



Social Distancing for Distressed Loan Negotiations: The Role of Reservation of Rights Letters

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In the wake of the global COVID-19 pandemic and the related economic fallout, Borrowers and Lenders have found themselves in a novel and challenging business environment. Commercial mortgage Lenders have been, and will continue to be for the foreseeable future, inundated with loan modification and workout requests from Borrowers who have defaulted under their loans, are facing an imminent Default or just need some “breathing room.” In light of the difficulties facing many commercial mortgage Borrowers, the FDIC and other federal agencies have issued statements encouraging banks to work with Borrowers to find constructive methods for alleviating the temporary hardships imposed by COVID-19. However, Lenders face a delicate balancing act of working with Borrowers to reach a mutually beneficial loan workout or modification and protecting their rights, remedies and powers pursuant to the loan documents and applicable law. In this context, many Lenders will utilize a reservation of rights letter or include the substance of a reservation of rights letter in correspondence with a Borrower in any distressed situation.

A typical example of a reservation of right is as follows:

“The Agent hereby informs you that the Lender Group has not waived any Default or Event of Default which may exist currently or hereafter pursuant to the Loan Documents. The Lender Group further reserves the right to identify potential Defaults and Events of Defaults, that have either already occurred, whether with knowledge of the Lender Group or otherwise, or shall occur and to pursue the Lender Group’s rights and remedies in connection therewith.

Each of the rights, remedies and privileges of the Lender Group pursuant to the Loan Documents, at law, in equity or otherwise are cumulative and exercisable and enforceable by the Lender Group at any time and from time to time. Nothing contained herein or in any correspondence with the Borrower, any Guarantor or their respective Affiliates shall constitute a waiver of the rights of the Lender Group in connection with the Loan, or any Default or Event of Default under the Loan Documents.

Nothing contained herein or in any correspondence, communications, discussions or negotiations with the Borrower, any Guarantor or their respective Affiliates shall (i) prejudice, waive, modify or constitute a forbearance with respect to, and the Lender Group hereby reserves the rights of Lender Group fully to invoke, any and all rights, remedies, powers and privileges pursuant to the Loan Documents, at law, in equity or otherwise at any time the Lender Group deems appropriate with respect to any Default or Event of Default that may exist; or (ii) constitute, or be deemed to constitute a waiver, modification or forbearance with respect to the Loan Documents or acceptance of any event, occurrence or circumstance, which may constitute a Default or an Event of Default under the Loan Documents.”

There are various circumstances when the use of a reservation of rights letter is prudent. First, Lenders may want to send a reservation of rights letter prior to or contemporaneous with administering draw requests under a loan when there may be the potential for a Default in the near future due to the property’s operation or the Borrower’s business. In this instance, the Lender may believe the Borrower will be in violation of its financial covenants when the next monthly or quarterly financial reports are due.

Second, if, after a Default or an Event of Default has occurred, a Lender desires to accept an interest payment from the Borrower or grant a Borrower’s request for a release of reserve funds or take any other action with respect to the Loan, then any such action by the Lender or delay in enforcing its rights and remedies could be grounds for a Borrower’s claim that the Lender has waived its rights and should be estopped from taking any further action in connection with the Default or Event of Default in question. In this context, a reservation of rights letter is warranted as a manner in which a Lender can preserve its rights and remedies while simultaneously making it clear that any

previous or subsequent communications between the parties and their respective representatives or attorneys will also not constitute a waiver of any Default or Event of Default. While any negotiations or discussions between a Borrower and Lender with respect to a forbearance, modification, waiver or other matter once a loan is in distress or a Default or an Event of Default has occurred should be preceded by the execution and delivery by the relevant parties of a pre-negotiation agreement (please see our [prior publication](#) on these agreements), a reservation of rights letter can further insulate a Lender from specious claims of a Borrower.

As with any notice, when drafting a reservation of rights letter, it is vital to check the notice provisions within the relevant loan documents to ensure that the notice is given in strict compliance with such provisions and that every party that is entitled to such notice is provided with a copy of such letter at the correct address. Care should also be given to notify any Guarantors or additional environmental indemnitors. The letter should, if possible, include an express statement identifying the Default, Event of Default or circumstances that prompted Lender to send the letter and explicitly include an express and unconditional reservation by the Lender of its rights to pursue all of its available legal rights, powers and remedies under both the loan documents and applicable law in connection with such Default or Event of Default. It is important to note that the letter itself should include a broad definition of the term “loan documents” to ensure the Lender’s rights under all applicable loan documents (including all guaranties and indemnities) are encapsulated in the reservation.

Since a reservation of rights letter is also meant to act as a shield against any Borrower’s claims that past or future communications or delays on the Lender’s behalf estop the Lender from taking any enforcement actions, it is typical, following the express reservation, to include a statement that Lender’s rights, powers and remedies are, and will remain, in full force and effect. Additionally, the letter should include language making it clear that the letter and any action or inaction by the Lender is not a waiver of any Default or Event of Default, or its rights, powers and remedies following such Default or Event of Default. In order to reinforce the estoppel function of the letter, a provision is required stating that nothing in the letter itself and any previous or future communications among the parties and/or their respective representatives or counsel will constitute a waiver.

Reservation of rights letters not only act as a conduit to open and productive communications among the parties, they protect Lenders at a time where Borrowers are often looking for any and every opportunity to avoid or delay the enforcement of remedies by the Lender. When the lending relationship becomes tenuous or contentious is when the Lender should exercise the utmost care in protecting their rights and remedies.