

COVID-19: TIPS FOR PRENEGOTIATION LETTER AGREEMENTS IN LOAN WORKOUTS

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The COVID-19 pandemic (COVID-19) has significantly impacted the global economy. The cash flow crunch caused by COVID-19 closures and its related economic impacts are causing many borrowers to seek forbearance or other economic relief from their lenders. Forbearance or other proposed modifications in response to distress is often referred to as a “workout.” A loan “workout” is a plan of restructuring or amendment to the existing loan terms in order to address or avoid a potential or existing default or other nonperforming loan aspect. When lenders and borrowers engage in discussions around workout terms, a Pre-Negotiation Letter Agreement (PNL) is the first step in the “reset” process. In this alert, we offer an overview of the role of a PNL in workout discussions and include a list of key terms that a typical PNL should contain.

THE PRE-NEGOTIATION LETTER AGREEMENT

A PNL may take the form of a letter or more formal agreement between a lender and its respective borrower. In addition to borrower(s), most lenders also seek to have the existing guarantor(s) execute the PNL or at least sign on as a party by acknowledgment. For the benefit of all parties, a PNL will set forth a framework for governing the related workout, modification, or restructuring discussions. Upon execution of a PNL, the interested parties should not be bound by any subsequent discussions until the terms and provisions of a proposed modification have been reduced to a formal written agreement fully approved and executed by all necessary parties.

STANDARD PROVISIONS

PNLs should be drafted to ensure that the parties do not unknowingly waive or relinquish any of their respective existing rights set forth in the loan documents. A typical PNL should include the following concepts:

1. *Voluntary Termination of Discussions*: The parties to the PNL should acknowledge that the “discussions” are voluntary and may be terminated by either party at any time. If discussions fail to lead to a formal workout, modification or forbearance agreement, lender may exercise its remedies and borrower may seek bankruptcy protections or refinance options.¹
2. *Only Written Agreements and Amendments Shall Modify the Loan Documents*: The parties should acknowledge that preliminary discussions or agreements related to a loan workout, restructuring, or modification are inadmissible by all parties in any later proceedings and further, any preliminary agreement is nonbinding (and no formal modification will be effectuated) unless the negotiations are reduced to a final, definitive written agreement executed by all parties.
3. *Status of the Loan*: For lenders, borrower should acknowledge the status of its current obligations under the loan documents. If borrower is unwilling to admit a default, then at minimum, borrower should provide

an acknowledgement as to whether or not lender has sent default notices and that borrower has received such notice.²

4. *Status of the Loan Documents*: The parties should acknowledge and agree that the loan documents remain in full force and effect unless and until further modifications are made pursuant to the PNL. Lenders may consider including a list of all operative loan documents and any existing modifications, or incorporate these by reference to defined terms contained within the governing loan agreement.
5. *Estoppel*: Lenders may seek a statement from borrower confirming the outstanding amount of the debt and/or an acknowledgment from borrower that lender has no further duty to fund, make advances, or perform other affirmative obligations and that there are no offsets, abatements, or other defenses of borrower or guarantor. Lenders should seek to avoid incorporating any estoppel language, which may hinder their own interests, such as confirming sums held in reserve, etc.
6. *No Forbearance or Modification*: Lender should not agree to forebear loan enforcement while the discussions are ongoing, nor should lender modify any existing loan terms in the PNL itself. Instead, lender should retain its right to exercise any available right or remedy, including, but not limited to, sending additional default notices, accelerating the loan or commencing a foreclosure action at any time during the negotiations and any proposed loan modification should be separately documented.
7. *Waivers/Strict Compliance*: The parties should acknowledge that neither waives any of their rights, remedies, or obligations under the loan documents.
8. *Release/Indemnity*: Lender may find it beneficial to include provisions wherein borrower and any guarantor(s) or other obligor(s) expressly (i) agree that that they will not assert any claim, action, cause of action, suit, and defense against lender as a result of the post-PNL discussions and negotiations; and (ii) irrevocably and unconditionally release and discharge lender from any claims, actions, causes of action, suits, or damages caused by or arising out of the post-PNL discussions and negotiations.
9. *Non-Admissible*: The parties should acknowledge that evidence of conduct and communications of any kind, related to and made during the course of discussions are inadmissible as evidence in judicial proceedings. However, it should be noted that the PNL itself is admissible and the PNL should state that neither party will object to the admissibility of the PNL in any legal proceeding.
10. *Consent (if applicable)*: Lender may provide an acknowledgment that lender cannot agree to any proposed amendment that may result from the post-PNL discussions and negotiations without first obtaining the appropriate written approval of various parties (e.g., in the mezzanine loan context, consent of any senior lender(s)), as well as an acknowledgment that the persons who will participate in the discussions for lender are not authorized to enter into any binding agreement unless and until they first obtain that approval.
11. *Authorized Representatives*: The parties should acknowledge that certain individuals in the negotiations are the authorized representative of the respective party (typically on behalf of borrower, only) and may agree to final terms on behalf of such party.
12. *Legal and Other Fees and Expenses*: Typical PNLs will provide that borrower is required to pay and/or reimburse all of lender's fees and expenses, including attorney's fees, in connection with the workout or modification discussions and related negotiations.

13. *Interested Third Parties*: Lender may choose to include a provision that allows lender to discuss and share information with: (i) other co-lenders involved in the capital structure of the project, particularly if the original financing involved subordinate debt or a mezzanine debt structure; and (ii) other “interested third parties,” including, administrative agents, loan servicers or special servicers, as applicable.
14. *Confidentiality*: Subject to the interested “Third Parties” provision discussed above, the discussions between the parties to the PNL are required to be kept strictly confidential and may only be disclosed to a third party with express written consent of the other parties, subject to certain exceptions (e.g., to a respective party's successors and assigns, a party's legal counsel, accountants or other financial or professional advisors, by a lender to lender's co-lender).
15. *Continuous Operations; Alternative Options*: Because the negotiation process may not produce a mutually agreeable resolution, borrower should agree that it shall continue to operate and maintain possession of the property (or other loan collateral) in a manner they see fit and continue to assess possible alternative opportunities, including, but not limited to, refinancing, sale, lease or other disposition of the loan collateral, as permitted by the loan documents.

CONCLUSION

A PNL is a useful tool for both lenders and borrowers when entering into discussions around a potential loan workout. PNLs offer lenders the ability to limit their risk exposure to lender liability claims in advance of substantive discussions with borrower regarding the loan restructure or loan modification and borrowers can look to the PNL as a road to open and productive discussions in furtherance of amicable resolutions.

This client alert is an abridged version of the article “Tips for Prenegotiation Letter Agreements in Loan Workouts” published on June 19, 2020 in Law360. Please click [here](#) to access the full text of the article.

FOOTNOTES

¹ Pre-Negotiation Letter for a Commercial Real Estate Loan available at Practical Law Real Estate, Resource ID: 4-507-0496 (last visited Jun. 13, 2020).

² Commercial Real Estate Loans: Workouts available at Practical Law Real Estate, Resource ID: 7-505-9925 (last visited Jun. 13, 2020).

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