JMR Construction Corp. v. Environmental Assessment and Remediation Management, Inc.

01.15.2016

A recent decision published by the California Court of Appeal, *JMR Construction Corp. v. Environmental Assessment and Remediation Management, Inc.* ("*JMR v. EAR*"), is bound to be relied on widely by public works contractors seeking to recover unabsorbed home office overhead using the Eichleay formula* and seeking to recover other delay and disruption damages using the "modified total cost" method.

In *JMR v. EAR*, JMR Construction Corp. ("JMR") was a prime contractor on a federal public works project. Environmental Assessment and Remediation Management, Inc. ("EAR") had the subcontracts for the electrical and plumbing portions of the work.

JMR alleged that EAR caused delays to the project from deficient and late submittals, and from improper plumbing work. As a result, JMR claimed that it was entitled to recover delay and disruption damages, including extended or unabsorbed home office overhead from EAR. Home office overhead damages are sought on the theory that additional overhead costs are incurred when the contract is extended or on the theory that a contract has not absorbed its portion of the overhead during a delay period. In those cases, where unabsorbed overhead is sought, it is assumed that extending the performance period will increase the overhead allocable to the contract. In theory, when a project is delayed, the same income for the project is spread out over an extended period of time—if the contractor is unable to take on additional work during the delay, it has experienced damages.

Whether a contractor is entitled to recover unabsorbed home office overhead as an element of its delay damages, and how to calculate that unabsorbed home office overhead, are often topics of great dispute when attempting to settle contractor claims in cases where

RELATED INDUSTRIES

Environmental

JMR Construction Corp. v. Environmental Assessment and Remediation Management, Inc.

California law applies. Although the use of the Eichleay formula is frequently utilized by federal contracting law, there is little California legal authority to guide claimants, defendants, lawyers, and trial courts in regards to a contractor's entitlement to these damages and their calculation. However, *JMR v. EAR* now provides significant legal authority supporting damage awards for unabsorbed home office overhead claims using the Eichleay formula.

Under federal law, and as reiterated in *JMR v. EAR*, in order for a contractor to show entitlement to Eichleay damages, the contractor must prove that: 1) the contractor was required to keep its workforce on standby during the delay; 2) the delay is not concurrent with some other delay for which the owner is not responsible; and 3) the contract performance period was extended, or if the contractor finished within the contract period, that it intended on finishing early. If the contractor can prove these three elements, the burden shifts to the government to show that it was not impracticable for the contractor to take on replacement work to mitigate its overhead damages. The hardest element to prove is the "standby" requirement as the contractor must show that the delay was for an indefinite period, it was ready to resume work immediately and at full speed, and that most, if not all, of the work on the contract is suspended.

While the court in *JMR v. EAR* did find that the claimant met these requirements, the court did so in a rather novel way, because it upheld an award to JMR, the prime contractor, against its subcontractor, EAR—in a typical situation, courts award Eichleay damages to a prime contractor against an owner. In addition, the court allowed JMR to satisfy the requirement that the contractor not be able to take on other work, by showing that because of EAR's performance on the project, JMR was no longer considered a responsible enough contractor to perform federal contracts.

The court's holding in regards to the use of the Eichleay formula to calculate damages outside the parameters it was designed to be used suggests that courts should follow the common law rule that as long as a plaintiff can prove that a defendant caused the plaintiff damages, the amount of the damages is only required to be a reasonable estimate, and not an exact calculation. The court's holding also suggests that lower courts should be open to other methods besides the Eichleay formula to calculate unabsorbed home office overhead as long as there is evidence that the method used will result in a reasonable estimated of the claimant's damages.

It is notable that in *JMR v. EAR*, JMR required the testimony of three experts to prove its entitlement to home office overhead—this is never cheap—JMR spent over $90,000 on experts to prove its case. However, it seemed to be necessary, because the court's holding relied heavily on the experts' testimony regarding the impact EAR's lack of performance had on the schedule's critical path. Without this testimony, it is doubtful that JMR would have prevailed.

Almost as controversial as home office overhead claims are claims referred to as "total cost claims" or "modified total cost claims." In a total cost claim, a contractor calculates its damages as the difference between what it planned to spend on completing a project and what it actually spent on the project. The modified total cost claim was designed to overcome a major flaw in total cost claims, that is, it assigned all

JMR Construction Corp. v. Environmental Assessment and Remediation Management, Inc.

the excess costs to the defendant regardless of whether the claimant was partially responsible for the increased costs. When using the modified total cost method, the claimant estimates and subtracts any increased costs it caused to itself.

In *JMR v. EAR*, the court of appeal upheld the trial court's award of damages in favor of JMR, using a modified total cost method.

Some courts have deemed total cost claims and modified total cost claims as "disfavored." However, they have been allowed under California law. The chief concern expressed by courts is that a total cost claim may be used to substitute for the causation element of a breach of contract damages claim. A claimant is not necessarily entitled to recover its additional costs just because it incurred additional costs—it must prove that the defendant actually caused the additional costs. Therefore, to guard against this, the courts have imposed the following requirements on a contractor seeking to calculate its damages using the total cost or modified total cost method: 1) It must be impractical or impossible to prove the damages directly; 2) the contractor must prove that its original estimate was reasonably accurate; 3) its actual costs were reasonable; and 4) that the contractor was not responsible for its added costs.

In *JMR v. EAR*, the claimant, JMR, again relied heavily on expert testimony to prove its total cost claim. The court reviewed each of the required elements of a total cost claim and the evidence supporting each of the evidence. The court determined that each was supported by substantial evidence. The court's holding suggests that EAR failed to object to much of this testimony and that if it had, the result might have been different. While experts are often helpful, many courts will exclude expert testimony that is based on hearsay, where the expert lacks personal knowledge, or where the facts upon which the expert relies are not established by witnesses who do have personal knowledge.

Regardless of how JMR met the elements for a total cost claim, the case is significant because it is solid legal authority allowing a damage award based on a total cost claim.

Based on *JMR v. EAR*, owners might expect to find that contractors put up a bigger fight when an owner seeks to reach a compromise regarding claims for home office overhead and claims based on the total cost method.

AALRR's lawyers have years of experience in handling these types of claims. One of the lawyers listed above would be happy to answer any questions you have regarding any potential claims you may be dealing with, and will be able to guide you to the best way to calculate and prove those claims or defend against them.

**The Eichleay formula is a multi-step calculation which is beyond the scope of this alert.*

Download PDF