

# DEBTOR/CREDITOR

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## *Underfunded 401(k) Prevents Discharge*

Wiedeman Church Products was a small company that ran into financial difficulties. As a result of cash flow problems, the company stopped forwarding 401(k) contributions withheld from employee paychecks to the 401(k) plan administrator. After the company closed, its president filed a personal bankruptcy.

The U. S. Department of Labor successfully argued that the president was personally liable for the unpaid 401(k) contributions and that this obligation could not be discharged in his bankruptcy case. Because he had signed the documents setting up the 401(k) and was president of the company, he became the de facto fiduciary for the 401(k) plan without his knowledge. As a statutorily defined fiduciary, he was responsible for the unpaid contributions. Additionally, his obligation could not be discharged in bankruptcy, because the failure to make the payments was a “defalcation while acting in a fiduciary capacity”.

Owners of small businesses should be aware that they may be fiduciaries of employee benefit plans and that failure to fund employee benefits during a time of financial difficulty may result in personally liability without the option of bankruptcy protection.

*Chao v. Gott (In re Gott)*, 387 B.R. 17 (Bankr. S.D. Iowa 2008).

## *No Harm, No Foul*

Steve Meredith operated his accounting practice through a professional corporation. After a \$250,000 judgment was entered against his PC, he transferred all of the accounting practice to MFG, a shell corporation owned by his wife, Darlene. The judgment creditor filed an involuntary bankruptcy petition against the PC. Darlene initiated

divorce proceedings. Steve then transferred the accounting practice from MFG to a new corporation that he formed.

Steve’s bankruptcy trustee sued Darlene, claiming that the transfer of assets from the PC to MFG was a fraudulent transfer intended to harm Steve’s creditors and that Darlene, as sole shareholder of MFG, was an “entity for whose benefit” the transfer was made. The bankruptcy judge agreed.

However, the federal appeals court in Richmond reversed the bankruptcy court, holding that a person must actually receive a benefit from the transfer in order to be “an entity for whose benefit” the transfer was made. Because Darlene had, in fact, received nothing herself during the period of time that Steve operated his accounting practice through MFG, the trustee could not recover from her.

*Terry v. Meredith (In re Stephen S. Meredith, CPA, P.C.)*, 527 F.3d 372 (4<sup>th</sup> Cir. 2008).

## *Previously Reported Case Reversed*

The April 2008 Notes reported a Maryland bankruptcy court decision holding that a corporation which has forfeited its charter cannot commence a legal action. That ruling was reversed on appeal. Barring a further appeal, a corporation whose charter is forfeited may sue as part of the process of winding up its affairs.

*Mintec Corp. v. Miton*, 392 B.R. 180 (D. Md. 2008).

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*This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.*

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