

Settlement Agreements That Survive A Bankruptcy Filing

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All too often, after protracted and contentious litigation, the parties finally reach a settlement that requires the opposing party to pay your client over time, only to find that they file bankruptcy shortly after the ink dries. There is language you can include in a settlement agreement that could prevent the agreement from being completely undone. Simply declaring the settlement payments to be “nondischargeable” is unenforceable.

Here are some ideas to try.

- Include language that stipulates to certain facts, particularly facts reciting the common law elements of fraud. While a discharge releases personal liability from certain types of debts, there are debts that are excepted from discharge, such as certain taxes, spousal or child support, fines, and penalties to governmental entities, etc. Still other debts require bankruptcy litigation to determine dischargeability. For example, debts incurred by fraud, fraud or defalcation while acting in a fiduciary capacity, and willful and malicious injury to another entity or property, just to name a few.
- Additionally, assuming the settlement was for less than the full claim for damages, you can include language that reinstates the entire claim amount in the event of default or bankruptcy. Certain examples include “that in the event of a bankruptcy filing, the settling party shall be entitled to an allowed claim for the full claim amount (less any payments made by the debtor) and the debtor waives any right to contest the enforceability or the amount of the claim.”
- Another tact could be to delay releasing the opposing party until the settlement amount has been paid in full. Thus, in the event of a bankruptcy filing, the full claim amount is preserved, including any underlying basis for an objection to discharge.
- Finally, if bankruptcy is filed soon after the settlement agreement is executed (usually within 90 days) any settlement payments may be clawed back (preferential or fraudulent transfer actions). Thus, try to incorporate a new obligor and/or secure the settlement payments with collateral.

While the above tactics are not infallible, courts have upheld these default provisions and it gives the opposing party pause before trying to completely undo the deal.