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Reassessing *Eichleay*

Extended home office overhead costs are frequent in construction contracting. They result from extending the performance period of a contract, which, in turn, increases a contractor's performance costs. When a contract is delayed, suspended or extended by actions not attributable to any fault of the contractor, the contractor

the contractor is entitled to delay damages. While home office overhead costs are a well-recognized item of delay damages, the recovery of these costs – and their manner of calculation – is often disputed. This article examines recent case law in which the courts have revisited the *Eichleay* formula, a method for measuring home office overhead damages. While *Eichleay* and its progeny originated with federal government contracts, the concepts that have evolved have been borrowed and utilized in both state government and private construction contracts. Now, despite the musings of many that *Eichleay's* days have passed, the *Eichleay* formula appears to be the most widely applied methodology for calculating lost overhead. For example, the Virginia Supreme Court recently recognized for the first time the *Eichleay* formula as the proper measure of unabsorbed home office overhead incurred as a result of a project owner's delay in obtaining necessary easements.

The concept of unabsorbed overhead as an item of damages arises at least in part from the basic accounting concept that all business costs are incurred to support ultimate, specific revenue-generating objectives and therefore should be allocated to these objectives. Overhead costs

do not directly benefit any specific objective and are therefore referred to as "indirect" costs. For accounting purposes, such indirect costs are allocated to each cost objective by way of formulas. Through such an allocation, each revenue-generating objective pays for, or "absorbs," its share of the indirect overhead costs. In construction, the revenue-generating objective is the contract, and indirect costs are usually allocated as a percentage of either costs or contract rev-

...the most widely applied methodology for calculating lost overhead.

enue. If the performance of the contract is prevented or delayed and the contractor cannot replace the delayed work, some of the overhead costs incurred by the company are not "absorbed" as expected – and the contractor is damaged.

Eichleay: Reconsidered, Rejected, Reaffirmed

The fact that a contractor suffers damages by way of unabsorbed overhead as a result of delay to performance of a construction contract has been recognized by federal courts for more than 50 years. Although the *Eichleay* case merely estab-

The Formula and Its Origin

The *Eichleay* formula is named after a 1960 federal Board of Contract Appeals case, *Appeal of Eichleay Corp.* (1961), which utilized a formula to estimate a daily

rate for unabsorbed home office overhead damages that a contractor incurred as a result of project delays. The *Eichleay* formula is as follows:

- 1 $\text{Contract Billings} \div \text{Total Billings for Contract Time} \times \text{Total Overhead for Contract Time} = \text{Overhead Allocable to the Contract};$
- 2 $\text{Allocable Overhead} \div \text{Total Days of Contract Performance} = \text{Daily Contract Overhead Rate};$ and
- 3 $\text{Daily Contract Overhead Rate} \times \text{Number of Days of Delay} = \text{Amount of Unabsorbed Overhead}.$

lished one particular formula for calculating unabsorbed overhead, it soon became the one used most often in the case law. However, in 1983, the General Services Administration (“GSA”) Board of Contract Appeals in the case *Appeal of Capital Electric Company*, rejected the underlying assumptions supporting the *Eichleay* formula and the formula itself. In *Capital Electric*, the board ruled that a contractor did *not* suffer overhead damages as a result of government delays that extended the duration of contract perfor-

reversed the GSA Board’s decision and reaffirmed the concept of under-absorbed overhead as a recoverable item of damages for a delayed construction contract, based upon a long line of federal court of claims’ cases awarding such damages. The *Capital Electric* court did not significantly discuss the theoretical analysis that the GSA Board had engaged in with respect to the distinction between unabsorbed home office overhead for work suspensions and extended home office overhead for project delays, but estab-

lished one particular formula for calculating unabsorbed overhead that led to a higher result. This debate essentially ended when the Federal Circuit Court held in *Wickham Contracting Co. v. Fischer* (1994) “that the *Eichleay* formula is the exclusive means for compensating a contractor for unabsorbed overhead when it otherwise meets the *Eichleay* prerequisites.” Therefore, under current precedent binding on both the Board of Contract Appeals and the Court of Federal Claims, the *Eichleay* formula is the only appropriate method for calculating unabsorbed overhead in a construction contract setting.

The contractor must have been placed on standby...and unable to take on other work to

mance (“extended home office overhead”), and, therefore, such damages were not the proper subject of a damage award. The board further held that even if such damages existed, the *Eichleay* formula was not an appropriate method for calculating extended home office overhead because that formula calculated what the board described as underabsorbed overhead. The board held that such underabsorbed overhead was properly calculated using a percentage markup on direct costs.

Somewhat earlier, in *Appeal of Savoy Construction Company, Inc.* (1983), the Armed Services Board of Contract Appeals had also rejected the concept of using the *Eichleay* formula to calculate extended home office overhead. The United States Court of Appeals for the Federal Circuit, however, in *Capital Electric Company v. U.S.*,

lished that the *Eichleay* formula was an appropriate method for calculating such damages, thereby reversing the GSA Board decision and overruling the *Savoy* case.

While the Federal Circuit’s decision in *Capital Electric* reestablished the *Eichleay* formula as an acceptable method for calculating unabsorbed overhead, disputes continued as to whether the *Eichleay* formula was the only correct method and whether other formulas led to a more accurate calculation of unabsorbed overhead. This debate allowed government auditors to create and promote numerous alternate formulas, which invariably resulted in much lower estimates of unabsorbed overhead than the *Eichleay* formula did. This uncertainty occasionally also allowed a particularly inventive contractor to find a means of calculating unab-

Applying *Eichleay*

Recent Federal Circuit cases have established the conditions that must exist for application of the *Eichleay* formula to estimate unabsorbed overhead resulting from government-caused delay (the “*Eichleay* prerequisites”) as follows:

- The contractor must have been placed on standby as a result of government-caused delay; and
- The contractor must have been unable to take on other work to replace the work that had been delayed.

Each of these two *Eichleay* prerequisites has been the subject of significant recent Federal Circuit cases.

In *Interstate General Government Contractors v. West* (1993), the Federal Circuit clarified that the “standby” requirement did not necessitate that the contractor have idle workers and equipment standing around waiting for work

to be performed. Rather, the court held that “the delay or suspension of contract performance for an uncertain duration, during which a contractor is required to remain ready to perform,” satisfies the standby requirement. In an earlier case, *C.B.C. Enterprises Inc. v. United States* (1992), the Federal Circuit had denied recovery of extended home office overhead damages when change orders added work to a project and extended the duration of the project for a specific period of time for performance of the extra work. As one basis for the denial of recovery, the court found that there was no uncertainty as to the duration of the suspension, disruption or delay created by the change order. *Interstate* and *C.B.C. Enterprises* demonstrate that the key to the first of the *Eichleay* prerequisites is establishing a delay of uncertain duration.

Once the contractor establishes that it has been subjected to a government, caused delay of uncertain duration, the Federal Circuit has held that the uncertainty, in and of itself, raises a rebuttable presumption that the contractor could not take on replacement work and has shifted to the government the burden of producing evidence that the contractor

- Any limitation on the contractor’s bonding capacity was due, at least in part, to its own failure to properly submit invoicing; and
- Competition for other contracts was stiff.

On these facts, the *Satellite Electric* court found that it was not as a result of the government’s delay, but rather factors beyond the government’s control that had prevented the contractor from taking on other work. While, at first blush, the *Satellite Electric* case might suggest that *Eichleay* damages are not available during a period of time when a contractor is bidding other work, that conclusion is directly contrary to the earlier holding in *Altmeyer v. Johnson* (1996),

that merely establishing the fact that the contractor was bidding on other work did not satisfy the government’s burden of producing evidence that the contractor could have taken on additional work to replace the delayed work.

The most recent Federal Circuit decision on the *Eichleay* formula reexamined and reaffirmed each of the two prerequisites for application of the *Eichleay* formula and, as to the second *Eichleay* prerequisite, clarified that the contractor did not have to prove that it was impossible to take on new work, but only that it was impractical to do so and that once the first *Eichleay* prerequisite had been proven, it is the government’s burden to

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replace the work that had been delayed.

did or could have taken on substitute work. *Mech-Con Corp. v. West* (1995). In *Satellite Electric Co. v. Dalton* (1997), the Federal Circuit clarified that while *Mech-Con* had shifted the burden of production of evidence to the government, the contractor still bore still the ultimate burden of proving that it was unable to take on replacement work. In *Satellite Electric Co.*, the Federal Circuit found that the government had successfully rebutted any presumption that the contractor could not take on replacement work because of the uncertain duration of the delay and that the contractor had not met its burden because:

- The contractor had bid on 49 contracts during the “standby” period;
- The project was almost 97 percent complete at the time of the delay;

Reinvigorating *Eichleay*

1999 Federal circuit decision reinvigorates use of *Eichleay* as measure of indirect delay damages.

E.R. Mitchell Construction Co. v. Danzig

In a case decided in May 1999, the United States Court of Appeals for the Federal Circuit held that a contractor may recover delay damages from the government for the delayed performance of a subcontractor, even when the overall project has not been delayed by the government’s actions. In *E.R. Mitchell Construction Co. v. Danzig*, the performance of the contractor’s HVAC subcontractor was disrupted and delayed by defective government-issued drawings. As a result, the HVAC subcontractor’s performance started and finished 60 days later than the dates established in the contractor-prepared and government-approved CPM schedule. The government’s contracting officer agreed to pay the direct costs caused by the defective drawings but refused to pay the subcontractor’s claimed delay costs because overall contract completion had not been delayed. The Armed Services Board of Contract Appeals agreed with the contracting officer and held that the government could not be liable for delay damages suffered by a

subcontractor where the overall project had not been delayed by the government’s actions. The Federal Circuit reversed, holding that the contractor was entitled to recover for the subcontractor’s delay damages where the government knew of and approved the contractor’s project schedule, which contained a shorter duration for performance of the HVAC work than the overall project duration. Since there was no dispute that the subcontractor had been required to “standby” for 60 days while the government resolved the design errors, the Federal Circuit held that the contractor was entitled to recover the subcontractor’s damages calculated pursuant to the *Eichleay* formula. The Federal Circuit reaffirmed that the *Eichleay* formula is the proper means for calculating recovery of unabsorbed home office overhead. The Federal Circuit left for another day the question whether the government would be liable for the subcontractor’s damages where it did not have knowledge of the subcontractor’s schedule and performance obligations. ⚙



Florida Supreme Court Upsets Economic Loss Doctrine

Florida Joins List of States That Recognize Claims for Negligence Against Design Professionals

The Florida Supreme Court, in an opinion issued this past July in *Moransais v. Heathman, et al.*, abandoned its long-standing notion that the economic loss doctrine limited most third-party claims for negligence against design professionals, and ruled that an employee of an engineering firm could be sued directly by the purchaser

residence for professional malpractice. The opinion makes clear that Florida courts will recognize contractor claims for negligence against an owner's design professionals.

In *Moransais*, the purchaser contracted with an engineering firm for a detailed home inspection to advise him of the condition of the home. The contract was signed on behalf of the corporation by its chief of civil engineering. Another engineer performed the inspection, which reflected some limited concerns about the foundation, but no significant concerns about the air-conditioning and electrical systems and roof. After going through with the purchase, the purchas-

er discovered defects that rendered the home uninhabitable. He then complained that he had relied on the advice of the individual inspector in going through with the purchase.

The disgruntled homeowner sued the engineering firm for breach of contract and alleged a claim for professional negligence against the chief of the civil engineering division, as well as against the individual inspector. The trial and appellate courts in Florida dismissed the claims against the two individuals, relying on numerous past rulings from the Florida Supreme Court, which have barred claims for negligence against design professionals unless there is

physical injury or property damage. The rationale has been that claims – such as the homeowner's in this case – that do not involve bodily injury or property damage, fall within the definition of “economic loss,” and that the “economic loss rule” bars any claims for these type of damages except for those claims based on breach of contract or warranty. Since the homeowner had a contract with the corporation, not the two individual engineers, the homeowner was prohibited from bringing suit against them.

Economic Loss Rule Not a Bar

The Florida Supreme Court, in a stunning overruling of a number of its fairly recent decisions on this same issue, observed that the application of the economic loss rule would leave the homeowner without a remedy, at least against the individual engineers. Significantly, the homeowner/engineering firm contract contained a clause limiting the company's liability to \$50,000. Presumably, any damages the homeowner incurred in excess of that amount would not be compensable, unless the homeowner were allowed to directly sue the individual engineers based upon a theory of professional negligence, the negligence claims not being subject to the contractual limitation of liability. In developing the rationale for its ruling, the court pointed out

that the common law of negligence imposes on a professional a duty to perform requested services in accordance with the standards of care used by similar professionals in the community under similar circumstances. The court acknowledged that Florida has long recognized claims for professional malpractice. These claims, the court reasoned, should not be limited simply because the professionals, such as the engineers in this case, performed their professional services under the shield of a corporate entity. The court stated that individual professionals are still liable for their negligent acts, notwithstanding the fact that they have no contract with the damaged party.

Court Admits "Fuzzy" Earlier Rulings

With respect to the supposed bar of the "economic loss rule," the court allowed that its earlier pronouncements on this issue had been less than clear and justifiably were subject to criticism, especially in the context of third-party claims against design professionals. As a result, the rule, which originated in product liability cases to limit claims against manufacturers of products where there was no physical injury or property damage, had been inappropriately extended to claims by owners and contractors against architects and engineers. In reconsidering this situation, the court agreed that claims against design professionals by those who rely upon and utilize their professional services would essentially be extinguished if limited to those situations where there is physical injury or property damage because most design claims involve only economic losses. The court ruled that it never intended to bar the well-established common law claim for negligence against those providing professional services.

Most importantly, the court did not in any way limit its ruling to the facts in this case, but specifically and emphatically ruled that Florida law recognizes a common law cause of action against professionals based on their negligent acts, despite the lack of a direct contract between the professional and the aggrieved party. ❁

Moransais Validates 1973 Florida Decision

Interestingly enough, Florida recognized third-party claims against design professionals for negligence as early as 1973 in the Florida Supreme Court case of *A.R. Moyer v. Graham*. In *Moyer*, the court affirmed the principle that a third-party general contractor who may be injured by the negligent performance of a contractual duty of an architect has a claim against the architect, despite the fact that the architect and the contractor have no contract between them. At that time, the court noted that the architect and his firm had supervisory authority over the contractor and ruled that the power of the architect to stop the work alone is tantamount to a power of economic life or death over the contractor. Therefore, the court ruled that such authority carried with it commensurate legal responsibility.

Ever since the *Moyer* decision was rendered, parties lacking a contractual relationship with a particular defendant have attempted to rely upon that decision to argue that the court should allow negligence claims for economic losses in order to avoid an inequitable result. However, the Florida courts had been reluctant to extend the doctrine based on the argument that there exists no alter-

Moyer decision, with each new pronouncement the court limited *Moyer's* applicability further and further until it applied only in those situations where the design professional had direct supervisory power over the contractor and the power to stop the work. The court observed recently that the architect's supervision and power to stop the work were "pivotal" to *Moyer's* ruling. However, with the latest decision in *Moransais*, the limitations previously imposed on *Moyer* apparently no longer exist.

The *Moransais* case puts Florida back solidly among those jurisdictions that recognize third-party claims for negligence against design professionals. New Jersey has been a member of that group since 1980, when in the case of *Conforti & Eisele, Inc. v. John C. Morris Associates*, this firm established the right for contractors to directly sue an owner's design professionals. The *Conforti & Eisele* opinion has been extensively followed not only in New Jersey but throughout the country, and has never been seriously questioned. New York courts still do not fully embrace such claims, although there have been a number of notable exceptions in situations where the design professionals are aware of the use and purpose of their design

Moransais puts Florida back solidly among those jurisdictions recognizing third-party claims.

native theory of recovery for pure economic losses. In conjunction with the growing trend in the product liability field to limit claims for purely economic losses against manufacturers of goods by parties not under contract with the manufacturers, the Florida courts had limited or denied claims for professional negligence against architects and engineers by condominium associations, owners, contractors, subcontractors and other construction project participants. Although, the Florida Supreme Court stubbornly refused to specifically overrule its

plans and the contractor who sues is part of a definable class that would be expected to rely on the design documents. California uses a balancing test to determine whether in a specific case the architect will be held liable, depending upon the extent to which the transaction was intended to affect the injured party, the foreseeability of harm, and the closeness of the connection between the designer's conduct and the injury suffered. Pennsylvania, Virginia and a number of other states still do not recognize any such cause of action. ❁

Contractors and Labor Unions Beware

The recent trend in the courts is to liberally apply antidiscrimination statutes in claims alleging sexual harassment.



tion of a portion of a state highway. In an effort to pressure George Harms Excavating Company, Local 825 picketed the construction site maintained by George Harms Construction Company. The female plaintiffs were construction workers employed by George Harms Construction Company.

On June 22, 1999, the Superior Court of New Jersey, Appellate Division, ruled regarding a claim for damages asserted by three female construction workers against a labor union and two of its members for sex discrimination in violation of the New Jersey Law Against Discrimination (NJLAD). The decision, *Christine Baliko, Claudia Case-Clayton and Kelly Carroll v. International Union of Operating Engineers, Local 825, A.B.C.D. and RH:AFL-CIO* (“*Baliko*”), comes on the

Trial and Appeal

At trial, the plaintiffs testified that individual union members harassed them as they passed the picket line by making “foul, vulgar and obscene gestures,” including at least one instance of a worker “grabbing and pointing to his genitals and then putting his hand to his mouth as if inviting the woman to perform [oral sex].” At least two of the plaintiffs were documenting each instance of

“Union members harassed them as they passed the picket

heels of two 1998 decisions by the United States Supreme Court in *Faragher v. Boca Raton* and *Burlington Indus., Inc. v. Ellerth*. (These are the two decisions that caused much speculation last year by media pundits that Judge Wright’s dismissal of Paula Jones’s sexual harassment case against President Clinton was in danger of being reversed and the claim reinstated. The decisions very likely were instrumental in precipitating the president’s financial settlement with the former Arkansas state employee.)

Background

The plaintiffs in the New Jersey case, all skilled laborers, alleged that they were subjected to a sexually hostile work environment, thereby discriminating against them because of their gender, in violation of the NJLAD. Specifically, the plaintiffs, who were required to pass defendants’ picket line during the course of their work, alleged that individual defendants and other pickets who were members of the defendant Local 825, verbally berated them and made overt sexual gestures and exclamations as they passed.

The following background sets the stage for the ill-fated and inappropriate encounters. Defendant union Local 825, affiliated with the International Union of Operating Engineers, had a contract dispute with George Harms Excavating Company, a subsidiary of George Harms Construction Company, the general contractor for construc-

abusive treatment at the time these acts were occurring.

Despite the horrific conduct, after the presentation of evidence, the jury returned a verdict in favor of the defendants. The defense verdict was inevitable based on the trial judge’s instruction to the panel that even assuming there was a hostile work environment, the plaintiffs needed to show a “causal connection or link” between the conduct and any work-related harm, such as discharge, demotion or undesirable reassignment. On appeal, however, the appellate court reversed the verdict and ruled that the trial judge erred in his instructions by requiring the jury to find a causal link between the conduct and tangible employment action in order to find liability.

In its decision, the appellate court clarified the standard of proof in sex-based discrimination cases. Specifically, in order to make out a case of sex-based discrimination, the plaintiff must prove that (1) the conduct complained of would not have occurred “but for” the employee’s gender; and it was (2) severe or pervasive enough to make a (3) reasonable woman believe that (4) the conditions of employment are altered and the working environment is hostile and abusive. While such conduct need not be sexual in nature, it must nevertheless be based upon a person’s gender. The

court used at its authority the 1993 New Jersey Supreme Court case of *Lehmann v. Toys "R" Us, Inc.*

Under *Lehmann*, the court held that in the case of a hostile work environment, the harassing conduct need not be sexual in nature, but only that the harassment occurred because of a person's gender. Assuming that criteria has been satisfied, the "but-for," or cause or link element of proof, is automatically satisfied. Thus, when a plaintiff alleges that he or she has been subject to sexual touching or comments, or that he or she has been subjected to harassing comments about lesser abilities, capabilities, or the "proper role" of his or her sex, the plaintiff has established that the harassment occurred because of gender.

New Jersey Applies Less Restrictive Standards than Federal Court

In this respect, the New Jersey law differs from federal law because under federal law, the "but-for" element is a separate requisite element of proof in the claim for a hostile work environment. Furthermore, in New Jersey, a single utterance of a racial epithet has been held to be sufficiently severe to produce a hostile environment. New Jersey also differs from federal law because the action complained of need not be both severe *and* pervasive, but only severe *or* pervasive. Clearly, New Jersey law applies a more liberal and less restrictive standard of proof in sex-based discrimination cases.

In *Baliko*, the court ruled that in determining whether comments or gestures are severe *or* pervasive, the trial judge must instruct the jury to consider: (1) the total physical environment of the plaintiff's work area; (2) the degree and type of obscenity that filled the environment of the workplace, both before and

the outset because the plaintiffs failed to establish any "adverse employment action." However, that is not the proper test in New Jersey. The court held that evidence of specific, tangible adverse changes in the work environment would *not* be required under the NJLAD in either racial or sexual harassment claims, based on the rationale that the loss of tangible job benefits is not necessary since the harassment itself affects the terms or conditions of employment. A plaintiff in a sexual harassment action need only prove that the conduct complained of would make a reasonable woman believe that the conditions of employment had been altered to the extent that the workplace environment had become hostile or abusive. Support for this proposition is found in the recent U.S. Supreme Court cases previously mentioned, *Faragher v. Boca Raton* and *Burlington Indus., Inc. v. Ellerth*, where the Court concluded that a claimant need not prove that harassment culminated in a tangible employment action, such as discharge, demotion or undesirable reassignment. It would appear that both state and federal courts are gradually moving away from the stricter standard of adverse employment action most typically found in Title VII cases.

A Hostile Work Environment Is Actionable

The purpose of the NJLAD is to end discrimination. Because discrimination itself is the harm that the NJLAD seeks to eradicate, additional harms (such as firing, demotion, etc.) need not be shown in order to state a claim under the NJLAD. In a hostile work environment/sexual harassment case, the hostile work environment is the legally recognized harm. Therefore, a plaintiff in such a case establishes the requisite harm if he or she

line by making 'foul, vulgar and obscene gestures.'"

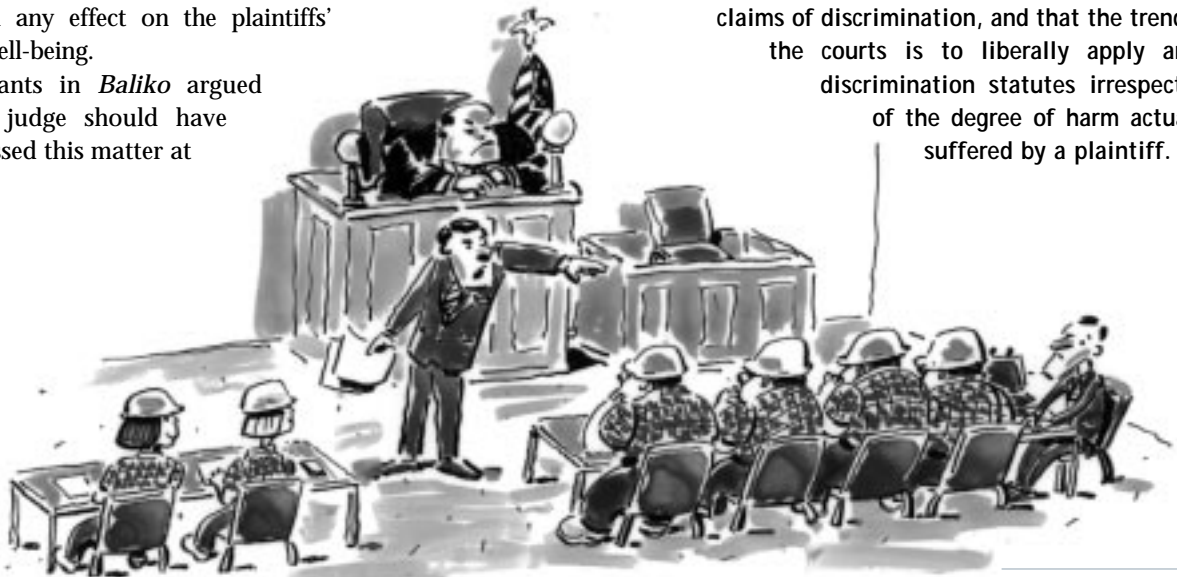
after the plaintiffs' were assigned to their specific workplace; (3) the nature of the unwelcome sexual words or sexual gestures; (4) the frequency of the offensive encounters; (5) the severity of the offensive encounter; (6) whether the unwelcome comments or gestures were physically threatening; (7) whether the offensive encounters unreasonably interfered with any plaintiff's work performance; and (8) whether the offensive encounters had any effect on the plaintiffs' physiological well-being.

The defendants in *Baliko* argued that the trial judge should have properly dismissed this matter at

shows that his or her working conditions were affected by the harassment to the point at which a reasonable person would consider the working environment hostile. ☼

EDITOR'S NOTE

Employers must recognize that, under certain circumstances, an isolated comment or gesture may give rise to claims of discrimination, and that the trend in the courts is to liberally apply anti-discrimination statutes irrespective of the degree of harm actually suffered by a plaintiff.



No-Damage-for-Delay Clause Enforceable But ...

Clifford R. Gray, Inc. v. City School District of Albany

In April 1994, an electrical prime contractor, Clifford R. Gray, Inc. ("Gray"), entered into a contract with the City School District of Albany, New York ("School District") to perform electrical construction work on a local school. Gray was one of four multi-prime contractors and was considered a follow-on trade. The electrical work was

comprised of two phases: Phase II involved construction of a new addition to the existing elementary school, and Phase III involved renovation of the existing school building. Gray was not involved in Phase I. According to the anticipated schedule in the contract documents, Phase II was a 10-month project, scheduled to begin on April 13, 1994 and to be completed on February 17, 1995. Phase III was a six month project, scheduled to begin in the middle of February 1995 and to be completed on August 31, 1995. Gray's contract with the School District contained a liquidated damage provision, a no-damage-for-delay clause and a strict 72-hour notice-of-delay provision.

York Hunter of New York, Inc. ("York Hunter"), was the School District's construction manager for the project. According to Gray's contract with the School District, York Hunter was responsible for scheduling and coordinating the work of all contractors on the project, including their use of the site and the facilitation of information about the project schedule. The prime contractors were required to submit preliminary schedules to York Hunter, which, in turn, was to prepare a coordinated construction schedule to ensure that construction activities followed in sequence.

Gray submitted its preliminary schedule of work on May 17, 1994, and expected to receive the coordinated schedule from York Hunter one month after the contract was awarded.

However, Gray did not receive a fully coordinated Phase II schedule until October 12, 1994, only four months before the entire 10-month phase was to be completed. Not only was York Hunter late in producing the initial coordinated Phase II schedule, York Hunter thereafter failed to provide any further updates to the October schedule. As a result of its failure to coordinate the contractors, the School District terminated York Hunter as construction manager on December 2, 1994.

Einhorn, Yaffee & Prescott, P.C. ("EYP"), the project architect, took over as construction manager. However, coordination and scheduling problems continued.

Specifically, in December 1994, EYP issued a coordinated construction schedule for both Phases II and III. Although the project was drastically behind schedule, the Phase III schedule indicated substantial completion to occur early in September 1995, the same time as provided for in the original contract. On May 30, 1995, Gray received a schedule from EYP that further reduced the Phase III work from six months to 10 weeks! It was not until October 1995 that Gray received a coordinated schedule for Phase III.

In response to the myriad of scheduling, performance, sequence and concurrent work issues, Gray gave the School District notice of its intent to file a claim for money damages resulting from the delay in completion of Phase II. Gray also told the School District that it needed seven months to complete

the project and outlined in general terms the delays that had affected its progress and were the basis for its claim. Phase III was ultimately completed by Gray in July 1996, 335 days after the original anticipated completion date. The School District did not assess Gray any liquidated damages for delay.

Gray initiated an action for breach of contract, alleging that the School District hindered and impeded its performance. In defense of the claim, the School District argued that the delays, hindrances and

Gray's Damage Recovery

Increased Project Duration (September 1, 1995 - July 31, 1996) Extended Site Overhead	\$76,380
Labor Rate Increase	\$8,211
Disruptions/Loss of Efficiency/Loss of Labor Productivity 13.416% (2,604 lost craft man-hours/19,409 total actual man-hours) x 19,409 mhs x 27.72 per mh	\$72,180
SUBTOTAL	\$156,771
Small Tools/Consumables 2% x 156,771	\$3,135
Profit 10% x \$156,771	\$15,677
TOTAL DAMAGES	\$175,583

obstructions encountered by Gray were within the scope of the no-damage-for-delay clause, and Gray was barred from recovering any damages. The court found that the no-damage-for-delay clause was valid and enforceable, but that such a provision, which purports to preclude all damages from all delays resulting from any cause, is not to be read literally. The court enumerated four exceptions to the no-damage-for-delay rule. Damages may be recovered for (1) delays caused by the contractee's bad faith or its willful, malicious or grossly negligent conduct, (2) unanticipated delays, (3) delays so unreasonable that they constitute an intentional abandonment of the contract by the contractee, and (4) delays resulting from the contractee's breach of a fundamental obligation of the contract.

While the court did not find any evidence of exceptions (1) and (3), there was sufficient proof that the delays were unanticipated and that the School District had breached a fundamental obligation of the contract. The court emphasized that damages for breach of a fundamental obligation are recoverable *only* upon proof of an *affirmative obligation* that the contract expressly imposed on the contractee. In other words, this obligation must be express and not implied.

Gray pointed to Article VIII, Section 8.04 of its contract with the School District as evidence of such an obligation. The provision required the construction manager, as the School District's representative, to schedule and coordinate the work of all the contractors on the project and to keep all of the contractors informed of the project's schedule. In support of its claim, Gray produced evidence and exhibits demonstrating that the School District, through its representatives, breached this obligation by failing to provide Gray with adequate and timely coordination schedules, drawings and updates for work on the project.

Ultimately, the court found that the School District's breach prevented Gray from performing its work in an efficient, timely and economical manner, and that this was the cause of the 335-day delay

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Reassessing *Eichleay*

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“show” that it was not impractical for the contractor to take on replacement work. For example, see *West v. All-State Boiler, Inc.* (1998). The *All-State Boiler* court held that the government could meet its burden by showing either: “(1) that it was not impractical for the contractor to obtain other work to which it could reallocate its indirect costs; or (2) that the contractor's inability to obtain other work was not caused by the government's suspension. . .”

Is the delay from a Change or a Suspension of Work?

One significant unresolved issue is the availability of the *Eichleay* formula for calculation of delay damages under the typical federal contract's changes clause. For instance, broadly read, the *C.B.C. Enterprises* case would suggest that unabsorbed overhead may not be recoverable where the sole cause of delay is the performance of additional work, and that the proper calculation of overhead

Contractors must demonstrate the impracticality of taking on replacement work.

for a delay caused by the performance of extra work is of a percentage markup on direct costs. Therefore, in any case where a delay is caused by a change, the government can be expected to argue that *C.B.C. Enterprises* bars recovery of unabsorbed overhead. Other cases have held that recovery of unabsorbed overhead by way of an *Eichleay* calculation is inappropriate for delay caused by the performance of change order work where the contract contains a provision expressly limiting the contractor's overhead recovery on change orders to a fixed markup on direct costs. See, for example, *Reliance Insurance Co. v. U.S.* (1991). Such clauses have been prevalent over the years in Veterans Administration contracts and have been present in some GSA contracts. Because of the uncertainties created by these cases, it is often pru-

dent to couch delay claims in terms of suspensions under the suspension of work clause. However, the downside to this approach is that the contractor is not entitled to profit under the suspension of work clause.

Conclusion

The application of the proliferating case law on the subject of unabsorbed overhead can become quite complicated. A contractor must examine the contract to determine whether any clauses limit the method of calculating overhead and therefore present a problem to recovery. He or she then must carefully examine the facts to determine whether any delays of “uncertain duration” have occurred satisfying the “standby” requirement. It must also be considered whether these delays can properly be characterized as arising under the changes clause or the suspension of work clause. Where a delay can properly be characterized under either clause, as where work is delayed while waiting for issuance of an expected change order, the contractor must carefully consider whether avail-

ability of profit under the changes clause is worth dealing with the government's inevitable argument that the *C.B.C. Enterprises* case bars recovery for unabsorbed overhead. Finally, contractors must also consider how to demonstrate the impracticality of taking on replacement work by analyzing bidding practices, bonding capacity and the availability of equipment and supervisory personnel, as well as other factors.

Nevertheless, as can be seen from the foregoing, the concept of unabsorbed overhead as an element of damages still retains vitality, as does the *Eichleay* formula. It appears that *Eichleay* is still the most prevalent and accepted method for measuring extended home office overhead costs as a result of work delays and suspensions. ⚙

Winning Strategies

Utilizing demonstrative exhibits to prove your claim

Making something complicated look easy isn't always possible, especially when it comes to resolving disputes on construction projects. Even if the final decision rests in the hands of an arbitrator who is experienced in the construction industry, it can be difficult, if not impossible, to present the facts in a clear and convincing manner without using some form of demonstrative evidence. Almost every major point within a claim can be reinforced with the sound use of demonstrative exhibits to complement the testimony given by fact witnesses or experts.

This is also true in settlement conferences. Many times, the decision maker for the opposing side has no firsthand knowledge of the project and might be amenable to settlement if convinced that the claim has merit. Well-designed visual displays help the spokesperson present the claim in a clear and concise manner, leaving no doubt as to position, entitlement and conviction in recovering damages.

But what are demonstrative exhibits, and why the necessity to use them? In short, demonstrative evidence is anything other than oral testimony that can be presented during a settlement conference, arbitration, mediation, litigation or alternative dispute resolution. Whether we like it or not, we live in a world that is increasingly oriented toward the visual. From traffic signals and road signs to advertisements in magazines and on television, we use visually obtained information as a basis for decisions and actions. Studies have shown that after 72 hours, people remember as little as 10 percent of the information presented to them orally. However, when the same information is presented both orally and visually,

people will retain as much as 87 percent. Obviously, demonstrative exhibits are worth using, but can a contractor presenting information on a small-to-mid-



size claim afford to use them? A more appropriate question might be to ask if the contractor can afford not to?

Today's world of computer technology has provided many ways to prepare exhibits and present claims. For maximum impact, care must be taken to select the correct type of exhibit as well as a presentation medium that will work best within the presentation arena.

Case in Point

Consider the example of a contractor and owner who enter into a \$6 million contract to design and build a soil remediation plant. Con-

struction is started and completed on time and within budget, and the plant is turned over to the owner after the required training period. The plant operates for the next five years with no major problems other than a few instrument or gauge failures, which, for the first year, are under warranty and repaired by the contractor. All repairs thereafter are the responsibility of the owner. At the end of the fifth year, there

is a major fire, leaving the plant badly damaged and inoperable. The owner files a demand for arbitration against the contractor for \$1.7 million in damages, alleging poor design and faulty construction.

In response to this claim, the contractor through counsel retains a

soil remediation expert to assist in the formulation of a defensive strategy. The expert comes to the following conclusion: One of the reasons for the fire was the failure on the owner's part to test the soil before it entered the plant. This caused the temperature within various parts of the plant to exceed the design maximums, creating automatic system shutdown situations. In addition, the owner failed to maintain the instrumentation and gauges throughout the plant. At the time of the fire, only the fuel usage gauge was fully functional and accurate, indicating that fuel usage had dropped to zero. It was this gauge that the operator viewed and



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relied upon before making the decision to open the oxygen vents and inject fuel.

Sounds simple enough. But what type of exhibits could be used to help ensure a favorable decision for the defense?

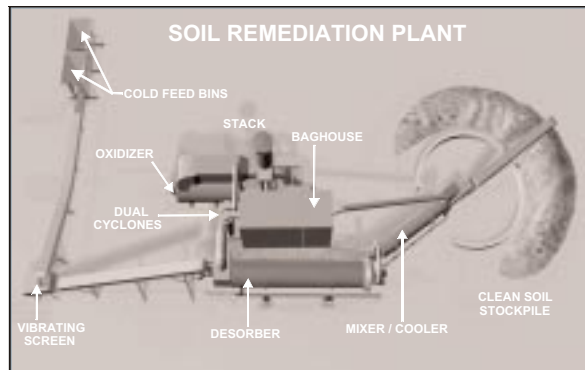
Demonstrative Options

In this scenario, the defense might elect to use a series of low-cost demonstrative exhibits including document enlargements, as-built drawings, and charts and diagrams, along with expert testimony. Using these types of exhibits, the expert would be able to familiarize the arbitrators with the plant configuration or layout, compare operating temperatures and highlight passages in key documents. At first glance, this assortment of exhibits would appear to be the perfect answer to the demonstrative exhibit question.

However, there is one critical problem with this strategy and the exclusive use of these exhibits. There is no focus on the most important issues: How was the plant designed to operate; how did it operate for five years without incident; and what happened to change the normal sequence of events? The arbitrator's clear understanding of these issues and the plant's operation will ultimately be the deciding factor in this proceeding. It is important to remember that this will be the contractor's best opportunity to defend against this claim, and, depending on the circumstances, the arbitrator's decision could be binding. Based on the potential liability, it would be worthwhile to explore other demonstrative options.

The best option in this case would be to prepare a simple, three-dimensional computer animation which, when accompanied with a limited oral explanation, would educate the arbitrators as to how the plant was designed to operate and its actual operation over the past five years. The animation would start with an overhead view of the plant, identifying all of the major buildings or components. It would then zoom in to the start of the soil remediation process, showing where contaminated soil is tested and mixed

with clean soil to achieve the correct combustion blend. Then, the mixed soil would be shown moving along conveyors into a cut-away view of the inside of the Thermal Desorber; where the contaminants are burned off. The animation would also show the soil being burned and follow the resulting hot flue gases through the Desorber; then into a cut-away view of the Baghouse, where the remaining suspended particles are cap-



tured as the gases are drawn through the bags. The final sequence would show the gases being returned in a cut-away view of the Oxidizer, with the resulting clean gas recirculated into the Baghouse or released through the stack as clean air.

Expert's Opinion

The animation described here would visually depict the plant's entire soil remediation process. It would be presented at a deliberately slowed rate, allowing ample time in each segment for the expert to explain how the plant was designed to operate, and how it operated for five years without incident. It would not, however, make any attempt to convey the expert's opinion as to why the fire

occurred. This would be accomplished using captured still images (see illustration at left) of the key components of the plant. These captured images would be enlarged, printed and mounted on foam-core board, and then coated with a laminate. The expert would be able to write or draw on the exhibits with erasable markers, illustrating his or her opinion of what actually caused the fire.

This combination of the animation and exhibit boards provides the defense with a cost-effective clear and convincing presentation that focuses on the issues with maximum impact.

Conclusion

The difference between winning and losing is oftentimes the ability to transpose complexity into simplicity. Addressing this problem successfully will contribute significantly to the most persuasive presentation of any claim. When the exhibits come together to tell a story in a compelling way, the fact finder has a well-marked and logical path to follow. These images support and enhance understanding of the oral testimony presented by witnesses or experts. The fact finder can test alternative theories and be satisfied that a decision in favor of the proponent of the exhibits is right and justified. In short, demonstrative exhibits are an extraordinary means of simplifying complex issues and, therefore, should be considered an integral part of any claim presentation. ☼



Y2K – Are You Ready?

The Y2K bug – the popular phrase for computers reverting to the year 1900 after December 31, 1999, thus jamming operations – is being addressed not only by reprogramming efforts, but also by federal legislation that will impact the construction industry. Contractors have been aware for some time that systems that they may share some responsibility for, such as alarms, security and elevators, may be affected by the Y2K bug, and that claims may ensue if these systems shut down and cause economic losses or, worse, physical injury and property damage. As a result, subcontracts that include any computer equipment, systems or software programs have contained and should continue to include warranties that the work shall be “year 2000 compliant,” and that the subcontractor will defend, indemnify and hold harmless the contractor and owner from any claims if the systems fail.

Realizing that contract provisions such as these are permeating all aspects of the economy and that there may be a proliferation of lawsuits as a result of the impact of Y2K, the president in July signed into law the Y2K Act (Act). The purpose of the Act is to prevent the straining of the legal system, as well as the technology and businesses that are attempting to ensure that computer systems become or remain operational. The Y2K Act essentially establishes procedures for civil actions for damages relating to the failure of any device or system to process or otherwise deal with Y2K issues, and makes alternative dispute resolution (ADR) the focus for addressing Y2K issues.

Highlights of the Act:

- All state and federal court actions, as well as agency board and contract appeals proceedings, are included within the Act's scope;
- The Act applies to government entities, including all states and the District of Columbia, when they act in a commercial or contracting capacity, but not in a regulatory or enforcement capacity;
- Provides for voluntary ADR to assist in the resolution of issues through processes such as early neutral evaluation, mediation, mini-trial and arbitration;
- Applies to Y2K failures occurring before January 1, 2003, for actions brought after January 1, 1999;
- Does not expand liability or create any new causes of action and excludes claims for physical injury or wrongful death;
- Preserves and enforces contractual limitations of liability and disclaimers of warranty;
- Supersedes any inconsistent state law addressing Y2K; and
- Limits and caps punitive damages to the lesser of three times the amount awarded for compensatory damages, or \$250,000.

The point of the Act is to encourage businesses to responsibly approach their disputes relating to year 2000 computer date-change problems, and to avoid unnecessary, time-consuming and costly litigation about immaterial Y2K failures. In that regard, the Act encourages private and public entities to promptly identify and correct Y2K problems and to engage in ADR mechanisms as early as possible to resolve them. ☼

No-Damage-for-Delay-Clause Enforceable But ...

[continued from page 9]

in construction. Based upon the fundamental breach exception and the conclusion that these types of delays were not contemplated by the parties upon formation of the contract, Gray's claim for damages were not barred.

The court allowed Gray to recover for damages incurred only after it complied with Article VI, Section 6.06 of the contract, the provision requiring timely notice of any delay claim. As such, Gray was entitled to recover a total of \$175,783 (see figure on page 8).

The court specifically disallowed damages for extended home office overhead, as opposed to site overhead, because no proof was adduced to demonstrate that the delay in the contract performance actually caused an increase in home office activity or expense. ☼

EDITOR'S NOTE

The trend in recent cases is for courts to find exceptions to no-damage-for-delay provisions. However, notice and substantiation of claim requirements are being strictly upheld because they afford an owner an opportunity to investigate and presumably prevent productivity losses. Contractors are well advised to document all claims and delays as soon as they occur.

Peckar & Abramson Newsletter
Volume X, Issue 2, Fall 1999
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