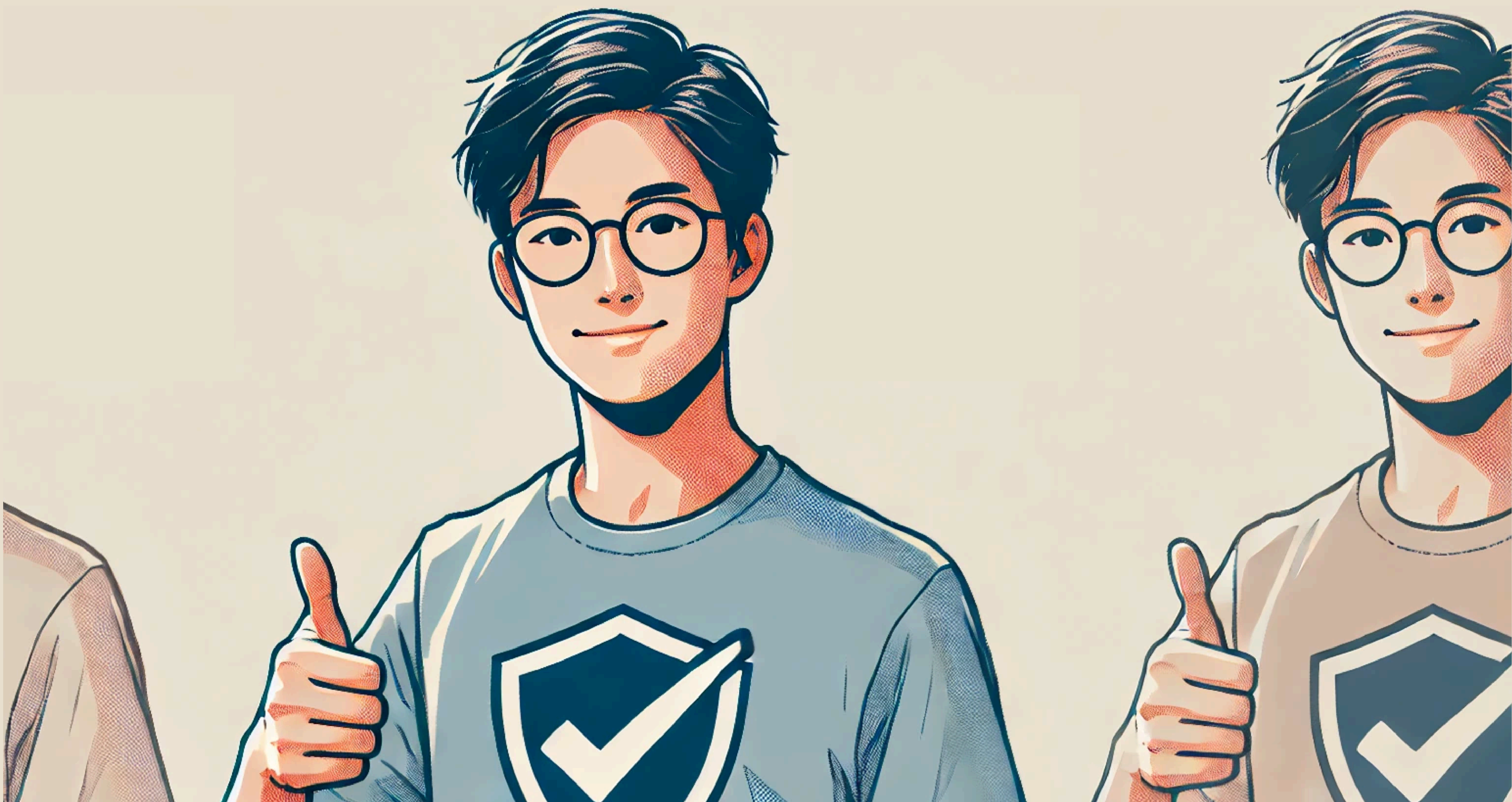
The Founder's 101 Guide To 'Warranties'

Understanding investor legal rights in claims and contractual promises



It’s risky investing in early stage companies w/ incomplete info

Sort of akin to buying digital gadgets. There’s no way to 100% determine if every part works in a complicated device.

A quick guide on warranties:

✳️ Warranty

is used to accelerate the funding round cycle while also used as an instrument protecting investors from fraudulent claims.

1️⃣ Shortens due diligence process especially for small rounds

2️⃣ Protects against elements and factors that are not possible to do diligence on. (e.g. impending churn)

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What are ‘Warranties?’

Startups typically provide warranties about the company's condition, operations, and financials.

These may include:

✅ Accuracy of financials

✅ Compliance with laws

✅ Intellectual Property Ownership

✅ Absence of material litigation

False promises = False warranties

A warranty is a clause in itself.

Whilst the focus is on commercial clauses (preference stack, anti-dilution etc.), this doesn't mean warranties are any less important in agreements.

Warranties create a win-win both ways if done right.

❌ Investors can quickly get comfortable in a reasonable amount of time

❌ Both save money on additional due diligence prep fees

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How do Warranties work?

Important to know:

💰**DURATION:**
Runs typically 18-24 months at least through one accounting cycle

💰**QUANTUM:**
Usually capped at investment amount for claims

💰**QUALIFIERS:**
There are key factors that will determine the extent of warranties

Qualifiers

Qualifies the extent of warranties.

ACTUAL KNOWLEDGE:

Very low bar to qualify. Has to be proven that warrantor knew warranty was false.

CONSTRUCTIVE KNOWLEDGE:

Executive bar, someone who's in a high position and carries out duties w/ responsibility and diligence

Worst case?

Investors are entitled to remedies for breaches.

- **Indemnification:** Startup may be required to compensate investors for losses resulting from breach.
- **Rescission:** Investors might have the right to a full refund of their investment.
- **Damages:** Investors may claim damages to cover losses incurred from reliance on false warranties.

KEY DOCUMENT*

✳️ Disclosure Letters

This is an avenue for founders to highlight key items that if not disclosed would breach warranty.

Think of it as a document to provide context, list of exceptions and transparency.

Over-disclosure can raise unnecessary concerns, while **under-disclosure** can leave the company vulnerable to warranty claims.

Warranties don’t need to be extremely complex.

It can be useful if both parties are honest with each other.

Though it can seem to only protect investors...

It’s meant to offer mutual benefit, not crucify founders.

Use it wisely!

In Summary:

- Understand warranties
- Use it, but protect yourself with disclosures
- Understand the worst case scenarios
- Work with lawyers after to solidify it.