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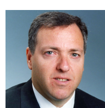
We Can Work It Out: The Need for Pre-Negotiation Agreements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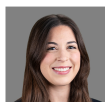
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In light of the current economic climate, real estate lenders and borrowers will certainly be communicating with one another frequently concerning potential loan modifications and accommodations. It is prudent for lenders to require that the parties enter into a pre-negotiation agreement, or a "PNA," as a sine qua non to having such communications.

A PNA is an agreement between a borrower and lender which sets forth the framework that will govern discussions surrounding potential loan modifications, accommodations or restructuring, without the lender forfeiting its ability to enforce the loan documents. Upon executing a PNA, the parties thereto are not bound by the ensuing discussions unless and until the terms of a proposed modification have been documented in a formal written agreement executed by the necessary parties. In addition, a PNA provides comfort to a lender that the borrower will acknowledge the validity and enforceability of the loan documents.

The main purpose of a PNA is to maintain the status quo between the parties and ensure that the borrower cannot use the negotiations to oppose any of the lender's efforts to enforce the loan documents or assert any claims against the lender on the basis that throughout the course of negotiations, the lender committed to modifying the loan documents or that the parties' correspondence itself constitutes a modification. Without a PNA, the parties may be hesitant to engage in productive discussion for fear that correspondence, emails, representations or statements made in the course of negotiations could be used in future litigation. Even if ultimately unsuccessful, a borrower claiming that it relied on lender's statements to its detriment in believing the lender committed to any modifications would be prejudicial for the lender.

The obvious parties to a PNA are the borrower and lender, but it is also typical for lenders to require existing guarantors under the loan to join or acknowledge the PNA. From the lender's perspective, it is crucial to prevent guarantors from making any claims similar to those of the borrower against the lender. In addition, lenders

are always careful to protect against claims by guarantors that they are discharged due to suretyship arguments that the underlying transaction was modified without their consent. A PNA serves as a potential defense to lender liability claims and could thus save lenders from time-consuming and costly litigation.

PNAs will include provisions necessary to maintain the status quo throughout the course of negotiations. This normally takes the form of an agreement that negotiations, including all communications, discussions, meetings, e-mail or other correspondence, are non-binding until a formal, written agreement is executed by all parties and that either borrower or lender may terminate the discussions at any time. Lenders should also have the borrower acknowledge its current obligations under the loan documents, agree that the loan documents remain in full force and effect, and that neither party waives any of their rights, remedies or obligations under the loan documents.

While a forbearance agreement may be entered into in the course of workout discussions, it is imperative that lenders do not agree to forbear loan enforcement or otherwise modify existing loan terms by the PNA itself. Having entered into a PNA prior to the negotiations surrounding a forbearance agreement provides those discussions with the same protections of the PNA.

PNAs can also include confirmation of who has the authority to negotiate and agree to terms on behalf of the borrower and guarantors. In the context of a syndicated loan, the administrative agent enters into the PNA, which would cover discussions between both borrower and the administrative agent or the other lenders in the syndicate, but typically provides that borrower can only discuss the loan with the administrative agent. If an asset is financed by both mortgage and mezzanine loans, each of the mortgage and mezzanine lenders should enter into separate PNAs with their respective borrowers and potentially with each other.

Some additional provisions that are beneficial to lenders and often included in a PNA are confirmation of the amount of debt, a release of claims against the lender caused by or arising out of the PNA, if the subject loan is in default, an acknowledgement of such default and waiver of defenses, confidentiality of discussions, and authorization for the lender to deal with other lienors without the possibility of raising the defense of tortious interference.

While seemingly adversarial, our experience is that PNAs have become fairly standard practice and do not engender significant negotiation. They have thankfully become a commonplace protection for all parties to workout negotiations and are, for the most part, universally accepted without excessive negotiation.

Given the present state of economic conditions, and the corresponding increase in potentially distressed commercial real estate loans, borrowers and lenders will likely be considering or already in the midst of discussions surrounding workouts or accommodations. Lenders should be prioritizing a PNA as a first step as soon as negotiations are anticipated and should endeavor to defer conversations until the PNA is entered into to limit their risk exposure.

The foregoing does not address all provisions contained in a PNA and only highlights some salient points. Care should be taken in the preparation,

negotiation, execution and delivery of PNAs as a condition to any substantial workout discussion.