MISTAKE in the LAW of CONTRACT

By Stephen Carius

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Every law student learns that one of the potential grounds for challenging the enforcement of a contract is 'mistake'. Most contract texts have a chapter on the subject. But what does it actually mean?

In order to be effective, the rules of the private law must be predictable. In contract, objectivity is the principle that infuses each of these rules. The law is not sympathetic to a person who labours under a purely subjective misapprehension, unless that state of mind was caused by some wrongful conduct on the part of another party. And yet, to speak of a 'doctrine of mistake' is to accept that a mistake may be actionable even where it is purely self-induced. Some cases appear to recognise mistakes of this kind.

However, if mistake is to have any role in the law of contract, it must be a limited one. To allow mistake a free rein would compromise the integrity of commercial transactions and undermine the purpose of having well-established rules with relatively predictable outcomes. This assertion is consistent with the approach taken by the courts. But as a matter of principle, how does one decide which mistakes are actionable and which ones are not?

An analysis of the cases makes it difficult to discern any unified doctrine of mistake. While there are some quite recognisable types of case in which a 'mistake' is held to be operative, these cases do not appear to have much in common. In my view, the problem arises because the term 'mistake' is a misnomer. All mistake cases are defined as such by reference to other contractual doctrines, which are much more likely to provide guidance to practitioners as to the resolution of so-called 'mistake' disputes. On closer inspection, there is little (if any) scope for a meaningful doctrine of mistake, and the 'mistake' cases need to be reconsidered in this context so that clients can be properly advised as to their legal rights.

SPECIES OF MISTAKE

Let us examine the orthodox taxonomy that applies to the doctrine of mistake. This can be found in any common law textbook and is frequently adopted by judges as well. According to this scheme, there are three categories of mistake: common mistake; mutual mistake; and unilateral mistake. A 'common mistake' occurs in respect of a contract where both parties are labouring under the same erroneous assumption. 'Mutual mistake' refers to a situation where both parties are mistaken, but they are mistaken about different things. 'Unilateral mistakes' arise where only one party is mistaken; the other party is either oblivious to the mistake or has actively induced it. In addition, a separate doctrine applies where an illiterate person signs a document that they do not comprehend; this is called a plea of *non est factum*.[1] >>

The aforementioned categories refer to the form of the mistake without telling us anything about the substance of it. Different considerations arise depending on the substantive nature of the mistake and (to an extent) different rules apply.

It is useful to note the major categories of substantive mistake that can arise:

(a) mistake over the subject matter of a contract (either its existence or its qualities);
(b) mistake as to the identity of the contracting parties; and
(c) mistake in the text of a written document.

As we shall see, the courts intervene to varying degrees, depending on the substantive nature of the mistake.

Finally, mistakes can also be categorised according to their legal consequences. The remedies that are available will depend largely on whether the mistake is operative at law or in equity. Mistake is fundamentally a common law concept. At common law, a contract is either valid or void and where a mistake is operative a contract may be declared void. In equity, however, a contract may be voidable (that is, the party who is aggrieved by the mistake has a right to elect either to rescind the contract or to affirm it). Equity has remedies at its disposal that are not available at law (for example, rectification). The scope for equity's intervention in cases where a mistake is operative is highly contentious. While equity's intervention is discretionary, a number of rules guide this discretion, and it is important to understand what role (if any) it has in the present context. This matter is explored in the analysis of each of the categories of mistake below.

Common mistake at law

A contract may be void on the basis of a common mistake. In this situation, the parties have entered the contract on the basis of a common assumption of fact that later proves to be erroneous. This is usually a mistake about the subject matter of the contract (for example, the existence thereof or its quality). The early case of *Couturier v Hastie*[2] is an example of such a mistake. This case concerned a contract for the sale of corn. Unknown to both parties, the corn had been destroyed by the time of the sale. The House of Lords held that since both parties entered the contract upon the 'common mistake' that the corn actually existed, and since it had in fact perished, the contract was void. A rule to this effect has now been codified in each of the Sale of Goods Acts[3] of each of the states. Importantly, the court in *Couturier* resolved this question, not by reference to a stand-alone doctrine of mistake, but rather by an exercise in contractual construction.[4]

In addition, there are some rare cases in which a contract will be void because of a common mistake as to the quality of the subject matter. In *Bell v Lever Brothers*,[5] a company reached a compromise agreement terminating the services of its managing director. The company later discovered that, at the time of the compromise, it had grounds to terminate the manager's contract for misconduct. It argued that the compromise agreement was therefore void. The House of Lords rejected this argument, holding that while a contract could be rendered void on the basis of a 'common mistake', the mistake in this case was not of sufficient importance or materiality.[6] Thus, a contract is void on the grounds of a common mistake only if the mistake is – for want of a better word – 'fundamental'. The problem arises when distinguishing between fundamental and non-fundamental mistakes.

The problem is best resolved by disregarding an independent concept of 'common mistake' altogether and adopting what Lord Atkin called 'the alternative mode of expressing the result of a mutual [sic] mistake'.[7] This approach has found favour in the leading High Court case of *McRae v Commonwealth Disposals Commission*.[8] In this case, the Commission sold an oil tanker and its contents, which were said to be wrecked at Jourmaund Reef. It turned out that there was no such oil tanker at that location and McRae sued for damages. The Commission claimed that the contract was void because both parties laboured under a common mistake about the existence of the oil tanker.

The reasoning adopted by the High Court was based solely on contractual construction. It held that if the common assumption of fact constitutes an implied condition precedent, which must be satisfied for the contract to come into existence, then the failure of that condition precedent will render the contract void. In this case, the Court found no such condition precedent. Rather the vendor had promised that the goods were in existence and, as such, McRae was entitled to sue for damages.[9] The implied term approach is clearly applicable whether the mistake pertains to the existence of the subject matter of a contract or the quality thereof, and it provides a more principled explanation for the decisions in cases of 'common mistake'. In my view, this is the correct approach to such cases in Australia and, as such, any reference to 'common mistake' is unnecessary.

Common mistake in equity

In *Solle v Butcher*,[10] Lord Denning advanced the view that there is a distinct form of mistake recognised in equity. The scope of equitable mistake is even more controversial and its very existence is highly questionable given the foregoing discussion. In *Solle v Butcher*, Lord Denning did not articulate the limits of mistake in equity except to indicate that it was a broader and more flexible doctrine than that expressed in *Bell v Lever Brothers*.[11] The existence of an independent equitable jurisdiction for mistake has found some positive comment in Australia,[12] but has not been authoritatively applied. Recently, in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd*,[13] the English Court of Appeal rejected the equitable form of mistake as formulated in *Solle v Butcher*.[14] In my view, the authorities cannot sustain the claim that there is (in Australia) an independent equitable doctrine of mistake that may render an otherwise valid contract voidable at the suit of an aggrieved party.

This is not to imply that there is no role for equity. Equity has jurisdiction to intervene to ameliorate the harsh effects of common law rules. One example applicable to certain kinds of genuine mistake is the remedy of rectification. However, where rectification is concerned, the mistakes in question are not mistakes about the agreement itself; rather, they are mistakes about the document that purports to

express the parties' intentions. Where, through some error, a written document does not correspond to the intention of the parties who negotiated it, a court of equity may rectify this defect.[15] The remedy of rectification may be sought in cases of both common and unilateral mistake.[16] The party seeking rectification bears the onus of proof, and the evidence must be quite persuasive.[17] However, the court will intervene only in limited circumstances where it would be unconscionable for a party to rely on the strict terms of the written document.[18] A detailed discussion of rectification is beyond the scope of this paper, but it is a remedy that needs to be considered in cases of common and unilateral mistake.

Mutual mistake

The second species of mistake is the 'mutual' mistake. This is a circumstance where the parties are simply at cross-purposes. For example, A intends to contract with B to purchase X and B intends to contract with A to sell Y. Both parties are mistaken, but in a substantively different way. In my view, to characterise this kind of dispute as a 'mutual mistake' is quite incorrect. Essentially, this is a contractual dispute about the terms of the agreement.

Courts are frequently called upon to resolve competing claims as to the meaning of a contract, and they do not need to resort to a doctrine of mistake. In the usual course of events, the court will consider the verbal and non-verbal evidence probative of the parties' intentions and determine, objectively, which parties' contention as to the meaning of the contract is correct.[19] Alternatively, if the court is unable to ascertain any objective common intention, then the contact is void. However, such a purported contract is void not because it is vitiated by a mutual mistake but, rather, because there is a lack of correspondence between offer and acceptance.

It follows that where the parties have radically different expectations about the performance of a contract, their dispute can be resolved in one of two ways: firstly, the court can declare that the contract is void for lack of a true meeting of minds; alternatively, if the court finds that there was a meeting of minds, it is simply a matter of construction to determine which party's expectations should be fulfilled. Any reference to a concept of mistake and any incorporation of this term in the resolution of such disputes is likely to lead to incoherent reasoning and unpredictable results. Once again, cases of so-called 'mutual mistake' are incorrectly designated, and practitioners should eschew such terminology when making an assessment of their clients' prospects.

Unilateral mistake

The last category to be considered is the unilateral mistake. 'Unilateral mistakes' refer to situations where one party is under a misapprehension but the other party is not. Such mistakes usually arise with respect to the subject matter of the contract or the identities of the contracting parties. But the reference to 'mistake' in this context is just another misnomer.

Consider the case of a unilateral mistake as to the identity of a contracting party. This is a field of growing interest, particularly where the proliferation of information databases has increased the risk of identity fraud. The standard problem is simply stated. Suppose A contracts with B, believing him to be C. The transaction is completed. B sells the subject matter of the transaction to D and then A discovers that B is an impostor and cannot fulfil his side of the bargain. We shall assume that B is insolvent or has emigrated to Majorca so A has only one practical remedy; namely, to sue the other innocent party, D. Whether A has any cause of action against D depends on whether the transaction between A and B was void or merely voidable. There have been a number of reported decisions involving disputes of this kind.[20] In these cases, there is a distinction between mistakes of identity where the parties negotiate face-to-face[21] and those where they negotiate *in absentes*.[22] Regrettably, there remains a division of opinion about the legal consequences of such transactions.

The recent House of Lords decision of *Shogun Finance Ltd v Hudson*[23] illustrates this problem. In this case, a rogue signed a hire-purchase agreement with Shogun using a false identity (Mr Patel) and was given possession of a motor vehicle. The next day, the rogue sold the vehicle to Mrs Hudson who purchased it in good faith and without knowledge of the hire-purchase agreement. While at common law the rogue did not have good title, Mrs Hudson sought to rely on a statutory exception whereby a debtor to a hire-purchase agreement is allowed to transfer the creditor's title if the >>

third-party transferee purchased in good faith and without knowledge of the hire-purchase agreement.

The case turned on whether the rogue was a 'debtor' within the meaning of the Act. In other words, was the hire-purchase agreement void (in which case the rogue was not a debtor) or voidable? The House of Lords was split 3:2 on the question. The majority held that upon a proper construction of the written agreement, there was no contract between Shogun and the rogue; the contract was therefore void.[24] Lord Millett and Lord Nicholls of Birkenhead disagreed. They held that where two parties deal with each other, then a contract arises between them notwithstanding the fact that one of the parties has deceived the other about his identity. On this view, the contract was voidable on the basis of the fraudulent misrepresentation, not void.[25] This question has not been resolved in Australia, but the position of the majority of the House of Lords is likely to be persuasive.

A unilateral mistake can also arise in respect of the terms of the agreement. In this context, the case of *Smith v Hughes*[26] is significant. A farmer entered an oral contract to purchase a particular parcel of oats (sold by sample). The purchaser believed that the oats were 'old oats' but he was mistaken. He argued that because of this mistake, there was no meeting of minds and thus no contract. The court rejected this argument. There was no evidence that the other party knew of this misconception or did anything to induce it.[27] Upon a proper construction of the transaction, the purchaser had agreed to purchase the oats. Where one of the parties is aware of the mistake or has induced it, then the situation may be quite different. The courts do not allow an unscrupulous party to 'snap up' an offer where it would be unconscionable to do so.[28] In particular, where the mistake arises from an innocent, negligent or fraudulent misrepresentation, the contract is rendered voidable and may be rescinded at the suit of the aggrieved party.

Thus, while the law of 'unilateral mistake' is not entirely settled, none of the cases needs to rely on an independent doctrine of mistake. There is no advantage (and considerable disadvantage) in referring to 'mistakes' in these cases. Disputes of this kind are resolved by reference to the rules of offer and acceptance (where the contract is held to be void) or to vitiating factors such as innocent, negligent or fraudulent misrepresentation.

CONCLUSION

Confronted with a contractual dispute in which one party alleges a mistake, practitioners should attempt to re-classify the dispute in order to place it on a more principled foundation. While references to mistake continue to be made in both the cases and the literature, this arises more for historical reasons and seldom has any bearing on the legal rule used to resolve the dispute. In general terms, the legal position may be summarised as follows:

1. Where the parties purport to enter an agreement on the basis of a common erroneous assumption, the agreement will be void if they impliedly agreed that the common assumption was a condition precedent to the formation of the said agreement.
2. Where the parties are at cross-purposes as to the terms of an agreement, this dispute must be resolved by a process of construction unless the parties' intentions are so at odds that there is a lack of correspondence between offer and acceptance.
3. Where one party is under a misapprehension about an agreement but the other party is not, the agreement will be construed objectively according to its terms unless there is either (a) a lack of correspondence between offer and acceptance; or (b) some inducement by the unmistaken party rendering the contract voidable at the election of the mistaken party.
4. Where a mistake occurs in the text of a document, such that the document does not reflect the parties' real intentions, there is an equitable jurisdiction to rectify the written terms of the document. ■

Notes: **1** This is not discussed in this paper but, for reference, see: *Saunders v Anglia Building Society* [1971] AC 1004, 1019; *Petelin v Cullen* (1975) 132 CLR 355 at 359; *Muskham Finance Ld v Howard* [1963] 1 QB 904, 912 per Donovan LJ; *Saunders v Anglia Building Society* [1971] AC 1004, 1019 per Lord Pearson; *LF v RA* (2006) 2 Qd R 561, 568-9 per White J; *Frank Fat NG v Ha Duk Chong* [2005] NSWSC 270, [21] per Hamilton J; *Perpetual Trustees of Victoria v Ford* (2008) 70 NSWLR 611, 626-7 per Harrison J; *Downham v McCallum* [2008] TASSC 81, [78] per Porter J; *Cellnet Group Ltd v Fan-Min (Michael) Kong & Anor* [2007] QDC 005.
2 (1856) 5 HLC 673; 10 ER 1065. **3** Section 11, *Sale of Goods Act* 1923 (NSW); s11 *Sale of Goods Act* 1954 (ACT); s10 *Sale of Goods Act* 1972 (NT); s9 *Sale of Goods Act* 1896 (Qld); s6 *Sale of Goods Act* 1895 (SA); s11 *Sale of Goods Act* 1896 (TAS); s11 *Goods Act* 1958 (VIC); s6 *Sale of Goods Act* 1895 (WA). **4** *Couturier v Hastie* (1856) 5 HLC 673 at 681. **5** [1932] AC 161. **6** *Bell v Lever Brothers* [1932] AC 161, 225-6 per Atkin LJ. **7** *Ibid*, 224-5 per Atkin LJ. Here 'mutual mistake' means 'common mistake'. **8** (1951) 84 CLR 377. **9** *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 407 per Dixon and Fullagar JJ. **10** [1950] 1 KB 671. **11** *Solle v Butcher* [1950] 1 KB 671, 693-4 per Lord Denning. **12** *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377 at 402, 407 ; *Svanosio v McNamara* (1956) 96 CLR 186 at 195-6; *Taylor v Johnson* (1983) 151 CLR 422 at 429-31; 45 ALR 265 at 269-71 per Mason ACJ, Murphy and Deane JJ. **13** [2003] QB 679. **14** *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2003] QB 679, 724-6 per curiam. **15** *Riverlate Properties Ltd v Paul* [1975] Ch 133. **16** *A Roberts & Co Ltd v Leicestershire County Council* [1961] Ch 555 per Pennycuick J. **17** *Pukallus v Cameron* (1982) 180 CLR 447 at 452; per Wilson J; *Atlantic Marine Transport Corp v Coscol Petroleum Corp (The Pina)* [1991] 1 Lloyd's Rep 246 at 250; *Mangistaumunaigaz Oil Production Association v United World Trade Inc* [1995] 1 Lloyd's Rep 617 at 621 per Potter J.
18 *Riverlate Properties Ltd v Paul* [1975] Ch 133, 140-1. **19** *Raffles v Wichelhaus* (1864) 2 H & C 906. **20** *Cundy v Lindsay* (1878) 3 App Cas 459; *Phillips v Brooks Ltd* [1919] 2 KB 243; *Ingram v Little* [1961] 1 QB 31; *Lewis v Averay* [1972] 1 QB 198; *Hector v Lyons* (1988) 58 P & CR 156; *Shogun Finance Ltd v Hudson* [2003] 3 WLR 1371. **21** *Lewis v Averay* [1972] 1 QB 198, 207 per Lord Denning. **22** *Cundy v Lindsay* (1878) 3 App Cas 459, 465 per Lord Cairns. **23** [2004] 1 AC 919. **24** *Shogun Finance Ltd v Hudson* [2004] 1 AC 919, at 942-942 (per Lord Hobhouse), at 976 (per Lord Phillips of Worth Matravers), and at 979 (per Lord Walker of Gestingthorpe). **25** *Shogun Finance Ltd v Hudson* [2004] 1 AC 919, at 937-938 (Lord Nicholls of Birkenhead) and 953 [81]-[82] (Lord Millett). **26** (1871) LR 6 QB 597. **27** *Smith v Hughes* (1871) LR 6 QB 597, 609 per Blackburn J. **28** *Taylor v Johnson* (1983) 151 CLR 422, 433 per Mason ACJ, Murphy and Deane JJ.

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