

THE AMERICAN WAY



DAGMARA PRZYBYTNIOWSKA, ASSOCIATE AT DENTONS, AND BARTOSZ JU SZCZAK, SENIOR ASSOCIATE AT DENTONS, POINT OUT SOME EXPECTATIONS THAT US INVESTORS MAY HAVE WHEN FINANCING STARTUPS IN POLAND

Recent years have been undeniably fruitful, if not booming, for the Polish startup ecosystem. In the face of social and economic challenges, the Polish venture capital (VC) market has not only proven immune to turbulence but exceeded the boldest expectations. Poland has become the leader in the VC markets in Central and Eastern Europe given such factors as the size of the market, the total amount of VC investment accumulated year after year, and the increasing number of megarounds.

Foreign investors have noted that Poland has all the necessary ingredients to become another Silicon Valley—a region with a high concentration of top tech talent, exceptional quality engineers, an entrepreneurial mindset, and a versatile startup scene. Combined with relatively low labor costs and overall lower living costs as compared to Western Europe, Poland can be attractive to foreign investors who eye access to new growing markets.

Poland's potential to become the main technological hub in the region has been confirmed by such international tech giants as Google, Microsoft and Nvidia, who have created their million-dollar centers in Warsaw.

ATTRACTING US VENTURE CAPITAL

When going through an investment round, many Polish startups pledge to expand onto the American market and scale their products there. It seems that their ambition is to gain financing from US venture capital funds. Some companies open their structures in the US right away while others plan to flip their shareholders as the next step, and take advantage,

for example, of phantom rights at the American vehicle's level which grants the contractual equivalent of corporate powers acquired without taking up actual equity, as it is often one of the restrictions for funds with public backing. Yet, the goal of those companies remains the same—to make the investment process as accessible to American VC funds as possible. US investors put money in Polish startups both directly, sometimes acquiring them entirely, and through investment funds available all over the world. Investment rounds are usually governed by

Polish law, as they require the issuance of new securities by a Polish company. Direct investments in secondary shares indicate that US investors strongly prefer the investment documentation to be governed by their local law (usually the laws of Delaware). For this reason, US investors as well as Polish founders should be aware of key differences between investment documentation based on these two legal systems.

COMING TO TERMS

As a rule, documentation based

on US law seems more investor-friendly. It is reflected in higher expectations regarding representations and warranties to the startup, being a series of statements serving as assurances regarding the current state of the business. Such statements are not qualified by information made available to the investor during the due diligence process—through the so-called general disclosure. With this, the startup in which a US investor wishes to invest should prepare an in-depth “examination of conscience” to verify the expected representations and warranties, confront them with the actual situation and prepare a detailed disclosure letter. The burden of such extra effort is typically carried by the founders and the company management. On the other hand, with investment rounds governed by US law, it happens more often that the representations and warranties are made by the company but not directly by its founders, which seems to have become a market standard in Europe. This approach limits the founders' exposure to personal liability, which they are very reluctant to risk for obvious reasons. Unfortunately for the founders, US investors are increasingly expecting that the founders make a general backup representation (issue a statement that the representations and warranties, as made by the company, are true and correct) or directly offer some assurances, usually those related to the intellectual property of the company. This aspect of risk allocation is usually crucial during negotiations regarding investment documentation.



Startups in Poland are increasingly eyeing opportunities offered by American angel investors who offer not just capital but the so-called “smart money”.

EXPERT VENTURE CAPITAL

The scope of the representations and warranties should always be adjusted to the specifics of the investment. For example, different representations and war-

concepts and get adjusted to local regulations and formalities. As many Polish startups have benefited in some form from the involvement of public funds, po-

cent amendments and introducing, for example, a simple joint-stock company, as a new, startup-friendly legal form. Concerns about foreign legal sys-

first half of 2022 was 76 percent better for Poland in terms of the total value of investment, compared to the same period in 2021.

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ranties are made in an investment round and full exit; they also differ between founders, investors from previous rounds and other shareholders, such as employees who acquired securities through the employee stock option plan.

The US investment documentation is usually more standardized, often based on the standards of the National Venture Capital Association.

The Polish VC market is still an emerging market and so are its standards, although they derive from western

tential constraints related to it shall also be considered and reflected in investment documentation.

MAKING THINGS SIMPLE

The Polish investment process may seem to involve more formalities than its American equivalent, including the presence of a notary or court registration procedure, depending on the legal form of the target and the structure of the pursued deal. However, Polish legislators increasingly recognize the need for digitization, as reflected in re-

tem do not outweigh the potential spotted in talented CEOs, harmonious teams, and, most importantly, defensible IP, which can attract industry investors willing to acquire the idea and then acquire key staff members; or attract a deep tech VC offering more than just financing, but also the so-called "smart money".

HIGH EXPECTATIONS

According to the quarterly report from PFR Ventures on the Polish VC market, despite the global turmoil in the CEE region, the

Given the projections for Poland and the announcement of the continuation of the EU public programs for 2021-2027, juxtaposed with the US VC market facing choppy waters due to the underperformance of tech companies on the stock market in 2022, plummeting valuations and warnings from leading investors for startups that "winter is coming," Poland may present an attractive alternative for enhancing active US capital participation in the CEE region.

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