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Delayed Performance of a Contractual Term May Constitute Substantial Performance Even Where the Parties Agree that Time is of the Essence.

In September 2015, Rugger Investment Group agreed to sell, and Magic Carpet Ride (“MCR”) agreed to purchase, a pre-owned aircraft. MCR deposited \$610,000, the purchase price, into escrow, for payment to Rugger upon completion of the transaction.

The sale agreement required that Rugger would transfer the aircraft to MCR on the closing date free and clear of all liens and encumbrances and that “time was of the essence” for all events contemplated under the agreement.

Rugger was not able to transfer the aircraft free and clear of all liens. As a result, MCR and Rugger amended the agreement to provide Rugger 90 days from the closing date to secure the release of a pending lien. The amendment stated that if Rugger could get the lien released within the 90-day term, then MCR would release the entire amount of the holdback to Rugger, and that if Rugger could not get the lien released within the 90-day term, then Rugger agrees to release entire amount of holdback to MCR. The amendment did not contain a time-is-of-the-essence provision.

MCR and Rugger agreed on a closing date of February 23, 2016. On that date, Rugger passed the aircraft’s title to MCR, and MCR accepted the aircraft. However, despite Rugger’s diligent efforts to secure the release of the lien, it did not secure such release until May 31, 2016, eight days after the expiration of the 90-day period, due to a recalcitrant lien holder.

Following the May 31, 2016 lien release, Rugger requested that MCR release \$38,000 from escrow in order to cover the amount that Rugger paid for the lien released. MCR did not release the escrow amount, but rather filed suit against Rugger, alleging that Rugger breached the contract by failing to secure the lien release within the requisite 90-day time period and by refusing to release the \$90,000 escrow holdback to MCR. Rugger then filed a complaint against MCR, asserting that MCR breached the contract by refusing to release the \$90,000 holdback to Rugger after Rugger substantially performed the contract by delivering the contracted aircraft free and clear of all liens.

The trial court concluded that Rugger breached the contract, and “as [Rugger]’s conduct violates the plain language of the Agreement, ‘substantial compliance’ cannot be shown.” Rugger argued that it performed the important provisions of the contract, known as “substantial compliance,”

and that the eight-day delay was immaterial to its performance. The trial court disagreed and awarded MCR \$90,000 in damages. Rugger appealed.

On appeal, the Court of Appeal concluded that there is an issue as to whether Rugger substantially performed its obligations under the amendment and was entitled to the entirety or a portion of the holdback. The Court found a jury should decide this issue after a trial. The Court also held that the doctrine of substantial compliance applies to circumstances where a party to a contract performs its obligations under the contract, but misses a deadline associated with such performance. The Court noted that where the contract does *not* provide a “time is of the essence” provision, performance made within a reasonable time after the due date constitutes substantial performance.

In the case of Rugger and MCR, the Court concluded that the evidence submitted by both parties showed that Rugger did not willfully depart from the terms of the contract. The Court found that Rugger diligently sought to secure the lien release, but that the lien holder resisted, and, consequently, Rugger was not able to secure the lien release until eight days after the expiration of the 90-day period. However, the Court found that MCR received what it contracted for – an aircraft free and clear of liens and encumbrances – and that the eight-day delay in the lien release resulted in no injury or damages to MCR.

The Court of Appeal then considered whether the time-is-of-the-essence provision of the parties’ initial agreement applied to the amendment. The Court initially indicated that the plain language of the provision in the initial agreement would seem to apply to the amendment. However, the Court concluded that the scope of the provision was not as simple or as obvious since MCR took title to and possession of the aircraft the day after the parties executed the amendment, and it was not clear whether the parties intended time to be of the essence with respect to the provision of a clear title.

The Court reviewed the traditional rule on the legal effect of a time-is-of-the-essence provision that when time is made of the essence of a contract, a failure to perform within the time specified is a material breach of the contract. However, the Court also noted that recent cases hold that the inclusion of such a provision does not automatically transform untimely performance into breach of contract. Further, the Court held it would not enforce a time-is-of-the-essence provision if doing so would work a forfeiture, and be inequitable.

In this case, the Court determined that if it enforced strict compliance with the time-is-of-the-essence provision, Rugger would lose not only the \$90,000 holdback to MCR, but also any reimbursement for the \$38,000 it spent on the lien release. Further, MCR, which has had possession of the aircraft since the closing date of February 23, 2016, would receive an aircraft free of liens and encumbrances as well as a \$90,000 price reduction. The Court stated that the amendment contemplated MCR receiving the aircraft free and clear of liens and encumbrances or a receiving a \$90,000 price reduction by means of the holdback, but not both.

The Court of Appeal reversed the trial court decision for MCR and remanded for additional review.

Magic Carpet Ride, LLC v. Rugger Investment Group, LLC (2019) __ Cal.App.5th __ [2019 WL 5485327]

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