

## PART III – MISTAKE

### I OVERVIEW

#### A Introduction

The doctrine of mistake is concerned with the operation of a false but genuine belief held by one, or both, parties to a contract such as to induce its formation under a misapprehension as to its terms or nature. Principally, the doctrine serves to uphold the classical contractual notion that both parties in a transaction are rational actors capable of acting in furtherance of their own interests. It does so by allowing misinformed parties to escape their obligations without incurring liability to the other. If either of the parties agrees to the contract under an erroneous belief about its nature or effect, it cannot be said that they truly consented to its terms as objectively agreed.

The question asked by the doctrine of mistake is: 'can a party avoid performance of a contract when they have made a mistake?' For there to be any possibility of avoidance, there must be a causal relationship between the operation of the mistake and the party's entry into the contract.

Differences between a party's subjective understanding and the objective standards by which contractual intentions are legally evaluated comprise the principal source of conflict within the doctrine. Subjective misunderstandings of a contract are traditionally eschewed in favour of objective inferences from conduct, making the use of mistake as a doctrine to vitiate agreements a somewhat problematic departure from established principles. The operation of common law mistake is thus tightly confined (though equitable rescission for mistake is slightly wider in scope).

Mistake looks at the situation and any beliefs possessed as their subjects exist when the contract is made. That is, mistakes about future events or things yet to be done are not the subject of the doctrine. (Note, however, that the contract may be frustrated in such cases, justifying termination.)

#### B Relationship between Mistake and Misrepresentation

Mistake is different to misrepresentation in that it is purely an excuse. Unlike misleading and deceptive conduct, for example, it does not provide a statutory cause of action nor any right to relief by way of damages. Mistake is purely defensive, allowing mistaken parties to deny their obligations under the contract to which they have erroneously agreed. A mistake will usually be raised as a defence to a claim of enforcement against that party for failing to perform (or for their anticipatory breach).

Further differences:

- Misrepresentations of third parties induce the creation of the contract; by contrast, mistakes that induce entry into a contract are made by the party themselves
- Misrepresentation is a more powerful doctrine to raise, since it has an offensive component as well as a defensive (excusatory) one
  - Note: *Solle v Butcher* (defendant raised both misrepresentation and mistake, in the alternative, simultaneously)
- The mistaken party may attempt to attribute their incorrect belief to the other party
  - There is thus a large overlap between mistake and misrepresentation

Note every mistake allows rescission. Were that the case, many everyday transactions would become unduly complicated, and contracts would lose their certainty. Parties rarely possess a complete understanding of all relevant facts and terms, so some element of risk must be involved in committing to obligations – at least to the extent that any of those facts and terms may turn out to be constituted differently to that party's original perception or understanding.

With this in mind, two types of mistake may be identified:

- 1 *Inoperative mistakes*  
These mistakes are trivial or unimportant, and do not provide a valid excuse to performance of the terms of the contract
- 2 *Operative mistakes*  
These mistakes are legally significant because they are sufficiently severe to justify rescission

### C *Classes of Mistake*

The classification of mistakes is a somewhat haphazard, at times arbitrary process, leading some commentators to liken its many overlaps and intersections to Borges' *Chinese Encyclopaedia*.<sup>1</sup>

Broadly, three classes of operative mistake exist:

- 1 *Common (shared) mistakes*  
These mistakes are common to both parties, who each make the *same* mistake
- 2 *Mutual mistakes*  
Here, both parties each make complementary (but different) mistakes
- 3 *Unilateral mistakes*  
A mistake is made by only one party

Of these categories, mutual mistake is the most exceptional. In order to occur, both parties must each hold mutually exclusive but equally plausible interpretations of the contract. As such, it will only arise in an ambiguous contract where a term is capable of more than one meaning.

The first step in an analysis of mistake is thus to classify the mistake into one of the three categories of operative mistakes. This is an important preliminary step, because different rules (arguably) apply to each category.

In summary, the primary distributive classification consists in

- shared/common
- mutual; and
- unilateral

mistakes.

However, mistakes may also relate to

- subject matter; and
- identity;

though these are usually subsidiary classes.

---

<sup>1</sup> MP Ellinghaus, 'Mistake' [Lecture], *University of Melbourne*, 12 August 2004.

## D *Effect of Mistake*

A mistake, successfully raised, will result in a court order declaring the contract void (setting it aside *ab initio* – at common law) or voidable (in the case of equity).

Different rules apply to mistakes at common law to those in equity. If the common law accepts that a mistake is operational, then contract is void *ab initio*. In equity, however, the contract is merely said to be *voidable*, meaning that the contract remains valid until the party relying on the mistake elects to avoid their obligations.

This distinction between void and merely voidable is important for third parties upon whom the contract confers rights or benefits. For example, if a contract purports to sell an item, which is later sold to an independent third party, then if the original contract of sale is found to be void *ab initio* then the third party does not possess good title. However, if that contract is merely voidable, then if the resale occurs prior to the avoidance, valid title passes.

No component of the doctrine relates to the restriction upon or loss of a 'right' to rescind for mistake, because it is purely concerned with the creation of an *excuse*. The excuse, once established, immediately justifies non-performance.

## II COMMON MISTAKE

### A *Common Law Approach*

The common law approach to common (shared) mistake is set out in *McRae v Commonwealth Disposal Commission*.

#### ***McRae v Commonwealth Disposal Commission (1951) HCA:***

##### Facts

- An advertisement for an oil tanker stranded in the ocean nearby New Guinea is placed by the Commonwealth
- In fact, no oil tanker exists at the location to which the advertisement refers – there is only a barge
- McRae makes an offer for what both parties believe is a 'tanker', signs an agreement, pays money, hires salvage equipment, and sails for New Guinea to collect the tanker
- Upon arriving, McRae discovers that no tanker in fact exists and brings an action against the Commission for breach of contract, claiming damages for the costs of his expedition
- However, the Commission asserts that it was mistaken as to the existence of the tanker, and that the contract should consequently be voided [???

##### Issue

- Can the contract of sale be void for common mistake at common law?

##### Reasoning

- No, there is no rule at common law that allows common mistake to operate such as to void a contract

- There is no doctrine of common mistake at common law
- The only question to be asked is: ‘was the promisor’s promise conditioned on the existence of the presumed state of affairs?’
  - This is a question of construction (ie, interpretation) similar to that encountered in the context of conditional formation (*Masters v Cameron*)
  - If the promise was so contingent, then the failure of those affairs to be manifested will prevent the contract coming into existence
  - However, if the contract was not contingent upon the presumed state of affairs, then the contract continues on foot until validly terminated
- Even if such a doctrine did exist, it does not apply where, as here, the mistake is the fault of the party seeking to rely upon it
  - Such a rule could not apply to *McRae* because the buyer was here induced to believe in the existence of the tanker by the recklessness of the Disposal Commission
  - The Commission induced the common mistake, and now seeks to use it to avoid their obligations under the contract
  - Mistake cannot be relied upon by the party that induces the common mistake

#### Decision

- The Disposal Commission is liable because they did not make their promise to sell the tanker conditional upon its existence
- The Commission initiated the transaction and are responsible for the mistaken assertion made and induced in the other party by them
- Therefore, it may be inferred that no common intention to make the contract conditional on the tanker’s existence existed, and thus the contract validly came into existence

Other views have been expressed as to the existence of common mistake at common law. Most notably, the House of Lords has stated that it *is* a doctrine at common law, but that it is confined to cases where the mistake is of a ‘radical nature’ or is ‘fundamental’ with respect to the contract. This approach is also said to affect the equitable doctrine.

If common mistake is indeed a doctrine, it seems clear that it applies only in certain exceptional circumstances. At least two examples are given:

- 1 Where the subject of the contract is not in existence (*res extinctas*); or
- 2 Where the title to the land being sold is already owned by the buyer (*res sua*).

Authority exists for the application of common mistake to these situations.<sup>2</sup> However, it is also frequently the case that contracts forming in these situations are nevertheless valid. As it stands, it seems unlikely that the common law doctrine of mistake has any independent operation.<sup>3</sup>

<sup>2</sup> The House of Lords view (exists but confined) is more recent than the High Court of Australia’s denial of the doctrine in *McRae*, and is perhaps an indication of the direction that the Australian common law will take in the future.

<sup>3</sup> Seddon and Ellinghaus, *Cheshire and Fifoot’s Law of Contract* (8<sup>th</sup> Aust ed, 2003) [12.21].

## B *Equitable Approach*

Denning LJ originally proposed that equity can intervene in cases of common mistake.

### ***Solle v Butcher* (1949) HL:**

#### Reasoning

- The equitable jurisdiction encompasses mistake generally – even common mistake (Denning LJ)
- Equity can set aside a contract on the basis of common mistake
- However, the result is that the contract becomes voidable (but not yet void or void *ab initio*)

### ***Svanosio v McNamara* (1956) HCA:**

#### Reasoning

- Accepts Denning LJ's proposition that equity can set aside contracts on the basis of mistake
- The case is ultimately decided on a non-equitable basis, however

The High Court of Australia appears to have accepted this view in *Taylor*, which, together with *Svanosio*, clearly establish an equitable jurisdiction which may result in the voiding of a contract due to common mistake on a basis similar to unilateral mistake.

### ***Taylor v Johnson* (1983) HCA:**

#### Reasoning

- Applies equitable doctrine in the context of *unilateral* mistake to vitiate the formation of a contract in circumstances of mistake

As a further complication, the House of Lords recently reversed *Solle* (*Great Peace Shipping*). In this case, it was decided that the common law jurisdiction does exist, but only where the actual state of affairs comprises a 'radically different subject' to the mistaken parties' belief. The equitable jurisdiction of *Solle v Butcher* 'a chimera'.

The relevant UK principle may be stated as follows:

- A contract formed on the basis of a mistake that*
- *Is shared by the parties;*
  - *Relates to facts existing at the time the contract was made; and*
  - *Renders 'the subject matter of the contract essentially and radically different from the subject matter which the parties believed to exist';*
- is void ab initio at common law* (*Great Peace Shipping Ltd*).

In light of the House of Lords' rejection of *Solle*, two possibilities exist for the future of the equitable doctrine of common mistake in Australia:

- 1) The High Court of Australia again follows the House of Lords, overruling *Taylor* and *Swanasio* and denying the equitable jurisdiction in relation to common mistake; or
- 2) The High Court of Australia (perhaps wary of again following the UK approach and subsequently being misled) affirms *Taylor* as good law.

No preference for either course has yet emerged from recent case law.

## II MUTUAL MISTAKE

### A General Approach

Mutual mistake is the category most ready to allow mistakes to operate as an excuse to invalidate the contract – it poses a powerful reason to do so, in light of traditional contractual principles, since *both* parties are each mistaken (contractual intention is neither accurate nor shared).

However, cases of mutual mistake are also relatively rare, since they require an ambiguity susceptible to multiple, equally valid meanings. There is no difference between the approaches of the common law and equity: ‘equity follows the law’.

*Goldsborough Mort* provides an example of a mutual mistake.

#### ***Goldsborough Mort* (1910) HCA:**

##### Facts

- The price of a parcel of land is set at 30 s/- per acre on a freehold basis
- However, the land is only partly freehold
- The buyer thought that this term meant “30 s/- per acre but only if the vendor bore the cost of converting all the land to freehold”
- The seller thought that the term only “made the sale conditional upon all land being sold on a 30 s/- per acre basis”

##### Issue

- Will the mutual mistake of the parties vitiate their respective obligations under the contract?

##### Reasoning

- Mutual mistake arises whenever there is any ambiguity in the contract

### B Requirements

Ordinarily, mutual mistake will be sufficient to invalidate a contract. However, if an objective meaning can be given to the term misunderstood the parties, the contract will remain on foot.

Thus, in *Raffles v Wichelhaus*, where two identical ships were docked (only one of which was the subject of the contract, and whose identities were misunderstood), it was noted that it was difficult

to give the contract any objective meaning – the reference to the ship could equally refer to either ship A or ship B. Therefore, the contract was void at common law.

This is unlike *Life Assurance v Phyllis*, where each party was mistaken about the other's intentions. Here, however, an objective meaning was capable of being given to the words spoken by the parties. In this case, though the parties acted under mutual and complementary mistakes, they are still each bound by the contract's actual construction.

### III UNILATERAL MISTAKE

#### A Common Law Position

Unilateral mistakes form the most common class of mistake in contemporary transactions. Here, the question to be raised is, 'can the common law void a contract where one party is mistaken?'

At common law, the reception of unilateral mistake is initially hostile: prima facie, unilateral mistake is not a valid basis for invalidating a contract (*Taylor v Johnson*).

Thus, the objective meaning of a term prevails over a party's subjective belief, even if the individual party is mistaken as to the objective meaning:

*Neither party can rely on his own mistake...if there is an objective meaning, that prevails.*

Were a party able to rely on their own misinterpretation of a clause in a contract, they would effectively be able to dictate a favourable interpretation of the contract.

However, this position is qualified by several exceptions – most importantly, *non est factum*. Mistake as to the identity of a party is also a recognised exception (*Taylor v Johnson*).

#### B Non Est Factum

Non est factum, literally 'it is not done', may apply if a contract is signed on the basis of a mistake as to the very nature of the contract. Where applicable, the doctrine of non est factum has the effect of overcoming the common law's reluctance to recognise unilateral mistake, voiding the contract *ab initio* and freeing both parties from their obligations under the contract.

#### ***Petelin v Cullen* (1975) HCA:**

##### Facts

- P, an individual lacking familiarity with the English language, thought he was signing a receipt, but it was actually an option paper giving C a right to buy P's property
- Six months later, the option expires; C encloses £50 in a letter to P, in consideration of an extension of the option
- P does not respond, so C visits P, showing him an extension form
- C says to P: 'sign this to receive another £50'
- P signs, mistakenly believing that it was a receipt for the £50

Issue

- Can P escape his obligations under the option extension on the basis of a unilateral mistake made by him about the fundamental nature of the agreement?

Reasoning

- The person pleading unilateral mistake must be either unable to speak or unable to read
  - Eg, blind, foreign migrant, etc
- Non est factum is *not* available against an innocent party where the mistaken party merely signs carelessly
- Here, P was not careless he was entitled to believe it was a receipt
- Because C knew P could not read English properly, he cannot assert that he was an innocent party, or that P was careless in examining the document

Decision

- Signing the extension was a 'non est factum' and the option agreement is voided

Thus, at common law, unilateral mistake is not sufficient to avoid a contract *unless* non est factum, or one of the other exceptions, applies.

### C *Mistaken Identity*

If a party fraudulently represents themselves as someone else (eg, an authorised agent) and induces the other to enter into a contract, that other is said to be operating under a unilateral mistake as to identity. Where that other then contracts with an innocent third party, if the original contract is rendered void, the third party would suffer loss.

If only equitable remedies are available, the mistaken party will bear the loss and the existence of the third party will prevent an order for rescission. However, if the contract is void for mistake at common law, the *nemo dat* principle dictates that the third party will bear the loss.

### D *Equitable Approach*

Equitable mistake is prepared to intervene far more powerfully. Equity will render voidable a contract in cases of unilateral mistake if it falls within the bounds of the principle enunciated in *Taylor v Johnson*.

#### ***Taylor v Johnson (1983) HCA:***

Facts

- Mrs J is a local farmer, and Mr T a local businessman
- J signs a document entitling T to purchase 10 acres of land for a total of \$15 000
- J did not read the document because she was without her reading glasses at the time
- J *believes* she is signing a document that provides for \$15 000 per acre of land to be sold (thus, \$150 000 in total)
- The market value of the land is \$50 000, but this might increase to \$195 000 if a residential rezoning were to occur
- J, thinking she is getting a good price, signs with alacrity



- T does not mention the price again, realising she was making a mistake as to the cost per acre he was paying her
- Meanwhile, J thinks T is the one making the mistake by paying so much, so she does not mention the price to him either
- J later discovers the actual content of the contract to specify the much lower price
- She sues T for specific performance at the higher price

Issue

- Is Mrs J's unilateral mistake operative?

Reasoning

- The contract would not be void at common law because non est factum does not apply and the mistake does not pertain to the identity of the parties
- However, equity *can* set aside the contract in circumstances where:
  - Broad view:
    - It would be unconscionable to enforce the contract in light of the mistake
    - That is, the mistake will be allowed to operate if it would be unconscionable to enforce the contract according to its objective interpretation; or
  - Narrow view:
    - A party who enters into a contract under a mistake may assert voidance if the other party is aware of the mistake and takes deliberate action to maintain it

Decision

- Here, Mr T knew Mrs J was making a mistake and took great care in ensuring Mrs J remained under its influence
- Therefore, according to both the narrow and broad views of equitable intervention, the contract should be voidable

It may be remarked that *Taylor v Johnson* marks a radical simplification of mistake under the heading of unconscionability.

## IV HYPOTHETICAL

### A Exercise 7

The many mistakes of Austin ('A'):

- (a) Unilateral mistake, voidable in equity
  - Ask whether unconscionable
  - Here, not really – just looking for a bargain
- (b) Unilateral mistake, as above
  - Here, unconscionable
  - Deliberately seeking to maintain the mistake
- (c) Common mistake, *McRae* applies

- In equity, if *Taylor v Johnson* is to be followed, then unconscionability should be examined
- (d) Common mistake, as above
- (e) Common mistake (thinking that it is owned by A)
- (f) Non est factum
  - Ask whether Dr E is innocent
  - If A was careless, won't apply
- (g) Mutual mistake, void at common law or voidable in equity