

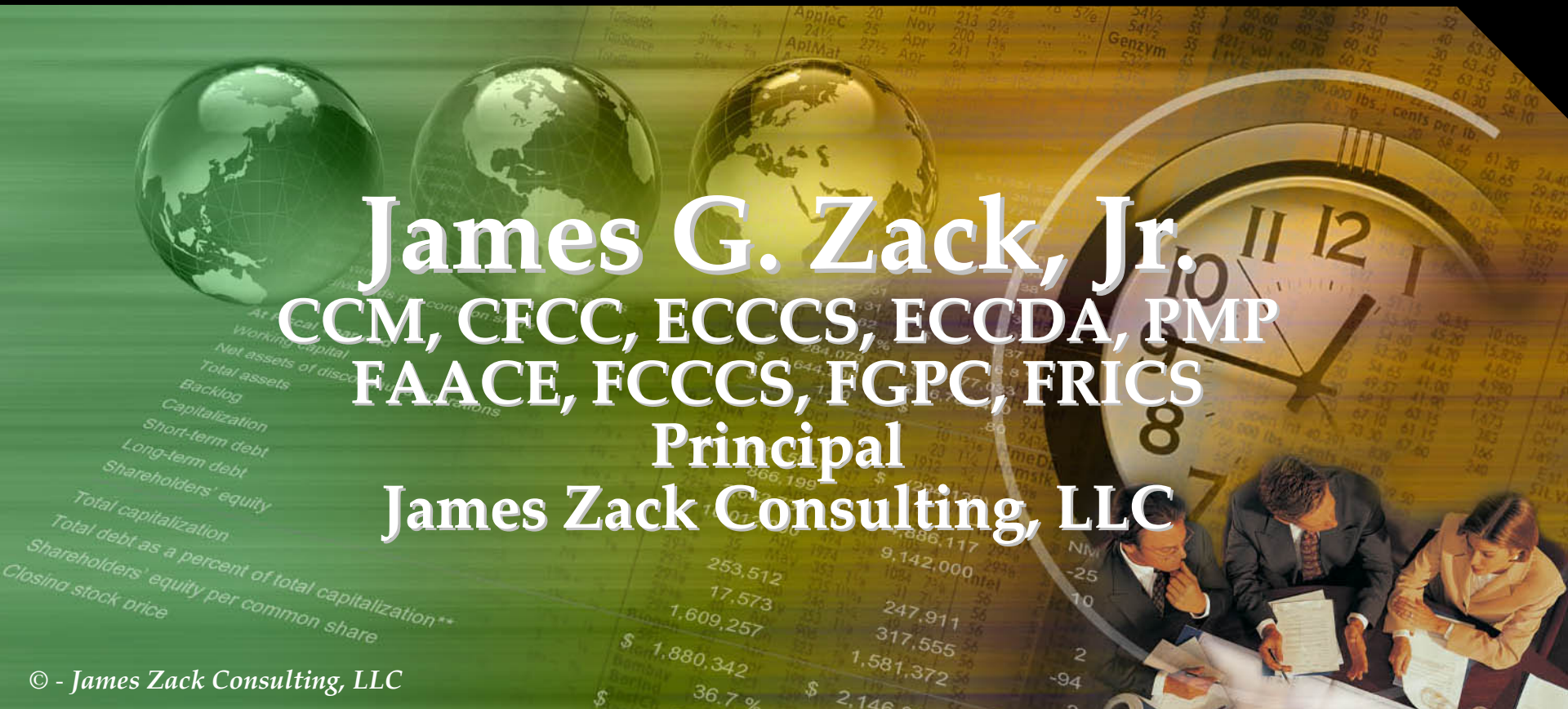
Practical Problems with Pricing Delay Using Eichleay

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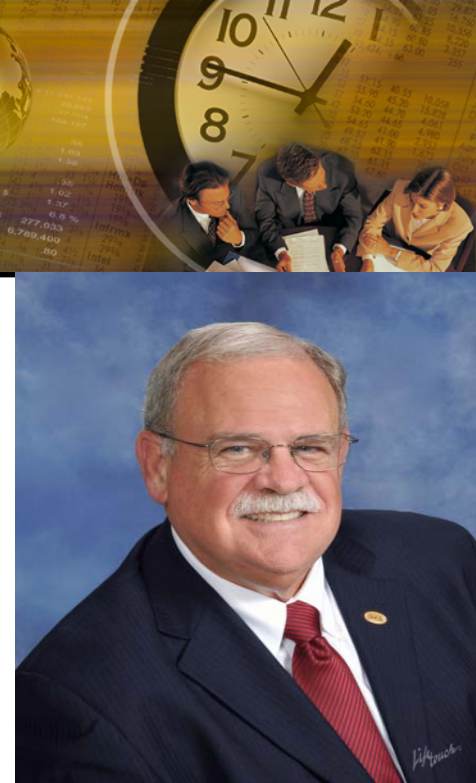
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“The construction industry’s premier resource for thought leadership & best practices on avoidance & resolution of construction project disputes globally”
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Introduction

Introduction



- **Delay common on construction projects**
 - Many causes – contractor, owner, force majeure
- **Most contracts deal with 3 types of delay**
 - Inexcusable – No time, no money
 - Excusable – Time, no money
 - Compensable – Time & money
- **Other types of delay recoverable even if not mentioned in contract**
 - Pacing, concurrent, early completion & impact delay

Introduction



- Once cause of delay determined, argument turns more technical
 - Extent of delay?
 - Cost of day of compensable delay?
 - Total compensation for delay?
- Simple delay costs fairly easy to handle
 - Idled labor & equipment
 - Extended Field Office Overhead (FOOH)
- **But what about extended/unabsorbed Home Office Overhead Costs?**

What is Home Office Overhead? (HOOH)



- *“G&A is an expense an enterprise expends to support its ... revenue generating activities”*
- HOOH = Cost expended by contractor for benefit of **all** ongoing projects that **cannot** be directly allocated to any specific project
- Definition **excludes** costs incurred solely in support of a single project or group of projects

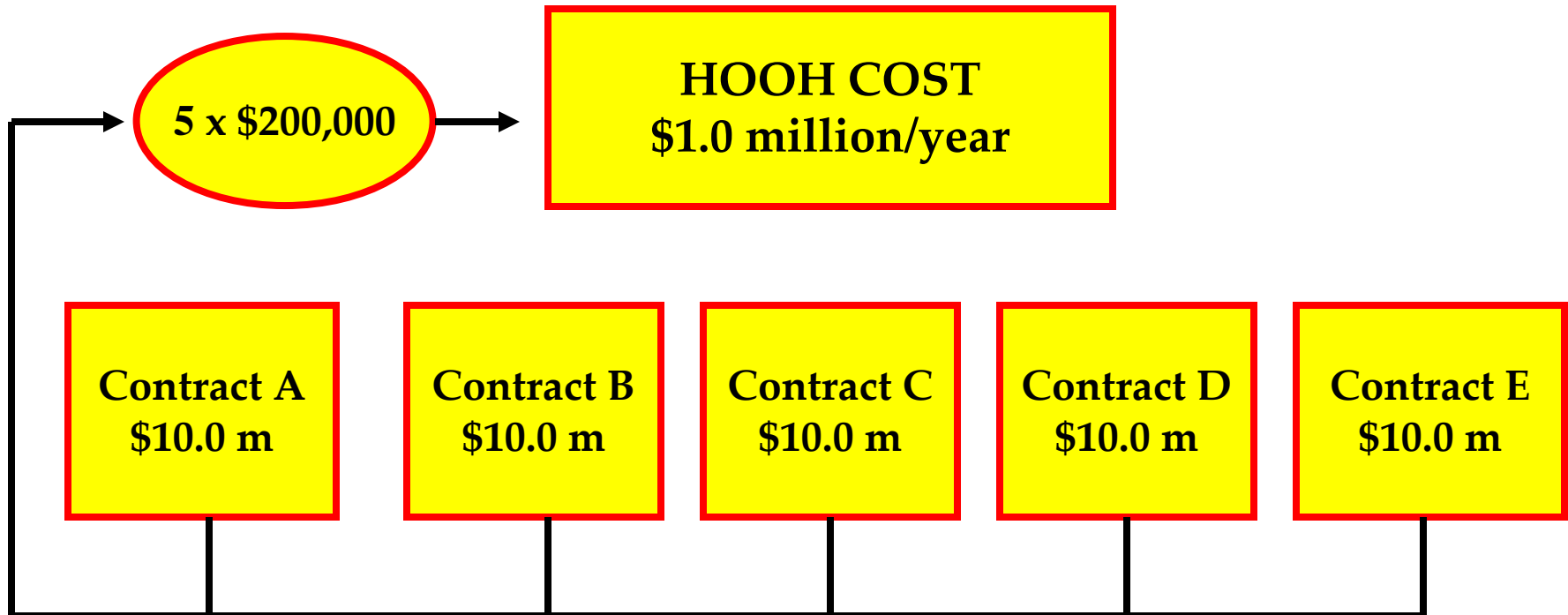
What is HOOH?

Typical Costs

Executive & Admin salaries
Home office rents,
expenses
Company insurance
Utilities, telephone, fax,
computer costs
Travel for home office staff
Depreciation
Professional fees
Bid costs
Licenses & fees
Data processing & copying

Legal & accounting costs
Advertising
Recruiting costs
Human relations costs
Interest on borrowings
Bad debt
Entertainment
Contributions
Automobiles
Property taxes
Office supplies

How Is HOOH Allocated To Projects?



- To remain in business, contractor must take some revenue from each project to “*absorb*” or “*support*” HOOH costs

How Is HOOH Allocated To Projects?



- There are no formal rules of what is/is not HOOH?
 - ❑ **But** once system established must use at all times on all projects
- As a result, compensation sought by contractors for unabsorbed HOOH is “*one of the most contentious factors on a project*”

What Is Eichleay Formula & How Does It Work?

- Attempts to allocate company's total HOOH cost to a project & then calculate a daily cost
 - ❑ *"There is no exact method to determine the amount of home office expenses to be allocated to any ... contract"*
 - ❑ *"It is not necessary to prove a specific amount of home office expenses, but only to determine a fair allocation for the purpose of compensating a contractor for delay by the government"*
- **CONCLUSION**: Eichleay Formula not an accounting formula, it's an estimating formula!

What Is Eichleay Formula & How Does It Work?

- Allocates company's HOOH to specific project & then calculates daily cost

$$\frac{\text{Total Contract Billings}}{\text{Total Company Billings For Project Period}} \times \frac{\text{Total Company Overhead for Project Period}}{\text{Total Company Billings For Project Period}} = \text{HOOH Allocable to Project}$$

$$\frac{\text{HOOH Allocable to Contract}}{\text{Actual Days of Contract Work}} = \text{Daily HOOH Rate}$$

$$\text{Daily HOOH Rate} \times \text{Days of Compensable Delay} = \text{Recoverable HOOH}$$

Genesis of Eichleay Formula

- **Not really “*created*” by ASBCA in 1960!**
 - ❑ Logical result of previous cases concerning recovery of HOOH in event of owner caused delays
- **Issue started with 1933 VA contract**
 - ❑ *Herbert M. Baruch Corp. v. U.S.*
 - ❑ Court of Claims ruled contractor “... *should be permitted to recover ... costs ... flowing from delay*”
 - ❑ “*We have ... apportioned the general office overhead and allotted ... part to this ... contract*”
 - ❑ Awarded \$3,107 for “*general office overhead*” for government caused delays
 - ✓ But did **not** explain how damage amount calculated

Genesis of Eichleay Formula

- Issue continued in 1935 contract
 - ❑ *Fred R. Comb Co. v. U.S.*
 - ❑ “... plaintiff is entitled to recover a proper proportion of main office overhead for the period of delay...”
 - ❑ Again, did not publish a formula for calculating recovery
- Finally, in 1960 ASBCA adopted formula put forth by contractor in *Appeal of Eichleay Corporation*

Practical Problems with Eichleay Formula



➤ Let's explore practical problems with Eichleay Formula from 3 viewpoints

□ Accountants & Auditors

✓ Consider it an accounting formula

□ Owners

✓ HOOH not real cost & Eichleay pays too much

□ Contractors

✓ Too many restrictions on collecting HOOH

➤ Offer some practical remedies to problems

Practical Problems: Accountants & Auditors



- Eichleay assumes proportional relationship between contract billings & fixed indirect costs
 - Questionable assumption
 - Contract billings rarely used as base for distribution of indirect costs
 - ✓ Contract billings = cost of sales + profit
 - ✓ Profit varies by contract
 - Thus, no proportionate relationship between billings & indirect costs
 - Eichleay does not adjust for this

Practical Problems: Accountants & Auditors

- Eichleay assumes indirect cost pool does not contain any variable cost
 - May or may not be correct
 - *“To the extent that a claim includes expenses that vary over time, the Eichleay Formula does not reliably measure the contractor’s actual loss”*
 - HOOH costs & indirect cost pools must be examined closely to remove variable costs
 - Eichleay does not adjust for this

Practical Problems: Accountants & Auditors



- Eichleay assumes contractor performs no substituted work during delay period
 - ❑ Needs to be closely examined
 - ❑ If contractor remobilized to another part of project & kept working, HOOH being paid for
 - ❑ If contractor took on new work, HOOH being offset
 - ❑ Substituted or replacement work mitigates damages
 - ❑ Eichleay does not adjust for this

Practical Problems: Accountants & Auditors



- Eichleay assumes contractor working at full capacity for entire period of contract
 - Examine carefully – may or may not be true
 - If contractor has 3 projects underway, 1 is completed & then this contract is delayed, HOOH compensation goes up
 - But increased compensation not result from this owner caused delay
 - Eichleay does not adjust for this

Practical Problems: Accountants & Auditors



- Eichleay assumes effect of delay always the same, regardless of when delay occurs
 - Examine closely, may not be true
 - If delay occurs in winter period when contractor less productive, has fewer resources in field
 - Delay has less impact than if arose during summer when have more resources working more productively in field
 - Eichleay does not adjust for this

Practical Problems: Accountants & Auditors



- Eichleay assumes actual contract duration acceptable base period for calculating fixed indirect costs
 - Presumption may be accurate under normal, stable business conditions
 - But in times of economic turbulence, indirect costs may vary widely
 - ✓ But Eichleay assumes indirect costs not variable
 - Eichleay does not adjust for this

Practical Problems: Accountants & Auditors

➤ Additional shortcomings of Eichleay Formula

□ Eichleay cannot be adjusted for

✓ Seasonal work fluctuations

✓ Substituted work during delay

✓ Capacity at which contractor working before delay

□ HOOH recovered through change order markup
not accounted for by Eichleay

✓ Unless owner adjusts HOOH amount from Eichleay
to account for this, overcompensation may result

Practical Problems: Accountants & Auditors



- Eichleay does **not** take into consideration that project delay simply defers HOOH recovery from one period to another
 - ✓ There may be **no** true economic loss

Practical Problems: Owners

- Eichleay Formula, strictly applied, may cause overpayment of damages
- Owner may pay for contractor's
 - ❑ Skybox at Angel's Stadium
 - ❑ Condo in Squaw Valley
 - ❑ Golf club membership in Palm Springs
 - ❑ All under the guise of "*employee health, welfare and morale*" expenses

Practical Problems: Owners

- Contractor using Eichleay may be double dipping
 - ❑ Unless portion of change order markup paid for HOOH previously removed from delay damages
- For those owners who want to settle delay as it occurs, Eichleay is an end of project calculation
 - ❑ Cannot be applied mid-project – time & costs employed are all end of project numbers

Practical Problems: Contractors

- Eichleay not accepted in many State courts
 - Only few States have case law accepting Eichleay
 - ✓ Some of these have substantial restrictions on when Eichleay can be applied
 - Some States specifically disallow Eichleay
 - Most states have no appellate level court cases discussing acceptability of Eichleay

Practical Problems: Contractors

- Federal courts restrict when Eichleay can be used & some State courts have followed suit
 - ❑ Must experience compensable delay
 - ❑ Of indefinite (**unknown**) duration
 - ❑ Suspending / stopping most, if not all, work
 - ❑ Resulting in substantial decrease in project revenue
 - ❑ Contractor required to remain on "hot standby"
 - ❑ Contractor unable to perform replacement work

Practical Problems: Contractors

- Eichleay an end of job formula
- Time & costs employed in formula are all end of project numbers
 - Actual duration of work, total project revenue, total company HOOH during project period
 - ✓ Cannot be used to price delay claims contemporaneously – as project progresses
 - ✓ Does not help resolve delay issues as they arise

New Hurdle



➤ *The Redland Company v. U.S.* (2011)

- ❑ Issued contract to repave aircraft parking area
- ❑ NTP issued to Redland on 12/01/00
- ❑ Suspension of Work order for **all work** issued 12/01/00
- ❑ Suspension lifted 10/18/04 – nearly **4 years** later
- ❑ Redland directed to complete all work by 12/18/04 – 61 days
- ❑ Work **not** completed until 01/11/06 – **388 days late**
- ❑ Contracting officer did **not** hold Redlands responsible
 - ✓ Issued time extension until 01/11/06
 - ✓ **Not** assess liquidated damages
 - ✓ **Not** issue any delay damages

New Hurdle



➤ Redlands filed several claims

- ❑ Contracting officer **not** issue a final decision
- ❑ Redlands appealed to U.S. Court of Federal Claims
- ❑ Sought Eichleay damages for period of suspension

➤ Court discussed recovery of Eichleay damages based on previous cases

- ❑ To recover unabsorbed HOOH contractor must prove
 - ✓ Government caused delay or suspension of **unknown duration**
 - ✓ Delay **must** extend original time of performance
 - ✓ Government must “**...require contractor to remain on standby during period of suspension, waiting to begin work immediately or on short notice...**”

New Hurdle



➤ Court ruled

- ❑ Redlands had **not** started performance of work before suspension directive issued
- ❑ Redlands **not** “*on standby*”
 - ✓ Contracting officer **not** direct Redlands to “*remain on standby*” when issued suspension directive

➤ **NOTE:** Decision **ignores** reality of construction

- ❑ Project work “**starts**” before any dirt moved
- ❑ Contracting officers unlikely to ever write “*remain on standby*” in future suspensions
 - ✓ To detriment of contractors & to protect government
- ❑ For 4 years Redland’s bonding capacity impaired
 - ✓ But **not** entitled to any recovery

Some Potential Remedies



- Discussed problems with Eichleay Formula from 3 viewpoints
- Let's examine some potential remedies
- But must be included in contract documents
- And only after seeking competent legal advice

Prohibit Recovery of HOOH

➤ No Damage for Delay Clause

- Include clause in contract – Seek legal advice
 - ✓ Some States enforce
 - ✓ 15 States prohibit such clauses
- Many States recognize 6 exceptions to clause
 - ✓ Delay not covered by clause
 - ✓ Delay not contemplated by parties
 - ✓ Delay of unreasonable duration
 - ✓ Delay resulting from active interference or wrongful conduct of owner
 - ✓ Waiver of clause by actions of parties
 - ✓ Owner breach of contract

Prohibit Recovery of HOOH

➤ Include HOOH cost in Consequential Damages Clause

- AIA A201-1997 ¶8.3.3 does not preclude delay damages
- But AIA A201-1997 ¶4.3.10 waives consequential damages arising or related to contract including
 - ✓ *“Damages incurred by contractor for principal office expenses including compensation of personnel assigned there...”*

Prohibit Recovery of HOOH

➤ Grace Period or “Dead Band” Clause

- ❑ Establish period, by contract, after project completion during which contractor precluded from filing delay claims & owner precluded from assessing LDs
- ❑ If owner delays exceed period, contractor may file delay claims
- ❑ Owner – gambles their delays will not exceed time stated
- ❑ Contractor – may include some potential delay contingency costs in bid

Change Rules on HOOH Recovery

➤ Audit/Access to Records Clause

- ❑ Insert clause in every contract
- ❑ Enables owner to look at certain issues
- ❑ If **not** have one, use FAR 52.214-26 or 52.215-2

➤ Adopt Mortensen Rule by Contract

- ❑ Contractor has option at outset of contract
- ❑ Choose between
 - ✓ Percentage markup on each change, **or**
 - ✓ Per Diem rate on changes causing time extension
 - ✓ Choice applies to **all** change orders

Change Rules on HOOH Recovery

➤ Adopt Absorption Rate Formula in Contract

☐ *Alleghany Formula*

Incurred OH Rate During Actual Period - Actual OH Rate for Projected Performance Period = Excess Overhead Rate

Excess OH Rate x Base Contract Cost = Unabsorbed HOOH During Delay Period

Change Rules on HOOH Recovery

□ *Carteret Formula*

Incurred OH Rate - Normal OH Rate = Excess OH Rate
During Delay Period

Excess OH Rate x Total Base Costs = Unabsorbed HOOH
During Delay Period

Change Rules on HOOH Recovery

➤ Fixed Markup Rates in Contract

□ Establish fixed markup rates in contract which specifically includes HOOH

□ GSA, VA & USPS all do this

➤ Extended vs. Unabsorbed HOOH Rates

□ Preclude recovery of unabsorbed HOOH with contract language similar to AIA A201-1997

□ But allow recovery of extended HOOH costs based on actual value of additional administrative services incurred due to delay

Change Rules on HOOH Recovery

➤ Establish Alternative Formulas for Pricing HOOH

❑ *Anderson's Modified Eichleay Formula*

$$\frac{\text{Delayed Contract's Value for Normal Period}}{\text{Total Value of All Contracts for Normal Period}} \times \text{Total Fixed Home Office Expenditures for Delay Period} = \text{Allocable HOOH}$$

Change Rules on HOOH Recovery

➤ *Canadian Method*

$$\frac{\% \text{ Markup from Bid} \times \text{Original Contract Cost}}{\text{Original Days in Contract}} = \text{Daily HOOH Rate}$$

➤ *Florida Method*

$$\text{Average Overhead/Day} = \frac{\text{Original Contract Amount} \times 8\%}{\text{Original Contract Time}}$$

Change Rules on HOOH Recovery

➤ *Ohio Method*

$$\text{HOOH \%} = \frac{\text{Days of Delay} \times (\text{Original Contract Value} \times 5.5\%)}{\text{Original Contract Duration}}$$

➤ **May be other formulas**

- ❑ **Concept** is to create formula that is *“reasonable”*
- ❑ **Include very clearly in contract**
- ❑ **Specifically state formula covers all HOOH costs**

Incorporate Federal Rules in Contract

➤ Write Federal rules on unabsorbed HOOH recovery into contract

- Delay must be owner caused
- Of indefinite (unknown) duration
- Suspending most (include %) of project work
- Resulting in substantial decrease in monthly project revenue
- Contractor required in writing to “*remain on standby*” to return to work immediately
- And unable to work around or secure new work

Incorporate Federal Rules in Contract

- Incorporate FAR Unallowable Cost provisions by contract language
 - ❑ Disallows some specific HOOH costs
 - ❑ Require contractor to produce audit document to demonstrate removal of such costs
 - ❑ Use Audit/Access to Records Clause to check on compliance

Create Mid-Contract HOOH Recovery Rule in Contract

➤ Limited Reservation of Rights Clause

- ❑ For owners who want to settle delay claims as they occur
- ❑ Include clause providing for payment of direct delay costs (i.e., extended equipment & storage, extended FOOH, etc.)
- ❑ Include reservation of rights language preserving contractor's right to recover HOOH at end of project
- ❑ Resolves most of delay cost issue

Create Mid-Contract HOOH Recovery Rule in Contract

➤ Create & include mid-contract clause

- Adopt one of previous formulas to use to craft mid-course delay claims settlements
- Reserve owner's rights to apply Eichleay at end of project & recover overcompensation paid, if any

Bid Daily Delay Cost

➤ Time Related Overhead (TRO) Approach

□ Caltrans approach

□ Include TRO cost in bid as line item

✓ Contractor includes daily TRO cost in bid & multiplies by number of days in Time of Performance Clause

✓ TRO stipulated to include both FOOH & HOOH

✓ Contractor paid daily TRO monthly during project on daily cost basis

✓ If delay arises, TRO cost is used to pay for delay

✓ Uses Escrow Bid Documents so build up of TRO preserved in event of dispute

Bid Daily Delay Cost

➤ Bid Delay Cost

- Include line item in bid for 60 days of owner caused delay
 - ✓ Bid documents stipulate this is total delay cost (FOOH, HOOH, etc.)
 - ✓ Contractor fills in daily cost & multiples by 60
 - ✓ Delay cost included in total bid cost
 - ✓ Must still be low bidder to receive contract award
 - ✓ Delay cost treated as an allowance, daily cost not subject to Quantity Variation Clause
 - ✓ At end of job, if delay less than 60 days, owner takes remaining cost back at daily rate
 - ✓ If more than 60 days, owner pays at bid rate at daily rate

Conclusion

- Eichleay Formula more than a half century old
- Nearly as controversial today as at creation
- If owners comfortable with Eichleay, **not** a problem
- If **not** comfortable, think through issues
 - Consult legal counsel
 - Consider one or more of potential remedies
- Choose & craft solution into contract prior to bidding!

Questions or Discussion?

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