

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
Southern Division

_____)	
PROGRESSIVE CASUALTY)	
INSURANCE COMPANY,)	
)	
Plaintiff,)	
)	
v.)	Case No.:
)	
FEDERAL DEPOSIT INSURANCE)	
CORPORATION, AS RECEIVER FOR)	
MICHIGAN HERITAGE BANK; AND)	
TIMOTHY J. CUTTLE,)	
)	
Defendants.)	
_____)	

**PROGRESSIVE CASUALTY INSURANCE COMPANY'S
COMPLAINT FOR DECLARATORY JUDGMENT**

Plaintiff Progressive Casualty Insurance Company ("Progressive"), for its Complaint for Declaratory Judgment against the Federal Deposit Insurance Corporation ("FDIC"), as Receiver for Michigan Heritage Bank (the "Bank" or "MHB"), and Timothy J. Cuttle, alleges as follows:

Nature of the Action

1. On August 8, 2011, the FDIC, in its capacity as receiver for the Bank, filed a Complaint and Jury Demand against Mr. Cuttle, captioned *Federal Deposit Insurance Corporation as Receiver of Michigan Heritage Bank v. Timothy J. Cuttle*, Case No. 2:11-cv-13442-BAF-MKM (U.S. Dist. Ct., E.D. Mich.) (the "Lawsuit"). A true and correct copy of the Complaint and Jury Demand in the Lawsuit is attached hereto as Exhibit A. The FDIC and Mr. Cuttle have asserted that loss arising from the Lawsuit is insured under certain directors and officers liability policy coverage issued by Progressive to the Bank. In this action, Progressive

seeks a declaration that there is no coverage for the Lawsuit under any directors and officers liability policy it issued to the Bank.

Parties

2. Plaintiff Progressive is a corporation organized and existing under the laws of the State of Ohio, with its principal place of business in Mayfield Village, Ohio.

3. Defendant FDIC is an agency and body corporate organized and existing under the laws of the United States of America with its principal place of business in Washington, D.C. *See* 12 U.S.C. § 1819. On information and belief, the Bank was a state-chartered bank insured by the FDIC. The Bank was located in Farmington Hills, Michigan. On April 24, 2009, the Bank was closed by the Michigan Office of Financial Insurance and Regulation, and the FDIC was appointed receiver for the Bank. This action is brought against the FDIC in its capacity as receiver for the Bank.

4. On information and belief, Defendant Timothy J. Cuttle is a citizen of the State of Michigan and resides in Washington Township, Michigan.

Jurisdiction and Venue

5. This Court has subject matter jurisdiction over this action pursuant to 12 U.S.C. § 1819(b)(2)(A) and 28 U.S.C. § 1331 because all suits to which the FDIC is a party are deemed to arise under the laws of the United States.

6. Venue is proper in the Eastern District of Michigan pursuant to 28 U.S.C. § 1391(a)(1) and (a)(2) because, on information and belief, Mr. Cuttle resides in this District and a substantial part of the events or omissions giving rise to this action occurred in this District.

7. Progressive brings this declaratory judgment action pursuant to 28 U.S.C. §§ 2201 and 2202. An actual controversy within the meaning of 28 U.S.C. § 2201 exists between the parties regarding coverage afforded by Progressive for the Lawsuit.

Factual Allegations

The Policy

8. Progressive originally issued Directors & Officers/Company Liability Insurance Policy No. 10021519-05 to the Bank for the claims-made Policy Period from March 3, 2007 to March 3, 2010 (the “Policy”). A true and complete copy of the Policy is attached as Exhibit B. (Policy, Declarations Page, Item 2). The Policy was cancelled effective June 30, 2008. (*Id.*, Form Nos. 5082 (06/05) & 2254 (12/06)).

9. When the Policy was cancelled, the Bank purchased an optional extended reporting period, or Discovery Period. (*Id.*, Form No. 2254 (12/06) and § III.B.). The Discovery Period for the Policy ran from June 30, 2008 to June 30, 2009. (*Id.*, Form No. 2254 (12/06)).

10. Subject to its terms, conditions, and limitations, the Policy provides certain coverage for claims that are “first made” against **Insured Persons** during the **Policy Period** or Discovery Period. The Insured Persons Liability Coverage Insuring Agreement (the “D&O Coverage”) provides:

The **Insurer** will pay on behalf of the **Insured Persons**, **Loss** resulting from **Claims** first made during the **Policy Period** or the Discovery Period against the **Insured Persons** for which the **Insured Persons** are legally obligated to pay for **Wrongful Acts**, except for **Loss** the **Company** pays as indemnification.

(*Id.* § I.A.).

11. As a former officer of the Bank, Mr. Cuttle is an **Insured Person**. (*Id.* § IV.K.).

12. The Limit of Liability applicable to the D&O Coverage is \$5 million. (*Id.*, Declarations Page, Items 3 & 8). The Limit of Liability for D&O Claims made during the

Policy's Discovery Period is part of, and not in addition to, the \$5 million Limit of Liability for D&O Coverage for all Claims made during the immediately preceding Policy Year. (*Id.*, § III.E.).

13. The claim asserted in the Lawsuit was initially asserted in a letter from the FDIC dated June 26, 2009, as supplemented by a letter dated June 25, 2010. That single claim is properly deemed "first made" in the June 26, 2009 letter, during the Policy's Discovery Period. (Ex. B, Policy, §§ III.E, VII.C.).

14. A successor policy issued by Progressive is not implicated by the Lawsuit. Progressive originally issued Directors & Officers/Company Liability Insurance Policy No. 10021519-06 to the Bank for the claims-made Policy Period from June 30, 2008 to June 30, 2009 (the "Successor Policy"). The Successor Policy was cancelled effective December 21, 2008. A true and complete copy of the Successor Policy is attached as Exhibit C.

15. The Bank purchased the Discovery Period on the Successor Policy effective for the period from June 30, 2009 to June 30, 2010. Because the Lawsuit asserts a single claim deemed made at the time of the FDIC's June 26, 2009 letter, the claim is deemed made during the Policy's Discovery Period and prior to the Discovery Period of the Successor Policy. (Ex. B, Policy, §§ III.E, VII.C.).

The Claim Against Cuttle

16. On August 8, 2011, the FDIC, in its capacity as receiver for the Bank, filed the Lawsuit.

17. The Lawsuit alleges as follows:

The FDIC-R seeks to recover losses in excess of \$8.2 million that Defendant Timothy J. Cuttle ("Cuttle"), a former MHB loan officer, caused the Bank to incur. Among other things, Cuttle failed to conduct adequate due diligence and analysis prior to originating and

recommending approval of 11 commercial loans that resulted in losses to the Bank, recommended the approval of those loans in violation of the Bank's lending policy ("Lending Policy") and prudent lending practices, failed to adequately inform MHB's Board of Directors ("Board") and senior management of deficiencies with respect to those loans, and caused the Bank to fund loans even though borrowers had failed to satisfy prefunding conditions. Cuttle is liable for the losses that the Bank suffered as a result of his negligence, gross negligence, and breach of fiduciary duty.

(Ex. A, ¶ 1).

18. In the Lawsuit, the FDIC alleges that it is acting "in its capacity as Receiver of MHB," (*id.* ¶ 2), and that, pursuant to the Federal Deposit Insurance Act, 12 U.S.C. § 1819, the FDIC "is empowered to pursue claims held by the Bank, including its claims against the Defendant [*i.e.*, Mr. Cuttle]," (*id.* ¶ 4).

19. In the Lawsuit, the FDIC alleges that, "throughout his tenure at MHB, Cuttle routinely ignored the Bank's Lending Policy and prudent lending practices in originating loans and recommending them for approval," (*id.* ¶ 18), and further alleges that, "[b]etween June 2005 and October 2007, Cuttle caused the Bank to approve and fund loans that would have been rejected had Cuttle complied with MHB's Lending Policy, followed prudent lending practices, and conducted adequate due diligence, including undertaking basic loan review procedures," (*id.* ¶ 19).

20. The FDIC alleges in the Lawsuit that Mr. Cuttle's allegedly wrongful acts "caused the Bank to incur losses in excess of \$8.2 million," (*id.* ¶ 19), in connection with 11 loans identified and described in the FDIC's Complaint, (*id.* ¶¶ 20-48). Nothing in this complaint is intended to state or imply that Progressive believes the FDIC's allegations against Mr. Cuttle have merit.

21. The specific loans at issue in the Lawsuit, and the purported losses sustained by the Bank in connection with the defaults on those loans, are as follows:

Borrower	Estimated Losses
Redwood Development, LLC	\$1,760,000
Shelby City Place, LLC	\$1,760,000
B&E Royal Oak Investments, LLC	\$700,000
Elias Jewelry & Repair of Novi, Inc. and Tiffany Diamonds, Inc. (4 loans total)	\$1,300,000
Delta Acquisitions, LLC – Traverse City	\$1,470,000
Delta Acquisitions, LLC – Bay Harbor	\$150,000
Green & I-96 Investments, LLC	\$500,000
Eight & Farmington Service, Inc.	\$500,000
Total	\$8,140,000

22. The FDIC sets forth three causes of action against Mr. Cuttle in its Complaint: Count I for negligence, Count II for gross negligence, and Count III for breach of fiduciary duty. (*Id.* ¶¶ 50 -62).

23. In each count, the FDIC alleges that Mr. Cuttle was either negligent, grossly negligent, or breached his fiduciary duties to the Bank “by routinely and repeatedly failing to conduct and direct the business and affairs of MHB in a manner consistent with safe and sound principles of banking.” (*Id.* ¶¶ 52, 57, 61).

24. For each count in its Complaint, the FDIC alleges that the Bank suffered damages in excess of \$8.2 million, which is the amount of losses that the Bank allegedly incurred in connection with the 11 defaulted loans identified in the Complaint. (*Id.* ¶¶ 53, 58, 62).

25. The FDIC and Mr. Cuttle have asserted that the Lawsuit is covered under the Policy. The FDIC and/or Mr. Cuttle may also assert that the Lawsuit is covered under the Successor Policy.

COUNT I

**Declaratory Judgment
The Policy's Insured vs. Insured Exclusion Bars Coverage for the Lawsuit**

26. Progressive repeats and incorporates by reference the allegations in Paragraphs 1 through 25 of this Complaint.

27. The Policy provides:

The **Insurer** shall not be liable to make any payment for **Loss** in connection with any **Claim** by, on behalf of, or at the behest of the **Company**, any affiliate of the **Company** or any **Insured Person** in any capacity except where such **Claim** is brought and maintained:

- (1) in the form of a cross-claim or third-party claim for contribution or indemnity which is part of and results directly from a **Claim** which is not otherwise excluded by the terms of the **Policy**;
- (2) by an **Insured Person** solely as a customer of the **Company**; provided such **Claim** is brought independently of, and totally without the solicitation, assistance, participation, or intervention of any other **Insured**; or
- (3) by a security holder of the **Company** as a derivative action on behalf of the **Company** or such affiliate; provided such **Claim** is brought independently of, and totally without the solicitation, assistance, participation, or intervention of any **Insured** or any affiliate of the **Company**.

(Ex. B, Policy, § V.J. (the "Insured vs. Insured Exclusion"))).

28. The Policy defines **Company** to include the Bank. (*Id.* § IV.E. (as amended by Form No. 2254 (12/06))).

29. The Bank was closed by the Michigan Office of Financial and Insurance Regulation on April 24, 2009, and the FDIC was appointed receiver for the Bank.

30. In the Lawsuit, the FDIC asserts the Bank's claim against its former officer to which the FDIC succeeded as the Bank's receiver.

31. The Lawsuit seeks to recover losses in excess of \$8.2 million that Mr. Cuttle, in his capacity as a former officer of the Bank, allegedly caused the Bank to incur.

32. The Lawsuit, therefore, constitutes a **Claim** “by, on behalf of, or at the behest of the **Company** [*i.e.*, the Bank].”

33. None of the carve-outs from the Insured vs. Insured Exclusion are applicable.

34. The Insured vs. Insured Exclusion precludes coverage under the Policy for the Lawsuit.

35. Accordingly, Progressive seeks a declaratory judgment that the Policy’s Insured vs. Insured Exclusion applies to preclude all coverage under the Policy for the Lawsuit.

COUNT II

Declaratory Judgment The Policy’s Loan Loss Carve-Out Bars Coverage

36. Progressive repeats and incorporates by reference the allegations in Paragraphs 1 through 35 of this Complaint.

37. The Policy provides no coverage for amounts that do not constitute **Loss**. The Policy defines **Loss**, in pertinent part, as:

Defense Costs and any amount which the **Insured Persons** or the **Company** (if applicable) are legally obligated to pay resulting from a **Claim**, including, damages, judgments, settlements, and pre- and post-judgment interest, punitive or exemplary damages and the multiple portion of any multiplied damage aware where insurable by law. **Loss** shall not include:

* * *

(3) any unpaid, unrecoverable or outstanding loan, lease or extension of credit to any customer or any forgiveness of debt[.]

(Ex. B, Policy, § IV.N. (the “Loan Loss Carve-Out”)).

38. In the Lawsuit, the FDIC “seeks to recover losses in excess of \$8.2 million that [Mr. Cuttle], a former loan officer, caused the Bank to incur” in connection with 11 loans discussed in its Complaint. (Ex. A, ¶ 1).

39. The Lawsuit Complaint describes 11 specific loans to borrowers that subsequently defaulted, resulting in alleged losses to the Bank. (*Id.* ¶¶ 20-48). Such amounts constitute “unpaid, unrecoverable or outstanding loan, lease or extension of credit to any customer or any forgiveness of debt.”

40. Accordingly, Progressive seeks a declaratory judgment that the Policy’s Loan Loss Carve-Out precludes coverage for the alleged damages sought by the FDIC in the Lawsuit.

COUNT III

Further Declaration/Reservation of Rights

41. Progressive repeats and incorporates by reference the allegations in Paragraphs 1 through 40 of this Complaint.

42. To the extent that the FDIC and/or Mr. Cuttle seek coverage for the Lawsuit under the Successor Policy, Progressive further seeks a declaration that the Successor Policy is not implicated by the FDIC’s Lawsuit. The Lawsuit is not a claim deemed first made during the Successor Policy (including the Discovery Period for that policy). Further, insofar as the Successor Policy contains an Insured vs. Insured Exclusion and Loan Loss Carve-Out identical to those contained in the Policy, those provisions likewise would apply to preclude coverage under the Successor Policy.

43. Progressive has reserved all of its rights under the Policy and applicable law. By seeking a judicial declaration based on the foregoing provisions of the Policy, Progressive does not waive its potential coverage defenses pursuant to the Policy’s other terms, conditions, and

limitations. Developments in connection with the Lawsuit may render additional defenses to coverage ripe for judicial determination.

Prayer for Relief

WHEREFORE, Progressive prays this Court order, adjudge, and decree the following relief:

A. A judicial declaration that the Policy's Insured vs. Insured Exclusion precludes coverage for the Lawsuit;

B. A judicial declaration that the Policy's Loan Loss Carve-Out applies to preclude coverage for the damages sought by the FDIC in connection with the Lawsuit;

C. A judicial declaration that Progressive has no duty to advance defense costs or to indemnify Mr. Cuttle in connection with the FDIC Lawsuit;

D. If necessary, a further declaration that no coverage is available under the Successor Policy for the Lawsuit;

E. Such further declaration of the rights and obligations of Progressive, Mr. Cuttle, and the FDIC under the Policy and Successor Policy as may prove necessary and justiciable in connection with the Lawsuit; and

F. Awarding Progressive such additional declaratory and other relief as shall be found to be appropriate under the circumstances.

Respectfully submitted this 1st day of November, 2011.

/s/ Thomas H. Howlett
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