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CALIFORNIA COURT OF APPEAL AUTHORIZES RECOVERY OF *EICHLEAY* UNABSORBED HOME OVERHEAD AS DELAY DAMAGES

On December 30, 2015, the Court of Appeal issued its decision in *JMR Construction Corp. v. Environmental Assessment & Remediation Management, Inc.*, 2015 Cal. App. LEXIS 1172 (Cal. Ct. App. 2015), affirming the right of a contractor to recover unabsorbed home office overhead calculated pursuant to the *Eichleay* formula. The opinion in *JMR Construction* decided a question that had remained unanswered in California for over five decades.

In entering into a contract for construction, a contractor necessarily includes a portion of home office overhead expenses, which it calculates based on the contract's duration, in its estimate of costs to perform the contract. When a defendant delays or disrupts contract performance, ultimately requiring that it be extended, the contractor's stream of income for the direct costs it has incurred under the contract is reduced or interrupted. However, home office overhead continues to accrue throughout both the original and extended performance periods, regardless of direct contract activity. Thus, when a project is delayed, the contractor often contends that it has suffered a loss because it has not received the same amount of revenues it had anticipated receiving during the original time frame within which the project was to be performed.

In 1960, the Armed Services Board of Contract Appeal issued a decision that recognized the right of the contractor to recover for such losses, which often are referred to as unabsorbed home office overhead. That decision, *Eichleay Corp.* (A.S.B.C.A. 1960) 60-2 BCA (CCH) 2688, included a formula for calculating unabsorbed overhead damages for delay. The *Eichleay* formula has become the standard typically used in disputes arising out of federal public works projects and has also been adopted

in many other jurisdictions.

The *Eichleay* formula consists of three steps. First, the contractor must find the amount of overhead allocable to the contract by multiplying the total overhead cost incurred during the contract period times the ratio of billings from the delayed contract to total billings of the firm during the contract period. Second, the contractor must calculate the daily contract overhead rate, by dividing the allocable contract overhead by days of contract performance. Third, to calculate *Eichleay* damages, the daily contract overhead is multiplied by the number of days of delay.

Allocable overhead: (% of overall billings that contract represents) X (total overhead during the period)

Daily overhead rate: allocable overhead ÷ number of days of contract performance

Eichleay damages: (no. of days of delay) X (daily overhead rate)

For example, if a project represents 30% of a company's billings, and the overhead during the relevant period was \$5 million, the allocable overhead would be \$1.5 million. If the project period was 300 days, then the daily overhead rate would be \$5,000 per day. Thus, if the defendant was responsible for 10 days of delay, *Eichleay* damages would be \$50,000.

The decision in *JMR Construction* did not arise in the usual context of a claim by a contractor against the project owner. Instead, the Court of Appeal decided a case brought by a general contractor against a subcontractor and the subcontractor's bonding company. JMR Construction was the general contractor on a federal construction project to construct a new dental clinic at the Presidio in Monterey, California. JMR Construction subcontracted the plumbing and electrical work for the project to Environmental Assessment and Remediation Management, Inc. (EAR). Suretec issued bonds guaranteeing EAR's performance of the electrical and plumbing subcontracts.

After a court trial, the judge found that EAR had breached the subcontracts, delaying the project, and that Suretec had breached its obligations under the performance bonds. JMR Construction sought to recover delay damages, including *Eichleay* overhead. Among other arguments, JMR Construction asserted that because EAR had delayed the project, creating concurrent delays, JMR was not able to recover *Eichleay* damages from the project owner.

The Court of Appeal noted that the only prior reported decision in California to apply the *Eichleay* formula was a case in which both parties had agreed that the formula should apply. (There previously had been a number of unreported California decisions, which cannot be cited as precedent, in which *Eichleay* had been applied.) The Court nevertheless upheld the trial court's use of the formula:

We conclude the trial court did not err in applying the *Eichleay* formula as a legally permissible method of determining JMR's home office overhead damages. We base this conclusion upon the expert evidence presented at trial, the general recoverability of extended home office overhead as an element of delay damages, and the federal courts' general acceptance of the *Eichleay* formula. In other words, the calculation of extended home office overhead damages using the *Eichleay* formula was an appropriate method to

compensate JMR “for all the detriment proximately caused” by EAR's breach of contract. (Civ. Code, § 3300.) That recovery facilitates the goal of placing the plaintiff ‘in as good a position as he or she would have occupied’ if the defendant had not breached the contract. Indeed, it would be anomalous to allow recovery to JMR for Eichleay extended home office overhead damages in a claim against the government-owner—had there been no concurrent delay and where, as here, JMR had established the fact of such damages and causation—while denying such recovery from EAR where EAR was concurrently responsible for the delay.

Answering another open question, the Court of Appeal adopted requirements under federal case law that limit when *Eichleay* damages can be recovered. These requirements are that the “contractor must establish: (1) a government-caused delay; (2) that the contractor was on ‘standby’; and (3) that the contractor was unable to take on other work.” In the case before the court, JMR Construction was able to prove that it was on standby because the delays at the project caused it to lose its bonding capacity, so that it was not able to take on any new work.

Approval of Modified Total Cost Approach

In a different part of its decision, the Court of Appeal ruled that the “modified total cost” method was an appropriate way to calculate onsite damages for delay under the particular circumstances in the case. Decisions prior to *JMR Construction* had also upheld the use of the modified total cost approach. See, e.g., *Dillingham-Ray Wilson v. City of Los Angeles*, 182 Cal. App. 4th 1396 (2010); *State of California ex rel. Dept. of Transportation. v. Guy F. Atkinson Co.* 187 Cal. App. 3d 25 (1986); *C. Norman Peterson Co. v. Container Corp. of America*, 172 Cal. App. 3d 628 (1985).

Summary

California is now one of the many jurisdictions that allow use of the *Eichleay* formula to calculate unabsorbed home office overhead damages for delay. The Court of Appeal’s requirement that the contractor prove it was on standby and was unable to take on other work, however, may prevent claimants from recovering *Eichleay* damages in certain instances. In addition, some contracts contain provisions that seek to waive or limit the recovery of unabsorbed home office overhead. Provisions of this type may be enforceable depending on how they are written and the circumstances involved.

For further information, please contact Janette Leonidou, Bob Rosin, or Patricia Walsh at (650) 691-2888.

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