would have been in had the warranties been true.[24] However, the scope of protection of the innocent party's expectation interest is not unlimited; in particular, a loss too remote from the consequence of a breach of contract may not be compensated.[25] As

18. MCKENDRICK, *supra* note 12, at 741–42.

19. MCKENDRICK, *supra* note 12, at 741, 757.

20. Reluctance of common law to compel the breaching party to perform its duties traditionally served as a reinforcement of the argument developed by *Oliver W. Holmes* that liability for a breach of contract was strict and that contracts might be treated as options, with the promisor's competence to choose whether to perform or to pay damages. Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).

21. *See, e.g.*, Hong Kong Fir v. Kawasaki Kisen Kaisha, (1962) 2 QB 26; *see also* MCKENDRICK, *supra* note 12, at 741–42.

22. MCKENDRICK, *supra* note 12, at 745.

23. LAURENCE KOFFMAN & ELISABETH MACDONALD, THE LAW OF CONTRACT 537 (7th ed. 2010).

24. *See* Sale of Goods Act, 1979, §53(3), c. 54 (U.K.); U.C.C. §2–714(2) (1963); *see also* Oversea-Chinese Banking Corp. Ltd. v. ING Bank NV (2019) EWHC (QB) 676 (Comm).

25. MCKENDRICK, *supra* note 12, at 847. DONALD HARRIS ET AL., REMEDIES IN CONTRACT AND TORT 88 (2nd ed. 2002).

established in the landmark case *Hadley* v. *Baxendale*,[26] for the innocent party to recover from the breaching party, the loss shall be a natural consequence of the breach or must have been "foreseeable" or in the contemplation of both parties when the contract was made.[27] This rule is derived from the idea that because each party is in the best position to anticipate the consequences of a potential breach of contract, the parties should disclose such consequences to assess the risks associated with the execution of the contract and to price it adequately.[28] One might say that foreseeability is a "softener" of strict liability.[29] As pointed out by Richard A. Posner, the remoteness rule induces the party aware of the risk to take adequate precautions or to disclose the risk to the contractor so that the contractor assumes such a risk, which would be optimal if the contractor is a more efficient risk avoider.[30]

In addition, the law obligates the breaching party to mitigate the loss by taking reasonable steps to minimize the loss suffered due to a breach of contract.[31] The duty to mitigate loss adds a component of comparative fault during the calculation of damages owed by the strictly liable breaching party.[32] In this context, it softens the rigidity of the strict liability rule.

C. Indemnities in the "Prevent loss" and "Redress loss" Model

The obligation to pay damages in the case of a breach of warranty is secondary or, put differently, remedial.[33] It is a consequence of a breach of a primary obligation, namely, the failure to perform the original promise.[34] This distinguishes the so-called "damages claim" from "debt claims" relating to the primary promise of the promisor.[35]

Debt claims are at the core of certain types of indemnities. While indemnities may take various forms, generally, they are a promise to "save another from a legal consequence of the conduct of one of the parties, or of some other person" (as defined in Section 2772 of the

26. Hadley v. Baxendale, 156 Eng. Rep. 145 (1854).

27. *See also* RESTATEMENT (SECOND) OF CONTS. § 351 (AM. L. INST. 1981).

28. HARRIS ET AL., *supra* note 25, at 88.

29. Grundmann, *supra* note 13, at 1597; *see generally* KOFFMAN, MACDONALD, *supra* note 23, at 566.

30. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 94 (2nd ed. 1977).

31. MCKENDRICK, *supra* note 12, at 872.

32. Saul Levmore, *Stipulated Damages, Super-Strict Liability, and Mitigation in Contract Law*, 107 MICH. L. REV. 1365, 1367 (2009).

33. WAYNE COURTNEY, CONTRACTUAL INDEMNITIES 17 (2015) (ebook).

34. *Id.*

35. *Id.* at 76.

California Civil Code).[36] Importantly, it is also conceivable to promise to save another from a legal consequence of a breach of another promise of the promisor (e.g., a breach of warranty). This is how we understand indemnities against a breach of contract[37] used in American M&A practice, where warranties are typically granted on an indemnity basis.[38]

Indemnities are a frequently used[39] yet highly contested concept.[40] In particular, it is not always clear whether a given indemnity clause gives rise to a debt or damage claim. This qualification is of significant practical importance. Should the indemnity be qualified as a debt claim, the indemnified party would be entitled to recover damages for the entire loss caused by an event against the consequences of which it is indemnified. The rules of remoteness and mitigation would not limit such damages because they apply to the damages for a breach of contract, not to the promise itself (even if the promise assumes the coverage of the loss suffered by the counterparty). In turn, qualifying the indemnity claim as a damage claim opens the door for applying limitations.[41] Both of these interpretations of indemnity clauses may be traced in case law.[42]

It seems that the answer to the question of whether a particular indemnity clause gives rise to a debt claim or a damages claim depends upon its wording[43] and on whether the intention of the parties is (1) to impose on a promisor a primary obligation to keep the promisee from

36. *Id.* at 268.

37. John Carter, *Indemnities Against Breach of Contract*, *in* 25TH ANNUAL BANKING & FINANCIAL SERVICES LAW & PRACTICE CONFERENCE 417, 420–21 (2008); COURTNEY, *supra* note 33, at 268.

38. Jacek Jastrzebski, *"SANDBAGGING" AND THE DISTINCTION BETWEEN WARRANTY CLAUSES AND CONTRACTUAL INDEMNITIES*, 19 U.C. DAVIS BUS. L.J. 208, 212 (2019).

39. *E.g.*, in leases, sale agreements, loan agreements, security documents, and services contracts; s*ee R*afal Zakrzewski, *The Nature of a Claim on an Indemnity*, 22 J. OF CONT. L. 54 (2006).

40. Febechi Chukwu, *The Breach of Contractual Indemnities under English Law—A Debt Claim or a Damages Claim?*, 7 IALS STUDENT L. REV. 1, 3 (2020); John Carter & Wayne Courtney, *Indemnities Against Breach of Contract as Agreed Damages Clauses*, 7 J. OF BUS. L. 555, 558 (2012); COURTNEY, *supra* note 33, at 275.

41. On the differences between debt claims and damages claims, *see also* Zakrzewski, *supra* note 39, at 65; Chukwu, *supra* note 40, at 5.

42. *See, e.g.* Caledonia North Sea Limited (Respondents) v British Telecommunications Plc (Appellants) (Scotland) and Others Islamic Investment Co ISA, [2002] BLR 139; Transorient Shipping Ltd [1998] Int.Com.L.R. 07/24 [1999] 1 Lloyd's Rep. 1; Royscot Commercial Leasing Limited v Ismail [1993] EWCA Civ J0429-4; ABN Amro Commercial Finance Plc v Ambrose McGinn & others [2014] EWHC 1674 (Comm) (qualifying indemnity as a debt claim and stating that the rules of remoteness and mitigation did not apply); *but see* Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti), [1991] 2 A.C. 1; Durley House Limited v Firmdale Hotels plc [2014] EWHC 2608.

43. Chukwu, *supra* note 40, at 12.

loss, in which case the infringement of this obligation constitutes a breach of contract entitling the promisee to a claim for the remedial damages, calculated under the general rules of common law[44] (what is sometimes referred to as a "prevent loss indemnity"[45]), or (2) to impose on a promisor a primary obligation to pay the promisee compensation in specific circumstances, in which case the limitations applicable to remedial damages would not apply (what is sometimes referred to as a "redress loss indemnity").[46] To create the latter type of indemnity, the relevant contract clause "must be particularly clear and explicit, and will be construed strictly against the indemnitee."[47]

III. WARRANTIES AND INDEMNITIES UNDER GERMAN LAW

A. Introduction

A general principle of German contract law envisages that the debtor is liable only if it intentionally or negligently breached its promise (§ 280 Section 1 in connection with § 276 Section 1 BGB), where negligence is understood as a failure to exercise commercially reasonable care (*im Verkehr erforderliche Sorgfalt*) (§ 276 Section 1 of BGB).[48] In other words, unlike in common law jurisdictions, in German law, the liability for a breach of contract claim is fault-based, which means that if the breach of contract occurs for reasons not attributable to the promisor, the promisee is not liable.[49] Thus, a standard term of an agreement governed by German law does not operate in the same way as a common law warranty.[50]

The attempts to transpose warranties to the agreements governed by German law are most common for sale agreements (*Kaufvertrag*), especially in the context of M&A transactions.[51] At first glance, this may

44. In which case the right to damages does not constitute indemnity but rather the consequence of a breach of indemnity, *see* Zakrzewski, *supra* note 39, at 62 and the case law there cited.

45. We follow the terminology proposed in *Id.* at 59.

46. Zakrzewski, *supra* note 39, at 63; *see also* COURTNEY, *supra* note 33, at 275.

47. Crawford v. Weather Shield Mfg., Inc., 44 Cal. 4th 541, 552 (2008).

48. Bürgerliches Gesetzbuch [BGB] [Civil Code], 2003, I, 42, 2909, https://www.gestze-im-internet.de/englisch_bgb/englisch_bgb.html (Ger.); 2003 I S. 738 (as amended).

49. BARBARA DAUNER-LIEB, BGB. SCHULDRECHT. NOMOS KOMMENTAR 421 (Barbara Dauner-Lieb et al. eds., 2016); STEPHAN LORENZ, BÜRGERLICHES GESETZBUCH, KOMMENTAR 1535 (Heinz Georg Bamberger et al. eds., 2019).

50. In this paper we do not discuss the terms of contracts governed by German law that could be qualified as equivalents of "conditions."

51. Herm P. Westermann, *Münchener Kommentar zum Bürgerlichen Gesetzbuch [Munich Commentary on the Civil Code]* 48 (8th ed. 2019).

seem surprising, as the BGB contains a complex regulation of the so-called statutory warranty (*Gewährleistung*) governing the seller's duty to provide the subject matter of the transaction to the buyer free from material and legal defects (*Sach- und Rechtsmängeln*) and the consequences of a breach of this duty (§ 434 *et sec.* BGB).[52] Moreover, in addition to the statutory warranty, the seller may assume strict liability for the lack of certain features concerning the subject matter of the agreement by extending a guarantee of quality (*Beschaffenheitsgarantie*) or guarantee of durability (*Haltbarkeitsgarantie*) governed by dispositive provisions of BGB (in particular its § 443).[53]

Thus, one could argue that German contract law has developed mechanisms that operate as functional equivalents of the common law warranties; therefore, the attempts to transpose the latter to the German legal system are futile and redundant. However, such a conclusion would not be justified, as the statutory warranty and the general rules governing the guarantee of quality and guarantee of durability fall short of what is required in complex M&A transactions; this renders Anglo-American contractual standards as a very attractive alternative for the parties contracting under German law.[54]

B. Statutory Warranty for Defects

Traditionally, German law on statutory liability for defects of the subject matter of the purchase agreement was adjusted to the sale of movables and real estate (*Sachen*) or immaterial rights (*Rechte*). Such an approach caused difficulties in the case of transactions relating to complex business structures, such as an enterprise (*Unternehmen*) sold in the form of an asset deal or share deal. The abandonment of the dichotomic division between the sale of goods and the sale of rights and the introduction of the third category of the subject matter of purchase agreements (*sonstige Gegenstände*) did not fully solve the problems connected with the application of statutory provisions governing liability for defects related to the sale of organized businesses.[55]

First, it is not always certain whether one defect of the assets belonging to the sold business constitutes a subject matter defect relating to a sale agreement, i.e., of the sold enterprise. Under the prevailing view,

52. Dieter Medicus & Stephan Lorenz, *Schuldrecht II: Besonderer Teil; ein Studienbuch [Law of Obligations II: Special Part; a study book]* 22 (18th ed. 2018).

53. Barbara Dauner-Lieb & Werner Langen, *Nomos-Kommentar BGB 2, BGB Schuldrecht [Law of Obligations]* (Barbara Dauner-Lieb et. al. eds. 3rd ed. 2016).

54. Duys & Henrich, *supra* note 6 at 1378.

55. *Id.*

an asset defect of the sold enterprise constitutes a subject matter defect only if it affects the enterprise as a whole.[56] This determination is sometimes challenging to make.[57]

Second, in the case of share deal transactions, it is not entirely clear whether defects in the company's assets may be qualified as defects of the subject matter of the sale agreement. This is so because the parties sell and purchase shares in the company rather than its assets—the latter remain owned by the company, an independent legal entity, and are not subject to any transfer. German case law, however, has determined that, in the case of a disposal of substantially all of the shares in the company, a share deal should be treated in the same way as an asset deal because the disposal of substantially all of the shares in the company leads, in practical terms, to the disposal of the business run by such company, and the value of the business maintained by the company is pivotal to determine the value of its shares.[58] Nevertheless, it is difficult to determine the distinction between the plain-vanilla sale of shares (where no liability for the defects of the company's assets applies) and the sale of an enterprise hidden behind the veil of the share deal.[59] Moreover, the liability for defects of an enterprise run by the company will not be available in the case of a purchase of a minority shareholding or a substantial controlling stake that does not comprise substantially all of the company's shares.[60]

Third, the German system of statutory warranty has traditionally not been flexible enough to meet the expectations of the parties to a complex M&A transaction. According to the prevailing view in legal writings, even after the reform of the German law of obligations in 2002, the seller shall be liable only for lack of certain features at the time of the so-called transfer of risk (*Gefahrenübergang*).[61] In other words, the seller shall not

56. Franz-Jörg Semler, *Gesetzliche Regulung der Gewährleistung, in* HANDBUCH UNTERNEHMENSKAUF 778 (Wolfgang Hölters et al. eds., 7th ed. 2010).

57. Annedore Streyl, *Erwerb von Unternehmensanteilen*, *in* ARBEITSHANDBUCH FÜR UNTERNEHMENSÜBERNAHMEN, BAND 1: UNTERNEHMENSÜBERNAHME, VORBEREITUNG, DURCHFÜHRUNG, FOLGEN, AUSGEWÄHLTE DRITTLÄNDER 525 (Johannes Semler & Rüdiger Volhard eds., 2001).

58. *See* Bundesgerichtshof [BGH] [Federal Court of Justice] Nov. 12, 1975, ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFES IN ZIVILSACHEN [BGHZ] 65, 236 (Ger.).

59. It is not fully clear what percentage of shares in the company needs to be sold so that a share deal could be considered to be a *de facto* sale of an enterprise. Additional problems may arise in the case of the acquisition of substantially all of the company's shares in a series of related transactions. *See* Semler, *supra* note 56, at 780.

60. Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 4, 2001, Neue Juristische Wochenschrift [NJW], 2163 (Ger.); Bundesgerichtshof [BGH] [Federal Court of Justice], June 2, 1980, Neue Juristische Wochenschrift [NJW], 2408 (Ger.).

61. Westermann, *supra* note 51, at 67.

be liable for failing to meet the buyer's future-oriented expectations (e.g., if the sold business fails to generate the level of EBITDA declared by the seller in the prospective accounting period).[62] This limitation also causes practical difficulties in complex M&A transactions, where buyers frequently expect that the warranties on the sold business will be made both at the time of entering a conditional share purchase agreement (the so-called "signing") and at the time of entering the final agreement (the "closing"), and only the latter point in time is typically connected with the transfer of risk.[63] In addition, it is arguable whether circumstances external to the subject matter of the agreement, for instance, the tax or accounting treatment thereof,[64] may be regarded as the features of the subject matter of the sale agreement (*Beschaffenheiten*), the lack of which amounts to a defect of the sold good.

Fourth, the remedies available to the purchaser in the case of defects in the subject matter of the sale agreement are not adjusted to the expectations of the parties to complex M&A transactions. Under § 437 BGB, if the subject matter of the sale agreement is defective, the purchaser may demand a specific performance (*Nacherfüllung*), which is usually impracticable. Only if it is impossible to cure the defect, or if the seller refuses, may[65] the buyer rescind the contract (*Rücktritt*) or unilaterally reduce the purchase price (*Minderung*).[66] Also, such remedies are inadequate in complex M&A transactions.[67] In addition, although § 437 Section 3 BGB similarly provides the buyer with a claim for damages (Schadensersatz) for material or legal defects in the goods sold, such a claim is available only if the seller is at fault.[68]

Thus, the German statutory warranty for defects in the subject matter of the sale agreement is only seemingly the functional equivalent of common law warranties. Therefore, in the case of straightforward implementation of the common law-style contractual warranties to sale agreements governed by German law, parties are at risk that the relevant clauses will be treated as mere descriptions of the subject matter of the

62. BGB 2909 (2003) (Ger.) at 1664; Westermann, *supra* note 51, at 71.

63. HERMANN J. KNOTT ET AL., UNTERNEHMENSKAUF 45 (4th ed. 2012).

64. Semler, *supra* note 56, at 780.

65. Bürgerliches Gesetzbuch [BGB] [Civil Code], § 440 (Ger.); *see also* Westermann, *supra* note 51, at 137.

66. No proof of the seller's fault (*Vertretenmüssen*) is required to claim such damages; *see* Medicus & Lorenz, supra note 52, at 46.

67. Mark C. Hilgard, *Der Freistellungsanspruch beim Unternehmenskauf*, BETRIEBS-BERATER 1218, 1221 (2016).

68. WOLFGANG MEYER-SPARENBERG ET AL., BECK'SCHES M&A-HANDBUCH PLANUNG, GESTALTUNG, SONDERFORMEN, REGULATORISCHE RAHMENBEDINGUNGEN UND STREITBEILEGUNG BEI MERGERS & ACQUISITIONS, § 48, par. 7, (2017).

sale agreement (*Beschaffenheiten*), which may be effective or ineffective (e.g., if the warranties refer to the assets of the target company, while only a minority stake therein was sold) with different consequences than intended by the contracting parties. Therefore, in complex M&A transactions, parties usually contract out of the statutory warranty (§ 444 BGB).[69]

C. Dependent and Independent Warranties

Similarly, common law-style warranties should not be treated as equivalents of express guarantees of quality or durability (§ 443 Sections 1 and 2 BGB).[70] The seller typically extends express guarantees in addition to the statutory liability for a defect in the subject matter of the agreement, which are therefore treated as dependent guarantees (*unselbstständige Garantien*). Similarly to common law warranties, German dependent guarantees are binding obligations of the guarantor, imposing strict liability on the seller for the lack of declared features of the subject matter of the sale agreement.[71] However, according to § 443 BGB, remedies for a breach of dependent guarantees include an obligation of the guarantor to reimburse the purchase price, to exchange the thing, or to repair it. Just as in the case of the statutory warranty for defects, default remedies for breach of dependent guarantees are considered inadequate in complex M&A transactions. Thus, when trying to implement common law-style warranties in a sales agreement governed by German law, parties should avoid qualifying such warranties as dependent guarantees within the meaning of § 443 BGB.

The above-outlined differences between German statutory warranties for defects and guarantee of quality or durability and common law-style warranties do not mean that it is impossible to efficiently transpose common law-style warranties into contracts governed by German law. To this end, it is necessary to contract an obligation to pay damages where the warranty outlined in the contract turns out to be false.[72] The principle of freedom of contract (*Vertragsfreiheit*), set out in

69. KNOTT ET AL., *supra* note 63, at 46; MEYER-SPARENBERG ET AL., *supra* note 68, at $48.

70. See more on the differences between a guarantee of quality and a guarantee of durability in Semler, *supra* note 56, at 780.

71. Bundesgerichtschof [BGH] [Federal Court of Justice] Nov. 29, 2006, Neue Juristische Wochenschrift [NJW] 1346 (Ger.).

72. Astrid Stadler, et al., Bürgerliches Gesetzbuch: Kommentar [Civil Code: Commentary], (Rolf Stürner ed. 2021), 1486.

§ 311 Section 1 BGB, makes it possible[73] for parties to extend "independent guarantees" (*selbständiges Garantieversprechen*).[74]

The BGB or other statutory law does not expressly regulate independent guarantees, but their admissibility is well established through German legal writings.[75] The term "independent guarantees" is used to refer to contracts of various forms and applications, with the common feature of an obligation of the guarantor to place the guarantee in the same position it would have been in had the specified favorable event occurred or the specified loss not been inflicted (*Garantiefall*).[76] Thus, the primary obligation of the guarantor is not to procure the occurrence of a specific event or prevent the infliction of loss but rather to pay damages (generally equivalent to the common law expectation damages) if the specific event did not occur, or if the specified loss was inflicted,[77] thereby indemnifying (*schadlos halten*) the promisee for the loss suffered in the specified circumstances.[78] This apparent subtlety is pivotal, given the general assumption of German law that liability for a breach of contract is fault-based (§ 280 Section 1 in connection with § 276 Section 1 BGB). If the primary obligation of the debtor were to procure the occurrence of a specific event or prevent the infliction of loss, the remedies for a breach of contract (including the damages) would not be due had the debtor exercised commercially reasonable care to achieve the promised goal. Imposition of the primary obligation to pay damages to the debtor is irrespective of the reason for the non-occurrence of the specified event or infliction of specified loss (i.e., even if the guarantor is not at fault (*verschuldensunabhängige Haftung*)).[79]

Despite the generally favorable approach of German courts to the inclusion of independent guarantees of the sale agreements,[80] there is no unanimity among scholars as to whether the differences between dependent and independent warranties are material enough to qualify the latter as a distinct category (and not just as a modification of the standard

73. KNOTT ET AL., supra note 63, at 234.

74. Dauner-Lieb & Langen, *supra* note 53, at 1664.

75. *See* Mathias Habersack et al., Münchener Kommentar Zum Bürgerlichen Gesetzbuch, Band 7, Schuldresch – Besonderer Teil IV [Munich Commentary on the Civil Code, Vol. 7, Part IV] (M. Habersack ed. 2020), 882.

76. *Id.*

77. *Id.*

78. *Id.*

79. Bundesgerichtshof [BGH] [Federal Court of Justice] July 11, 1985, Neue Juristische Wochenschrift [NJW] 2941 (Ger.); Bundesgerichtshof [BGH] [Federal Court of Justice] June 18, 2001, Neue Juristische Wochenschrift [NJW] 1611 (Ger.).

80. *See, e.g.*, Bundesgerichtshof [BGH] [Federal Court of Justice] Jan. 19, 1977, Wertpapier-Mitteilungen [WM] 365 (Ger.).

specified in § 443 BGB).[81] Nevertheless, from a practical point of view, when transposing the common law-style warranty clause to the agreement governed by German law, it is essential to make clear that the intention of the parties is not to specify the quality of the subject matter of the sale agreement (the absence of which would trigger statutory liability for defects or would qualify as a guarantee of quality or durability as per § 443 BGB), but to impose on the seller the obligation to compensate loss suffered by the counterparty in the case of a breach of warranty.[82]

From a comparative point of view, it is worth mentioning that the German independent guarantees strongly resemble Anglo-American redress loss indemnities, which give rise to the debt claims. In both cases, the obligation to pay damages to the promisee is a primary obligation of the promisor. In the case of German independent guarantees, unless the parties decide otherwise, the quantum of the damages is determined under the general rules applicable to the remedial damages for a breach of contract, laid down in § 249 *et sec*. BGB.[83]

It is not our intention to discuss the details of the German law of damages. It suffices to mention that while the rules related to the remoteness of loss seem more lenient for the party seeking compensation in Germany than in common law,[84] they are not completely disregarded by the German courts.[85] Therefore, traces of the foreseeability rule may be found in debt and damages claims (unlike in common law). Similarly, unlike in common law, the duty to mitigate losses plays a certain role in both types of claims (§ 254 Section 2 BGB).[86] In view of the above, it seems that German debt claims are akin to both common law debt claims (since the obligation to pay damages is a primary promise of the promisor) and damages claims (since the quantum of damages is calculated while taking into consideration some elements of foreseeability and the duty to mitigate the loss). At the same time, the advantages of debt claims over damages claims, viewed from the perspective of the party seeking damages, are more evident in German

81. Stadler et al., *supra* note 72 at 1486 (related literature). This academic dispute does not entail any practical implications (*see* ENGELHARDT, *supra* note 6, at 209) and thus will be omitted herein.

82. KNOTT ET AL., *supra* note 63, at 234; MEYER-SPARENBERG ET AL., *supra* note 68 § 48.

83. NJW 2941 (1985) (Ger.); NJW 1611 (2001) (Ger.).

84. MEYER-SPARENBERG ET AL., *supra* note 68 § 48.

85. *See* Tobias Wagner, *Limitations of Damages for Breach of Contract in German and Scots Law. A Comparative Study in View of a Possible European Unification of Law*, 10 HANSE L. REV. 73, 84 (2014); Reinhard Zimmermann, *Limitation of Liability for Damages in European Contract Law*, 18 THE EDINBURGH L. REV. 2, 193, 207 (2014).

86. Wagner, *supra* note 85 at 95.

law than in common law, as the damages are due only in the case of a breach of the primary promise for reasons attributable to the promisor (§ 280 Section 1 BGB).

D. Indemnities (Freistellungsklauseln)

Just like warranties, indemnities (*Freistellungsklauseln*) are also frequently used in contracts governed by German law (not only in M&A transactions,[87] but also in construction contracts, IP licenses, and many other fields).[88] German authors usually seek equivalents of common law indemnities in clauses imposing a primary obligation on the promisor to prevent the promisee from incurring specified loss (e.g., resulting from third-party claims).[89] The promisor may choose how to achieve this goal[90]—e.g., it may itself satisfy the claim of the promisee's creditor, as a third party acting instead of the original debtor (§ 267 Section 1 BGB), it may take over the debt of the promisee (§ 414 BGB) or enter with the creditor's promisee into a so-called *pactum de non petendo* (an agreement not to sue) for the benefit of the promisee.[91] A breach of such a primary obligation leads to the imposition of a secondary obligation on the promisor to indemnify the promisee, i.e., to compensate the latter for the loss suffered.[92] However, under German contract law, the promisor will be liable for a breach of its promise to prevent the infliction of a specific loss on the promisee only if such loss was inflicted because the promisor failed to exercise commercially reasonable care (§ 280 Section 1 in connection with § 276 Section 1 BGB).[93] Notably, the fault principle refers to the breach of promise to prevent the infliction of loss—it is irrelevant if the loss was attributable to the promisee.[94] Moreover, it is typically irrelevant if the claims of a third party covered by indemnity

87. Mathias Habersack, RISIKOVERTEILUNG IN UNTERNEHMENSKAUF, IN TRANSAKTIONEN. VERMÖGEN. PRO BONO. Festschrift zum zehnjährigen Bestehen von P+P Pöllath + Partners [RISK ALLOCATION IN BUSINESS ACQUISITIONS] (Dieter Birk ed., 2008), 43 (Ger.).

88. Patrick Ostendorf, VERTRAGLICHE FREISTELLUNGSANSPRÜCHE FÜR DEN FALL MÖGLICHER VERTRAGSVERLETZUNGEN DES FREISTELLUNGSSCHULDNERS IM DEUTSCH-ENGLISCHEN RECHTSVERGLEICH [CONTRACTUAL RELEASE OF CLAIMS IN THE CASE OF POSSIBLE BREACH OF CONTRACT BY THE INDEMNIFIER], 68 Juristen Zeitung [JZ] 13, 654 (2013) (Ger.).

89. Olaf Muthorst, DER ANSPRUCH AUF BEFREIUNG VON DER EVENTUALVERBINDLICHKEIT [THE CLAIM FOR EXEMPTION FROM CONTINGENT LIABILITY], 209 Archiv für die civilistische Praxis [AcP] 214 (2009) (Ger.).

90. BGH Apr. 19, 2002, NJW 2382 (2002) (Ger.).

91. Philipp Schütt, *Streitigkeiten über Freistellungsansprüche in Unternehmenskaufverträgen*, 14 NEUE JURISTISCHE WOCHENSCHRIFT 980, 981 (2016).

92. Ostendorf, VERTRAGLICHE FREISTELLUNGSANSPRÜCHE (2013) (Ger.) at 655.

93. *Id.;* Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 15, 2010, Neue Juristische Wochenschrift [NJW] 479 (2011) (Ger.).

94. Ostendorf, VERTRAGLICHE FREISTELLUNGSANSPRÜCHE (2013) (Ger.) at 655.

were justified.[95] Those two aspects are the primary added value of this type of clause.[96]

The type of indemnity clause described above shares many similarities with the common law indemnities in the "prevent loss" model. The breach of either gives rise to a claim for damages. However, the level of protection of the indemnified party in a contract governed by German law is significantly reduced compared to the one available to a party protected under the "prevent loss" indemnity clause in the common law model because it seems conceivable that the indemnitor will be able to successfully argue that it was unable to prevent loss even though it had exercised due care and, therefore, should be released from a secondary obligation to pay damages,[97] which would not be the case in the common law model due to the strict liability for a breach of contract.

German legal writings and case law have traditionally characterized "prevent loss" indemnity as the default model of an indemnity clause.[98] Generally, the indemnitor's obligation to protect the indemnitee from third-party claims (*Verpflichtung zur Freistellung*) is embedded in the indemnity clause, even if the parties do not expressly mention it.[99]

This does not mean that "redress loss indemnities," where the indemnitor is liable for a debt claim and pays damages to the indemnified party if certain risks occur, are unavailable in the German market.[100] Quite to the contrary, this model seems to prevail in the case of M&A transactions. This is so because the "prevent loss indemnity model" does not account for the reality of deals involving the sale of a business where, upon the transfer of control, the seller is in no position to effectively protect the buyer or the target company from third-party claims or the purchaser refuses such (because it would inevitably involve the seller's interference in the buyer's business, already under the latter's control).[101] In German law, redress loss indemnities may seem to be construed as independent guarantees, where a primary obligation of the debtor is paying damages to the promisee upon materializing the risk that the indemnity is meant to prevent.[102] Thus, German law has no structural

95. *See* Hilgard, *supra* note 67, at 1223; *see* Schütt, *supra* note 91 (related case law and literature)

96. Ostendorf, VERTRAGLICHE FREISTELLUNGSANSPRÜCHE (2013) (Ger.) at 662; Hilgard, *supra* note 67, at 1223.

97. Ostendorf, VERTRAGLICHE FREISTELLUNGSANSPRÜCHE (2013) (Ger.) at 655.

98. *See* Schütt, *supra* note 91, at 980 (related case laws and literature).

99. Hilgard, *supra* note 67, at 1223.

100. Schütt, *supra* note 91, at 980; ENGELHARDT, *supra*, note 6, at 243.

101. ENGELHARDT, *supra*, note 6, at 243; Schütt, *supra* note 91, at 980.

102. Schütt, *supra* note 91, at 980.

differences between warranties and redress loss indemnities.[103] Such differences are just a matter of contractual practice and how parties draft particular clauses.[104] Surprisingly, this issue has not drawn much attention from German authors yet. Moreover, it is rarely the object of scrutiny of common courts; most M&A disputes in Germany are settled by arbitration, with ensuing secrecy and a lack of public access to arbitration awards.[105]

IV. WARRANTIES AND INDEMNITIES UNDER POLISH LAW

A. Warranty

In Poland, just like in Germany, the legal constructs of representations, warranties, and indemnities are widely used in M&A transactions.[106] The reasons for a successful import to Poland from common law jurisdictions were presented elsewhere; other domestic determinants, discussed in greater detail below, are mostly related to those constructs providing the contracting parties with more flexible instruments of allocating legal and economic risks in an M&A transaction than those offered by statutory law.[107]

As mentioned, we will not deal with representations here, as it would require a separate study. Also, a prevailing view in Poland is that they may be considered under the same cover,[108] namely that of a guarantee agreement,[109] even though a representation is a statement regarding a past or present fact, and a warranty is of a different legal nature. We will revisit this issue when we discuss guarantee contracts under Polish law.

103. ENGELHARDT, *supra* note 6, at 243; Schütt, *supra* note 91, at 985.

104. ENGELHARDT, *supra* note 6, at 243; Schütt, *supra* note 91, at 985.

105. Schütt, *supra* note 91, at 980.

106. *See, e.g.*, ANDRZEJ SZLĘZAK & PAWEŁ MAZUR, WYBRANE UMOWY W TRANSAKCJACH MERGERS & ACQUISITIONS (SHARE DEALS) W Świetle KC I KSH (2022).

107. *Id.* at 85.

108. We assume that it is a prevailing view that the distinction between a representation and a warranty is gradually disappearing in the US jurisdictions, while it is still of significance in the English one; *see* Adams, *supra* note 10 at 215.

109. As distinct from a statutory warranty and statutory guarantee see further below; *see also* SZLĘZAK & MAZUR, *supra* note 106 at 97.

Under the statutory law of Poland pertaining to a sale contract,[110] a statutory warranty (*rękojmia*)[111] is an instrument applicable when the goods sold have a physical or legal defect (Article 556 of the Polish Civil Code ("PCC")); such defect exists when the goods are non-compliant with the contract (describing the characteristics, use, and other particulars of the goods sold) (Article 556(1) PCC).[112]

Under the statutory warranty for defects,[113] the buyer is entitled (alongside a claim for a breach of contract, i.e., a claim for damages resulting from the seller's non-performance) to (i) decrease the price without the seller's consent to it (i.e., the price is adjusted downwards solely by the Buyer's declaration to that effect); (ii) demand that the defective goods sold be repaired or replaced with the new ones, or (iii) rescind the contract if the defect is significant enough.[114]

The statutory warranty for defects is hardly compatible with the expectations of the parties to an M&A transaction. When the goods sold are non-compliant with the contract (i.e., defective), the rescission thereof is a last resort only. Additionally, the price adjustment is but one of the outcomes desired by the parties; likewise, repairing or replacing the goods sold is often impossible or not considered the optimum solution to restore the economic balance of the transaction.

Another hurdle not yet overcome by the jurisprudence in Poland (unlike in Germany) is that, according to a prevailing view, the statutory warranty for defects applies only to the goods sold and not to the assets not covered by a contract.[115] In a share deal,[116] the parties do not sell (*scil*. transfer the ownership of) a going concern to the buyer; it is only the shares that are so traded, and the statutory warranty for defects is then applicable only to such shares (i.e., to their being fully paid for, not

110. The PCC's regulation on the sale contract is of a dispositive nature, i.e., the parties to a contract may opt out of the statutory regulation; very few of the PCC's provisions on the sale contract are mandatory, i.e., are applicable no matter whether the parties wish so or not. The PCC's regulation on the sale contract would apply to all kinds of goods (shares, tangible and intangible property, a going concern, etc.; thus, it would likewise apply to "assets" and "share" deals, i.e., to the most commonly recognized types of M&A transactions.

111. To be distinguished from a contractual warranty, hereinafter discussed under the heading of "guarantee contract."

112. DZIENNIK USTAW [DU] [CIVIL CODE] art. 535–602, 556 (Pol.).

113. Discussed hereinbelow in very broad terms only, e.g. without presenting the differences between "general" and "consumer" sales; M&A transactions rarely involve consumers.

114. DU CIVIL CODE art. 535–602.

115. *See* Part 3; *see also, e.g.*, DB 2259 (2009) (Ger.).

116. Other than a speculative one, i.e., when the purchaser intends to earn on resale of the purchased shares and is not interested in running a company it purchased. *See also* Andrzej Szlęzak, Kodeksowe Umowy Gwarancyjne Z Udziałem Osoby Trzeciej (art. 391 i 392 KC) [Code Warranty Agreements with the Participation of a Third Party] 3 (C.H. Beck, 2020).

encumbered, duly issued), while it is a going concern (and the state of affairs applicable thereto) that matters.

For such and similar reasons, it is standard practice in Polish M&A transactions to opt out of the statutory warranty for defects and to replace it with a more elaborate system of representations and warranties consistent with common law-style contracts.

However, new problems appeared, resulting from the fundamental differences between common law and *droit civil* systems and some additional legal requirements specific to Polish law only.

In particular, in a common law jurisdiction, when one warrants something and the warranty appears to be untrue, incomplete, or misleading (or, more generally, a warranted state of affairs has not materialized), a buyer may claim damages for a breach of contract because what was promised and bargained for did not occur.

This is not the case in Poland. There, a breach of contract appears when one has not performed as promised; in turn, "performance" is understood as the debtor's behavior (action or inaction) envisaged in a contract.[117] Therefore, if the seller (the debtor) warrants in a share deal (or, rather, guarantees, as we are now dealing with a contractual guarantee and not with statutory warranty, the latter usually being contractually excluded) that, for example, the company has no outstanding liabilities exceeding the amount stated in the contract, or that the company's key clients will perform as promised under the terms of their contracts entered into with the company, then there is nothing the debtor is obligated to do.[118] The debtor merely warrants (guarantees) a certain state of affairs but does not promise to do anything to make these things happen.[119] Then, if the warranty (guarantee) has not materialized (i.e., the state of affairs turned out to be different than the one warranted), one cannot say that the debtor "breached" the contract. This is the case as long as the debtor was not expected to do (i.e., to "perform") anything. When it only warranted (guaranteed) a certain state of affairs yet did not promise that through its action/inaction, it would make such state of affairs compliant with that envisaged in the contract, no breach of contract occurred.[120]

The notion of "performance" of an obligation (a promise) is crucial for *droit civil* systems. Performance is involved when determining

117. For a more detailed discussion, *see, e.g.*, Zbigniew Radwański, Adam Olejniczak, Zobowiązania – Część Ogólna [Obligations-Gen. Part] 41–42 (C.H. Beck, 13th ed. 2018).

118. Unless a contract not only warrants the company's or its clients' behavior but also obligates the debtor to make efforts to ensure that the company or its clients act as warranted.

119. For a more detailed discussion, *see* Szlęzak, *supra* note 116, at 1–2.

120. *See* Andrzej Szlęzak, Czy naruszenie oświadczeń i zapewnień jest naruszeniem umowy? [Is the breach of representations and warranties a breach of contract?], Oct. 26, 2017, 24 &26.

whether the debtor was delayed or whether its performance was or was not impossible.[121] The content of the debtor's promised activity/inactivity stipulated in the contract is also a measure for assessing whether the debtor did not perform its contract or only improperly performed it.[122]

Performance also matters when determining whether some state of events complied with the contract; non-compliance means that the debtor did not perform as promised and not merely that the state of affairs is different from that promised in the contract.

In short, a *droit civil* lawyer cannot escape from the notion of performance to determine whether a breach of contract occurred. Under the common law approach, this is not so. Here, it suffices that what had been promised did not occur; whether such non-occurrence appeared through the debtor's action/inaction is immaterial.

For these reasons, a common law warranty cannot operate in Poland as it does in common law jurisdictions. Therefore, some additional element (the debtor's performance) needs to be added to a warranty (guarantee) so that the result could be functionally similar. A guarantee contract—to be discussed later—is the answer. A breach of a guarantee contract occurs not because the state of affairs differs from the guaranteed one but because the debtor failed to perform as agreed when the discrepancy between the guaranteed and actual state of affairs became apparent.

However, even such an approach cannot align the common law notion of a breach of contract with the notion of a breach of contract under Polish law.

Namely, while in common law jurisdictions, the liability for a breach of contract is, in principle, strict (i.e., it does not depend on the fault of the debtor), under Polish law, the debtor is liable for a breach of contract (i.e., for non-performance or improper performance thereof), unless such non-performance/improper performance resulted from circumstances for which the debtor was not liable (Article 471 PCC). More specifically, Article 472 PCC presumes the debtor's lack of due care in its non-performance/improper performance.[123] It follows that the debtor could escape liability if it proves that it was not its fault but other circumstances that brought about the damage through non-

121. DZIENNIK USTAW [DU] [CIVIL CODE] art. 471 (Pol.).

122. *Id.* ("[T]he debtor is obligated to redress the damage resulting from non-performance or improper performance of an obligation, unless such non-performance or improper performance results from circumstances for which the debtor is not liable").

123. DZIENNIK USTAW [DU] [CIVIL CODE] art. 472 (Pol.) ("Unless a specific provision of [statutory] law or a contract provides otherwise, the debtor is liable for failure to observe due care").

performance/improper performance. Even though a standard of due care is objectivized, one would compare the debtor's behavior with the standard of behavior of a diligent person of similar knowledge, qualifications, and occupation and would not venture into determining whether the individual features of the debtor in question would qualify such debtor as being at fault—the standard of due care still allows the debtor to escape liability for a breach of contract.[124]

This is, in principle, not so in common law jurisdictions. The debtor is liable for a breach of contract (*scil*. a breach of warranty) regardless of whether or not it acted diligently. Again, the way to remedy the discrepancy between the common law approach and that of Polish law is through a guarantee contract. A guarantee contract allows the possibility to achieve a result economically similar to that under common law where a claim for damages is available to the creditor when a breach of contract occurred (i.e., when the warranty stipulated in the contract did not come true).

1. Guarantee Contract—Statutory Regulation

In the PCC's provisions on the sale contract, the legislator offers a model regulation of a "sale-related" guarantee contract.[125] Unlike the statutory warranty for defects, which applies unless the parties decide to exclude it from their contractual arrangement (the opt-out approach), the statutory model regulation applies only when the parties expressly include it in their sale contract (the opt-in approach) (i.e., when the seller (manufacturer) hands over a guarantee certificate (with the terms of the guarantee stated therein) to the buyer, and the latter accepts it).

The statutory model provides, among other things, that if the goods sold do not have the characteristics specified in the guarantee certificate,

124. It should be added that Polish law allows one to opt-out of the due care (fault-based) standard. According to Article 473 §1 PCC, the debtor may assume liability for non-performance or improper performance of an obligation by contractually agreeing to be liable also for the specific reasons for which the debtor would not be liable pursuant to the statutory model. DZIENNIK USTAW [DU] [CIVIL CODE] art. 473, §1 (Pol.). While the case law is divided as to what degree of specificity is required for such opting-out to be effective, one may (in principle) contractually replicate a strict liability model for non-performance/improper performance, thereby excluding a fault-based statutory standard.

125. The language of the PCC is unclear; according to a prevailing view, the "sale-related" guarantee is a contract concluded by handing over to the buyer a guarantee certificate; the buyer's acceptance of such certificate creates a contract. *See* ZBIGNIEW RADWAŃSKI & JANINA PANOWICZ-LIPSKA, ZOBOWIĄZANIA - CZĘŚĆ SZCZEGÓŁOWA 53 (13th ed. 2019). An alternative view is that a "sale-related" guarantee is a so-called unilateral legal act, binding on the seller (manufacturer) no matter whether the buyer accepted it or not. *See* JOANNA HABERKO, ET AL., KODEKS CYLWILNY (2nd ed. 2019), commentary to DZIENNIK USTAW [DU] [CIVIL CODE] art. 577.

the seller (manufacturer) is obligated to perform as stated therein; in particular, such obligations may consist of reimbursing the price paid, repairing or replacing the goods sold, or rendering other services (Article 577 § 1–2 PCC).[126] Moreover, if the guarantee concerns the quality of the goods sold, the guarantor is obligated to remove a physical defect in such goods or supply the buyer with the goods free of defects, provided that the defects become manifest during the period determined in the guarantee certificate (Article 577 § 3 PCC).[127]

The PCC's regulation is best suited for consumer transactions, where a buyer has little impact on what is stated in the guarantee certificate; often, the sellers do not even offer their guarantees but pass on to the buyers the certificates issued by the manufacturers of the goods sold. For obvious reasons, such a course of events is hardly typical for a negotiated M&A transaction.

2. Guarantee Contract Based on Freedom of Contract (Article 353(1) PCC)

A guarantee contract, designed to approximate (or, rather, surpass[128]) the effects achievable under common law when a "breach"[129] of warranty occurs (i.e., when the warranted state of affairs is different from the actual one), is structured similarly to the model outlined in the PCC's provisions on the sale contract.

In particular, such a contract contains a so-called **"**guarantee declaration," wherein the seller (guarantor) assures the buyer (beneficiary) of a certain state of affairs (whether past, present, or future), i.e., warrants (guarantees) that such state of affairs did, does or will (or not) take place. The said state of affairs may pertain to any circumstance, thus also to events over which the guarantor has no control whatsoever (including the existence/non-existence and enforceability of third parties' claims). The boundaries of a legally enforceable **"**guarantee declaration" are determined by the rules of freedom of contract, whereby "the parties entering into the agreement may shape their legal relationship as they see

126. HABERKO, *supra* note 125.

127. *Id.*

128. From the seller's perspective.

129. Whenever in this text the word "breach" is used in inverted commas (like in a "breach" of warranty), it is to stress that under Polish law, a "breach" of warranty (guarantee) is not a breach of contract (as it would be in the common law parlance); a "breach" of warranty (i.e., the manifestation of the difference between the warranted state of affairs and the actual one) is a precondition which triggers the beneficiary's rights to enforce a guarantee agreement through a specific performance. A breach of a guarantee contract would appear only after the guarantor failed to perform as promised under such a contract; *see also* Szlęzak, *supra* note 120, at 24.

fit, as long as its content or purpose were not contrary to its characteristics (nature), the applicable statutory law or the principles of social co-existence [*bona mores*]" (Article 353(1) PCC).

Then, in the "operative part" of such an agreement, where the parties' rights and duties are stipulated, the parties agree upon the debtor's (guarantor's) performance; should the guaranteed state of affairs not materialize, such performance may be of any kind. For instance, the parties may agree that should the warranty (guarantee) be "breached," the guarantor will redress the damage incurred by the beneficiary. They may agree that the beneficiary will pay a fixed sum for any such "breach."[130] They may also agree that the guarantor will finance the defense related to third-party claims raised against the beneficiary. Generally, they may agree on any performance by the guarantor that is not found unlawful under statutory law or contrary to *bona mores*.[131]

Eventually, at the performance stage of such a guarantee contract—in which performance becomes due (in principle) when the warranted (guaranteed) state of affairs did not materialize—the beneficiary may demand that the guarantor act as promised under the contract. If brought before a court of law, such an action is (functionally) similar to an equitable relief for specific performance available in common law jurisdictions. This is not an action for damages for a breach of contract (a secondary duty) but an action whereby the creditor (beneficiary) demands that the guarantor act as promised (a primary duty). It should be stressed here that in Poland, just like in many other *droit civil* systems, specific performance is not a default remedy, i.e., when damages for a breach of contract are inadequate, but a remedy available at the creditor's choice. Generally, if the debtor fails to perform as promised, the creditor may sue for performance agreed in a contract (provided that specific performance is still possible) or, if the creditor sees fit, for damages for a breach of contract.

In this way, a "breach" of warranty (guarantee) offers the creditor (beneficiary) possibilities that may not necessarily be available in common law jurisdictions. The beneficiary is unrestrained in enforcing the promised performance (i.e., a primary duty) also when such performance, agreed in the guarantee contract, consists in the debtor's

130. *Nota bene*, such a 'fixed sum of money' is not tantamount to a so-called 'contractual penalty' (liquidated damages). Under Article 483 PCC, a contractual penalty is a substitute for damages for a breach of contract, while a 'fixed sum of money' is the subject matter of a guarantee contract, i.e., the performance bargained for and promised to the beneficiary in such a contract.

131. *See* JACEK JASTRZĘBSKI, UMOWA GWARANCYJNA, (Wydawnictwo C. H. Beck & Warszawa) (2021) (extensive discussion on the guarantee contract under Polish law); *see also* Szlęzak, *supra* note 120.

obligation (promise) to repair the damage sustained by the creditor through a "breach" of warranty.

However, when the parties agreed that the debtor's (guarantor's) performance (i.e., its primary duty) in the case of a "breach" of warranty is to redress the damage incurred by the beneficiary through such "breach," then the usual limitations applicable to establishing the scope of the damage may be found applicable.

In particular, under Polish law, for a claim to redress the damage to be successful (no matter whether the claim is primary, i.e., for performance—where performance under a guarantee contract consists in repairing the damage, or secondary—i.e., for damages due for non-performance of a guarantee contract), the claimant must demonstrate the extent of the damage it incurred. While there is no general obligation to mitigate the loss,[132] the damage must still be an adequate (i.e., normal, typical)[133] consequence of the causative event (i.e., non-occurrence of the warranted state of affairs or non-performance, respectively). In addition, when determining the extent of the damage (loss), one must take into account the mechanism of *compensatio lucri cum damno* (i.e., when benefits obtained by an injured party decrease the loss) and contributory negligence (i.e., when the injured party's unlawful acts/omissions are a single or concurrent cause of the loss, increase the loss or prevent its mitigation; Article 362 PCC).

Therefore, as far as the claim to redress the damage is concerned (whether primary or secondary), there are no advantages of a primary claim for performance under a guarantee contract (as understood under Polish law) over a secondary claim for a breach of contract (as understood in common law jurisdictions). However, if the latter claim were derived from a typical common law-style agreement (yet subject to Polish law), whereunder a "breach" of warranty alone would be sufficient to sue for damages for a breach of contract, such an action would be unsuccessful in Poland.

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132. A duty to mitigate nonetheless appears as one of the insured's duties under the insurance contract. *See* DZIENNIK USTAW [DU] [CIVIL CODE] art. 826 (Pol.).

133. DZIENNIK USTAW [DU] [CIVIL CODE] art. 361 ("A person obligated to redress the damage is liable only for normal consequences of the activity or inactivity from which the damage ensued"). The test of "normalcy" of consequences resulting from a given causative event resembles that of remoteness or foreseeability. Note that Polish law requires that the extent of the damage (attributable to a given causative event) be determined by reference to objective criteria. The test of "normalcy" of consequences resulting from a given causative event resembles that of "remoteness." As for "foreseeability," Polish law requires that the extent of the damage be determined by reference to objective criteria, while "foreseeability" seems to refer to cognitive powers of the parties (i.e., is not sufficiently objective).

In Poland, a breach of contract means that the defendant did not perform or improperly performed a contract, i.e., did not act as promised; a mere discrepancy between a warranted state of affairs and the actual one does not translate into non-performance or improper performance. In turn, a guarantee agreement, stating what the guarantor is expected to do, should such discrepancy occur, solves the problem. Under such an agreement (subject to Polish law), the guarantor may be sued for a specific performance. If such performance consists of a promise to redress the damage, the beneficiary may obtain what it would have obtained had the agreement been enforced in a common law jurisdiction under a breach of contract cause of action.

B. Indemnity

The reception of various indemnity clauses in Poland is most often carried out by translating *verbatim* phrases such as "indemnify and hold harmless," "make good," or "indemnify and keep indemnified." There is, as yet, no case law in Poland that would help to see how the judiciary interprets such constructs and whether they are enforceable under their terms. The reason for this is quite simple (and similar to the one observed in Germany): M&A disputes (and it is in M&A transactions that the indemnity clauses are most often used) are usually handled by arbitration courts, and the parties seldom agree to the publication of arbitration awards; secrecy of such proceedings and their outcomes takes precedence over transparency, and arbitration courts publish the awards only when the parties do not oppose this.

In common law jurisdictions, an indemnity claim (originating from indemnity contracts whereby the indemnitor promises, e.g., to indemnify and hold harmless the indemnitee from the loss originating in the events specified in such a contract) is generally believed to offer more to the creditor than a claim for damages for a breach of contract (a breach of warranty), even though functionally both are designed to liquidate the damage incurred: in the former case, because the indemnifier failed to provide the agreed indemnity or, in the latter, because the indemnifier breached a contract. This is so because, as generally believed,[134] amounts awarded to the indemnified party are not subject to the tests of remoteness or foreseeability and the requirement of mitigation.[135]

134. *See* COURTNEY, *supra* note 33, at 60–79 (general discussion).

135. As a side note, for a *droit civil* lawyer, both claims (under the indemnity contract on the one hand and under the sale contract equipped with warranties on the other) may seem identical, as both are, in fact, the outcome of a breach of contract (a failure to prevent or redress the loss in the first case and a failure to comply with the warranties in the second one), unless, in the case of the

In many *droit civil* jurisdictions, and certainly in Poland, the difference between the "prevent loss" and the "redress loss" indemnities also exists. The matter is rather complex; one should first see how Polish law explains the two types of indemnities (in theoretical terms).[136]

1. "Prevent loss" Indemnity

In the case of a "prevent loss" indemnity, a *droit civil* lawyer, and a Polish lawyer in particular,[137] would say that when the indemnitor is unsuccessful in averting the loss, it is liable for a breach of contract.

As mentioned earlier, under Polish law, in the case of a claim for a breach of contract (i.e., for non-performance or improper performance of an obligation), the debtor may escape liability by rebutting the presumption of its failure to observe due care when performing its obligation (promise). Such an outcome does not offer much for the indemnitee. The latter is interested in obtaining what it bargained for, namely the protection against the loss and, eventually, the coverage of such loss, which the debtor failed to prevent from appearing, no matter how diligent the indemnitor was in its attempts to avert such loss.

To arrive at such an outcome, two concurring interpretations are offered.

The first consists in arguing that when the subject matter of a contract was to obtain a result that was to be certain (i.e., in France, where, until the reform of Code Napoléon in 2016, there was a clear distinction between *l'obligation de résultat* and *l'obligation des moyens*, the former meaning that the debtor was to achieve a promised state of affairs, while the latter meaning that the debtor was merely to act diligently, with the result of its attempts not covered by its promise), the debtor's liability is strict, i.e., is not dependent upon the debtor's fault.[138] Therefore, damages for a breach of contract would be awarded (and thus the loss liquidated), regardless of whether the debtor acted with due care. According to a prevailing view in Poland, the preceding interpretation finds no support in the Civil Code's provisions.

Article 472 PCC does not distinguish between the types of obligations; fault (a presumed failure to observe due care) is a

"redress loss" indemnity, a request to indemnify were considered not as a claim for a breach of contract (a damages claim) but for performance thereof (a debt claim).

136. We refer here to the terminological distinction proposed by Rafal Zakrzewski; Zakrzewski, *supra* note 39, at 55, 62.

137. But also a German lawyer, *see* p. 11–12 *infra*.

138. *See* with respect the guarantee agreement stipulated in Article 392 PCC, PRZEMYSŁAW DRAPAŁA ET AL., PRAWO ZOBOWIĄZAŃ – CZĘŚĆ OGÓLNA 1109–11, 1119–20 (3rd ed. 2020).

prerequisite for any claim for a breach of contract, i.e., it is not excluded where the debtor promised to achieve a result certain.

The second interpretation looks for the answer elsewhere (i.e., it does not refer to a breach of contract theory) but dresses up the "prevent loss indemnity" in the robe of a guarantee contract (where a guaranteed outcome would be the absence of loss), discussed further below. Just to signal where it leads, the indemnitor would guarantee that no loss would ensue from a certain event, and when its guarantee does not materialize, the guarantor promises to render the performance stipulated in the contract; such performance may also consist of liquidating the damage. Such an interpretation explains the indemnitee's position not in terms of a claim for a breach of contract but for a specific performance, which is always available in *droit civil* jurisdictions. It could be employed not only to the "prevent loss" indemnity but also to the "redress loss" indemnity. In the latter event, however, other interpretative measures are also available.

2. "Redress loss" Indemnity

In the case of a "redress loss" indemnity, a claim for a breach of contract would appear only when the indemnitor did not act as promised in the agreement, i.e., did not redress the damage. In other words, the indemnitor would be, under a claim for a breach of contract, liable to liquidate the loss resulting from its failure to liquidate the loss.

However, there is no need to go that far. A simpler solution is to sue the indemnitor for a specific performance, i.e., to request that the court order that the indemnitor redress the loss (in practical terms, pay a sum of money equal to the value of the loss), as promised in the indemnity contract.

A theoretical construct employed to explain the above concept is a *conditional indemnity contract*, a suspensive condition (a rough equivalent of a condition precedent in common law parlance) for such contract coming into operation being the emergence of damage (loss).

In such a case, there is no room for the indemnitor to turn to a "no-fault" defense (i.e., no room to prove that it acted with due care). Such a defense is not available when the indemnitee demands performance of a contract. It is available only when the indemnitee claims a breach of contract (i.e., non-performance/improper performance) because the presumption of failure to exercise due care applies only then.

For obvious reasons, a claim for specific performance under a conditional indemnity contract is available only for the "redress loss" indemnity, not the "prevent loss" indemnity when the loss has already

materialized. If the indemnitor was supposed to protect the indemnitee from the loss (the "keep harmless" leg of the indemnity promise), and the loss had already emerged, there is no room for demanding a specific performance: it is already too late. In other words, performance became frustrated (or, in *droit civil* parlance, became impossible), and the only claim available to the indemnitee is that for damages resulting from a breach of contract (non-performance), with the defense of observance of due care available to the indemnitor.

Another way to formulate the "redress loss" indemnity in Polish law is to dress it up in the robes of a guarantee contract (where a guaranteed outcome would be the absence of loss), to be discussed in further comments.

The difference between the two concepts (i.e., a conditional agreement to redress the loss and a guarantee agreement to redress the loss) is that, in the former, the debtor does not guarantee the absence of loss but merely promises to redress the loss, should it appear (usually from causes known to the parties).

Sometimes it is argued in Polish legal writings, along the lines present in discussions held in some common law jurisdictions (especially under English law), that the "redress loss" indemnity (similar to a conditional agreement to repair the loss under Polish law) is best suited to cover the loss ensuing from a known risk, past or present, because an alternative instrument, namely a warranty (or rather: a guarantee contract), is not fit to operate where both parties were aware of the warranted risk which already existed at a time when their contract was made.[139]

Under Polish law, there is no reason to claim so. The warranty (guarantee) clause could also operate when the risk is known to both parties. The warranted (guaranteed) result is not the absence of risk but the absence of (future) loss from such a risk.

3. Guarantee Contract as a Substitute for Indemnity Contract

Under common law, indemnity and warranty clauses (contracts) serve one general purpose: to avert or redress the damage (loss).

Under Polish law, the same purpose may be achieved by employing a guarantee contract, wherein the guarantor would assure the beneficiary (in the guarantee declaration, constituting part of a guarantee contract) that the events specified in such a declaration would not entail any loss for the beneficiary, and would promise (in the operative part of the

139. *See, e.g.*, JASTRZĘBSKI, *supra* note 131, at 338–45.

guarantee contract) that should such loss occur, the guarantor will repair the damage (i.e., will perform as promised).

As stated in earlier remarks, the remedy (performance) envisaged in a guarantee contract may extend beyond redressing the damage. For instance, if a guarantee contract provides for a promise other than compensatory (i.e., when the guarantor promises to put the beneficiary in the position the latter would be in had the assurance contained in the guarantee declaration materialized, while the beneficiary did not incur any damage resulting from the discrepancy between a guaranteed and an actual state of affairs, yet such discrepancy still makes a difference in terms of money), the guarantor will be obligated to do as promised, i.e., to pay the balance. However, when analyzed in the context of often-used indemnity instruments, a guarantee contract is designed to be compensatory.

Then, in the case of a "prevent loss indemnity" (and to avoid the risks of a fault-based concept of breach of contract under Polish law), the guarantor might declare—i.e., assure the beneficiary thereof in the guarantee declaration—that no loss would accrue from the events specified therein, and if such an assurance (guarantee) does not materialize, the guarantor will render performance promised in the operative part of the guarantee contract.

The same wording could be used for a "redress loss" indemnity. Again, the assurance given in the guarantee declaration would consist of guaranteeing that certain events specified therein will not bring about damage, and should such damage nonetheless emerge, the guarantor will redress it, i.e., will perform as promised.

A guarantee contract is, thus, under Polish law, an omnipotent instrument capable of providing the parties with the result that, under common law, they could reach via contractual indemnities. As demonstrated earlier, the same instrument may also serve the purpose of properly (i.e., similarly, from a functional point of view) rendering the results in common law jurisdictions achievable through contractual warranties. It must be remembered that to place the parties where they want to be, it is not enough to merely translate the respective clauses copied from common law agreements; it is necessary to transpose them into the institutions of *droit civil* systems, of which the Polish legal system is a part.

C. Varia

Before concluding these comments, some complementary remarks should be made regarding two specific issues: one important for all the

contracts discussed herein (warranty, indemnity, and guarantee clauses), and the other relevant only for the latter.

1. Damage

The first issue is how damage (loss) is understood under Polish law and whether the notions recognized in common law jurisdictions (particularly, distinctions made between the expectation, reliance, and restitution interests)[140] have their equivalents in Polish law.

While damage is not defined in the PCC, Article 361 § 2 PCC provides that, absent contrary statutory or contractual stipulations, the damage to be redressed encompasses the actual loss (*damnum emergens*) and lost profits (*lucrum cessans*). In some instances, the law dictates which "interest" is recoverable; for instance, in the case of unjust enrichment, the recoverable amount would (roughly) correspond to the restitution interest; sometimes, the law says that only the amount corresponding to the reliance interest is recoverable (e.g., in the case of a failure to enter into a so-called promised agreement); in turn, in the case of non-performance/improper performance of an obligation (e.g., a failure to act as promised and bargained for under a contract), the amount corresponding to the expectation interest would (in principle) be recoverable in full unless the parties agreed otherwise. The above notwithstanding, when entering into a contract whereby the debtor's performance (promise) consists in repairing the damage, the parties are always free (within the boundaries of the principle of freedom of contract) to agree on the cap for contractually recoverable damage, or on the components of damage (e.g., *damnum emergens* but not *lucrum cessans*) to be so recoverable.

2. Subrogation

The second issue is connected with subrogation. In discussions related to indemnity and guarantee agreements addressing third parties' claims (and subject to the laws belonging to common law jurisdictions), it is sometimes held that if the indemnitor/guarantor redressed the damage (e.g., paid to a third party instead of the indemnitee/beneficiary to prevent loss, or reimbursed the indemnitee/beneficiary with the amounts the latter paid to a third party), then the indemnitor/beneficiary becomes subrogated into the rights of such third party.[141]

140. *See, e.g.*, E. ALLAN FARNSWORTH, CONTRACTS 46 (4th ed. 2004).
141. *See, e.g.*, COURTNEY, *supra* note 33, at 78–79.

Under Polish law, no such subrogation could take place. According to Article 518 PCC, subrogation occurs only in some specified instances, among them when the payment was made by a party personally liable for a third party's debt or when such payment was agreed upon with such third party.

Neither the indemnity nor the guarantee agreements fall under the category of "personal liability for a third party's debt." Such liability appears only when the statutory law provides it. It does so in the case of a suretyship contract, which an indemnity/guarantee contract is not. The latter types of contracts do not create any legal relationship between the indemnitor/guarantor and a third party (they are so-called non-accessory contracts); therefore, no subrogation may ensue from their performance.

V. CLOSING REMARKS

The law must follow where there is a justifiable societal need (e.g., a business one). Usually, it does, but it is tough and rarely with speed. The need must first become sufficiently embedded in people's minds, and the way for the change must be properly paved. In *droit civil* systems, this is done by legal writings and by the courts. The former are usually the first to voice the need for reforms, while the latter creates precedents to the extent that the statutory law leaves them sufficient room for maneuver.

In common law systems, the courts are usually the first to react, especially in contract law, where statutory law interferes less frequently than in many other branches of law. This is not so in *droit civil* systems. Codified systems are believed to be less prone to the agility required in a quickly changing world.

The discussion about warranties and indemnities in Germany and Poland has shown just that. In both those countries, a similar system (and similarly rigid) of statutory warranty for defects created the need to look for alternative solutions (such as those adopted in common law jurisdictions) better fitted to meet the expectations of business communities in their M&A transactions.

This, however, led to different results in Germany and Poland.

In Germany, the attention was first focused on eliminating the rigidity of the system by first making it possible to apply the statutory warranty for defects not only to asset deals but also to share deals, where the subject matter of the sale was the entirety (or close to that) of the shares in the company. This, however, still proved insufficient because of a limited range of remedies available under the statutory warranty for defects system. Then, the next step was to allow for a stand-alone

(independent) guarantee, with a contractually agreed obligation to pay damages (as a primary obligation) for the inaccuracy (i.e., falsity, misleading nature) of warranties set out in the contract.

This certainly loosened the stiff corset of statutory warranty for defects, yet still did not make it as flexible as necessitated by the needs of the M&A transactions. Namely, there still exists the risk of a guarantee being qualified not as independent (based on the freedom of contract) but as a mere modification of the statutory warranty for defects.

The next step came with the efforts to replicate a system of indemnities in German law. As to the "prevent loss" indemnity, the efforts are still not satisfactory, as German law tends to qualify it as an obligation of "best efforts," with non-performance sanctioned by damages, and thus also with a possibility for the debtor to escape liability by proving that its non-performance resulted from reasons not attributable to it.

In turn, as to the "redress loss indemnity," German law is closer to common law solutions due to the application of an independent (stand-alone) guarantee to pay damages if the guarantee proved incorrect and the beneficiary incurred a loss therefrom. In this respect, a breach of indemnity and a breach of warranty lead practically to the same results, i.e., to a contractually agreed obligation to pay damages, understood as a primary duty of the guarantor/indemnitor.

In Poland, the evolution took a different path. From the early years after the change of the political system (in 1989), statutory warranty for defects has been believed to be an unsatisfactory solution for M&A transactions (for reasons similar to those observed under German law) and used to be summarily excluded from the majority of all sizeable domestic and cross-border transactions.

Therefore, by necessity, Polish efforts were not focused on "improving" the (practically non-applicable) statutory regulation of warranty for defects but on devising a system that could replicate the common law warranties and indemnities in terms of Polish legal parlance.

This has been achieved first of all by proposing that in M&A transactions, warranties, and indemnities be expressed in terms of a guarantee contract (allowed pursuant to the freedom of contract rule), equipped with a so-called guarantee declaration, wherein the guarantor/indemnitor would assure the beneficiary/indemnitee that a certain state of affairs would, or would not, materialize (i.e., that there would be no discrepancy between the warranted and the actual states of affairs, or that there would be no loss from a certain event, respectively) and, should such guarantee prove not accurate (i.e., false, misleading), a

guarantor/indemnitor would perform as promised, i.e., would redress the damage suffered by the beneficiary/indemnitee, or would perform otherwise (as agreed), all such remedies to be considered as primary obligations of the guarantor/indemnitor.

In this way, the German and Polish legal systems are similar in their approach to warranties and indemnities, though the German one still has "one bridge to cross." Namely, a "prevent loss" indemnity is still (predominantly) understood in Germany as the debtor's obligation to take steps (best efforts) to protect the creditor from loss, sanctioned by damages as a secondary obligation. Such sanction may, however (and in principle), be avoided if the debtor can prove that its efforts to prevent the loss were destroyed due to reasons not attributable to it.

In Poland, such a defense would not work. Under a guarantee contract, a duty to pay damages is not the secondary, but the primary obligation of the debtor (guarantor/indemnitor); to such a duty, the defenses taken from the "breach of contract" catalog do not apply.

In Poland, this works not only for warranties but also for both types of indemnities; in our opinion, there is no reason why this could not be the same under German law. After all, a "no loss" stand-alone (independent) guarantee contract (with the guarantor's primary obligation to liquidate the damage) could apply to both situations. In either of them, the guarantor's primary duty pertains to the liquidation of damage (loss), irrespective of whether the guarantor was in a position to prevent or not prevent such loss from occurring and notwithstanding whether it did anything to avert the damage.

KEYWORDS

Breach of contract, claim, common law, contract, contractual warranty, damages, droit civil, indemnity, prevent loss, redress loss, representation, statutory warranty for defects, warranty

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