

ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --)
)
Roy McGinnis & Co., Inc.) ASBCA No. 49867
)
Under Contract No. DACA63-94-C-0111)

APPEARANCE FOR THE APPELLANT: Theodore M. Bailey, Esq.
San Antonio, TX

APPEARANCES FOR THE GOVERNMENT: Frank Carr, Esq.
Engineer Chief Trial Attorney
Charles L. Webster III
Engineer Trial Attorney
U.S. Army Engineer District
Ft. Worth, TX

OPINION BY ADMINISTRATIVE JUDGE SHACKLEFORD

This is an appeal from a final decision denying a claim for unabsorbed home office overhead due to Government-caused delay to a construction contract. The parties agree that the delay amounted to 110 days and they reached agreement on all other costs. The only issues remaining are entitlement and quantum for unabsorbed home office overhead. A hearing was held in San Antonio, Texas and both parties have filed initial and reply briefs.

FINDINGS OF FACT

1. On 13 May 1994, the Department of Army, Corps of Engineers, Fort Worth District (Government or respondent), awarded Contract No. DACA63-94-C-0111 to Roy McGinnis & Co., Inc. (McGinnis, contractor or appellant) in the lump sum amount of \$7,264,660 (ex. G-3A).¹

2. The work, which was to be performed at Kelly Air Force Base, San Antonio, Texas, generally consisted of (1) the renovation of an existing 57,000 square foot hangar

¹ The Government's initial Rule 4 file included tabs 1 to 15. The file was supplemented with a volume containing tabs 16 to 33. Documents admitted at trial commence with number 34. Because there is no duplication of numbers, the Government documents will collectively be referred to as G-1, etc. Similarly the appellant submitted an initial file under Rule 4(b) including tabs 1 to 107. Documents offered at trial commenced with exhibit 108. We will refer collectively to appellant's documents as ex. A-1, etc.

converting it to an NDI/X-Ray Facility (X-ray Facility), (2) construction of a new 20,000 square foot testing laboratory (Engineering Test Facility) and related demolition of a storage building and (3) renovation of an existing 23,000 square foot avionics facility (Avionics Facility) (exs. G-2, 4).

3. The Engineering Test Facility was next door to the Avionics Facility and at most 200 yards separated the two. The X-ray Facility was 1/4 to 1/2 mile from the Engineering Test Facility (ex. G-33; tr. 3/75-76). The three facilities were not only physically separated from each other, but, moreover, the contract had separate completion dates for each sub-project and a separate liquidated damage rate was established for each of the three sub-projects (ex. G-3D).

4. Notice to proceed was issued on 7 June 1994 and acknowledged as received on 17 July 1994 (ex. G-5). Appellant mobilized on each of the three sub-project sites on 18 July 1994 (ex. G-38, report no. 1). From the very beginning, appellant experienced problems (tr. 1/102). On 19 July 1994, the contractor reported that it needed the Government to locate all utilities at the job site (ex. G-38, report no. 2). On 20, 21 and 22 July 1994, the contractor's quality control manager unsuccessfully tried to reach the Government official responsible for locating utilities at the job site (*id.*, report nos. 3-5).

5. When appellant commenced excavation to relocate utilities at the Engineering Test Facility, preparatory to beginning building construction, it encountered several differing site conditions. Many of the existing utilities were not exactly where they were shown on the drawings; some were shown on the drawings but never found; and some were found which were not shown on the drawings. This series of problems required the Government to determine how to relocate the underground utilities and delayed the work. (Tr. 3/77; ex. A-75) As to these differing site conditions, the parties have stipulated as follows:

During the period of July 17, 1994 through January 17, 1995, there were 110 days of compensable Government delay. These delays were of uncertain duration.

(Stipulation dated 16 May 1997)

6. After encountering the differing site conditions, the contractor, rather than waiting for the Government to resolve the problems, did some exploratory digging for which it was ultimately paid (tr. 1/124). Further, to mitigate damages, McGinnis performed whatever work it could. For example, it did some, but not all, of the storm drain work. (Tr. 1/124) Bryan McGinnis, President of Roy McGinnis & Co., Inc. (tr. 1/76), described the work effort as follows:

We could level the site after we figured out where things were. We just couldn't work where an unknown utility was, so we actually did some contract work But we couldn't do the critical finishing that would get us ahead, but we did pick up about 40 days out of the 150. And that's why our CPM at the end of January showed negative 110 instead of negative 150.

(Tr. 1/125)

7. Thus, none of the delaying events caused a complete suspension of work, the delays merely stretched out the performance period (tr. 1/179-80).

8. For the 26 payrolls from the week ending 20 July 1994 to the week ending 11 January 1995, essentially encompassing the total period of delay, the number of people employed by the contractor on the job averaged 19.88 people per week. When the delay ended the manpower employed on the job dramatically increased and for the 26 payroll weeks thereafter the payroll averaged 39.04 people per week. (Ex. A-107)

9. McGinnis prepared quality control reports on each of the three sub-projects and one consolidated payroll report. A comparison of the quality control and payroll reports demonstrates that on many days between 17 July 1994 and 17 January 1995, the total of the number of employees reported on each sub-project exceeded the number of employees on the payrolls (ex. G-26). This demonstrates that the contractor moved workers between sub-projects to perform whatever work was available.

10. Based upon the foregoing, we conclude that while McGinnis was not totally suspended, progress was significantly interrupted by Government-caused delays for 110 days.

11. Prior to award of the contract in question at Kelly Air Force Base (Kelly contract), appellant had been awarded a contract on 17 March 1994 in the amount of \$4,895,152 at Laughlin Air Force Base (Laughlin contract) (ex. G-27). Laughlin AFB is near Del Rio, Texas, about 150 miles from San Antonio (tr. 2/175, 187).

12. In early 1994, McGinnis' workload was less than \$2 million (ex. A-106). The Laughlin contract increased the workload to about \$6.5 million (*id.*; tr. 1/185). There is no evidence that a specific bonding limit was imposed on McGinnis, but Bryan McGinnis operated under a rule-of-thumb that the company's maximum bonded workload was ten times its net worth. However, they seldom worked at that limit, relying more on its management capability, *i.e.* how much work it could manage capably set the limit on how much work they would take on. (Tr. 1/183-84)

13. After award of the Laughlin contract, McGinnis was still looking for work because, in Bryan McGinnis' mind, they still had bonding capacity, since he saw their capacity at about \$10 million and they were at about \$6.5 million, so they bid the Kelly job (tr. 1/185). The Kelly contract elevated the workload to over \$13 million (tr. 1/190; ex. A-106).

14. Doug Wealty, an insurance agent specializing in contractor and surety bonding, represented Roy McGinnis & Co., Inc. as their bonding agent at all times relevant to this appeal (tr. 3/4). Wealty had the authority to approve bonding for McGinnis within established parameters in an expedited manner without interaction between the client and the bonding company (tr. 3/9). The Laughlin contract was outside those parameters, was the largest single contract awarded to McGinnis to date and for bonding needed the specific approval of the bonding company (tr. 3/8).

15. The Kelly contract was even larger than the Laughlin contract, and the bonding company approved it with the understanding that McGinnis would not bid on other work until the two major jobs (Laughlin and Kelly contracts) were substantially underway, progressing without problems and continued to be profitable jobs (tr. 3/10-11).

16. In September 1994, the bonding company allowed McGinnis to bid on a \$2.5 million job on a fire station at Laughlin AFB (tr. 3/13). McGinnis was not the low bidder (tr. 3/14). Two months later, in November 1994, the bonding company allowed McGinnis to bid on another job at Laughlin AFB (Plastic Media Blast Module) for about \$2.7 million (tr. 3/14-15) McGinnis was not the successful bidder on this second project (tr. 3/15).

17. The two jobs appellant bid on (Fire Station and Blast Module) were bid to replace workload for the Laughlin contract, and not to replace work delayed under the Kelly contract (tr. 1/205). Had McGinnis received the Fire Station job, it would not have been allowed by the bonding company to bid the Blast Module job (tr. 3/22).

18. Much testimony and documentary evidence was presented on the issue of the extent to which appellant's cash flow during the 110-day delay compared to the expected cash flow under an early start schedule, average start schedule or late start schedule. Much of that testimony from both parties was speculative. Appellant's analysis presumed it would perform all work activities according to the early start schedule and thereby earn progress payments earlier (tr. 1/96). Appellant historically did not always achieve that level of performance (tr. 2/188). The Government's analysis presumed the late start schedule (tr. 2/210, 3/100) even while admitting that most contractors would shoot for the early start (tr. 3/101). Testimony by the Government witness who prepared a graph depicting a comparison of actual versus expected cash flow, admitted that the graph was hand drawn and "eyeballed" (tr. 2/215). We are not persuaded as to the probative value of any of the evidence on expected cash flow.

19. During the delay period, 17 July 1994 to 17 January 1995, appellant did not perform all the scheduled work for that period as they were busy overcoming the differing site conditions, pricing changes, dealing with the delays (tr. 1/180-81), planning and re-planning the work. McGinnis was unable to replace the delayed work because it had to be available at any time to resume the work when the events causing the delay were resolved. (Tr. 2/124)

20. On 2 March 1995, the contracting officer received appellant's 28 February 1995 Request for Equitable Adjustment for Delay Costs. This request concerned the aforementioned difficulties experienced by appellant with regard to underground utilities. In the request, which was certified in accordance with the Contract Disputes Act, McGinnis sought an adjustment of \$288,083.08 and a contract extension of 110 calendar days. McGinnis sought unabsorbed home office overhead using the Eichleay formula for the 110 days in the amount of \$118,505.81. (Exs. G-2, -8)

21. On 5 June 1995, McGinnis confirmed that on 31 May 1995, the parties negotiated and agreed that 110 days would be added to the contract, the Government would pay McGinnis \$158,861, the contract modification to be issued would exclude compensation for unabsorbed home office overhead, and that McGinnis would not be precluded from filing a claim for unabsorbed home office overhead related to the agreed 110 day delay. Attached to the 5 June 1995 confirmation was a revised unabsorbed home office overhead request for \$101,105.56 which took into account figures which were revised between a draft and a final audit report. (Ex. A-67)

22. On 14 June 1995, McGinnis advised the contracting officer in writing that it considered the remaining issue of unabsorbed home office overhead to be in dispute, certified its claim for \$101,105.56, and requested a contracting officer's final decision (ex. G-10). The claim was revised to \$139,634.70 on 17 October 1995 to take into account actual, as opposed to estimated overhead costs for 1995 (ex. G-14). As of 19 May 1997, appellant further revised its claim to \$115,388.24, which took into account actual overhead expenses incurred in 1994, 1995 and 1996 (ex. A-109).

23. On 26 January 1996, the parties bilaterally executed Contract Modification No. P00027 thereby increasing the contract price by \$158,861, extending the contract performance period by 110 days with a revised contract completion date of 11 November 1995, and specifically excluding from its coverage all costs associated with unabsorbed home office overhead (ex. G-15). The agreed amount included a profit of 10% and a bond cost of 1% (ex. A-67).

24. On 10 May 1996, the contracting officer issued a final decision denying appellant's claim for unabsorbed home office overhead (ex. G-2) and that decision was timely appealed to the Board and docketed as ASBCA No. 49867 (ex. G-1).

25. For purposes of making an Eichleay calculation of unabsorbed home office overhead, we find that the total billings under the contract were \$7,648,038. The total billings for the period of the contract were \$11,684,081. There were 623 days of performance time. (Exs. A-109, G-39) Appellant contends that the allowable overhead expenses for the contract period are \$898,643.83 (ex. A-109). The Government contends that the allowable overhead expenses for the contract period are \$605,414.00 (ex. G-39)

26. The difference between the two figures, \$293,229.83, is due to overhead expenses challenged and disallowed by the auditor, generally upon the ground that they were variable rather than fixed. The auditor, Gladys Mata, admits that her report does not include an amount for each of the questioned costs, but she provided that information to the contractor and the amounts in the contractor's Summary of Overhead Accounts (ex. A-110) are fairly accurate in her view (tr. 3/141). Each is discussed below.

27. The auditor disallowed automobile and truck expenses for vehicles assigned to home office personnel, determining such costs to be variable rather than fixed, based upon the following analysis in her testimony:

And the rationale being, okay, I said, Well, if indeed there is a reduction in work or suspension or delay or what have you, if there's less work, you're not going to use your automobiles and trucks as often or at all, if the case is where you just don't have any work. So, therefore, your expenses for it would be reduced, because the less you use an automobile, the less you use a truck, the less strain you're going to put on the vehicle, the less maintenance you're going to need.

It may not even need any work, any repairs. You're not going to need any fuel if you're not using it, and these are just expenses that would definitely vary. If you have a lot of work and you're constantly using your automobile and truck, of course your fuel's going to go up and your repair and maintenance is going to go up.

Just like I don't use my car as much, so my maintenance and repair would definitely not be as much as, let's say, like a friend of mine that I have that's a salesperson who's constantly driving that car and has high mileage and is constantly having to repair and maintain the vehicle. Therefore, at that point in time, it's obviously a variable expense.

(Tr. 3/128) Most of the questioned costs associated with these vehicles had already been deducted by the contractor (tr. 3/261). The remaining expenses such as registration,

licensing and insurance did not vary with contract work volume and thus they are fixed expenses (tr. 1/251-52).

28. Mata also disallowed consulting and bidding expenses. After examining the accounts over the three year period 1994 to 1996, she concluded that the expense was essentially for the cost of estimating work (tr. 3/130-31). She pointed to wide variations in the amounts incurred over the three years and when asked what that told her, she responded:

And so basically within that general account, these costs vary so significantly that, I mean, it's – in addition to that, these are expenses that – I mean, in looking at this, if Mr. McGinnis is compensated for consulting, I assume that he has the required knowledge to be able to do this job on his own, if need be, if he does not have the financial backing to pay these extra people to do this, because the smaller, small, small contractors, you see that they do – when they start off, they do all this bidding and consulting – or bidding and proposing on their own.

In this case, it would be a fringe benefit to the company to have the money to pay people \$150 an hour to help them bid and propose on different contracts, but that is not a necessary expense to continue in operating a business.

(Tr. 3/131-32) These costs were incurred to pay for an estimator working out of the home office who was paid as a contractor rather than as a direct employee of McGinnis. Those costs did not go up or down with the volume of work performed and were reasonable (tr. 1/253-54).

29. Appellant paid bonuses totaling \$73,719 in 1994, \$4,191 in 1995 and none in the first half of 1996 for a total of \$77,910 (ex. A-110 at 13). The auditor observed that \$50,000 of that total was distributed to the owners of the company (tr. 3/133) but disallowed this category based upon the following testimony:

Now, this is definitely not something – if you're suffering a delay, if you're suffering a suspension, if you're suffering some type of reduction in business activity, then at that point in time, you determine that there's no money to distribute bonuses. So that is definitely at the owner's discretion. This is definitely not a cost that is required, that is fixed, that if you don't pay it, someone's going to come and put you in jail. That's not going to happen.

So you just basically just eliminate it, and especially if the owners are receiving 80 percent of the bonus. That can be done away with. A lot of times even owners don't even pay themselves in operating their businesses if need be.

(Tr. 3/133-34) In fact, bonuses were based on profitability not volume of work and thus did not vary therewith (tr. 1/256-58). We find however that appellant has not established that the amount of \$50,000 paid to its owners was reasonable compensation for personal services rather than a distribution of profits (see FAR 31.205-6(b)(2)(i)).

30. The next category, miscellaneous costs, totaled \$14,313 for the years 1994, 1995 and the first half of 1996 (ex. A-110 at 23) and in the auditor's view were costs that did not fall into any particular classification (tr. 3/134). A reimbursement to an employee for the expenses of training at a hotel was problematic because the hotel cost, \$102 per day, exceeded per diem under the federal travel regulations and because:

[Training] is something that did not need to be incurred. It's not necessary. Like in my case, like an auditor, I haven't gone to training in a long time, because there's no money to send us to training. So these kind of things can be curtailed or even eliminated in the case of a delay or suspension or reduction of business activity.

(Tr. 3/135) The training expense, including the hotel costs, were incurred in connection with an accounting software seminar. These costs did not vary with the amount of work performed by McGinnis and were reasonable. (Tr. 1/261)

31. As to the cost of a Success Seminar, she challenged it because it could have been eliminated and was not needed, and agreed that her rationale had nothing to do with whether the cost was fixed or variable (tr. 3/136). A cost of \$90.87 for reimbursement to Bryan McGinnis for drinks and sandwiches purchased in connection with a seminar was rejected because it was on a handwritten piece of paper without source documents (tr. 3/136). An American Express charge for Bryan McGinnis to attend an aerobics center in Dallas was rejected as "definitely something that would not be required." As to other training costs (ex. A-110 at 32) and an employee handbook (*id.* at 33), she concludes that they are miscellaneous expenses which are not fixed (tr. 3/136-37). Except for the aerobics center charge, the costs for this personnel training course and other items were not variable with work volume and were reasonable (tr. 1/261). The aerobics center charge was not an expense of the home office and we disallow the \$111.70 included for it (ex. A-110 at 31).

32. For the category of costs termed office supplies, the auditor conceded that office supplies are needed but contended that they needed to be kept to the bare necessities, criticizing the purchase of mouse pads and CPM software (tr. 3/137). Finally she

concludes that the cost of supplies “always vary, and these do not fit the definition of fixed expenses” (tr. 3/138). We disagree. These office supplies related to the home office administrative functions (tr. 1/261-62), were not used on the jobs and did not vary with work volume (tr. 1/263).

33. The final category of costs questioned is travel and meals. She observes that the travel costs varied during the three years and concluded that travel costs could be controlled (tr. 3/139). These costs had already been deleted by the contractor (tr. 1/263-64) and the auditor may not delete them again.

34. In addition, the auditor questioned certain rent expenses (totaling \$93,000 over the 2 1/2 year period) derived from a related party transaction and equipment charges in 1996 (\$11,481) that should have been charged as a direct job cost (ex. G-39). The contractor has agreed to these adjustments in its 19 May 1997 computation of unabsorbed home office overhead. In addition McGinnis’s computations exclude other unallowable costs (e.g. claims, meals, entertainment, contributions, etc.) (ex. A-109). We find as a fact that allowable overhead expenses allocable to the period of contract performance are \$898,644 less \$112 for the aerobics center fee and less \$50,000 in bonuses or \$848,532² (ex. A-109).

35. Thus unabsorbed overhead is computed under the Eichleay formulas follows:

<u>Contract Billings</u>		x	overhead for period	=	allocable overhead
Total Billings					
\$7,648,038	[.6546]	x	\$484,532	=	\$555,449
11,684,081					
			<u>Allocable Overhead</u>	=	Daily rate
			Days of Performance		
			<u>\$555,449</u>	=	\$892
			623		
Daily Rate		x	Days of Delay	=	Unabsorbed Overhead
\$892		x	110	=	\$98,120
			Profit at 10%		<u>\$9,812</u>
			Subtotal		\$107,932
			Bond 1%		<u>\$1,079</u>
			Total		\$109,011

² Dollar amounts are rounded to the nearest whole dollar.

DISCUSSION

To establish entitlement to unabsorbed home office overhead using the Eichleay formula, appellant must satisfy two requirements:

(1) the government required the contractor to stand by during government-caused delay of indefinite duration; and (2) while and because of standing by, the contractor was unable to take on other work. . . . If the contractor can make out a *prima facie* case of (1) above, i.e., that the government-imposed delay was uncertain and that the government required the contractor to remain on standby, ready to resume full work immediately, the burden shifts to the government to show either (1) that it was not impractical for the contractor to obtain “replacement work” during the delay, or (2) that the contractor’s inability to obtain such work, or to perform it, was not caused by the government’s suspension.

Melka Marine, Inc. v. United States, 187 F.3d 1370, 1375 (Fed. Cir. 1999), *cert. denied*, 529 U.S. 1053 (2000).

In this case appellant has satisfied both requirements. The parties have stipulated to a Government-caused delay of indefinite duration and, as our findings indicate, the contractor was unable to take on other work because the bonding company would not allow it. Appellant, including its management team in place, had to remain on standby for resuming critical work when the delays ended. Thus it was impractical for appellant to take on replacement work. While McGinnis did attempt to secure other work in the Del Rio area, it was unsuccessful, and in any event, that potential work was to replace completed work in the Del Rio area and not to replace work delayed at Kelly AFB near San Antonio.

The Government’s primary defense to the Eichleay claim is a contention that the contractor was not on stand-by during the delay period, arguing that the Federal Circuit and the ASBCA have offered different interpretations of the term “stand-by,” but that, no matter which interpretation is employed, appellant’s circumstances do not amount to “stand-by.” The Government points to language in *Interstate General Government Contractors, Inc. v. West*, 12 F.3d 1053 (Fed. Cir. 1993), to argue that performance of the contract “was neither suspended nor significantly interrupted during the delay” because “Appellant was able to successfully shift his crews to other activities during the period of delay and managed to earn nearly 100 percent of what it had planned to make during the same time frame” and that McGinnis could not point to a “‘significant interruption’ in its activities during the delay period.” (Gov’t br. at 45, 48)

The Federal Circuit made clear in *Interstate* that application of the Eichleay formula does not require an idle work force. It is enough “that overhead be unabsorbed because performance of the contract has been suspended or significantly interrupted.” 12 F.3d at 1507. We have found the work to have been significantly interrupted (*see* finding 10).

The Government’s final argument in opposition to unabsorbed home office overhead rests upon the Government’s assertion that it was not impracticable for appellant to take on replacement work (Gov’t br. at 49), a fact we have found otherwise.

Appellant has made out a *prima facie* case of entitlement to Eichleay computed unabsorbed home office overhead. The Government has failed to meet its shifted burden of showing that it was not impractical for appellant to obtain replacement work and, moreover has not demonstrated that the contractor’s inability to obtain such work was not caused by the Government’s suspension of the work.

Accordingly, we find entitlement to damages for unabsorbed home office overhead computed in accordance with the Eichleay formula. Those damages, including mark-up, amount to \$109,011.

The appeal is sustained. Appellant is awarded \$109,011 together with Contract Disputes Act interest from 14 June 1995 until paid.

Dated: 28 September 2001

RICHARD SHACKLEFORD
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

I concur

MARK N. STEMLER
Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

EUNICE W. THOMAS
Administrative Judge
Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 49867, Appeal of Roy McGinnis & Co., Inc., rendered in conformance with the Board's Charter.

Dated:

EDWARD S. ADAMKEWICZ
Recorder, Armed Services
Board of Contract Appeals