



DEBT SETTLEMENT AGREEMENT & GUIDE

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1. Overview

No matter the protective measures taken, it is a simple market fact that borrowers default on loan terms or payments. In some cases, the overall amount may be too much for the debtor to manage, and continuing payments may force it into bankruptcy. A creditor can decide that rather than gamble on a debtor's future liquidity, an immediate debt settlement agreement will make the best of a declining situation. The borrower can get part of its burden lifted, eliminating continuing payments and growing default and interest costs, without sacrificing its credit score or business relationships.

The enclosed document allows the lender to forgive part of what a debtor owes if it receives an immediate settlement amount, and contains everything you'll need to release both parties from their obligations. A written contract minimizes confusion, misunderstanding, and error, and sets forth the parties' expectations and fulfillment obligations. In every way, this promotes successful and profitable business arrangements.

2. Dos & Don'ts Checklist

- Debt settlement is a means of reducing or eliminating unsecured debt by negotiating an agreed upon payoff amount with creditors. This usually does not occur if a debt is secured, since the lender will have the right to take the property that secures the loan in lieu of payment.
- Settling a debt can result in income tax liability. Creditors must report any forgiven debt in excess of \$600 to the IRS, and the debtor will receive an IRS form for the amount of the forgiven debt. Talk to an attorney or a tax professional for additional details about these consequences.
- There are pros and cons for the borrower looking to settle a debt. Although your monthly payments will be reduced, you will usually need to make an immediate large sum payment to complete the settlement. Your creditors may report any settlement to the credit bureaus. If you have a good credit score, this will have an immediate and large negative impact. If your credit score is bad, debt settlement or negotiation may have less of an impact and may be a better choice. Consider these and other personal factors before entering into a binding settlement agreement.
- There are also pros and cons for the lender looking to settle the debt. It can recover money that would be unavailable if the debtor entered bankruptcy: even a partial settlement is better than nothing. However, the creditor is ending the possibility of obtaining the total amount that it is owed.
- Before sitting down to write, decide exactly what your goals are for the settlement. How much of the debt balance will be paid off? When will this payment need to be made? Clarify these terms before writing them down.
- Allow each party to spend time reviewing the agreement. This will reduce the likelihood, or at least the efficacy, of a claim that a party did not understand any terms or how those might affect the agreement.

- Both parties should review the agreement carefully to ensure that **all relevant deal points** have been included. It is better to be over-inclusive than under-inclusive. Do not assume that certain expectations or terms are agreed to if they are not stated expressly on the document.
- Sign two copies of the agreement, one for you and one for the other party.
- Depending on the nature of its terms, you may decide to have the contract witnessed or notarized. This will limit later challenges to the validity of a party's signature.
- If your agreement is complicated, do not use the enclosed form. Contact an attorney to help you draft a document that will meet your specific needs.

3. Debt Settlement Agreement Instructions

The following provision-by-provision instructions will help you understand the terms of your debt settlement agreement.

The numbers below (e.g., Section 1, Section 2, etc.) correspond to the provisions in the contract. Please review the entire document before starting your step-by-step process.

- **Introduction.** Identifies the document as a debt settlement agreement. Identify the parties and the date of the agreement. The parties must be the same as those who signed the original document that generated the debt (unless one of the new signers is an agent of the same company that originally signed) and should have the same designations as well (i.e., the Borrower is still the Borrower, the Lender is still the Lender).
- **Recitals.** The "whereas" clauses, referred to as recitals, define the world of the agreement and offer key background information about the parties. Put in the effective date of the original loan agreement (or promissory note or other financing document) and the amount of the loan that was provided. Use the final blank space to indicate how the Borrower is in default under the loan agreement or other document. Note that the recitals require that you attach a signed copy of the loan agreement or other document as an exhibit to the document.
- **Section 1: Acknowledgment of Existing Obligation.** Both parties' acknowledgment of the amount of the original debt. The bracketed phrase is for use if the reason for the debt was loans made by the Lender to the Debtor.
- **Section 2: Settlement Amount.** The amount that the Lender is accepting in satisfaction of the debt. Enter the number that the parties have agreed on.
- **Section 3: Lender's Release.** The Lender's promise that after the signing of the agreement, and the taking of all needed actions under the agreement, it is giving up all of its rights to seek the full original amount of the debt or take any other actions against the Debtor. Note that the Lender is not releasing any claims that arise under the settlement agreement. For example, if the Debtor does not pay the settlement amount, the Lender is still entitled to bring a lawsuit to obtain that money.

- **Section 4: Debtor's Release.** The Debtor's promise that after the signing of the agreement, and the taking of all needed actions under the agreement, it is giving up all of its rights to sue or take any other actions against the Lender. Note that the Debtor is not releasing any claims that arise under the settlement agreement. For example, if the Lender is found to have assigned the debt to a third party in violation of the agreement, the Debtor can bring a lawsuit alleging a breach.
- **Section 5: Representations and Warranties of the Parties.** The Lender is here swearing that it has not assigned the debt to a third party (in other words, that this settlement agreement will be effective simply as between the parties). Most of the remaining clauses are applicable only if the Debtor or the Lender are not individuals (i.e., are partnerships, corporations, etc.), and can be deleted if the parties are individuals.

The parties can also use this section to list additional promises, understandings, and assumptions. For example, the lender may require the debtor to make a statement about its current financial condition before it will settle the debt. Delete the blank spaces if you do not have any additional representations and warranties that you want to include.

- **Section 6: Effective Time of Releases.** Indicates that the releases become effective when the agreement is signed and the money is paid.
- **(Optional) Section 7: Additional Terms.** This is an optional provision that can include any additional terms that have not already been listed. For example, if the parties will exchange confidential information, you may want to include a provision governing the protection of that information. If you remove this section, correct the section numbers in the agreement.
- **Section 8: General Provisions.** The following subsections contain universal contract language. Although the terms sound technical, they are general provisions with simple objectives.
 - **Section 8(A): Notices.** Lists the addresses to which all official or legal correspondence should be delivered. Write in a mailing address for each of the parties to the agreement.
 - **Section 8(B): Successors and Assigns.** States both that the agreement will be passed on to either party's successors and assigns, and that neither party can transfer its obligations under the agreement without the prior written consent of the other party.
 - **Section 8(C): Waiver and Amendment.** Explains that neither party can ignore or dismiss any part of the agreement, and that any changes to the agreement will be in writing and signed by both parties.
 - **Section 8(D): Entire Agreement.** The parties' agreement that the contract they're signing is "the agreement" about the issues involved. Unfortunately, the inclusion of this provision will not prevent a party from arguing that other enforceable promises exist, but it will provide you some protection from these claims.
 - **Section 8(E): Severability.** Protects the terms of the agreement as a whole, even if one part is later invalidated.
 - **Section 8(F): Governing Law.** Allows the parties to choose the state laws that will be used to interpret the agreement. Note that this is not a venue provision. The included language will not impact where a potential claim can be brought. Please write the applicable state in the blank provided.

- **Section 8(G): Voluntary Execution of the Agreement.** Indicates that all of the parties have had time to review and understand the agreement, and have had sufficient opportunity to obtain legal representation (if desired).
- **Section 8(H): Counterparts/Electronic Signatures.** The title of this provision sounds complicated, but it is simple to explain: it says that even if the parties sign the agreement in different locations, or use electronic devices to transmit signatures (e.g., fax machines or computers), all of the separate pieces will be considered part of the same document. In a modern world where signing parties are often not in the same city - much less the same room - this provision ensures that business can be transacted efficiently, without sacrificing the validity of the agreement as a whole.

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DEBT SETTLEMENT AGREEMENT

This Debt Settlement Agreement (the "Agreement") is entered into as of _____, 20____ (the "Effective Date"), by and between _____ (the "Lender") and _____ (the "Debtor," and together with the Lender, the "Parties").

RECITALS

WHEREAS, the Lender and the Debtor are parties to that certain [loan agreement][promissory note][etc.] dated as of _____, 20____ (the "Loan Agreement" [or "Promissory Note"]), a copy of which is attached to this Agreement as Exhibit A; and

WHEREAS, pursuant to the [Loan Agreement][Promissory Note], the Lender provided a loan of \$ _____ to the Debtor (the "Debt"); and

WHEREAS, a controversy arose between the Parties and neither Party admits responsibility nor assumes full liability, and both Parties, as evidenced by their signatures below, have agreed to the terms of this Agreement; and

WHEREAS, the Lender and the Debtor desire to resolve dispute between _____ and to fully and finally settle the subject matter of the aforementioned dispute, _____ claims which could be made in connection therewith, with no Party admitting liability to the other Party, other than for the obligations agreed _____

NOW THEREFORE _____
promises _____