

Recovering Extended Home Office Overhead: What Is the State of *Eichleay*?

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Contractors typically rely on project revenue to support their home office operations and accordingly include a markup in their bids for new work. Allocated over the project's planned duration, this markup provides monthly revenue that is used to pay or "absorb" rent, administrative staff salaries, accounting

and payroll services, general insurance, office supplies, telephone charges, depreciation, taxes, and utility costs. If the project time is extended without increasing the amount of the markup, the dollars available to absorb monthly overhead are reduced.

Several recent decisions by the U.S. Court of Appeals for the Federal Circuit appear to make it more difficult for a contractor to recover unabsorbed home office overhead for delays to contract performance caused by the government based on the *Eichleay* formula.¹ This article examines those cases, reflects on the evolution of the formula, and summarizes the current state of the law.

The Original *Eichleay* Decision

The *Eichleay* formula originated with *Eichleay Corp.*, an Armed Services Board of Contract Appeals (ASBCA) case, in which the ASBCA specifically approved the contractor's three-step formula for determining the amount of recoverable home office overhead.² Since the original decision, this formula has become the mandatory method for calculating claims for unabsorbed home office overhead on federal government construction contracts.³

First, the overhead allocable to the contract was determined by multiplying the total overhead by a ratio of the contract's billings to the total billings of the contractor for the contract period. Second, a daily overhead rate for the contract was computed by dividing the overhead allocable to the contract by the number of days of contract performance. Third, the total overhead recoverable was determined by multiplying the daily overhead rate for the contract by the number of days of delay. This formula may be schematically summarized (see Fig. 1.).

The Standby and Replacement Work Requirements

Since *Eichleay* was first decided, the courts have imposed two

major requirements as a prerequisite to recovering *Eichleay* damages: (1) the standby requirement—the government required the contractor to stand by during a government-caused delay of indefinite duration; and (2) the replacement work requirement—as a result of and while standing by, the contractor was unable to take on other work.⁴

Tightening the standby requirement. In *P.J. Dick, Inc. v. Principi*, the Federal Circuit reversed a decision by the Veterans Affairs Board of Contract Appeals (VABCA), denying the contractor's claim for unabsorbed home office overhead.⁵ In rendering its decision, the Federal Circuit summarized its view of the standby requirement in great detail and appears to have made the requirements more difficult to prove.

In *P.J. Dick*, the Veterans Administration (VA) awarded a contract to the contractor to construct a clinic addition to a medical center in Ann Arbor, Michigan.⁶ During contract performance, the VA issued over 400 change orders, increasing the contract price by more than 5 percent, and granted time extensions totaling 107 days.⁷ The contractor signed each of the changes and reserved its right to seek delay damages under the suspension of work clause. Ultimately, the contractor completed the contract 260 days after the original contract completion date and 153 days after the revised date.⁸ The VA and the contractor agreed to a stipulation that, to the extent the contractor could prove entitlement of delay under the suspension of work clause, the contractor's recovery for field and home office overhead would be calculated at stated daily rates

FIGURE 1

Step One:

$$\left(\frac{\text{Contract Billings}}{\text{Total Billings for Company}} \times \frac{\text{Total Overhead for Performance Period}}{\text{Period}} \right) = \text{Overhead Allocable to Contract}$$

Step Two:

$$\frac{\text{Overhead Allocable to Contract}}{\text{Actual Days of Contract Performance}} = \text{Daily Contract Overhead Rate}$$

Step Three:

$$\left(\text{Daily Contract Overhead Rate} \times \text{No. of Days of Delay} \right) = \text{Amount Recoverable}$$

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“without the need for future proof of costs or damages.”⁹

The VABCA held that the contractor was not entitled to recover unabsorbed home office overhead under the Eichleay formula because it had been able to continue work on other unaffected portions of the project and had never been placed in a standby position.¹⁰

On appeal, the Federal Circuit rejected the contractor’s argument that a contractor is automatically on standby any time there is a government-caused delay of uncertain duration that extends the performance of the contract and at the end of which the contractor can be required to immediately resume work.¹¹ The court began its analysis by reviewing its earlier decisions discussing the standby requirement.¹²

The Federal Circuit stated that in the absence of a written order suspending work for an indefinite duration and requiring the contractor to remain ready to resume work immediately or on short notice, the contractor must prove standby through indirect evidence.¹³ Accordingly, in order to satisfy the standby requirement, a contractor must show that:

1. the government-caused delay was not only substantial but was of indefinite duration;
2. during the delay, the contractor was required to be ready to resume work on the contract at full speed, as well as immediately; and
3. work on much, if not all, of the contract was suspended due to the delay.¹⁴

In this case, although the contractor characterized its direct billings as “minor,” it billed 47 percent of the monthly amounts billed before the delay and the court concluded that the contractor was able to perform substantial amounts of work during the suspension periods.¹⁵

The Federal Circuit went on to summarize the current status of recovery for unabsorbed home office overhead in the following words:

A court evaluating a contractor’s claim for Eichleay damages should ask the following questions:

1. Was there a government-caused delay that was not concurrent with another delay caused by some other source?
2. Did the contractor demonstrate that it incurred additional overhead (i.e., was the original time frame for completion extended)?
3. Did the government contracting officer issue a suspension or other order expressly putting the contractor on standby?
4. If not, can the contractor prove there was a delay of indefinite duration during which it could not bill substantial amounts of work on the contract and at the end of which it was required to be able to return to work on the contract at full speed and immediately?
5. Can the government satisfy its burden of production showing that it was not impractical for the contractor to take on replacement work (i.e., a new contract) and thereby mitigate its damages? and
6. If the government meets its burden of production, can the contractor satisfy its burden of persuasion that it was impractical for it to obtain sufficient replacement work?¹⁶

The unusual twist on *P.J. Dick* is that the Federal Circuit did not need to conduct a thorough review of the Eichleay formula because the court ultimately decided the case on an unrelated issue. Specifically, the court concluded that the contractor was entitled to Eichleay damages under the suspension of work (SOW) clause based on the stipulation authorizing recovery of field and home office overhead at stipulated daily rates.¹⁷ Consequently, the contractor was entitled to home office overhead under the terms of the stipulation despite the contractor’s inability to independently prove entitlement to Eichleay damages.

The Federal Circuit elaborated that entitlement under the SOW clause “requires proof entirely different, and less demanding, than that required to show entitlement to *Eichleay* damages.”¹⁸ Accordingly, under the four-part test to recover under the SOW clause:

1. There must be a delay of unreasonable length extending the contract completion time;
2. The delay must have been proximately caused by the VA’s action or inaction;
3. The delay resulted in some injury; and
4. There is no delay concurrent with the suspension that is the fault of the contractor.¹⁹

Work suspensions insufficient. In *Nicon, Inc. v. United States*, the Federal Circuit vacated and remanded a U.S. Court of Federal Claims’ decision that granted the government summary judgment against a contractor’s claim for unabsorbed home office overhead.²⁰ The court reconfirmed that the Eichleay formula is an “extraordinary remedy”²¹ available only where certain facts exist and determined that only delays that *extend* contract performance give rise to Eichleay damages.

In *Nicon*, the contractor was awarded a contract to repair a dormitory at McDill Air Force Base, Florida. Due in part to a bid protest, the government never issued a notice to proceed. When the government subsequently terminated the contract for convenience, the contractor sought to recover \$387,513 in unabsorbed home office overhead for the 288 days between award of the contract and the government’s termination.²²

The Federal Circuit clarified that Eichleay damages are awarded for the number of days for which a government-caused delay causes the overall contract performance to be *extended*—not the number of days that it causes work to be *suspended*.²³ The court held that, if performance has not yet begun, there is no way to determine how long the delay would have extended contract performance. The court further refused to assume that the contractor would have been paid its full contract price.

The U.S. Court of Federal Claims initially denied the contractor’s unabsorbed overhead claim, stating that the Eichleay formula could not be modified to fit a situation where the contractor had not yet started work. The contractor had no actual “contract billings” or “days of performance” to plug into the formula.²⁴ For purposes of the Eichleay formula, the contractor argued that it would have completed the project at the contract price and within the

contract but for the termination. Thus, the contractor computed its “daily contract overhead” by plugging the contract price for “contract billings” and the time the contract allowed for performance for actual “days of performance” into the Eichleay formula. The Federal Circuit ultimately rejected these assumptions and stated that “constructive figures may not be substituted into the Eichleay formula.”²⁵

After rejecting the contractor’s Eichleay claim, the Federal Circuit curiously noted that the terminated contractor nevertheless might be able to recover unabsorbed overhead through “some other method of allocation.”²⁶ The Federal Circuit has, however, consistently held that the Eichleay formula is the *only* acceptable method for computing unabsorbed overhead. The court reasoned that in a termination for convenience setting, where fairness to the contractor is a central concern, it would be inappropriate to rigidly apply the Eichleay formula to deny the contractor fair compensation.²⁷

The court cautioned that a contractor seeking unabsorbed overhead as part of its termination for convenience must still prove entitlement to unabsorbed overhead. Thus, the contractor must show that: (1) before the government terminated the contract there was a period of government-caused delay of uncertain duration, (2) the contractor itself played no role in the delay and the delay was not the fault of someone or something beyond the government’s control, and (3) the contractor was on standby and unable to take on other work.²⁸

Endnotes

1. See *P.J. Dick, Inc. v. Principi*, 324 F.3d 1364 (Fed. Cir. 2003);

Nicon, Inc. v. U.S., 331 F.3d 878 (Fed. Cir. 2003); *Charles G. Williams Constr., Inc. v. White*, 326 F.3d 1376 (Fed. Cir. 2003).

2. See *Eichleay Corp.*, ASBCA No. 5183, 60-2 BCA ¶ 2688, reheard and reaffirmed at 61-1 BCA ¶ 2894.

3. See *E.R. Mitchell Construction Co. v. Danzig*, 175 F.3d 1369, 1372 (Fed. Cir. 1999).

4. See, e.g., *Interstate General Government Contractors v. West*, 12 F.3d 1053 (Fed. Cir. 1993).

5. *P.J. Dick, Inc. v. Principi*, 324 F.3d 1364 (Fed. Cir. 2003).

6. *Id.* at 1368.

7. *Id.*

8. *Id.*

9. *Id.* at 1374.

10. See *P.J. Dick Inc.*, VABCA Nos. 5597 *et al.*, 01-2 BCA ¶ 31,647.

11. See *P.J. Dick, Inc.*, 324 F.3d at 1372.

12. *Id.* at 1373.

13. *Id.* at 1371.

14. *Id.*

15. *Id.* at 1374.

16. *Id.*

17. *Id.* at 1374-75.

18. *Id.* at 1374.

19. *Id.* at 1375.

20. *Nicon, Inc. v. United States*, 331 F.3d 878 (Fed. Cir. 2003).

21. *Id.* at 884.

22. *Id.* at 882.

23. See generally *id.* at 884.

24. *Id.* at 883.

25. *Id.* at 884.

26. *Id.*

27. *Id.* at 886-87 (“It would be inappropriate in the termination for convenience setting, where fairness to the contractor is the touchstone, to rigidly apply a formula developed in different factual circumstances and thereby deny the contractor fair compensation for unabsorbed home office overhead. Indeed, such would be contrary to the letter and spirit of 48 C.F.R. § 49.201(a)”).

28. *Id.* at 887.