Chapter 8: Mistake and Excuse

A. Introduction

B. Mistaken Beliefs About Facts That Exist at the Time of Agreement

1. Excuse Based on Mistake: (Herein of "Unilateral" and "Mutual" Mistake"

a. Hypo: A gemologist buys the largest sapphire in the world at a rock show for $5.00 to be delivered after the show. Must the seller deliver? If it has been delivered, can the seller get it back? Is it relevant that the buyer is a gemologist and not a lucky purchaser?

b. Hypo: Pedestrian is injured by negligent Driver. Driver offers to pay $1,000 in exchange for a complete release, and Pedestrian accepts. Subsequently, it is determined that Pedestrian had extensive latent injuries. Can Pedestrian rescind the contract? Is it relevant whether Pedestrian saw a doctor prior to the settlement? What if the doctor advised Pedestrian that a full diagnosis was impossible without additional tests, and Pedestrian settled prior to those tests?

c. *Sherwood v. Walker* (p. 694): According to the majority opinion, this case involved mutual mistake. The dissent, though, sees it as a case of unilateral mistake. See Note 4 (at 706) for the Court's subsequent rejection of the *Sherwood v. Walker* opinion.

d. *Anderson Brothers Corp. v. O'Meara* (p. 699): Does the court see this as a case of mutual mistake or unilateral mistake? Is that determinative, or is there something more? Note that the court criticized the buyer for sending a nonexpert to inspect the dredge. Note also that the dredge can be resold. Is that relevant? See RESTATEMENT OF CONTRACTS (2D) §152(2). Assuming the buyer had no knowledge that there were multiple types of dredges, was it really unreasonable for the buyer to make no inquiry? Should "unreasonable" be defined by reference to someone in the buyer's industry? How much does anyone know about what they do not know?

e. Mistake Under the RESTATEMENT (2D) OF CONTRACTS

i. A mistake is "a belief that is not in accord with the facts." §151.

ii. Note that the Restatement provides different rules for mutual mistake (§152) and unilateral mistake (§153). Is it fair to say that mutual mistake means that neither party considered the possibility of error, so that the risk of error was not allocated and neither knew of his insufficient information?

iii. Suppose a subcontractor mis-estimates the cost of a job because the subcontractor did not properly use estimating software? Is that a mistake that should permit recision?

iv. The baseball card case (Note 3 at 705): According to Kull, the outcome should turn on whether the buyer thought the seller has misvalued the card (no recision) or missorted the card (recision). Note the mention of the "windfall" principle. Kull determined that regardless of what courts wrote, the actual outcome generally was to leave parties where they in those cases *when the good in question was worth more than anticipated*.

v. Problem 8a (p. 709): Assuming that sterility cannot be determined at the age of 16 days, the buyer knew that it was purchasing without knowledge of breeding ability. The buyer should lose.

2. Mutual Mistake and Reformation

a. *Aluminum Co. of America v. Essex Group, Inc.* (p. 710):

i. Why is this opinion so long? Note that it is the trial court's opinion.

ii. The court calls this a mistake of a present fact, but it certainly is using the term "mistake" in a nonstandard way. Most courts would say the issue turns on impossibility or commercial impracticability. Note that the court, in footnote [8] (p. 717), does not understand the doctrine of frustration.

iii. What did the court hold? Note that the court did not allow the defense of impracticability to excuse performance by ALCOA but instead used that defense to permit an enforced adjustment of the price term in the contract. Given the market price of aluminum at this time, Essex did better under this outcome than under a discharge of all further obligations. Notice also the gloss that this opinion places on the mutual mistake cases: if the price reflects some element of risk associated with two possibilities, neither possibility will justify recision; but if the price reflects only one possibility, failure will be treated as a mutual mistake.

b. *Atlas Corp. v. United States* (Note 2 at p. 724): The plaintiffs agreed to and did supply uranium to the United states under contract. After finishing performance, it was discovered that the residual "tailing" presented a significant environmental hazard, and the plaintiffs incurred substantial costs in minimizing those hazards. The plaintiffs now want the United States to bear some of those costs, arguing for "reformation" of the contract.

i. What is "reformation"? Is it a remedy that should be used to force a party to do something it has not agreed to do or to make a party do something it has agreed to do?

ii. Note that this court is unwilling to do what the A*luminum Co. of America v. Essex Group, Inc.* court was willing to do, namely redefine the obligations of the parties.

iv. Note that the changed circumstance in this case was caused by the action of one of the parties; that is, it was the United States that passed the law making performance much more expensive. Should that influence the outcome?

C. Excuse (Impossibility)

1. *Taylor v. Caldwell* (p. 85): Plaintiffs rented from defendants the Surrey Gardens and Music Hall to give four days of concerts. After the contract was signed but before the concerts were to be performed, the hall burned down, thus rendering defendant's performance impossible. *Held*, that the defendant's performance is excused by reason of impossibility.

a. Note that impossibility is a defense to an action for breach of contract but does not excuse any condition. In particular, because the music hall was not made available to the plaintiffs, they have no obligation to pay. Suppose that the plaintiff had pre-paid for the music hall. Could they recover what they had paid? Is *Fort M. Dev. Corp. v. Inland Credit Corp.* (cited in Note 6 at p. 737) relevant? Compare *Krell v. Henry* (p. 760)

b. Suppose a house burns down during a one-year lease. Should the tenant be required to pay rent? If we say that the owner of property bears the costs associated with accidents to her property unless those costs have been shifted by contract, who is the "owner" during the lease period?

2. *Howell v. Coupland* (p. 729): Would this case have come out any differently if the contract had called for 200 tons of potatoes without any mention of where the potatoes were to be grown? Is it relevant in this hypothetical situation whether the parties both anticipated that Coupland would grow the potatoes on his land?

3. *Seitz v. Mak-O-Lite Sign Contractors, Inc*. (p. 730): The defendant subcontractor provides the low bid for repair of a neon sign, and the contractor uses that bid in its overall bid and wins the contract. The contractor promptly accepts the sub's bid, but the specialist employee of the defendant becomes ill and cannot do the work so the sub cancels the contract on the ground of impossibility. *Held*, no defense because the promised performance is not rendered impossible; the defendant is free to hire someone else. Is it relevant whether the general contractor knew that the sub had only one person who could do the work?

4. *Carroll v. Bowersock* (Supplemental): Contractor sues Owner for the value of work performed, where Contractor had begun to construct a reinforced concrete floor in Owner's warehouse. During construction, the warehouse burned. Owner did not rebuild the warehouse to its pre-improvement condition, and the work done prior to the fire would not constitute substantial performance under the contract. *Held*, that Contractor may recover for such work under the contract as had been "wrought into" the structure, but no recovery for the cost of temporary support structures. Note that the court's measure of recovery places the loss on the Owner to the extent that the Contractor's work had become part of the Owner's building. Thus, the loss was allocated to each in proportion to their ownership interests. While the court suggests that the recovery is based on restitution, it is hard to see any enrichment (unjust or otherwise) to the Owner.

5. Hypos:

a. Homeowner and Painter agree that Painter will paint Homeowner's house for $1,000. Unknown to both parties, the house burned down the previous day. What result? Both parties are excused by reason of mutual mistake.

b. Same facts as in (a) except the house does not burn until the day after the contract is formed but prior to the time when Painter is to paint. Can Homeowner sue Painter for breach of contract? No: Painter has the defense of impossibility. Can Painter sue Homeowner for the fee? No: it is a condition of Homeowner's obligation to pay that Painter substantially perform. Although impossibility excuses that performance (so Painter has a complete defense to the breach action), the condition did not occur so Homeowner has no obligation to pay.

c. Same facts as (b) except Homeowner pre-pays the $1,000. Can Homeowner sue to get the money returned? Not on a theory of breach of contract because Painter has the defense of impossibility, but Homeowner will sue on a theory of unjust enrichment to get back the value of what was paid but not earned.

d. Same facts as (c), but prior to the fire Painter spends $400 on custom paint that cannot be used on any other project. When Homeowner sues on a restitutionary theory for unjust enrichment, Homeowner should get only $600 back because letting Painter keep $400 is not *unjust*: it merely covers the costs incurred by Painter that are now wasted.

e. Same facts as (d), but no pre-payment. Can Painter sue for the $400? No: no suit on the contract because no substantial performance, and no suit off the contract for unjust enrichment because purchasing the paint that now cannot be used by anyone does not enrich Homeowner.

f. Same facts as (e), but $100 of the paint was used to paint part of the house prior to the fire. If we can determine the value of the portion of the work done prior to the fire, we might award that amount to the Painter on the theory that the contract is divisible; i.e., allow a recovery of the agreed exchange for the work performed on the contract. While the contract probably was not divisible (that is, it was entire), the court might be willing to use the accident of the fire to as an excuse to stretch the boundaries of divisibility. Indeed, this outcome has the effect of making Homeowner pay for the paint affixed to Homeowner's house,

and as to such paint, Homeowner has become the owner. In the absence of a reason to shift a loss, it usually falls on the owner. Note that the result in *Carroll v. Bowersock* yields precisely this outcome. As to the valuation of the partial performance, because the contract is not truly divisible, the court is unable to determine the agreed equivalent in the contract itself, so the court must determine the value of the work performed from all the facts, and that value presumably should be the value that would have been bestowed on Homeowner by the work done so far had the fire not occurred (thus explaining the restitution language in the opinion even though not an unjust enrichment claim).

6. Commercial Impracticability

a. *Transatlantic Financing Corp. v. United States* (p. 739): Because of the closing of the Suez Canal after the contract was written, the owner of a transport barge was forced to ship goods from the United States to Iran around the Cape of Good Hope, adding about 3,000 miles to an intended journey of 10,000 miles. The carrier seeks additional compensation of less than 15% of the contract price. *Held*, for the defendant that the risk that the Canal would be closed was allocated by the parties to the carrier.

i. Note that the Suez Canal had been nationalized by Egypt shortly *before* the contract was made, so that the parties were aware of instability in the area. The parties also knew that the Cape route was a commercial alternative to the Canal route.

ii. Suppose the court had determined the carrier could successfully assert the defense of impossibility. Does that mean it should recover additional compensation? Note that such a recovery is off the contract, and courts are reluctant to allow restitutionary recoveries when contracts could have been negotiated but were not. Further, the plaintiff had already been paid the contract price and did not offer to return it (or offset it against a full restitutionary recovery).

iii. How would this case come out if the contract had provided for shipment "via the Suez canal"? Recall *Howell v. Coupland*. Does the defense of impossibility require that the portion of the performance that becomes impossible be explicit in the contract? See Restatement of Contracts (Second) §§262, 263 (p. 37).

iv. Problem 7(a) (p. 746): Has the risk been assigned by the parties? Put another way, is it reasonable to believe that the Paul thought his order was subject to Larry's ability to complete a design still nonfunctional?

b. *Eastern Air Lines v. Gulf Oil Corp.* (p. 747): What does the court hold? (1) That the contract assigned the risk of price increase to Gulf; and (2) that the possibility of a substantial price increase was foreseeable. Note that this case arises because the parties failed to predict that Platts would post only the regulated price of crude oil and not the unregulated price. Is this best described as a "mistake" or as something else? How would this case have come out if Platts simply stopped posting prices? Are the actual facts significantly different?

i. Note that the court says that not only could the two-tier system have been anticipated but that Gulf Oil lobbied in favor of deregulation. (p. 769) But is the two-tier system really the issue?

ii. Ignore the remedy issue in this case.

c. *Aluminum Co. of America v. Essex Group, Inc.* (p. 749):

i. The court does not seem to understand the doctrine of "frustration" at all. See Restatement of Contracts (Second) §265 (p. 37) for a definition of "frustration." See also comment a to Restatement of Contracts (Second) §265 for the difference between frustration and impracticability.

ii. The court conflates multiple contract excuses for nonperformance, but it is correct that mistake, impossibility, impracticability and frustration speak to the same general concerns.

D. Frustration of Purpose

1. *Krell v. Henry* (p. 760): The defendant agreed to rent the plaintiff's flat for two days. The flat had a good view of the king's forthcoming coronation route, and the flat was rented pursuant to an advertisement which indicated the letting was for the purpose of watching the coronation. The defendant agreed to pay a total of £75, of which £25 was paid in advance. The plaintiff sues to recover the remainder of the contract price, even though the defendant did not use the flat because the coronation was canceled. *Held*, for the defendant, that the contract was enforceable because the defendant's purpose was *frustrated* by the unanticipated cancellation of the coronation.

a. Note that the rule of *Krell* is a background rule only: parties generally are free to allocate risks as they desire. The *Krell* case arose because the parties did not explicitly allocate the risk that the coronation would not occur.

b. Is it relevant that the contract price for the two days was substantially above the normal rental rate for a similar flat? Yes: the high price demonstrates that the coronation was an implicit term of the contract. What if the room had been reserved for a tryst with the coronation as a cover? Should frustration of purpose be found if, prior to the coronation, the affair is discovered? What if the discovery is followed by cancellation of the coronation?

c. Should the defendant be entitled to return of the down payment? Many courts would award it (here, it was not requested) unless there was some evidence that the down payment was a partial allocation of the risk of nonperformance. But on what theory? Is frustration of purpose a defense to breach or a justification for recision? More likely the down payment was a way of allocating the credit risk. Should it also function is a way of dividing loss if the purpose of one party to the contract is frustrated? If there had been no prepayment, would there by any way to award the property owner £25?

d. Note RESTATEMENT OF CONTRACTS (2D) §265.

e. Suppose you reserve a room in a hotel to attend an out-of-state wedding. If the wedding is unexpectedly canceled, can you avoid paying for the reserved room? Is it relevant whether you told the clerk why you were coming. Is it relevant whether a block of rooms were reserved (perhaps at a special price) for this particular wedding? A court is more likely to say that an event was a basic assumption of the contract if the terms of the contract are unusual in response to that event. In *Krell*, the rate for the room was unusually high, thereby allowing the court to conclude that viewing the king's coronation was a basic assumption of the contract.

2. *Lloyd v. Murphy* (p. 763): The defendant leased a location in Los Angeles, and the contract provided that the premises could be used only for selling new cars and related activities. In part because of the war shortage of cars, the defendant found it unprofitable to operate a new car dealership. The defendant sought to be excused from further performance on the ground that its purpose in renting the property was frustrated. The plaintiff offered to waive the provision in the contract restricting the use of the property. *Held*, for the plaintiff, that the war shortage was not sufficiently unexpected that it would justify excusing performance. In addition, the defendant failed to establish that value of the lease had been destroyed. *Quaere*: could the defendant object to the plaintiff's waiver of the use restriction clause in the contract? Presumably a limitation imposed on one party is in the contract solely

for the benefit of the other, and so, presumably, it can be waived. But is that not requiring the first party to do something other than what he contracted to do? No: the defense of frustration is extraordinary relief; a party need not seek it, but he must be reasonably flexible to obtain it.