

Churchill Holdings ESOP Participants Sue

The lawsuit plaintiffs are ESOP participants holding vested shares of Churchill stock in their accounts who were employed at Churchill Mortgage Corporation for several years.

Reported by [NOAH ZUSS](#)

Three Churchill Mortgage Corp. [employees are suing fiduciaries](#), members of the board of directors and the trustee of the Churchill Holdings Inc. Employee Stock Ownership Plan, alleging fiduciary breaches that harmed workers' vested retirement assets.

Plaintiffs Lisa Arnold, Brandi Trout and Sandra Golden-Woods brought a complaint on May 26 seeking class action certification under the Employee Retirement Income Security Act—on behalf of ESOP participants—alleging five counts of fiduciary breach against the defendants. The complaint claims the defendants failed to ensure the Churchill plan received every cent from dividends held by the plan on preferred shares acquired from 2013 through 2019 and that the plan bought remaining shares of Churchill for more than fair market value in a 2020 transaction.

The defendants include Prudent Fiduciary Services LLC, an ERISA consultant to the ESOP; Miguel Paredes, the founder, president and owner of Prudent Fiduciary Services; Lawson H. Hardwick III, a plan trustee and the president, CEO and a director at Churchill Mortgage; Matthew C. Clarke, a plan trustee and the CFO and chief operations officer at Churchill; and Cecil O. Kemp Jr., a plan trustee and a director at Churchill, the complaint shows. Brentwood, Tennessee-based Churchill Mortgage is a mortgage lender and consumer banking company.

"As a result of the prohibited stock transaction in 2020 ... Hardwick received Plan assets in payments above fair market value for his Churchill stock," and the defendants conduct "thereby misused the Plan's money to the benefit of Hardwick, and other plan-wide relief," the plaintiffs argue.

"The 2020 Transaction allowed Hardwick to unload his stake in Churchill above fair market value ... and saddle the Plan and Churchill with tens of millions of dollars of debt to finance the Transaction," the complaint states. "This harmed the ESOP and reduced the value of the shares in Plaintiffs' ESOP accounts by massively leveraging Churchill and thereby reducing the equity value of Churchill stock owned by the ESOP and Plaintiffs in their ESOP accounts."

The lawsuit, *Lisa Arnold et al. v. Miguel Paredes et al.*, was brought in U.S. District Court for the Middle District of Tennessee, Nashville Division.

The plan's most recent Form 5500 filing reports that, as of December 31, 2021, there were 649 participants in the plan, the record shows.

Requests for comment to Churchill, Paredes and Prudent Fiduciary Services were not returned.

Asset Valuation In Question

The plaintiffs are likely to argue an alleged fiduciary breach occurred—as in [previous ESOP disputes](#) involving private companies—in the valuation of assets, explains Drew Oringer, a partner in and general counsel at the Wagner Law Group, which is not involved in the litigation.

"A key for the plaintiffs will be to try to establish some kind of defective process or weak reasoning or to try to show that the trustee was affirmatively co-opted by company personnel," Oringer says. "If, as is alleged, there is a huge short-term increase in valuation preceding a follow-on sale by an insider, there may be particular pressure on the company and the trustee to justify that increase in value."

Oringer contrasts the plaintiffs' arguments with counterclaims likely to be made by the defendants.

“The company, the trustee and the seller will want to establish such things as the permissible use by the ESOP of its funds, a thorough and unconflicted approach by the trustee and otherwise the legitimacy of the trustee’s valuations,” he says. “They may try to establish the benefits to ESOP participants, notwithstanding the value captured by the inside seller.”

Plaintiff Claims

According to the complaint, Hardwick—the party-in-interest shareholder from whom the plan acquired Churchill Holdings stock—wished to begin cashing out his equity in Churchill while maintaining his control over the company in 2013. Hardwick founded Churchill and was the sole shareholder until the 2013 transaction.

The plan’s principal asset is Churchill stock, according to the complaint. The ESOP was created on or about October 31, 2013—at Hardwick’s direction—and Hardwick sold 490,000 shares of Series A Preferred Stock in Churchill Holdings to the ESOP for \$30 million, the complaint states.

The preferred shares entitled the plan and its participants to annual dividends of approximately \$4.90 per share, \$2.4 million annually, for the plan’s 490,000 shares. The \$2.4 million per year was partly used to pay principal and interest on the note used to finance the purchase of the 490,000 preferred shares as part of the 2013 transaction, the complaint states. The dividends represented more than double the income necessary to make payments on the note, the plaintiffs contend.

The shares represented 49% of all issued Churchill stock at the time, and Hardwick maintained his controlling interest in Churchill as majority shareholder and the sole owner of issued Churchill common stock, which represented 51% of all issued Churchill stock at the time, according to the complaint.

“In each year, \$2.4 million in dividends was deposited into the plan, but in most years a significant portion of the dividends were used to offset corporate obligations, like ESOP contributions, instead of being used for the benefit of the plan and its participants, like paying interest and principal on the 2013 Note or crediting dividends to the plan accounts of participants who held shares of Churchill stock” the complaint says. “Thus, Hardwick—who was a director, the president and Chief Executive Officer, and the sole owner of common stock—converted plan assets for his and his company’s own use and benefit.”

In 2020, Hardwick sold his remaining equity in Churchill—510,000 shares of common stock—to the plan for \$74,406,876. The transaction was also financed with a promissory note payable to Hardwick, which Churchill subsequently assumed from the plan.

ERISA prohibits a plan fiduciary from causing a plan to engage in a sale or exchange of any property with an interested party. Plaintiffs allege that is what happened in the 2020 transaction. ERISA also bars trustees from causing the plan to engage in a transaction that constitutes a direct or indirect transfer to a party in interest of any assets of the plan. Among other violations, the plaintiffs claim the 2020 transaction transferred plan assets to Hardwick as payment for Churchill stock, according to the complaint.

Shares of ESOP-held preferred stock were valued at \$52.25 as of December 31, 2019, and, a few months later, the plan paid Hardwick \$145.90 per share of common stock in the 2020 transaction, the complaint states.

“The allegations surrounding the ESOP’s use of dividends it received on its company stock are difficult to handicap,” Oringer says. “There is a wide range of permissible uses for ESOP dividends, and it’s not clear from the complaint whether the dividends were used improperly.”

ESOPs’ nature

Given the structure of ESOPs, previous lawsuits have targeted the plans. Lawsuits involving ESOPs have typically stemmed from the structure of plans, Oringer says.

“ESOPs have always been a lightning rod for controversy,” Oringer says. “[ESOPs] allow for financing techniques not available through other retirement plans. Their concentrated investment in company stock can be controversial, especially where, as here, the seller is an insider and the company is private.”

The Court Record

The plaintiffs are seeking class status and are seeking monetary damages. The plaintiffs also have requested that the court determine the lawsuit class period apply to all vested participants in the Churchill Holdings ESOP Plan and their beneficiaries during the period from May 26, 2017, to the present, excluding from the class the defendants and their immediate families, legal representatives, successors and assignees of any such excluded persons, the record shows.

Churchill Holdings is the parent company of wholly owned subsidiary Churchill Mortgage Corp., which was founded in 1992, according to court documents. Hardwick was the majority shareholder (and sole shareholder other than the ESOP) between the 2013 and 2020 transactions, the record shows.

The plaintiffs are represented by attorneys from the law offices of Herzfeld, Suetholz, Gastel, Leniski and Wall PLLC, based in Nashville, Tennessee and Cincinnati, Ohio; Bailey & Glasser LLP, headquartered in Washington, D.C.; and Izard, Kindall & Raabe LLP, headquartered in West Hartford, Connecticut.

Tags

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