

# THE CONSTRUCTION LAW BRIEFING PAPER

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Briefing Paper 99-1

January 1999

## A NEW EICHLEAY CASE: DON'T LEAVE HOME WITHOUT IT by Jocelyn L. Knoll, Esq.<sup>1</sup>

It almost goes without saying that when a construction project is delayed, the contractor incurs extended home office overhead, and when a project is shut down, the contractor is typically saddled with unabsorbed home office overhead. Contractors who have incurred these additional overhead costs due to project delays or disruption are familiar with the “*Eichleay* formula” which is used to calculate extended and unabsorbed home office overhead damages. A recent case from the United States Court of Appeals for the Federal Circuit, *West v. All State Boiler, Inc.*, provides new and important clarification on how and when contractors should use the *Eichleay* formula.

Part I of this Briefing Paper distinguishes “extended overhead” from “unabsorbed overhead” and explains the prerequisites to recovering home office overhead costs. Part II of this paper discusses *West v. All State Boiler, Inc.*, and Part III provides an example of *Eichleay* in action.

### I. THE EICHLEAY BASICS

Since its first appearance in 1960, the *Eichleay* formula has been used by federal boards of contract appeals, federal and state courts, and numerous arbitrators. In fact, some courts have held that the *Eichleay* formula is the only appropriate method to calculate extended and unabsorbed home office overhead.

The *Eichleay* formula captures two distinct forms of damage – extended overhead due to project delay, and unabsorbed overhead due to a project shut down. Projects are often subject to both shut down and delay and, correspondingly, contractors often suffer both unabsorbed home office overhead and extended home office overhead damages on the same project. Simply stated, “*extended overhead*” refers to the increased home office costs incurred after the original project completion date due to delays during the project. “*Unabsorbed overhead*” refers to overhead costs the contractor is forced to absorb due to a mid-project shut down or idle time when no work is performed but the contractor continues to incur general and administrative expenses.

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## II. RECENT COURT DECISION

Recently, in *West v. All State Boiler, Inc.*, the United States Court of Appeals for the Federal Circuit issued a decision in which it determined that the *Eichleay* formula is the only appropriate method for calculating the recoverable damages due to unabsorbed or extended overhead expenses. In *West*, the contractor entered into a contract with the federal government to upgrade boiler systems at a Veteran's Administration ("VA") medical center. During its work, the VA suspended the contractor's work. After a 58-day suspension, the contractor was allowed to resume its work and subsequently completed its contract 22 days after the contract-specified completion date. The contractor made a claim to recover unabsorbed home office overhead expenses. The VA denied the contractor's claim and the contractor appealed.

On appeal, the Federal Circuit noted that the *Eichleay* formula is the appropriate and only method for measuring extended and unabsorbed overhead expenses. The Federal Circuit, however, stated that the burden is on the contractor to establish entitlement to recover extended or unabsorbed overhead costs.

In order to establish a *prima facie* case of entitlement to extended or unabsorbed overhead under *Eichleay*, a contractor must satisfy a two-prong test. First, the contractor must show that it was required to be on "standby" while the work was delayed or shut down for a period of uncertain duration during which the contractor could be immediately required to resume its work. Second, the contractor must show that it was unable to take on substitute work during the suspension to replace the suspended work. Accordingly, if the contractor obtains substitute or replacement work, then there is no

unabsorbed overhead and the contractor incurs no damages due to the delay.

In the *West* case, there was no dispute that the contractor was on standby status during the entire 58-day suspension period, so the contractor satisfied the first part of the test. With regard to the second part of the test, however, the VA argued that the contractor cannot merely show that the contractor could not take on other work during the delay period, but that it was *impossible* for the contractor to perform other work. The VA further argued that if a contractor bids on, received and/or is capable of obtaining additional work during the delay period, it cannot use the *Eichleay* formula.

The Federal Circuit rejected the VA's argument. The court determined that once the contractor testifies that it could not take on other work during the delay period, the party delaying the project (i.e., the VA) has the burden of rebutting the contractor's testimony by showing that the contractor could have reallocated the disputed home office overhead to an "alternative or substitutional" contract.

Importantly, the determining factor is not whether the contractor was able to obtain or continue work on any other or additional projects. The key question is whether the contractor obtained a "replacement" contract that was "beyond the work it performs in the ordinary course of business." Examples of replacement contracts are contracts that are (1) different in size or duration from the contractor's ordinary type of work (e.g., a \$100,000 contract by a contractor that normally obtains multi-million dollar contracts), or (2) for a different type of work (e.g., for repair work rather than new construction). The relevant period for examining whether it was practical for the contractor to take on replacement work is measured from the

beginning of the suspension period until the contract is complete.

In *West*, the court held that the VA failed to rebut the contractor's *prima facie* case. The court further determined that it was impractical for the contractor to obtain replacement work due to the VA's suspension of the contractor's work.

The court then turned its attention to determining the length of the delay period to which *Eichleay* applies. The contractor argued that the delay period to which *Eichleay* applies is the actual suspension period (58 days) rather than the period in which the contract was extended (22 days). The Federal Circuit determined that *Eichleay* recovery "makes better sense" if it is awarded for the period in which the contract is extended, not the period in which the work is suspended.

The Federal Circuit reasoned that once the contract performance period extends beyond the initial deadline, the contractor (a) continues to accrue indirect labor costs that have not been allocated to the newly extended contract, and (b) is unable to begin a new contract to absorb the next portion of these continuing costs. If, however, the suspension does not actually extend the contract completion time, the contractor suffers no injury because the contractor's original estimate of the time required to complete performance remains accurate and the next contract can begin as scheduled.

Thus, a contractor can recover under *Eichleay* only if the overall performance period (according to either the original deadline or the contractor's provable early completion deadline) must be extended as a result of the suspension. With regard to early completion, the contractor must show that, from the start of the contract work, it (1) intended to complete its work early, (2)

had the capability of doing so, and (3) actually would have done so but for the suspension of its work.

In *West*, the Federal Circuit determined that the contractor failed to prove that it could have completed its work early but for the VA's delay. Accordingly, the Federal Circuit concluded that the Board of Contract Appeals correctly allowed the contractor to recover *Eichleay* damages for only the 22 days by which the original performance deadline was extended, rather than for the entire 58-day suspension period.

As a final note, the contractor must adjust its *Eichleay* calculation if it obtained a small replacement job that absorbed some, but not all of the overhead in question. Because some of the otherwise unabsorbed overhead will have been absorbed by the small replacement job, the contractor can only recover the balance of its unallocated and unabsorbed overhead costs.

### III. EICHLEAY EXAMPLE

Once a contractor establishes that it is entitled to recover extended and unabsorbed home office overhead, it then must quantify those damages. Enter the *Eichleay* formula.

The *Eichleay* formula requires three steps:

#### *Step 1*

$$\frac{\text{Contract Amount}}{\text{Total Billings for Actual Performance Period}} \times \frac{\text{Total Company Overhead for Actual Performance Period}}{\text{Performance Period}}$$

= Overhead Allocable to Contract

*Step 2*

$$\frac{\text{Overhead Allocable to Contract}}{\text{Days of Actual Performance Period}}$$

= Daily Contract Overhead

*Step 3*

Daily Contract Overhead x  
Number of Days of Compensable Delay =  
Recoverable Overhead

To see how the formula works, assume that XYZ Construction is awarded a contract in the amount of \$40 million to construct a school. The contract work was to be performed in 500 days. The contractor incurred 50 days of compensable delay during which time it was unable to take on other work. During the total 550-day contract period, the contractor had total contract billings of \$80 million and home office overhead of \$4 million. Under *Eichleay*, the contractor would recover \$181,818.00 for unabsorbed home office overhead.

*Step 1*

$$\frac{\$40,000,000}{\$80,000,000} = 50\% \times \$4,000,000 =$$

\$2,000,000

*Step 2*

$$\frac{\$2,000,000}{550 \text{ days}} = \$3,636.36/\text{day}$$

*Step 3*

$$\$3,636.36 \times 50 \text{ days} = \$181,818.00$$

**IV. CONCLUSION**

As a result of project delays and disruptions, contractors typically incur extended and unabsorbed home office overhead. Those damages are recoverable, and the *Eichleay* formula is the best way for contractor's to measure this type of loss. Although the right to use the *Eichleay* formula has been seldom litigated in state courts (including Minnesota), those state courts that have considered its use generally have accepted the *Eichleay* formula. The Federal Circuit Court of Appeals' decision in *West v. All State Boiler, Inc.* confirms that the *Eichleay* formula is to be used when certain criteria are satisfied.