

Contractor Not Entitled to Setoff Costs of Repairing Subcontractor's Defective Work

Shelter Products, Inc. v. Steelwood Construction, Inc. ____ Or App ____ (2013)

The Oregon Court of Appeals affirmed a trial court's decision that a contractor may not terminate its subcontractor for convenience and setoff costs incurred in repairing the subcontractor's defective work.

In *Shelter Products*, a contractor hired a subcontractor to supply and install structural steel for the construction of a Home Depot regional distribution center in Salem, Oregon. After the subcontractor began work on the project, the contractor's project manager sent the subcontractor a letter addressing several issues related to the schedule and quality of the subcontractor's work. The project manager concluded his letter by stating that he would continue to evaluate the subcontractor's work and determine how best to help the subcontractor perform its obligations. A few days later, the contractor terminated the subcontract for convenience.

The subcontract agreement's termination for convenience provision stated that the contractor could terminate the subcontract "without cause and without prejudice to any other right or remedy." It also stated that:

The obligations of the Subcontractor shall continue as to portions of the work already performed and as to bona fide obligations assumed by Subcontractor prior to the date of termination. Subcontractor shall be entitled to be paid the full cost of all work properly done by Subcontractor to the date of termination not previously paid for, less sums already received by Subcontractor on account of the portion of the work performed.

After termination, the contractor refused to pay the subcontractor. The subcontractor filed suit and the contractor sought to offset its costs of repairing the subcontractor's allegedly defective work. The subcontractor sought summary judgment against the contractor and its motion was granted.

On appeal, the contractor argued that, despite terminating the contract for convenience, it was entitled to setoff costs incurred in repairing the subcontractor's defective work. The contractor argued that the language of the subcontract permitted setoff. Specifically, the contractor argued that the termination for convenience was "without prejudice to any other right or remedy."

Further, the contractor argued that the termination provision required the subcontractor to remain responsible for work previously performed and that the subcontractor was only entitled to that portion of its costs for work “properly done by Subcontractor to the date of termination.”

The subcontractor countered that, because it was not given the opportunity to cure, the contractor was not entitled to any setoff against the subcontractor’s damages. The court of appeals agreed.

After examining the text and context of the subcontract, the court of appeals ruled that the contractor could not both terminate the subcontractor for convenience and subsequently assert a setoff. The court of appeals based its decision on several grounds. First, the court concluded that the language “without prejudice to any other right or remedy” did not permit the contractor to avail itself of two inconsistent remedies: termination for convenience and setoff of damages, at least when the subcontractor was not given the opportunity to cure its alleged breaches. Second, the court interpreted the reference to costs for work “properly done by Subcontractor to the date of termination” to mean work performed before termination, rather than work that should have been discontinued after receipt of notice of the termination. The court also found that the reference to “properly done” does not refer to the quality of work completed. Finally, the court concluded that no other provision in the contract permitted the contractor to receive an offset for costs of defective work done by the subcontractor before termination.

The court of appeals’s conclusion in *Shelter Products* is consistent with other cases holding that where a party has terminated a contract for convenience, it may not claim damages related to pre-termination breaches if it has not given the terminated party an opportunity to cure. However, the court’s interpretation of the frequently-used phrase regarding payment for work “properly done” will be disconcerting to those who include similar language in their contracts intending to preserve their rights to seek damages in the event of a pre-termination breach.

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