

U.S. DISTRICT COURT  
EASTERN DISTRICT OF WISCONSIN, MILWAUKEE DIVISION

FEDERAL INSURANCE COMPANY,  
15 Mountain View Road  
Warren, New Jersey 07061

'05 JUL 20 P12:36  
SOFRON B. NEDILSKY  
CLERK

Plaintiff,

vs.

CASE NO 05-C-0764

ABC, DEF AND GHI INSURANCE  
COMPANIES,

and

VIRCHOW KRAUSE & COMPANY, LLP,  
115 South 84<sup>th</sup> Street, Suite 400  
Milwaukee, Wisconsin 53214

Defendants.

COMPLAINT FOR DAMAGES

COMES NOW the Plaintiff, Federal Insurance Company ("Federal" or the "Surety"), and for its causes of action against the Defendants, ABC, DEF and GHI Insurance Companies and Virchow Krause & Company, LLP, would show unto this Court as follows:

I. PARTIES

1. The Plaintiff, Federal, is a corporation formed under the laws of the State of Indiana, with its principal place of business located at 15 Mountain View Road in the Township of Warren, State of New Jersey.

2. The Defendants, fictitiously identified as ABC, DEF and GHI Insurance Companies since their true identities are not known to the Plaintiff, are insurance companies who at all times material maintained primary and excess policies of liability insurance with the Defendant Virchow Krause & Company, LLP, which provide insurance coverage, in whole or in

part, for the claims as set forth herein. Therefore, these defendants are directly liable to Federal for its damages in accordance with applicable law.

3. Defendant, Virchow Krause & Company, LLP ("VK&C"), is a domestic limited liability partnership formed under the laws of the State of Wisconsin, with its principal place of business located at 115 South 84<sup>th</sup> Street in the City of Milwaukee, State of Wisconsin. Upon information and belief, VK&C may be served with process through its Registered Agent, Philip A. Galassie, Jr., at 4600 American Parkway, Madison, Wisconsin 53707.

## II. JURISDICTION AND VENUE

3. This Court has original jurisdiction under 28 U.S.C.A. § 1332(a) because the matter in controversy exceeds the sum or value of \$75,000.00, exclusive of interests and costs, and is between citizens of different states.

4. Venue is proper in the United States District Court for the Eastern District of Wisconsin under 28 U.S.C.A. § 1391 because (1) VK&C has offices in the Eastern District of Wisconsin and (2) a substantial part of the events and omissions giving rise to Federal's claims occurred in the Eastern District of Wisconsin. These events and omissions included (1) VK&C's performance of auditing activity and services at the offices of James Cape & Sons Company ("Cape") in Racine, Wisconsin; (2) the issuance of the Financial Statements which are the subject of Federal's claims in Racine and/or Milwaukee, Wisconsin; (3) delivery in Milwaukee, Wisconsin of subject audited Financial Statements to Federal through Regional Insurance Agency, Inc.; and (4) issuance in Milwaukee, Wisconsin by Federal of bonds in reliance on VK&C audited Financial Statements.

### III. ALLEGATIONS AND AVERMENTS

5. At all times referred to herein, VK&C was licensed as a certified public accountant by the State of Wisconsin and engaged in the practice of public accounting in the State of Wisconsin.

6. Upon information and belief, VK&C at all material times performed general accounting services for Cape.

7. VK&C conducted an audit of Cape's accounting records as of and for the year ended December 31, 2002, and as of and for the year ended December 31, 2003. VK&C also audited the financial statements to those dates. The Financial Statements as of and for the year ended December 31, 2002 (issued on March 30, 2003), and as of and for the year ended December 31, 2003 (issued on April 12, 2004) (collectively the "Financial Statements"), are collectively attached hereto as Exhibit A.

8. At all times referred to herein, VK&C understood that Cape was engaged in the construction industry as evidenced by the "Notes to Consolidated Financial Statements" contained in the Financial Statements.

9. As evidenced by the "Notes to Consolidated Financial Statements," VK&C also understood that Cape's construction work included paving streets and highways, underground utility construction, earthwork, concrete crushing, aggregate mining, bridge construction and general construction.

10. Upon information and belief, VK&C was aware at the time VK&C audited the Financial Statements that Cape obtained performance bonds and/or payment bonds as a necessary incident to performance of construction of public work.

11. At the time VK&C audited the Financial Statements, it was foreseeable to VK&C that third parties, including sureties, would rely upon the Financial Statements in their underwriting process, in their decisions relating to the issuance of surety bonds on Cape's behalf and in their decision to otherwise extend credit to Cape.

12. At the time VK&C audited the Financial Statements, it was foreseeable to VK&C that its negligent acts could cause injuries to third parties, such as sureties who issued surety bonds on Cape's behalf or who extended credit to Cape in reliance upon the Financial Statements and VK&C's audit reports.

13. Federal issued surety bonds to Cape and reasonably relied upon the Financial Statements audited by VK&C and VK&C's audit report in making its decision to issue surety bonds on Cape's behalf.

14. The Financial Statements, which were audited by VK&C and reasonably relied upon by Federal, contained numerous material errors with respect to Cape's true financial condition and results of operations at the time the Financial Statements were audited.

15. VK&C failed to report or disclose that the Financial Statements were not in accordance with Generally Accepted Accounting Principles ("GAAP") as adopted by the American Institute of Certified Public Accountants..

16. While performing the audit of the Financial Statements, VK&C failed to properly perform the audit in accordance with Generally Accepted Auditing Standards ("GAAS") as adopted by the American Institute of Certified Public Accountants.

17. VK&C's failures to adhere to GAAP and GAAS include, but are not limited to the following:

- (a) Failure to disclose \$8,863,969 in unbilled receivables in the 2002 Financial Statement (no unbilled receivables were listed);

- (b) Contract revenue and profit recognition was not in compliance with GAAP in the Financial Statements;
- (c) Contract retainage on certain contracts was included in the Financial Statements as cash and cash equivalents in 2002 and 2003 in violation of GAAP;
- (d) Failure to obtain evidential matter as to appropriateness and valuation of inventory in violation of GAAS; and
- (e) Cape had various debt covenant violations at the end of 2001, 2002 and 2003 and in violation of debt covenants. All debt should have been reflected in the 2003 Financial Statements as current maturity of long-term debt which would have resulted in a modified opinion. This also caused working capital to be materially overstated.

18. The material errors and misrepresentations in the Financial Statements and VK&C's audit reports created and perpetuated the appearance to third parties that Cape was a sound underwriting risk, when in fact Cape's financial condition was at best uncertain rendering Cape not suitable for bonding.

19. Cape was placed into receivership on or about April 8, 2005. Since Cape was unable to perform its existing contractual obligations, Federal was required to perform Cape's obligations and pay Cape's subcontractors and suppliers on the bonded projects.

20. Federal would not have issued any bonds or surety credit to Cape had VK&C's Financial Statements accurately reflected Cape's financial condition and results of operations. This has caused Federal to incur a loss in excess of \$75,000.

### COUNT ONE

#### **Negligence - Accountant Malpractice**

21. Federal hereby restates the allegations contained in Paragraphs 1 through 20 of this Complaint as if fully set forth herein.

22. At all times material VK&C owed Federal a duty to exercise reasonable care in the performance of the audits of the Financial Statements reflecting Cape's financial condition and results of operations.

23. At all times material VK&C knew or should have known that Cape intended to supply the audited Financial Statements to Federal and that Cape intended to use that information to influence Federal's decision to issue the bonds necessary for Cape to continue performing construction of public work.

24. VK&C was required to exercise the reasonable care and competency ordinarily required of accountants in the same or similar circumstances when performing the audits of the Financial Statements of Cape.

25. VK&C breached the duty of care owed to Federal by failing to adhere to GAAP and GAAS while performing the audits of the Financial Statements of Cape.

26. As a direct and proximate result of VK&C's breach of its duty of care, Federal has suffered damages in excess of \$75,000. Federal continues to suffer damages as claims are made under the bonds that were issued in reasonable reliance upon the Financial Statements.

## COUNT TWO

### **Negligent Misrepresentation**

27. Federal hereby restates the allegations contained in Paragraphs 1 through 26 of this Complaint as if fully set forth herein.

28. At all times material, VK&C owed Federal a duty of care because it was foreseeable to VK&C that sureties, such as Federal, would rely upon the Financial Statements audited by VK&C during the underwriting process with respect to issuing bonds on Cape's behalf or issuing other surety credit to Cape.

29. The Financial Statements audited by VK&C contained numerous misrepresentations of material fact.

30. VK&C failed to exercise ordinary care in making the representations contained in the Financial Statements and audit reports and in ascertaining the facts with respect to representations made therein.

31. Federal believed that the representations contained in the Financial Statements audited by VK&C were true; and Federal relied upon these representations to its detriment.

32. As a direct and proximate result of VK&C's failure to exercise ordinary care, Federal has suffered damages in excess of \$75,000. Federal continues to suffer damages as claims are made under the various bonds that were issued in reasonable reliance upon the Financial Statements.

### **COUNT THREE**

#### **Misrepresentation: Strict Responsibility**

33. Federal hereby restates the allegations contained in Paragraphs 1 through 32 of this Complaint as if fully set forth herein.

34. The Financial Statements audited by VK&C contained material misrepresentations of material fact.

35. In its performance of the audit, VK&C was uniquely situated to ascertain the material misrepresentations contained in the Financial Statements, and therefore either knew or should have known that the Financial Statements were materially misstated.

36. VK&C had a financial interest in continuing as the accountants and auditors of Cape, and therefore stood to make a financial gain if Cape obtained the necessary bonds from Federal to continue performing construction of public works.

37. Federal believed the audited Financial Statements to be true and accurate, and relied thereon in issuing bonds on behalf of Cape.

38. As a direct and proximate result of VK&C's material misrepresentations, Federal has suffered damages in excess of \$75,000. Federal continues to suffer damages as claims are made under the bonds that were issued in reasonable reliance upon the Financial Statements.

WHEREFORE, BASED ON THE FOREGOING, Federal prays and requests the Court for the following relief:

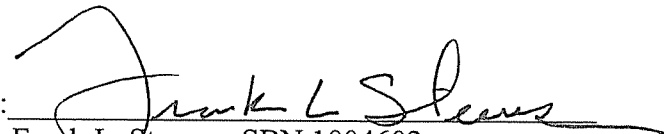
- a. That process issue requiring VK&C to answer this Complaint;
- b. That judgment be entered on Federal's behalf against the Defendants for actual damages and losses Federal has sustained and suffered by reason of issuing performance bonds to Cape and payment bonds in reliance upon the Financial Statements and audit reports;
- c. That judgment be entered on Federal's behalf against the Defendants for Federal's future damages and losses that will be sustained by reason of issuing performance bonds and payment bonds in reliance upon the Financial Statements and audit reports;
- d. That judgment be entered on Federal's behalf against the Defendants for pre-judgment interest, attorneys' fees and actual consulting fees, expert fees and other costs incurred in the prosecution of this action;
- e. That judgment be entered on Federal's behalf against the Defendants for such additional and further relief, both specific and general, as the nature of this cause may allow and is just; and
- f. That Federal have and recover post-judgment interest from the date of entry of a final judgment in this cause.

**TRIAL BY A JURY IS DEMANDED.**

Dated this 20<sup>th</sup> day of July, 2005.

**VON BRIESEN & ROPER, S.C.**  
Attorneys for Plaintiff, Federal Insurance Company

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