Can and Will Be Used Against You: The Importance of Pre-Negotiation Agreements for Troubled Commercial Loans

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When your commercial loan is about to go into default or is already in default, one of your first steps should be to enter into a pre-negotiation agreement if you intend to have discussions about the loan and/or its potential work-out. This article will explore some key components to a pre-negotiation agreement.

Whether you are a borrower, a guarantor or a lender, when your commercial loan is about to go into default or is already in default, one of your first steps should be to enter into a pre-negotiation agreement if you intend to have discussions about the loan and/or its potential work-out.

An appropriately worded pre-negotiation agreement sets the ground rules for these discussions and allows the parties to discuss the default and potential solutions and exchange documentation or information, without a party's actions or words being used against it. The pre-negotiation agreement thus facilitates an exploration of the feasibility of a loan modification.

As with most aspects of commercial real estate loan transactions, the contents of a pre-negotiation agreement may vary due to the parties' respective bargaining positions and local law considerations. Although not an exhaustive list of all topics, issues and considerations, this article will explore some key components to a pre-negotiation agreement.

Several Key Components to a Pre-Negotiation Agreement

Loan Parties, Document Description and Introduction of Purpose

In general, pre-negotiation agreements should begin by clearly identifying the loan transaction, the parties thereto, and the documents that evidence the transaction. A lender and borrower will be parties to a pre-

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negotiation agreement. A guarantor may be a party as well, or a guarantor may join in as to only certain provisions.

Inadmissibility of Discussions

The pre-negotiation agreement should then expressly set forth its purpose, *i.e.*, to make clear that the discussions that are about to take place — or, in some instances, which have already taken place — are to be considered settlement negotiations and, accordingly, shall not be admissible as evidence on any issue before any court. For example, the agreement may provide: "In order to ensure that our discussions will be as open and productive as possible, the parties are executing below to confirm our mutual understanding that all discussions concerning the loan, the loan documents and the property will be undertaken with a view toward settlement and compromise."

This concept is often supplemented by a statement that the scope of the agreement is intended to be as broad as possible under applicable law including the restrictions on admissibility contained in Federal Rules of Evidence 408 and all applicable state and common law privileges. The parties should then expressly acknowledge and agree that they will not make any claims or assertions inconsistent with this concept in any proceeding relating to the loan or the loan documents.

Payments and Advances

Pre-negotiation agreements frequently contain provisions in which the parties to a loan transaction acknowledge and agree that the lender may accept or reject payments or partial payments — whether from a borrower, guarantor or other party — without certain consequences. Specifically, a lender will seek to avoid an argument that its acceptance of such payments constitute:

- An agreement or commitment by lender to amend or modify the loan or the loan documents;
- An agreement to continue to accept such payments or partial payments or fund advances;
- A course of conduct by the lender;
- A reinstatement of the loan or a cure of any default or event of default under the loan documents;
- An agreement or commitment by the lender to forbear from the exercise of any of its rights or remedies pursuant to the loan documents, applicable law or otherwise; and/or
- A waiver or alteration of lender's rights or remedies pursuant to the loan documents, applicable law or otherwise.

A lender may also wish to add language that its failure to exercise rights or remedies or its delay in the exercise thereof with respect to a continuing or future default shall not affect any of its rights and remedies under the loan documents or applicable law, nor result in lender having consented to any of the bullet-pointed matters listed above.

Distribution of Information

Another key component of a pre-negotiation agreement is how information (e.g., documents, reports, correspondence, term sheets, letters of intent, etc.) obtained and/or generated during the "free and open" discussions

will be treated and maintained by the parties. All parties to a pre-negotiation agreement should agree that all such information is to be held in confidence, even after the pre-negotiation agreement has terminated (i.e., such agreement regarding confidentiality survives termination of the pre-negotiation agreement and discussions thereunder).

Given the parties' possible reporting obligations (for example, a lender's reporting obligations under applicable regulations or a party's reporting obligations under a judicial order), the parties often agree to confidentiality carve-outs permitting the distribution of such information to, for example, potential purchasers of a defaulted loan, attorneys, consultants and others. As appropriate, these parties should also, in turn, be required to agree to keep all information confidential.

A lender seeking to sell a defaulted loan must be particularly sensitive to this provision. Otherwise, it may preclude itself from sharing information needed by a prospective purchaser of the defaulted loan. A borrower party may not want any information shared with such a prospective purchaser. The parties can, of course, agree to waive any confidentiality provision with respect to certain specified information as well.

Defaults/Waiver of Claims

Depending upon the negotiation dynamics in a particular transaction, an express acknowledgment of default(s) and/or a release of a lender (and/or its servicer) may become part of a pre-negotiation agreement. While borrowers and guarantors will seek to retain all of their rights during the discussion process, lenders will be looking to get confirmation of the existing default(s) and confirmation that no other defaults exist and that the borrower parties have no defenses against the lender.

Miscellaneous

Pre-negotiations agreements will often contain other provisions that may be crucial to one side or the other of a loan transaction. For example, a lender may insist on adding generally customary language which specially provides that it may exercise rights and remedies at any time (which it may do for a variety of reasons while discussions are on-going including, potentially, statute of limitation considerations).

Conversely, a borrower and/or guarantor may seek a statement to the opposite effect for a specified period of time subject, in some cases, to certain conditions being satisfied, such as no further defaults or certain payments being made in a timely fashion.

Pre-negotiation agreements often contain a number of other provisions, such as a statement regarding the governing law, a representation that each of the parties signing the agreement has authority to do so, a provision regarding the binding nature of the agreement on the parties' respective officer's directors, shareholders, employees, affiliates, heirs, successors and assigns, and a severability provision regarding the exclusion of unenforceable provisions.

It is also common for a lender to have a borrower and/or guarantor acknowledge that they will not rely on the settlement agreement and that they should consider other offers to refinance the debt. The parties may agree that no compromise, settlement, agreement or understanding with respect to the loan or the

loan documents (oral, express, implied or otherwise) shall be binding unless and until reduced to a writing signed by all of the parties to a loan transaction.

The parties may also include a provision that provides that any of the parties may terminate discussions without liability under the pre-negotiation agreement, at any time, subject to certain matters which may survive termination. And while the existing loan documents may already address who is responsible for costs associated with negotiations and/or a potential work-out (including legal fees), these provisions can be restated in a pre-negotiation agreement or a lender may require the payment of certain expenses in connection with the execution of the agreement.

Be mindful that language usually considered "boilerplate" may become critical to a particular transaction. The parties should always consider whether the "boilerplate" language affects their substantive rights, and particularly whether it is inconsistent with the provisions of the existing loan documents.

Conclusion

Whether you are a borrower, guarantor or lender, it is critical that you speak with your counsel if a loan is about to default or is in default. If certain statements are made in this context without the protections of a pre-negotiation agreement, those statements may come back to haunt you.