

Practice Pointer: Should Lenders Use Pre-Negotiation Agreements?

October 7, 2020

Some states feature statutes of frauds that protect lenders, but not all such statutes of frauds protect all lenders, and some offer more protection than others. Just as critically, many people now communicate predominantly via email and other electronic media that might satisfy certain statutes of frauds. To reduce these risks, some lenders prefer to enter into pre-negotiation agreements with their borrowers and guarantors. What are the key components of these agreements, and are they worth the cost?

Pre-negotiation agreements are particularly, although not exclusively, helpful in jurisdictions that lack strong statutes of frauds. But pre-negotiation agreements are only worthwhile if they are enforceable, and whether they are enforceable depends on whether the borrower receives anything in exchange. Many courts will enforce a pre-negotiation agreement if the lender delays exercising remedies or actual negotiations follow, while some will enforce even if no delays or negotiations occur.

Whether pre-negotiation agreements are worth it also depends on who will be communicating. If all communication will flow through legal counsel anyway, they are much less valuable—if your only goal is to protect against statements inadvertently forming binding agreements.

Pre-negotiation agreements offer several additional critical advantages. They encourage free negotiations between the parties by more broadly excluding discussions than the Rules of Evidence. Pre-negotiation agreements usually render all communications inadmissible as evidence for any purpose, whereas the Rules of Evidence bar is more limited. Pre-negotiation agreements also control expectations by clarifying that agreements are not binding until they are reduced to writing and signed by authorized representatives, and encourage cooperation by requiring the borrower to provide information to the lender.

Some pre-negotiation agreements provide other benefits. For instance, the borrower and guarantor may acknowledge that the lender holds the loan, any existing defaults, and that the lender is entitled to certain types of fees and expenses. Sometimes, the borrower and guarantor release the lender from claims, or acknowledge that they hold none. Pre-negotiation agreements often state that discussions might not result in an amicable resolution, and the borrower and guarantor should not forgo other opportunities in the interim. Each of these can help avoid or swiftly resolve expensive fights in the future.

One of the most valuable elements is the insight it gives into how the matter will progress. With a few exceptions, borrowers who intend to proceed in good faith tend not to significantly negotiate pre-negotiation agreements. If a borrower or its legal counsel pushes back heavily on a pre-negotiation agreement, that alone may be all a lender needs to know.

This e-alert is the fourth in a series of practice pointers relating to lending-related issues, with a particular focus on distressed credits. If you have questions, or would like further information, please do not hesitate to call one of the authors or your favorite Miller Canfield attorney.