

USING THE EICHLEAY FORMULA TO RECOVER UNABSORBED OVERHEAD

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I. INTRODUCTION

The use of the *Eichleay* formula to recover unabsorbed home office overhead costs has been a hot topic in recent years as courts have struggled to provide a framework of objective factors to govern the formula's application. The result has been a string of decisions addressing the *Eichleay* formula that even the Federal Circuit itself has described as vague, inconsistent, and confusing. Moreover, *Eichleay* continues to be blessed with an amazing ability to rebound from death's door. The Federal Circuit's 1997 decision in *Satellite Electric* was viewed by many as the "death knell" for the *Eichleay* formula. More recent decisions have confirmed, however, that the *Eichleay* formula remains alive and well. In the 1998 case of *West v. All State Boiler*, the Federal Circuit reviewed and summarized several of its past *Eichleay* decisions and clarified misleading language that had influenced the court's decision in *Satellite Electric*. The result was the clearest statement yet of the legal test to recover unabsorbed home office overhead expenses using the *Eichleay* formula, one that gives new life to the now almost 40-year old *Eichleay* formula.

II. BACKGROUND

The *Eichleay* formula, first articulated in *Eichleay Corp.*, ASBCA No. 5183, 60-2 BCA 2688, *aff'd on reconsideration*, 61-1 BCA 2894, is intended as a mechanism for computing the compensation a contractor can appropriately recover for unabsorbed overhead due to a Government caused suspension or delay. The formula first determines the pro rata share of the contractor's total overhead that is allocable to the delayed contract. It then converts that into an amount per day, and finally the appropriate daily rate is multiplied by the number of days for which compensation is owed.

1.
$$\frac{\text{Contract Billings}}{\text{Total Billings for Contract Period}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to the Contract}$$
2.
$$\frac{\text{Allocable Overhead}}{\text{Days of Performance}} = \text{Daily Contract Overhead}$$
3.
$$\text{Daily Contract Overhead} \times \text{Number of Days Delay} = \text{Amount Claimed}$$

Sounds straightforward, right? In reality, it is considerably more complex than that.

The current formulation of the elements of an *Eichleay* recovery goes like this: in order to establish a prima facie case of entitlement to unabsorbed overhead using the *Eichleay* formula, the contractor must show that: (1) the Government caused a delay that requires the contractor to be on standby for an uncertain period; and (2) that the contractor is unable to take on replacement work during the standby period. The burden of proof then shifts to the Government to show that the contractor suffered no damage because either: (1) it was not impracticable for the contractor take on other work during the delay; or (2) because the contractor's inability to obtain additional work was not

caused by the Government's suspension. *West v. All State Boiler Inc.*, 146 F.3d 1368, 1373-76 (Fed. Cir. 1998); *See Interstate Gen. Gov't Contractors, Inc. v. West*, 12 F.3d 1053, 1056 (Fed. Cir. 1993). Moreover, the Federal Circuit has held that the *Eichleay* formula is the *exclusive* means available for calculating unabsorbed overhead costs on a federal construction contract. *Wickham Contracting Co. v. Fischer*, 12 F.3d 1574, 13 FPD 1, 18 C.C. 121 (Fed. Cir. 1994).

As the following year by year list of cases illustrates, *Eichleay* remains the topic of much appellate attention, to the tune of several cases per year.

III. CASES

A. Eichleay in the State Courts

Before examining the recent federal *Eichleay* cases, it is worth recalling that a number of state courts have considered and adopted the *Eichleay* formula for cases in their jurisdiction. In fact, despite its recent troubles in the federal arena, the *Eichleay* formula has never been stronger in the state courts. This is illustrated by the most recent decision from the states, *Fairfax County Redevelopment & Housing Auth. v. Worcester Bros. Co., Inc.*, No. 980731, 1999 Va. LEXIS 48, 1999 WL 107422 (Va. Feb. 26, 1999). In a case of first impression, the Virginia Supreme Court adopted the *Eichleay* formula as a method of calculating unabsorbed home office expenses. Finding that a public works contractor whose work was suspended due to the Housing Authority's delay in obtaining required clearances had incurred actual direct damages as a result of having to keep its workforce on standby, the court held that the *Eichleay* formula could be used to provide an intelligent and probable estimate of overhead damages.

Chilton Insurance Co. v. Pate & Pate Enterprises, 930 S.W.2d 877, 21 CC 75 (Tex. App. 1996). In a case of first impression in Texas, Contractor was precluded from recovering unabsorbed home office overhead using the *Eichleay* formula because the Contractor did not prove that it incurred additional home office overhead costs as a result of the delay.

Conti Corp. v. Ohio Dept. of Administrative Services, 90 Ohio App. 3d 462, 629 N.E.2d 1073 (Ohio Ct. App. 1993). Applying Ohio law, a public contractor was found entitled to recover unabsorbed overhead under the *Eichleay* formula, where the project was suspended for seven months after discovery of asbestos on the site. Application of the formula in the absence of expert testimony was allowed because of the simplicity of the formula, its widespread use, and credible testimony by the witnesses.

B. 1998 Federal Eichleay Cases

West v. All State Boiler Inc., 146 F.3d 1368 (Fed. Cir. 1998), 22 CC 279, is probably the most significant *Eichleay* case of the past five years.. The Federal Circuit clarified the legal test to recover unabsorbed overhead expenses using the *Eichleay* formula, rejecting the Government's position that a contractor must show that it was impossible to obtain other work. The court held that the burden was on the Government to rebut the contractor's prima facie case by showing either: (1) that it was not *impractical* for the contractor to obtain other work to which it could re-allocate costs; or (2) that the contractor's inability to obtain other work was not due to the Government suspension but to some other circumstance. The court also held that it was not enough for the Government to show that the contractor continued to bid on and perform other work in the ordinary course of business, but

rather, the Government must show that the contractor could have reallocated costs to a replacement contract to absorb indirect costs that would otherwise be unabsorbed as the result of a government suspension of one contract. Finally, the court clarified that the relevant period of delay to be considered in awarding *Eichleay* damages is the period by which overall performance is extended, rather than the period of suspension.

Keno & Sons Construction Co., ENGBCA No. 5837-Q, 98-2 BCA 29,336. Contractor was not entitled to recover unabsorbed extended overhead costs using the *Eichleay* formula where the contractor experienced performance inefficiencies due to a constructive change but the work was not suspended. The board also found that since the contractor's modified total cost approach already included home office charges, the contractor should not be permitted to use the *Eichleay* formula to obtain a double recovery.

Melka Marine, Inc. v. United States, 41 Fed. Cl. 122 (Fed. Cl. 1998). Contractor was not entitled to recover unabsorbed overhead using the *Eichleay* formula when the contractor bid on and obtained other small jobs even though the volume of the replacement work was a small fraction of the suspended job and could not fully compensate the contractor for the entire period of the suspended contract. Applying the logic of *Satellite Electric*, the Court held that by bidding on other work, it was reasonable to infer that Melka had the capacity to perform the other work that it obtained. Thus, the contractor was precluded from using the *Eichleay* formula.

During the suspension period, the contractor also performed work which it had accepted prior to the suspension. In a related decision, the Court of Federal Claims held that contracts executed prior to the work suspension cannot absorb overhead on the suspended contract and do not preclude

recovery under the *Eichleay* formula, even if the contracts obtained before the suspension were rescheduled to be performed during the delay period. *Melka Marine, Inc. v. United States*, 38 Fed. Cl. 545 (1997).

C. 1997 Federal Eichleay Cases

Satellite Electric Co. v. Dalton, 105 F.3d 1418, 21 CC 122 (Fed. Cir. 1997). The Federal Circuit rejected the Contractor's claim for damages based on the *Eichleay* formula where: (1) the Contractor had aggressively bid on replacement work throughout the suspension period; (2) only 3% of the work under the contract remained at the time of suspension, indicating that the contractor had the ability to take on additional work; and (3) the Contractor's inability to obtain replacement work was unrelated to the Government's suspension. It was held that to defeat an *Eichleay* claim, the Government need only show that the Contractor had the *ability* to obtain replacement work, even though no replacement work was *actually* obtained.

AEC Corp., ASBCA No. 45,713 *et al.*, 97-1 BCA 28,973, 21 CC 338 (1997). Citing *Satellite Electric*, recovery under the *Eichleay* formula was rejected because work actually obtained plus work sought during the suspension period would have replaced the suspended work.

Adventure Group, Inc., ASBCA No. 50,188, 97-2 BCA 29,081 (1997), *adhered to on recon.*, 98-1 BCA 26,362. Citing *Satellite Electric*, the Board rejected the Contractor's *Eichleay* formula claim on the basis that the Contractor's inability to obtain replacement work was due to a paucity of bidding opportunities, and thus was not directly caused by the Government's suspension.

D. 1996 Federal Eichleay Cases

P.J. Dick, Inc. v. General Services Administration, GSBCA No. 12058, 96-1 BCA 28,188 (1996). Contractor was not entitled to recover *Eichleay* formula damages for a delay resulting from the addition of asbestos removal work to the contract, because the delay was not sudden, sporadic or uncertain. Additionally, no extended home office overhead was payable for delays after substantial completion, because the contractor did not establish that the extended period after substantial completion affected its ability to otherwise absorb its overhead.

Stroh Corp. v. General Services Administration, GSBCA No. 11029, 96-1 BCA 28,265 (1996). Where the contractor finished the project by the required date and the duration of the government-caused delay was known in advance and occurred early in performance, the prerequisites for *Eichleay* formula recovery were not met. Furthermore, contractor's claim for underabsorbed overhead via a modified *Eichleay* calculation was in reality a claim for consequential damages that were not foreseeable by the government at the time of contract award.

Altmayer v. Johnson, 79 F.3d 1129 (Fed. Cir. 1996); 20 C.C. 271. The subcontractor was entitled to recover *Eichleay* formula damages due to the Government's three month delay in making materials selections, despite the fact that the subcontractor continued to perform minor tasks throughout the delay period. The standby element required for *Eichleay* recovery does not require that the contractor's workforce be idle, rather the test focuses on delay of contract performance for an uncertain duration during which the contractor is required to remain ready to perform.

E. 1995 Federal Eichleay Cases

Mech-Con Corp. v. West, 61 F.3d 883, 14 FPD 65, 19 C.C. 395 (Fed. Cir. 1995). The contractor established a *prima facie* case for *Eichleay* damages by showing:(1) the existence of a Government-imposed delay, and (2) that the delay was for an uncertain period during which it had to stand ready to complete the work. Because the delay was of an uncertain duration, the contractor did not have to prove that it was unable to take on other work during the period, or that it was unable to reduce its overhead. When the contractor can show that it was required to remain on standby during a period of uncertain Government imposed delay, the burden shifts to the Government to show that the contractor could have reduced its overhead or taken on other work.

F. 1993/1994 Federal Eichleay Cases

Wickham Contracting Co. v. Fischer, 12 F.3d 1574, 13 FPD 1, 18 C.C. 121 (Fed. Cir. 1994). In response to the Contractor's argument that the *Eichleay* formula should only be used when the home office overhead costs attributable to a delayed contract cannot otherwise be determined, the Federal Circuit held that the *Eichleay* formula is the *exclusive* means available for calculating unabsorbed overhead on a federal construction contract, assuming the prerequisites for its use are met. The Contractor's argument was based on confusion between overhead and direct costs, the Court reasoned, because "overhead costs are never directly attributable to or caused by any one contract."

Interstate General Government Contractors, Inc. v. West, 12 F.3d 1053, 12 FPD 120, 18 C.C. 89 (Fed. Cir. 1993). The Contractor was unable to recover unabsorbed home office overhead based on a constructive stop-work order by the Government, because it could not show it was on standby and that it was unable to take on additional contracts during the delay period. Although

use of the *Eichleay* formula does not require that the Contractor's workmen be idle, the Contractor must show that the delay disrupted the relationship between its revenue and its overhead costs.

Daly Constr., Inc. v. Garrett, 5 F.3d 520, 12 FPD 89, 18 C.C. 8 (Fed. Cir. 1993). The Contractor could not recover unabsorbed overhead in accordance with the *Eichleay* formula, because it did not show it reasonably incurred unabsorbed overhead costs attributable to the delay. The Contractor's showing of "about eighty specific records of overhead-type activity related to [a] defective specification, including letters, telephone calls, and faxes" did not establish entitlement under the *Eichleay* formula.

Eurostyle Inc. v. General Services Administration, GSBCA No. 12084, 94-2 BCA 26,891 (1994). The Contractor could not recover extended overhead based on delays precipitated by various change orders, because it had recovered for all allowable overhead under the change orders. There had been no *de facto* suspension of work, so use of the *Eichleay* formula was inappropriate. Instead of a situation where the Contractor was standing by with its stream of direct costs suspended, the delays were caused by increased work, which had increased the stream of direct costs.

CONCLUSION

While its scope of application is continuously refined, and in fact over the years has been significantly narrowed, the *Eichleay* formula must nevertheless still be considered alive and well. The most interesting issue to watch for the future, however, is whether the pace of *Eichleay*-related appeals and appellate decisions slows -- indicating at last some stability in the doctrine, or continues at the fairly heated pace of recent years.