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GUEST COLUMN

## Pre-Negotiation Agreements

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The increase in default rates on commercial loans and the number of over market commercial leases being modified has made the term “workout” very familiar in the world of commercial real estate.

Any time a lender or landlord agrees to enter negotiations to modify a loan or lease, a workout has technically begun. Ideally the parties will cooperate and come to an amicable resolution, but sometimes negotiations fail and the lender or landlord executes its remedies under the loan or lease documents.

These unsuccessful workouts have resulted in an increase in litigation where



borrowers or tenants allege that they were promised certain things during negotiations that didn’t materialize. This has caused some lenders and landlords to shy away from negotiating even though

it is often in their best interest to do so. Lenders and landlords should understand that after a successful workout, they will generally recover more than they would from a foreclosure, bankruptcy, abandonment, or costly litigation.

Lenders and landlords are now beginning to understand that much of the litigation involving failed workouts can be avoided if a well-written pre-negotiation agreement is in place prior to discussing a modification.

A pre-negotiation agreement (“PNA”) is a fairly simple document that every sophisticated lender and landlord likely has ready for workout situations. A standard PNA may protect the lender or landlord from liability if it includes any or all of the terms identified below.

Borrowers and tenants need to weigh their options carefully and understand what they are getting into when signing a PNA. This will help them determine whether a workout is the best solution for their particular situation.

Some of the PNA terms that both parties need to consider include:

**Not binding until new documents signed.** One of the more important terms in a PNA is that no final agreement exists until both parties have signed new

loan or lease documents. Pursuant to such a provision, all draft documents and communications (oral or written) between the parties are merely part of the negotiations and not binding on either party. This allows both sides to more openly discuss possible solutions without the fear that proposed modifications will be deemed binding in the event litigation follows.

**No obligation to negotiate or modify the document.** This provision provides that negotiations may be terminated at any time by either party. However, if the PNA requires the borrower or tenant to pay a fee to the lender or landlord to begin negotiations, the acceptance of payment may create an obligation to negotiate. This is open to interpretation and it is best to consult legal counsel in this situation.

**Confidential and inadmissible.** It is usually in the best interest of all parties to include language in a PNA requiring that all negotiations remain confidential and expressly stating that all communications and information exchanged during negotiation will be inadmissible in litigation. This provision allows both parties to frankly discuss their positions without fear that the information shared will later be used against them. In addition, both parties may agree that they don't want confidential information disclosed to the media or a third-party.

**Loan documents reaffirmed, no rights waived.** By signing the PNA, the borrower or tenant usually agrees that the current loan or lease documents remain in full force and effect and that the lender or landlord has not waived any rights by agreeing to negotiate.

**Verification of the amount owed and/or default.** By executing a PNA that acknowledges: 1) the exact amount

owing; and/or 2) the existence of default(s) under the loan or lease documents, the borrower or tenant may be making an admission that can later be used against them in court. Even where the PNA contains a provision limiting the admissibility of the substance of the negotiations, this typically does not limit the admissibility of the PNA terms themselves.

**Borrower/Tenant bears all costs of modification.** Lenders and landlords often take the position that, since the borrower requested the workout, it should be their responsibility to pay for all expenses incurred by the lender or landlord in connection with the workout, such as attorney fees and recording costs.

**Full Release.** Many lenders and landlords also include in the PNA a full release which says that the borrower or tenant is waiving their right to bring any claims against the lender or landlord regardless of whether the claims arise before or after signing the PNA. This provision may amount to a borrower or tenant agreeing to never sue the lender or landlord regardless of whether they have violated any of their duties and obligations under the lease or loan documents. Borrowers and tenants should consider this provision carefully and consult with an attorney before signing away their rights.

In order to obtain a modification, a borrower or tenant should be willing to sign a short, reasonable PNA so long as the PNA is not requiring that they give up too many of their rights.

Frequently, however, lenders and landlords add language to a PNA in an attempt to materially improve their position over the borrower or tenant. This is often successful but some borrowers and tenants may decide that

the price for the workout is just too high. This may result in the lender or landlord recovering less than they would after entering into a reasonable PNA and concluding a successful workout.

If a lender or landlord is requiring any special concessions in a PNA, the borrower or tenant should consult with legal counsel to help them understand and negotiate the PNA. Similarly, lenders and landlords should have their attorney assist in drafting a PNA that offers protection for their interests without jeopardizing the potential workout

Pre-negotiation agreements are a necessary and important part of the workout process and all parties to a PNA need to understand the consequences of signing the PNA. If drafted properly, a reasonable PNA can be a powerful tool in facilitating a resolution that will satisfy all parties.