

Clients & Friends Memo

COVID-19 Update: Revisiting Pre-Negotiation Agreements in the Era of Covid-19

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While the ramifications of the Covid-19 pandemic for real estate lenders and borrowers will unfold over time, at this point we know that lenders and borrowers will be communicating frequently and extensively regarding potential loan modifications and other accommodations. Lenders are well advised to insist on a pre-negotiation agreement, often referred to as a “PNA,” as a prerequisite to these communications.

A PNA is an agreement between a borrower and a lender intended to permit the lender to communicate with the borrower regarding a possible loan modification, waiver or other accommodations without prejudicing the lender’s ability to enforce the loan documents. The primary purpose of the agreement is to preserve the status quo over the course of negotiations and to prevent the borrower from using the negotiations as a basis for opposing any pending or potential enforcement efforts by the lender, or as a basis for bringing lender liability claims against the lender, by asserting that over the course of negotiations the lender committed to modify the loan documents, that correspondence exchanged during the negotiations itself constituted a loan modification, that the borrower justifiably relied on statements of the lender in forgoing refinancing opportunities and in incurring transaction costs, etc. Even if a borrower is ultimately unable to prevail on these claims, their potential use in opposing a lender’s motion for summary judgment and thereby prolonging an enforcement proceeding and increasing the borrower’s leverage should be of concern to the lender. The lender will typically require parties that entered into guaranties with respect to the loan to join in the PNA in order to prevent the guarantors from making similar claims, and to prevent the guarantors from asserting that the PNA itself precluded certain defenses and thereby increased the guarantors’ risk and raising so-called “surety defenses” on that basis.

It is advisable to enter into a PNA as soon as the lender anticipates negotiations with the borrower. In normal times, this would mean when a default occurs, when the borrower approaches the lender with a request to discuss a modification or waiver, or when a default is reasonably anticipated (e.g., when the lender has reason to believe that the borrower will be unable to refinance or satisfy the conditions to the exercise of an extension option on an approaching maturity date or to satisfy any other requirements under the loan documents, such as making a scheduled amortization payment

or continuing to pay monthly debt service). Under current circumstances, the universe of loans for which these events can be anticipated has dramatically expanded.

From the lender's perspective, a PNA should at a minimum include those provisions necessary to preserve the status quo during the course of negotiations. These typically include agreements to the effect that (i) negotiations, which should be defined broadly to include all discussions, meetings, conferences, correspondence, e-mails, exchange of term sheets and draft documents and all other communications, are non-binding unless and until a binding written agreement has been executed and delivered, (ii) either party has the right to, at any time, terminate discussions in its sole discretion, for any or no reason, (iii) the borrower has no right to rely on the negotiations resulting in a settlement and should not forgo refinancing opportunities, and (iv) the PNA does not constitute an agreement on the lender's part to forbear from exercising its rights and remedies under the loan documents during the course of the negotiations. While an agreement to forbear is sometimes entered into in connection with workout discussions, that is usually documented under a separate forbearance agreement that is negotiated and entered into subsequent to the PNA. A forbearance is often more complicated than a PNA and involves more negotiation. Entering into a PNA prior to the negotiation of a forbearance agreement gives those negotiations the protection of the PNA and permits concurrent discussion of both forbearance and ultimate settlement terms. To reiterate, a PNA simply preserves the status quo as to discussions between the borrower and lender and provides that the discussions themselves are not binding. A PNA is NOT a forbearance, and the lender retains the right to commence, continue, discontinue, pursue or otherwise exercise its remedies notwithstanding the existence of the PNA. Typically, however, a lender would not be aggressively pursuing its remedies when a PNA has been entered into.

In a syndicated loan, the PNA is entered into by the administrative agent and covers any discussions between the borrower and the administrative agent, as well as any discussions between the borrower and other lenders in the syndicate. While the co-lenders are named and all provisions are also for their benefit and protection, the co-lenders, however, will usually not be signatories to a PNA and will rely on the ability of the administrative agent to protect their interests. In addition, to preserve the unity of the lending group, a PNA covering a syndicated loan will typically provide that the borrower may discuss the loan only with the administrative agent. Where a property is financed by both mortgage and mezzanine loans, the mortgage lender and the mezzanine lender should each enter into a separate PNA with its respective borrower. The holder of any preferred equity should also consider entering into a PNA in order to protect its interests over the course of workout discussions.

The lender will typically want the PNA to cover past as well as future discussions. While technically this goes beyond preserving the status quo as of the date that the PNA is entered into, a lender might find it unacceptable for a borrower to preserve its right to make claims on the basis of an initial conversation that it had with the borrower before the PNA was prepared and entered into. It

is advisable for lenders to make every effort to defer these conversations until the PNA is entered into. Beyond the sanitizing of such past discussions, PNA's will sometimes include some or all of the following, which are advantageous to the lender: (i) a ratification of the existing loan documents, (ii) a statement of the outstanding amount of the debt, (iii) an acknowledgement that the lender has performed all of its obligations under the loan documents, (iv) where the loan is in default, an acknowledgement of the default and a waiver of defenses, (v) a release of claims against the lender, and (vi) an agreement that authorizes the lender to discuss the loan and the property with other parties providing debt and equity financing to the property and other creditors. Inclusion of the above can be helpful to the lender both in pursuing an enforcement proceeding and in protecting itself from lender liability claims. Whether and the extent to which the above are included are typically determined by negotiations between the lender and borrower, and their inclusion or exclusion ultimately depends upon the particular circumstances and the relationship and relative bargaining power.

Pre-Negotiation Agreements are widely required by real estate lenders as a matter of policy and borrowers have come to understand and accept that they are necessary for lenders to obtain in order to discuss loan modifications and waivers, and that there is no stigma attached to them. While the circumstances brought about by the pandemic are extremely unfortunate, and while neither borrowers nor lenders are responsible for the economic hardships that it is inflicting, PNA's are both appropriate and necessary to facilitate the discussions that will be required to mitigate the pandemic's consequences.

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