12-31-2003

Mistake in Contract Law

Melvin A. Eisenberg
meisenberg@law.berkeley.edu

Follow this and additional works at: https://scholarship.law.berkeley.edu/californialawreview
Part of the Law Commons

Recommended Citation

Link to publisher version (DOI)
https://doi.org/10.15779/Z385M62

This Article is brought to you for free and open access by the California Law Review at Berkeley Law Scholarship Repository. It has been accepted for inclusion in California Law Review by an authorized administrator of Berkeley Law Scholarship Repository. For more information, please contact jcera@law.berkeley.edu.
Mistake in Contract Law

Melvin A. Eisenberg†

TABLE OF CONTENTS

Introduction .............................................................................................................. 1576
I. A Functional Analysis of Mistake ..................................................................... 1578
   A. Efficiency ...................................................................................................... 1578
   B. Morality ....................................................................................................... 1579
   C. Experience ................................................................................................... 1580
II. Evaluative Mistakes ....................................................................................... 1581
III. Mechanical Errors ........................................................................................ 1584
   A. Mistaken Payments .................................................................................... 1587
      1. The Paradigm Case .................................................................................. 1588
      2. Lack of Actual Knowledge by the Payee ............................................... 1593
      3. Reliance ................................................................................................... 1593
      4. Administrability ....................................................................................... 1596
   B. Computational Errors ................................................................................... 1596
      1. The Nonmistaken Party Knew of the Error ............................................. 1596
      2. The Nonmistaken Party Had Reason to Know of the Error ................. 1598
      3. The Nonmistaken Party Neither Knew Nor Had Reason to Know of the Error ...................................................................................... 1599
   C. Other Recurring Cases and the Present Legal Framework ................. 1601
      1. The Nonmistaken Party Knew Or Had Reason to Know of the Error ... 1602
      2. The Nonmistaken Party Neither Knew Nor Had Reason to Know of the Error ...................................................................................... 1605
IV. Mistranscriptions .......................................................................................... 1610
V. Interpretive Mistakes ...................................................................................... 1611
VI. Shared Mistaken Factual Assumptions ........................................................ 1620
   A. The General Principle ................................................................................. 1620

Copyright © 2003 California Law Review, Inc. California Law Review, Inc. (CLR) is a California nonprofit corporation. CLR and the authors are solely responsible for the content of their publications.
† Koret Professor of Law, School of Law, University of California, Berkeley (Boalt Hall). I thank Adam Badawi, Meir Dan-Cohen, Jesse Fried, Jim Gordley, Zohar Goshen, Kent Greenawalt, Harris Hartz, Brett McDonnell, Ariel Porat, and Dan Rubinfeld for their extremely helpful comments, and Angela Howe and Howard Tony Loo for their valuable research assistance.
B. Four Limitations on the General Principle

1. The Adversely Affected Party Is Consciously Aware of the Risk that the Assumption Is Mistaken or Recklessly Disregards Facts that Put Him on Notice of that Risk ................................................................. 1630

2. The Risk that the Assumption Is Mistaken Is Contractually Allocated to the Adversely Affected Party ........................................................................................................... 1632

3. One Contracting Party Is in a Position to Have Clearly Superior Information About the Risk that the Assumption Is Mistaken ................................................................. 1636

4. Windfalls ............................................................................................................. 1637

VII. Conclusion ......................................................................................................... 1641
Mistake in Contract Law

Melvin A. Eisenberg

The problems raised by mistake have been a source of persistent difficulty in contract law. In part this difficulty results from the complex nature of the underlying issues: Intuitively, there seems to be a serious tension between the concept that mistake may be a ground for relief in contractual transactions and such basic ideas of contract law as risk-shifting, the security of transactions, and rewards to knowledge, skill, and diligence. Much of the difficulty, however, results from the use of legal categories and doctrinal rules that are not sufficiently based on a functional analysis. Traditionally, contract law has recognized four categories of mistake, each with its own body of rules: mutual mistake, unilateral mistake, mistranscription, and misunderstanding. Many of the rules that govern these categories turn on elements that are either of limited functional significance or are easy to verbally manipulate. Even the names of the categories generally fail to describe mistakes according to their functional characteristics.

The purpose of this Article is to develop the legal rules that should govern mistake in contract law on a functional basis. These rules are intended to be normative rather than descriptive, but by and large they are consistent with the results in existing cases and often explain the cases better than existing doctrine does. I begin by developing the considerations of efficiency, social morality, and experience that bear most heavily informing the rules that should govern mistake in contract law. Next, these considerations are brought to bear on various kinds of mistake that are described on the basis of their character. Five types of mistake are considered: evaluative mistakes, mechanical errors, mistranscriptions, interpretive mistakes, and shared mistaken factual assumptions. Evaluative mistakes arise when an actor who was capable and well-informed at the time he made a contract comes to believe that his choice to make the contract was mistaken due to a change in either his preferences, his subjective valuation of the performances due under the contract, or the objective or market value of those performances. Mechanical errors are physical or intellectual blunders that result from transient errors in the mechanics of an actor's physical or mental machinery. Mistranscriptions are a special kind of mechanical error, in which the drafter of a written instrument that is intended to transcribe an oral contract mistakenly fails to transcribe the
oral contract accurately. Interpretive mistakes are mistakes by one or both contracting parties about the most reasonable meaning of an expression the parties have employed, the meaning that the other party attaches to an expression, or both. A mistaken factual assumption is a mistake about the world that lies outside the mind of the party who holds the assumption. Such an assumption is shared if it is held by both parties, and unshared if it is held by only one party. In this Article, I consider shared mistaken factual assumptions. In a companion article, Disclosure in Contract Law, I consider unshared mistaken factual assumptions.

INTRODUCTION

Suppose that A and B enter into a contract that is either based on or reflects some kind of mistake made by A, or by A and B jointly. After the mistake is discovered, A claims that because of the mistake the contract should either be unenforceable, if it has not been performed, or reversible, if it has been.

The problems raised by claims of this kind have been a source of persistent difficulty in contract law. In part this difficulty results from the complex nature of the underlying issues: intuitively, there seems to be a serious tension between the concept that a mistake may be a ground for relief in contractual transactions and such basic ideas of contract law as risk-shifting, the security of transactions, and rewards for knowledge, skill, and diligence. Much of the difficulty, however, results from the use of legal categories and doctrinal rules that are not sufficiently based on a functional analysis. In this Article, I develop the legal rules that should govern mistake in contract law. These rules are intended to be normative rather than descriptive, but by and large they are consistent with the results in existing cases and often explain the cases better than existing doctrine does.

Traditionally, contract law has recognized four categories of mistake, each with its own body of rules: mutual mistake, unilateral mistake, mistranscription, and misunderstanding. Many of the rules that govern these categories turn on elements that are either of limited functional significance or are easy to verbally manipulate. Even the names of the categories generally fail to describe mistakes according to their functional characteristics.

What is needed, therefore, is a functional analysis of the issues raised by mistake. Such an analysis involves two steps.

The first step is to describe the types of mistake that are relevant in contract law on the basis of their character. In this Article I consider five different types of mistake: evaluative mistakes, mechanical errors, mis-transcriptions, mistakes in interpretation, and shared mistaken factual assumptions.
The second step is to develop the rules\textsuperscript{1} that should govern each type of mistake in light of applicable social propositions—that is, propositions of policy, principally in the form of efficiency; propositions of morality, principally in the form of social morality\textsuperscript{2}; and propositions of experience.\textsuperscript{3}

Part I develops the considerations of efficiency, morality, and experience that bear most heavily in formulating the rules that should govern the various kinds of mistake.

Part II concerns \textit{evaluative mistakes}. Evaluative mistakes arise when an actor who was capable and well-informed at the time he made a contract comes to believe that his choice to make the contract was mistaken due to a change in either his preferences, his subjective valuation of the performances due under the contract, or the objective or market value of those performances. Evaluative mistakes should not provide a basis for relief from a contract.

Part III concerns \textit{mechanical errors}. Mechanical errors are physical or intellectual blunders that result from transient errors in the mechanics of an actor's physical or mental machinery. Mechanical errors should provide a basis for relief from a contract except to the extent that the nonmistaken party has been injured by justifiable reliance on the contract.

Part IV concerns \textit{mistranscriptions}. Mistranscriptions are a special kind of mechanical error, in which the drafter of a written instrument that is intended to transcribe an oral contract fails to accurately transcribe the oral contract. In such cases either party should have the right to have the instrument reformed to match the actual contract if he can satisfy a requisite level of proof that a mistranscription occurred.

Part V concerns \textit{interpretive mistakes}. Interpretive mistakes are mistakes by one or both contracting parties about the most reasonable meaning

---

\textsuperscript{1} Within the universe of legal standards, there is no watertight distinction between those standards that might be called \textit{principles} and those standards that might be called \textit{rules}. For most purposes, the term \textit{legal rule} adequately describes all legal standards. For some purposes, however, a useful working distinction can be drawn between principles and rules: principles are relatively general legal standards, and rules are relatively specific legal standards. \textit{See MELVIN ARON EISENBERG, THE NATURE OF THE COMMON LAW} 77 (1988) (elaborating on this point). I will employ the terms \textit{principle} and \textit{rule} in this way in this Article. \textit{But see RONALD DWORKIN, TAKING RIGHTS SERIOUSLY} 22-28 (1977) (attempting to draw a watertight distinction between rules and principles).

Unless the context indicates otherwise, I will employ the term \textit{contract} in this Article as synonymous with \textit{bargain}.

\textsuperscript{2} By social morality, I mean moral standards that claim to be rooted in aspirations that apply to all members of the community and, on the basis of an appropriate methodology, can fairly be said to have substantial support in the community or can be derived from norms that have such support. In contrast, critical morality consists of moral standards whose truth does not depend on community beliefs and attitudes, except insofar as such beliefs and attitudes are relevant to the application of the moral standards.

\textsuperscript{3} On social propositions and their role in the law, \textit{see EISENBERG, supra} note 1.
of an expression the parties have employed, the meaning that the other party attaches to an expression, or both. The general principle that should govern interpretive mistakes is that if both parties are equally at fault, losses should be shared, but if one party is more at fault than the other, the interpretation of the party who is less at fault should prevail over the interpretation of the party who is more at fault. One party may be more at fault than the other either because his interpretation is less reasonable than the other's, or because he knows that the other attaches a different meaning to the relevant expression than he does and he does not make the other party aware of their different interpretations.

Part VI concerns shared mistaken factual assumptions. A mistaken factual assumption is a mistake about the world that lies outside the mind of the party who holds the assumption. Such an assumption is shared if it is held by both parties. It is tacit if it is so deeply embedded that the parties take the truth of the assumption for granted. A shared tacit factual assumption is implicitly part of the parties' contract. Accordingly, if a mistake concerning a shared factual assumption would provide a basis for relief to the adversely affected party if the assumption was explicit, so too should the assumption provide a basis for relief to that party if it is tacit, provided that the assumption is material. Therefore, a party who is adversely affected by a mistaken assumption of this type should be entitled to relief, as a matter of contractual interpretation, unless one of the following conditions prevails: (1) The adversely affected party is consciously aware of the risk that the assumption is mistaken or recklessly disregards facts that put him on notice of that risk. (2) The risk that the assumption is mistaken is contractually allocated to the adversely affected party. (3) One contracting party is in a position to have clearly superior information about the risk that the assumption is mistaken. (4) The mistake concerns a windfall rather than a loss.

In a companion article, I consider unshared mistaken factual assumptions.⁴

I

A FUNCTIONAL ANALYSIS OF MISTAKE

A. Efficiency

The analysis of any given type of mistake from an efficiency perspective principally turns on three overlapping issues:

1) Whether a legal rule that furnished relief to a party who has made a given type of mistake would provide efficient or inefficient incentives to contracting parties generally. On the surface, it might appear that rules that furnish relief for mistake would inefficiently provide a disincentive to take

precautions. That disincentive, however, will often be swamped by powerful incentives to be careful. Furthermore, maximum precautions are not always or even normally efficient. For example, a legal regime that provided an incentive for triple- and quadruple-checking might inefficiently require an unduly high level of precaution.

2) Whether the risk of a given type of mistake is explicitly or implicitly allocated by the parties' agreement. Bargains are instruments of efficiency, because they increase wealth through trade, allocate commodities to a higher valued use, and facilitate private planning by allowing actors to allocate risks, to coordinate and stabilize economic planning through the acquisition of control over inputs and outputs, and to reliably make investments that will increase the value of the exchange. Accordingly, if the parties have allocated the risk of a given kind of mistake by agreement, normally that allocation should be deemed to be efficient. (Of course, this assumes that both parties had full capacity, that neither party acted unconscionably, and so forth.) Moreover, if the agreement allocates the risk of a mistake to the mistaken party, any advantage that the nonmistaken party derives by reason of the mistake is an advantage that she has earned.5

3) Whether, if the risk of a given type of mistake is not explicitly or implicitly allocated by the contract, we can be reasonably confident how the parties would have allocated that risk had they addressed that question. Even if the parties did not allocate the risk of a given type of mistake by contract, if we can be reasonably confident that if the parties had considered how to allocate the risk of the mistake, they would have allocated the risk in a certain way, then allocating the risk that way is at least presumptively fair and efficient.

B. Morality

The analysis of any given type of mistake from a moral perspective also principally turns on three overlapping issues:

1) Whether it is morally proper for the mistaken party to assert a given type of mistake as an excuse for not keeping his promise, and for the nonmistaken party to take advantage of the mistake. Some types of mistake provide a moral justification for not keeping a promise. Correspondingly, a promisee may act badly if she insists on full performance even after she has been made aware of such a mistake. In the case of other types of mistake, however, the position that a promise need not be kept because of the

---

5. Here and in the balance of this Article, unless the context indicates otherwise I will use the masculine pronoun to refer to the mistaken party and the feminine pronoun to refer to the nonmistaken party.
mistake would be inconsistent with the concept of a promise, and therefore inconsistent with the moral obligation to which a promise gives rise.

2) Whether a legal rule that furnished relief for a given type of mistake would improperly leave the nonmistaken party with an unredressed injury caused by the mistaken party’s fault. Typically, a mistake is caused by some fault of the mistaken party. Therefore, even if a given type of mistake should be a basis for relief, the question remains to what extent the mistaken party should be relieved. Generally speaking, if a mistake is to have any effect as a basis for relief, it will be to excuse the mistaken promisor from making good the promisee’s expectation. However, where the promisor’s mistake results in making the promisee worse off than she would have been if the promise had not been made, and the promisee is not herself at fault, typically it would be inappropriate to excuse the mistaken party from making good that loss.

3) Whether a legal rule that allowed the nonmistaken party to enforce a promise, or retain a benefit, that is based on a given type of mistake would confer upon the nonmistaken party an unearned and ungifted advantage. The law typically protects or enforces advantages that have been earned or gifted, but it is not as solicitous to protect unearned and ungifted advantages. An advantage that one actor gains through another’s mistake may be earned, as where the mistaken actor has been paid to take the risk of the mistake. Sometimes, however, an advantage gained by virtue of another’s mistake may be exploitive at worst and lucky at best.

C. Experience

The most salient type of experiential propositions concerning mistake involves administrability. A rule that would be desirable if the cost of acquiring the relevant information was relatively low, and information was perfect, may be less desirable or undesirable if the rule would be hard to administer because the courts would have great difficulty in determining the facts required to apply the rule. If the rules that govern mistake did not take administrability into account, it could sometimes be both too easy and too tempting for an actor who has made a bad bargain to claim an excuse based on mistake.

Other kinds of experiential propositions concerning mistake will also be considered throughout this Article.

In some types of mistake, the moral and policy propositions that are relevant to resolving the issues set out above point in the same direction. In other types of mistake, the relevant moral and policy propositions may conflict. Just because social propositions conflict in given applications,
they are not for that reason inconsistent. If each of two conflicting moral norms has established its credentials in independent territories, we do not want to walk away from either norm just because there are some territories where they conflict. For example, the moral norm “don’t lie” is not inconsistent with the moral norm “venerate human life,” even though under certain circumstances venerating human life might require lying—as in lying to an assassin about his victim’s whereabouts. It does not lessen our commitment to truth-telling that we believe it is sometimes morally permissible not to tell the truth. Policy goals, too, are not inconsistent just because they conflict in certain applications. For example, the goal of developing a fruitful and rewarding career is not inconsistent with the goal of being a nurturing parent, although pressures of time may sometimes cause them to conflict. Where a type of mistake implicates conflicting moral values or social goals, a legal rule should be fashioned that gives proper weight and an appropriate role to each, given the context at hand. This can be accomplished either by concluding that in the context at hand one value or goal trumps the others, or by crafting a rule that is a vector of all relevant values and goals. In the latter case, good judgment must be exercised to determine such issues as the degree of relevance and the relative weight of the conflicting values and goals, and whether they can be reconciled with only minimal loss to each.

The question addressed in this Article is when, and to what extent, mistake should provide a basis for relief from a bargain. Some types of mistake should and do provide relief. Others should not and do not. I will begin with the archetypal mistake—which I call evaluative mistake—that should not and does not provide relief. An exploration of this archetype is important both in itself and because it provides a foundation for analyzing the types of mistake that should and do provide relief.

II
Evaluative Mistakes

A bargain promise requires and embodies two choices by the promisor. First, the promisor must choose to achieve a certain objective. Second, the promisor must choose to achieve or further that objective by making a given bargain. Bargain promises, like other choices, entail evaluations of various kinds. In particular, a bargain promisor must explicitly or implicitly evaluate: (1) the relation between his own preferences (including his values and his tastes) and the performances due from him and to him under the contract; (2) the expected value to him—that is, the personal, or subjective, value—of those performances; and (3) the expected market, or objective, value of those performances. Even though a promisor knew all the material information at the time a contract was made, and was capable of processing the information, a choice to enter into a bargain is often
characterized in everyday speech as a mistake where the promisor regrets having chosen to make the bargain because his preferences have changed, or because of the occurrence of unexpected circumstances or of events that fell on the unlucky tail of a probability distribution.\(^6\)

A few examples:

- A, who has only two weeks of vacation each year, signs a contract to take a cruise in the Caribbean. A later develops a passion for skiing, and regards his decision to make the commitment to spend his vacation in the Caribbean as mistaken.

- B, the general manager of a basketball team, signs J to a five-year contract. B later comes to believe this was a mistake, because K, another player already on the team, develops much more quickly than expected and renders J expendable.

- C, a toymaker, makes a contract with Z, a film studio, under which Z grants C a license to manufacture and sell toys based on characters in Z's forthcoming movie, *Rapunzel*. Everyone expects *Rapunzel* to be a blockbuster, and C pays a large lump for the license. *Rapunzel* turns out to be a flop. C's license is worthless, and C regards his choice to enter into the contract as mistaken.

I will use the term *evaluative mistake* to refer to these kinds of cases; that is, cases in which a well-informed and capable actor who made a contract comes to believe that his choice to make the contract was mistaken due to a change in his preferences or a change in the subjective or objective value of the performances due under the contract.\(^7\)

Evaluative mistakes should not provide a basis for relief from a contract.

---


7. Cases in which a well-informed and capable promisor comes to believe that his choice to enter into a bargain was mistaken because his preferences or valuations have changed can be ranged along a spectrum. At one end of the spectrum are cases in which the promisor's preferences have changed, as in the vacation hypothetical in the text. In the middle of the spectrum are cases in which circumstances have changed in an unexpected manner, as in the basketball-team hypothetical. At the other end of the spectrum are cases in which the promisor's determination of probabilities was incorrect, as in the *Rapunzel* hypothetical, and then cases in which the promisor's determination of probabilities was correct but events fell on the unlucky tail of the probability distribution. The various cases along this spectrum might be characterized and treated differently for some purposes. In particular, the case in which events fell on the unlucky tail of a correctly determined probability distribution might be characterized as a predictive mistake. However, in practice it may be very difficult to tell that case apart from the case in which the promisor's determination of probability was incorrect, and in any event for the reasons discussed in the balance of this Part all the cases along the spectrum should be treated in the same way. Accordingly, I treat all these cases under a unified nomenclature, and I prefer the term *evaluative mistake* to the term *predictive mistake* (although nothing in the analysis turns on this), because the former term is more comprehensive and better captures the reason why promisors come to regard their choices in these kinds of cases as mistaken.
Begin with efficiency considerations. Many bargains are motivated by the parties' conflicting determinations of the objective value of the performances due under their contract. To put this differently, in many cases the risk that a contracting party has made an evaluative mistake is the very risk that the other party has bargained for. In effect, such contracts normally are fair bets, and it is inherent in such contracts that one party will have made an evaluative mistake. To allow evaluative mistakes to provide a basis for relief in such cases would undercut the purpose of these contracts and the efficiency goals they serve. Even when bargains are not motivated by conflicting evaluations of objective value, but instead are motivated by other factors—such as a party's desire to coordinate and stabilize his economic activity through the acquisition of control over inputs and outputs, or to reliably make investments that will increase the value of the exchange—a rule that allowed an evaluative mistake to provide a basis for relief would inefficiently render wholly insecure a contract whose very objective was to achieve security. To put this somewhat differently, the risk that a party to a bargain has made an evaluative mistake is implicitly, if not explicitly, contractually allocated to the mistaken party.

Moral considerations point in the same direction.

To begin with, if a promisor is capable and well-informed, and does not act under a transient defect of cognition, then the choice reflected in his promise is what Thomas Scanlon has called a demonstrative choice: a choice that reflects and therefore demonstrates the actor's intelligence and skill, and not incidentally symbolizes the actor's view that he is competent to make a choice of this kind. Accordingly, the value of a demonstrative choice to an actor is not limited to promoting an outcome the actor wishes to achieve, but also includes the significance to the actor of the fact that he is capable of making, and has made, such a choice. A promisor may regret that he has made the choice embodied in a promise, but considerations of self-respect argue that this is the kind of choice that he should stand behind if his only reason for regret is that he made an evaluative mistake.

Even more fundamentally, it is a basic principle of morality that promises should be kept, and the whole point of a promise is to commit yourself to take a given action in the future even if, when the action is due to be taken, all things considered you do not wish to take it. A rule under which an evaluative mistake provided a basis for not keeping a promise would negate the point of a promise, and therefore the moral principle of promise-keeping, because to say that you are not obliged to keep a promise when you have made such a mistake is equivalent to saying that you do not have to keep a promise if all things considered you wish not to do so.

9. Id. at 179-80.
Finally, in the case of an evaluative mistake the promisee has entered into the bargain on the basis of her own evaluations, made through the use of her knowledge, skill, and diligence. If a capable and well-informed promisor could back out of a contract because it turned out that the promisee’s evaluation was better than his, the promisor would be depriving the promisee of an earned advantage.

Accordingly, an evaluative mistake should not, and does not, provide a basis for relief from a contract. Whether nonevaluative mistakes should and do provide such relief—or perhaps more accurately, the extent to which various types of nonevaluative mistakes should and do provide such relief—will be explored in the balance of this Article.

III
MECHANICAL ERRORS

A common kind of mistake in everyday life consists of physical blunders, like spilling coffee. This kind of mistake, although manifested externally, normally results from an error in the mechanics of an actor’s internal machinery, such as a lapse of concentration, a loss of balance, or an error in hand-eye coordination. Such errors are almost invariably transient. If an actor spilled every cup of coffee he handled we would not characterize his spills as mistakes, but instead would say that he had some type of disability.

A counterpart to transient physical blunders consists of intellectual blunders that result from transient errors in the mechanics of an actor’s internal machinery. For example, as a result of a transient error in the mechanics of an actor’s mental machinery the actor may write “65” when he intends to write “56” or may incorrectly add a column of figures.

I will call mistakes of this kind—that is, physical or intellectual blunders that result from transient errors in the mechanics of an actor’s internal machinery—mechanical errors. Mechanical errors resemble the kind of mistake sometimes made in the transcription of DNA. Almost invariably, that transcription is correct. Every once in a while, it goes transiently awry.

The legal principle that should govern mechanical errors is that mechanical errors should provide a basis for relief, except to the extent that the nonmistaken party has been injured by justifiable reliance. The reasons for this principle will be fleshed out in the balance of this Part, in the context of developing the rules that should govern various kinds of mechanical errors. These reasons differ marginally according to the kind of mechanical error at issue, but broadly speaking, they are as follows.

To begin with, mechanical errors differ from evaluative mistakes in several critical respects. For one thing, promises that are a product of mechanical errors are not based on, and do not reflect, the promisor’s preferences. On the contrary, such promises are based on, and reflect, a transient
MISTAKE IN CONTRACT LAW

and nondeliberate departure from those preferences—a departure that would not have been made if the promisor's mental or physical machinery had not temporarily gone awry. Also unlike evaluative mistakes, the prospect that a counterparty will make a mechanical error is not a risk that is bargained for. Finally, unlike relief for evaluative mistakes, relief for mechanical errors would not undermine the very idea of promise. A promisor who seeks relief on the ground of mechanical error does not come forward to say that all things considered, he doesn't wish to perform. Rather, he comes forward with a morally acceptable excuse for nonperformance that is well within the boundaries of promise.

Providing relief from contracts on the basis of mechanical errors is also efficient. It is inevitable that actors will make a certain number of mechanical errors even if they take optimal precautions, just as it is inevitable that a certain number of DNA transcriptions will go wrong even though the body's cellular machinery has mechanisms to prevent and cure DNA mis-transcriptions. Generally speaking, even under a relief regime actors will take optimal precautions against mechanical errors, as a matter of self-interest. As stated in S.T.S. Transport Service, Inc. v. Volvo White Truck Corp.:

The reason for the special treatment [of errors that are mathematical or "clerical"] is that they are difficult to prevent, and that no useful social purpose is served by enforcing the mistaken term. No incentives exist to make such mistakes; all the existing incentives work, in fact, in the opposite direction. There is every reason for a contractor to use ordinary care, and, if errors of this sort—clerical or mathematical—slip through anyway, the courts will generally find it more useful to allow the contract to be changed or rescinded than to enforce it as it is.10

In contrast, a no-relief regime would provide actors with incentives to take too much precaution—triple- and quadruple-checking.

Finally, a relief regime will also be efficient in the sense that it will reflect the preferences that most actors would express if they were choosing the legal regime from behind the veil. The phenomenon of loss-aversion is relevant here. Cognitive psychology has shown that actors are loss-averse; that is, the disutility of giving up what one has is greater than the utility of acquiring an equal amount of what one doesn't have.11 To put this differently, an actor perceives the loss of existing endowments as a greater harm than a failed opportunity to augment his endowments by an

10. 766 F.2d 1089, 1093 (7th Cir. 1985).

equal amount. Accordingly, perceived losses, such as out-of-pocket costs, are more painful than forgone gains, such as potential profits. As Daniel Kahneman explains it, “There is an asymmetry between gains and losses, and it really is very dramatic and very easy to see... People really discriminate sharply between gaining and losing and they don’t like losing.” Given the phenomenon of loss-aversion, if contracting parties addressed the issue whether one party could take advantage of the other’s mechanical error, they would probably agree that she could not, except to the extent that she has justifiably relied.

Providing relief for mechanical errors also comports with morality. It is morally proper for a party who has made a promise based on a blunder resulting from a transient error in the actor’s mental or physical machinery to ask to be relieved from his promise, provided he stands willing to compensate the promisee in such a way that she is not worse off than she would have been if the promise had not been made. Correspondingly, if the promisor stands ready to make such compensation, it would be exploitive for

12. Loss-aversion, the endowment effect (on which loss-aversion is partly based), and some of the evidence for loss-aversion, are nicely summarized by Jeffrey Evans Stake:

The endowment effect is a pattern of behavior in which people demand more to give up an object than they would offer to acquire it. This difference between the amount a person is willing to pay... and the amount she is willing to accept... has been explained by reference to the theory of loss-aversion. According to the theory of loss-aversion, losses have greater subjective impact than objectively commensurate gains. In graphical terms, utility curves are asymmetrical in that the disutility of giving up an object is greater than the utility of acquiring it.

... In one experiment, subjects were given either a lottery ticket or $2.00 cash. When they were given the chance to trade their initial endowment for the other endowment, somewhat surprisingly, very few subjects chose to switch. Almost everyone preferred what they were initially given.

In a test for endowment effects reported by Professors Kahneman, Knetsch, and Thaler, subjects were randomly assigned to one of three groups: sellers, buyers, or choosers. Sellers were given a coffee mug and a chance to sell it at various prices. Buyers were given a chance to buy a mug at various prices. Choosers were given an opportunity to get either a mug or cash. Put another way, choosers were given an option to get a mug (without paying anything) and given the chance to sell the mug-option at various prices. The only difference between choosers and sellers was that choosers were not actually endowed with a mug before they were put to the task of deciding their selling price. The major difference between choosers and buyers was that buyers were already endowed with the cash they would have to spend to get a mug whereas the cash was merely a prospect for choosers. The prices at which trades, or choices, could take place were varied across a range, and the results—how many subjects in each group would trade—were recorded. In this way, a median valuation (or reservation price) was determined for each group: sellers, $7.12; choosers, $3.12; buyers, $2.87. In a replication of the experiment, in which the price tags were left on the mugs, the results were: sellers, $7.00; choosers, $3.50; buyers, $2.00. These results confirmed conclusions from other loss-aversion experiments. People are biased toward the status quo. Losses have a subjectively larger impact than equivalent financial gains, and the difference is greater than would be predicted from declining marginal utility alone.


the promisee to insist on full performance of a promise even after she knows that the promise was based on a mistake of this nature. Furthermore, the advantage that a promisee would derive from a promisor’s mechanical error would be unearned and ungifted—gained not through the promisee’s skill and diligence, but only as a result of chance.

The principle that mechanical errors should provide a basis for relief, except to the extent that the nonmistaken party has been injured by justifiable reliance, might be inefficient if it was very difficult to determine whether a mechanical error has been made. Typically, however, it is very easy to make that determination. For example, many mechanical-error cases involve mistaken payments. In most cases, it is very easy to establish that a payment was mistaken, because, for example, it was sent to the wrong person, or the payor either owed nothing to the payee or indisputably owed a smaller sum than was paid.14 Many other mechanical-error cases involve computational errors in construction bids by contractors or subcontractors. Typically in these cases the work papers, surrounding circumstances, or both, clearly demonstrate that a computational error was made.15 Much the same is true in other kinds of mechanical-error cases.16 In any event, a party seeking relief on the basis of a mechanical error should have the burden of proving that the error was made, and if there is significant doubt on that issue, the benefit of the doubt should be given to the party who denies that an error was made.

I will illustrate these points by first discussing two extremely common types of mechanical error: mistaken payments and computational errors. Using this discussion as a springboard, I will then consider other recurring cases and the present legal framework.

A. Mistaken Payments

A recurring type of mechanical error involves the mistaken conferral by one actor of a tangible benefit on another. The mistaken conferral of a benefit may involve cash, services, or other commodities; may arise in a contractual or noncontractual context; and may result from factors other than a mechanical error, such as a mistake of law. In this Article, I consider only mistaken cash payments, made in a contractual setting, that result from mechanical errors. I use the term “contractual setting” broadly, to

14. Mistaken-payment cases are discussed infra Part III.A.
include, for example, insurance and banking transactions.\footnote{17} For ease of exposition, I will call such payments \textit{mistaken payments}.

The issues raised by mistaken payments are usually addressed by the law of restitution, rather than the law of contracts. This is partly because a suit to recover such a payment is not a suit to enforce a contract, and partly because mistaken payments are only a subset of cases in which one party confers a benefit on another by mistake. I consider mistaken payments in this Article both because of the contractual setting and, more importantly, because an examination of this relatively straightforward case is useful in examining more difficult cases of mechanical error.

\section{The Paradigm Case}

In the paradigm mistaken-payment case, the payment is indisputably not owed by the payor to the payee, and the payee knows that the payment is mistaken and does not justifiably rely upon the payment. For example, Debtor, who owes $1,000 to Creditor C1, sends that amount to C2, a stranger, in the transient mistaken belief that C2 is C1. Or Buyer sends $5,000 to Seller in the transient mistaken belief that he owes Seller that amount, when in fact it is undisputed that he owes only $500. Or as a result of a transient clerical oversight, Insurer pays the proceeds of a life-insurance policy to the deceased’s surviving spouse, when both Insurer and the surviving spouse knew that a former spouse was entitled to the policy proceeds.

As a legal matter, there is no doubt that in the paradigm case the payee is obliged to return the mistaken payment.\footnote{18} But why should this be so, when the payor was at fault in making the mistaken payment and the payee did not obtain the payment through a breach of contract, a tort, or any other wrongful act?

\footnote{17} I confine the analysis in this Article to cash payments made in a contractual setting because other kinds of benefits conferred by mistake, such as mistaken payments of taxes and mistaken improvements on another’s land, tend to raise complex issues that are not as salient for contract law as they are for the law of restitution. For example, as stated by Hanoch Dagan:

\begin{quote}
...[A]s the \textit{ALI Draft} [of the Restatement (Third) of Restitution and Unjust Enrichment] crisply explains, there are two cumulative problems [with noncash benefits]: valuation and liquidity. Regarding noncash benefits, “[n]either market value, nor cost to the provider, reveals the value to the recipient where the transfer is nonconsensual. Even where value may be established with confidence, the illiquidity of a given benefit . . . makes a liability to pay that value in money potentially disadvantageous to the recipient.”

Where problems of valuation and liquidity exist, liability in restitution may prejudice the recipient. This prejudice derives from the significant variations in the subjective valuations of people . . . [which] are a function of a person’s ability to pay and his or her personal tastes. Where these variations are genuine and significant—which is the case in many, although by no means all, instances of noncash benefits—the harm of the mistake amounts to the entire benefit mistakenly conferred.

\end{quote}

The issues arising out of the mistaken conferral of benefits are sometimes analyzed in terms of autonomy, voluntariness, and free choice. This analysis is not very productive. Hanoch Dagan has said that "the autonomy interest of a potentially mistaken party is the ability to act without fear that a mistake will irrevocably frustrate her intentions and threaten the integrity of her self." But surely it would not be an invasion of the autonomy interest to hold an actor responsible for his own uncoerced mistakes. Respect for autonomy may require that actors not be held responsible for involuntary actions, but an actor who made a mistaken payment has acted voluntarily. By way of comparison, if A, who is in the demolition business, tears down B's building in the mistaken belief that the building belonged to C, holding A responsible for the destruction of B's building could not reasonably be thought to interfere with A's autonomy or free choice, or to make A liable for an involuntary action.

I therefore examine the issues in more meaningful terms, concerning efficiency and morality. Call a legal regime in which payors are entitled to recover mistaken payments, minus the payee's transaction costs for voluntarily returning the payment and the amount of the payee's justifiable reliance, a restoration regime. Under such a regime, a mistaken payor fully internalizes the costs of the mistaken payment—both his own costs and those of the payee.

It might be thought that a restoration regime is inefficient, because it will fail to give payors an incentive to take optimal precautions against making mistaken payments, since under this regime a mistaken payor is entitled to recover the payment minus only the payee's transaction costs for voluntarily returning the payment (which are likely to be trivial) and the amount of the payee's justifiable reliance (which will typically be nothing, for reasons developed below). In fact, however, a restoration regime is more efficient than a nonrestoration regime. For payors, optimal precaution against making mistaken payments will balance the cost of precaution and the losses to payors and payees from such payments. Even under a restoration regime, payors bear a number of risks and costs. They bear the risk that the payee will rely. They bear the risk that the payee will be judgment-proof. They bear the risk that they may not discover that a mistaken payment was made. And even if the mistake is discovered, and the payee has not relied and is not judgment-proof, the payor will have to incur costs,

19. See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 5 cmt. b (Tentative Draft No. 1, 2001); Dagan, supra note 17, at 1797-1802.
21. There appears to be little or no law on the permissibility of a deduction by the payee for transaction costs of voluntarily returning a mistaken payment, presumably because those costs are almost always trivial.
including possibly the costs of litigation, to recover the mistaken payment. Given these risks and costs, it is highly unlikely that a restoration regime will lead payors to take less-than-optimal precautions against making mistaken payments.

In contrast, a nonrestoration regime would require payors to reimburse, and therefore to bear, not only the costs of mistaken payments to payees, but also the amount of windfall gains to mistaken payees. Such a regime would cause payors to take excess precautions, like triple- or quadruple-checking and delaying payments to perform such checking. These excess precautions would not only constitute a social cost, but would often harm payees as a class, because payors who make multiple payments, like large financial or commercial enterprises, would pass the increased costs of such excess precautions on to their customers, in the form of higher prices and delays. Most customers would probably prefer a legal regime that produces lower present prices and faster payments over a regime that produces higher present prices, and slower payments, coupled with lottery tickets for highly improbable windfalls of uncertain amounts in the remote future.

A comparable analysis applies to payees. It might be argued that a restoration regime fails to give actors incentives to take an efficient amount of precaution against receiving mistaken payments. But why should the law encourage actors to take precautions against receiving mistaken payments? We want actors to take precautions against being injured, but do we really care whether actors take precautions against being mistakenly benefited? In any event, even under a restoration regime actors will take precautions to determine whether payments they receive are correct. Payees have an incentive to check for mistakes not in their favor. The process of checking for mistakes not in one's favor is usually identical to the process of checking for mistakes in one's favor. For example, to determine whether a credit to an actor's bank account is smaller than it should be, the actor must compare the actual amount that was credited with the amount that she expected. In the process, the actor will also discover whether the actual credit is more than she expected. In general, in the process of looking for adverse mistakes actors will also uncover favorable mistakes.

Moreover, a payee can never be certain that if she spends all or part of a mistaken payment the court will find both that (i) she relied upon the payment by taking an action that she would not otherwise have taken, and (ii) her reliance was justified. This gives payees an additional incentive, if one was needed, to take optimal precautions in determining whether payments they receive are correct. If a payee of a mistaken payment takes an action that she would have taken anyway, she will not be able to retain any part of the payment, except the transaction costs of returning it. Even if the payee takes an action, in reliance on the payment, that she would not have taken in the absence of the payment, if she had exercised less-than-optimal
precautions in reviewing payments for accuracy, she runs the risk that the court will determine that she should have known of the mistake and that her reliance therefore was not justified.

A restoration regime is also efficient because it reflects actors' preferences. Such a regime can be analogized to a mutual-insurance scheme: Under a restoration regime, all actors insure each other against the casualty loss of mistaken payments by taking on a legal obligation to return any mistaken payment that knowingly falls to their lot. Given loss-aversion and the cost of taking super-high precautions under a nonrestoration regime, if actors addressed from behind the veil the issue of what should be done if one actor makes a mistaken payment to another, it is highly likely they would agree that the payment should be restored. To put this differently, most actors would probably prefer a restoration regime, in which random mistaken payments can be recaptured by the payor, to a nonrestoration regime, in which a party who makes a mistaken payment completely loses out. Thus, at least in contractual contexts, a restoration regime is also more efficient than a nonrestoration regime because it is the regime that parties would choose if they addressed the issue.

A restoration regime is also supported by considerations of morality. The payee has obtained possession of money that belongs to the payor, and has done so, not through skill or diligence, but by accident—by chance. It is morally improper to retain the money or property of another that has come into your possession simply through chance, without your having either earned or been gifted the property.

It might be argued that although a mistaken payment is neither earned nor gifted, if the payee is not at fault for inducing the payment she should be able to retain it because an actor should be entitled to ownership of benefits that she luckily obtains. In some cases it is acceptable for an actor to retain an unearned and ungifted benefit. For example, if the golden pheasant flies over your backyard and drops a golden egg, the egg is yours to keep. In these cases, the actor who benefits is said to be lucky. In many cases, however, an actor is not morally entitled to retain an unearned and ungifted benefit. In such cases, the actor is not lucky. What constitutes luck is largely a matter of social morality and policy, which may change over time, and law, which will normally follow social morality and policy over time.

For example, before the 1960s an actor who knowingly received inside information concerning corporate stock was lucky, because she could make money by trading on the basis of the information. Today, such an actor is not lucky; if she trades on the basis of the information she is considered a kind of thief and is therefore subject to moral and legal
sanctions.\textsuperscript{23} Similarly, as a matter of social morality and law if A loses property that B finds, and B knows or could determine by a reasonable effort that the property belongs to A, B must take steps to restore the property to A, and therefore is not lucky, except in the very attenuated sense that she may come in for a reward from A. (A finder who doesn’t know or have reason to know the loser’s identity may be somewhat luckier, because she may be able to claim ownership if the owner doesn’t appear.) Of course, B may wrongfully keep the property, and in such a case she may count herself lucky, just as a thief may count herself lucky to find a lot of money in a house that she has broken into. As a matter of social morality, however, both B and the thief would be regarded not as lucky, but as immoral. Indeed, B’s appropriation of the property, without having made reasonable efforts to restore the property to the owner, will constitute theft not only morally but under the criminal law.\textsuperscript{24}

In short, an actor who would derive an unearned and ungifted advantage from another’s mistake may be deemed lucky only if morality and policy permit her to retain it. If she has no proper claim to the advantage there is no need to protect or enforce the advantage. On the contrary, if she is not morally entitled to take advantage of the mistake then her attempt to do so is exploitative and improper, unless protecting the advantage would serve some countervailing policy goal.

From a moral perspective, there is no significant difference between keeping lost property that you know belongs to an identifiable person and keeping a payment that you know has been sent to you by mistake. An actor who receives such a payment, which is by hypothesis made by mistake and is neither earned nor gifted, is no more morally entitled to retain it than a finder of lost property who knows or could easily determine the owner’s identity. Indeed, under the criminal law, an actor who knowingly receives a mistaken payment, like a finder of lost property, is guilty of theft if she fails to take reasonable measures to return the payment.\textsuperscript{25} And although it is true that in the paradigm mistaken-payment case the payor is typically at fault, his fault causes no harm to the payee except the infliction of the transaction cost of repaying the money—a cost which the payee should be entitled to deduct from the repayment.

In short, an actor who receives a payment that she knows is mistaken has a moral obligation to return the payment, and an actor who makes such


\textsuperscript{24} See, e.g., MODEL PENAL CODE § 223.5 (1962); N.Y. PENAL LAW § 155.05 (McKinney 1999); 18 PA. CONS. STAT. ANN. § 3924 (West 1983); RAY ANDREWS BROWN, THE LAW OF PERSONAL PROPERTY § 3.15 (Walter B. Raushenbush ed., 3d ed. 1975).

\textsuperscript{25} See MODEL PENAL CODE § 223.5; N.Y. PENAL LAW § 155.05; 18 PA. CONS. STAT. ANN. § 3924.
a mistaken payment has a corresponding moral right to recover it, subject to an offset for the payee's costs of return.

2. **Lack of Actual Knowledge by the Payee**

Suppose the paradigm case is varied by assuming that at the time the payment was made the payee did not have actual knowledge that the payment was mistaken, but she learns of the mistake later on, before she has taken action on the basis of the payment. The efficiency reasons for a restoration regime in the paradigm case also generally apply when the payee learns of the mistake only later, and has not relied. The reasons of morality that support restoration in the paradigm case also support restoration in this variation. The payment is not an advantage that the payee earned by her knowledge, skill, and diligence, and she is not made worse off by the payment. The payee's moral obligation to return the payment when she learns of the mistake is the same as it would have been if she had known that it was mistaken at the time she received it—just as a finder of lost property who originally believed that the property was abandoned has a moral obligation to make reasonable efforts to restore the property to its owner when she learns that the property was not abandoned, but lost.

3. **Reliance**

Next, vary the paradigm case by assuming that the payee has relied on the mistaken payment.

Reliance counts in morality and law only if it is justifiable. In the paradigm case, in which the payee knew the payment was mistaken when she received it, she could not have justifiably relied upon the payment.

Suppose the payee relied upon the payment at a time when she did not actually know, but had reason to know, that the payment was mistaken. In this case, too, reliance is unjustified, because by hypothesis the payee was unreasonable in not knowing that the payment was mistaken.

Suppose finally that the payee justifiably relied on a mistaken payment, at a time when she neither knew nor had reason to know that the payment was mistaken. In such a case, the payee should be entitled to deduct the amount of her reliance from the amount of the repayment, because typically the payee's justifiable reliance is caused by the payor's fault and the payee would be injured if she was not allowed to retain the amount of her reliance. The Tentative Draft of *Restatement (Third) of Restitution* gives an illustration of such a case:

---

26 Jack Beatson and Hanoch Dagan have argued that actors who receive and justifiably rely upon mistaken payments should not routinely be allowed to retain the amount of their justified reliance. Beatson, *supra* note 22; Dagan, *supra* note 17. For simplicity of exposition, I will focus on Beatson's argument.

Beatson's reasoning is as follows. The problem of reliance on mistaken payments is like the problem of accidents. Like accidents, reliance on mistaken payments results in social costs. As in the
case of accidents, the law should provide incentives that will minimize these costs. A payor can take precautions to avoid making mistaken payments. If he fails to take optimal precautions, he is at fault. A payee can take precautions to avoid relying on mistaken payments. If she fails to take optimal precautions, she is at fault. Social costs will be minimized by developing rules, analogous to the rules that govern accidents, that provide proper incentives to both payors and payees to take optimal precautions to prevent the occurrence of, or reliance on, mistaken payments.

Beatson considers various possible rules to deal with the problem as so understood. These rules reflect the concepts of accident law, such as strict liability, contributory fault, and comparative fault. Beatson rejects a restoration regime (as I have defined it) because he believes it would give payors and payees insufficient incentives to take optimal precautions against the occurrence of reliance on mistaken payments. Beatson, supra note 22, at 161-62. In contrast, he considers several rules that he believes would provide such incentives. Under the rule that both Beatson and Dagan seem to favor, see id. at 161-63; Dagan, supra note 17, at 1817, the payee’s right to retain the amount of her reliance would normally turn on the comparative fault of the parties in taking precautions. If only the payee failed to take optimal precautions, her reliance would not be protected. If both the payor and the payee failed to take optimal precautions, the payee would retain the amount of her reliance that was proportionate to the parties’ comparative fault. Beatson, supra note 22, at 142-43.

Beatson argues that this comparative-fault rule is preferable to a restoration regime: Under such a rule, he says, payors would have an incentive to take optimal precaution to avoid making mistaken payments, because they would bear the entire reliance loss if the payee is not at fault. Similarly, payees would have an incentive to take optimal precautions to avoid relying on mistaken payments, because they would bear the entire reliance loss if the payor was not at fault. That is not true, Beatson believes, of a restoration regime. Therefore, he concludes, a relying payee should be entitled to retain the amount of her reliance only if and to the extent the conditions of the comparative-fault rule concerning optimal precautions are satisfied.

There are several problems with Beatson’s argument and with this rule. To begin with, the analogy between reliance on mistaken payments and accidents is far from complete. An accident results in a social loss, because the injurer does not gain what the victim loses. In contrast, mistaken payments are merely transfers: the payee gains what the payor loses. Accordingly, a mistaken payment does not injure the payee—at least, not if the payee’s justifiable reliance and transaction costs are compensated, as they would be under a restoration regime. Of course, the payor may suffer a loss if it makes a mistaken payment, but as shown in the text, just for that reason even under a restoration regime payors have adequate incentives to take optimal precautions against making such payments. (Similarly, as shown in the text, even under a restoration regime payees have adequate incentives to review the accuracy of payments they receive.) Therefore, the only social costs of mistaken payments are the transaction costs of restoring the payments. Under a restoration regime these costs are placed on the payor, whose fault causes the costs.

Beatson’s analysis also does not take into account the heavy transaction costs that would be entailed in judicial determinations, on a case-by-case basis, of what constitutes optimal precaution by actors situated as were the payee and the payor, and then of applying those determinations to the facts at hand. By hypothesis, optimal precaution reflects a balance between the cost of precautions and the cost of losses. In a perfect world, the courts could effortlessly determine whether payors had struck the optimal balance between the two types of cost to prevent mistaken payments, and whether payees had struck the optimal balance to prevent reliance on such payments. In the real world, however, such determinations would be very difficult, very costly, and highly problematic.

Beatson also argues for two rules under which reliance should be irrelevant in the case of mistaken payments from or to public authorities. Dagan takes a comparable position. See Dagan, supra note 17, at 1819.

Under the first rule, public authorities would not be able to claim reliance on mistaken payments from citizens, and instead would always be required to return the entire amount of such payments. Beatson, supra note 22, at 145. As a practical matter, this rule would reach pretty much the same result as would a restoration regime. Under a restoration regime, reliance in a mistaken-payment case will be protected only if it was justifiable. Reliance on a mistaken payment will seldom if ever be justifiable if the payment is very large, because a very large overpayment will almost always put the payee on notice that a mistake has been made. Accordingly, a public authority normally could only
A's life is insured for $5000 with B Company. At A's death, B by a clerical error pays $50,000 to A's surviving spouse C. C is unaware of B's mistake. By the time B notifies C of the overpayment, C has spent $25,000 on an elaborate funeral for A. B's claim in restitution against C is subject to an affirmative defense, to the extent the court finds a justifiable change of position in reliance on B's payment...

In practice, justifiable reliance on a mistaken payment will not often occur. Normally, a payee who receives a mistaken payment will either know or have reason to know of the mistake. Even where that is not the case, it is unlikely that payees will often rely upon mistaken payments. Reliance on a mistaken payment, in the form of an adverse change of position, can only occur if the payee engages, to her prejudice, in conduct that she would not have engaged in if the mistaken payment had not been made. In the case of an individual, reliance normally could occur only when the payment was very large in relation to the payee's wealth, because if the payment is not very large in relation to the payee's wealth, receipt of the payment is unlikely to cause the payee to take an action that she would not otherwise have taken. Accordingly, relatively small mistaken payments are unlikely to be relied upon. Thus if C in the Restatement Illustration had a net worth of $6 million, it is unlikely that she could show that she relied upon the mistaken $50,000 payment. On the other hand, where a mistaken payment is very large in relation to the payee's wealth, the payee will almost invariably know or have reason to know that the payment was mistaken. As a practical matter, therefore, in most mistaken-payment cases the claim reliance on relatively small mistaken payments. But given the large budgets of public authorities, it would be rare that a relatively small mistaken payment would cause a public authority to take an action that it would not otherwise have taken.

Under the second rule, a citizen would keep the entire amount of a mistaken payment by a public authority, rather than just the amount of her justified reliance. The argument for this rule is as follows: Citizens expect public authorities to operate without error. Therefore, public authorities act as "quasi-insurers against error." Id. at 144. Furthermore, compared to citizens, public authorities have superior mistake-avoidance capabilities. Especially considering these superior capabilities, it would be wasteful to give to many citizens, rather than to one public authority, the incentive to take precautions.

The premise that citizens expect public authorities to operate without error is dubious. Indeed, the opposite is more likely to be the case. Moreover, the second rule would lead public authorities to take inefficiently excessive amounts of precaution. Public authorities have an incentive to take precautions even under a restoration regime, because even under that regime they will lose all or part of undiscovered and relied-upon mistaken payments and will incur costs to recover other mistaken payments. Allowing citizens to keep all mistaken payments, whether or not relied upon, would give public authorities an incentive to take excessive precautions that would create additional costs and delays in making payments. The costs of the excessive precaution, plus the costs of the unrecoverable mistaken payments, would be passed on to all citizens in the form of higher prices, higher fees, higher taxes, and delay. Most citizens would probably prefer a regime of lower present prices, taxes, and fees, and faster actions, to a regime that produces higher prices, taxes, and fees, and slower actions, coupled with lottery tickets for highly improbable windfalls of uncertain amounts in the remote future.

payee will either know or have reason to know of the mistake or will otherwise not justifiably rely.

Of course, justifiable reliance on a mistaken payment can occur, as in the Illustration to the Restatement, or where an institution, like a clearing bank, bureaucratically passes on a mistaken payment to a third party from whom it cannot recover the payment easily or at all. Where justifiable reliance does occur, the payee should be entitled to retain the amount required to put it in the position it would have been in if it had not relied, as well as the transaction costs of voluntarily repaying the balance to the payor.\footnote{How to measure the payee’s reliance may sometimes be a very difficult question. For a masterly analysis of that question, see \textit{Beatson}, \textit{supra} note 22, at 137, 137-76.}

4. \textit{Administrability}

Finally, administrability is normally not a problem in the case of mistaken payments. It is usually clear that a payment was mistaken—because, for example, it was sent to the wrong person, or was indisputably in excess of any obligation the payor owed to the payee. True, in some cases a payor may claim that payment was mistaken when it was really a compromise of a disputed amount, so that the only possible mistake was evaluative. However, such false claims should normally be easy to see through, and as a safeguard, when a payment relates to a disputed debt the strong benefit of the doubt should normally be given to the payee.

B. \textit{Computational Errors}

Another type of mechanical error consists of computational errors, such as errors in addition. This kind of error is often found in bids on construction projects. Computational errors are usually categorized as “unilateral mistakes,” on the ground that they are made by only one party. However, what is most important about cases involving computational errors is not that only one party was mistaken, but rather the character of the mistake—that is, the fact that the mistake consisted of a transient error in the party’s mental machinery. Although a computational error may occur in performance, for ease of exposition I will consider only computational errors that occur prior to contract formation.

1. \textit{The Nonmistaken Party Knew of the Error}

Begin with the paradigm case of a computational error, in which the nonmistaken party, B, knew of the error made by the mistaken party, A. (For example, assume that B was looking over A’s shoulder when A erroneously added up the figures in a column.) Unlike mistaken payments, which are largely governed by the law of restitution, computational errors fall squarely within contract law, because normally an actor who has made
a computational error seeks to be relieved from contractual liability, rather than to recover a benefit conferred. However, the issues raised by computational errors are strikingly similar to those raised by mistaken payments—indeed, computational errors constitute one source of mistaken payments—and the analysis is substantially the same. As in the case of mistaken payments, actors have strong incentives to use care in making computations even under a regime in which computational errors provide a basis for relief. The error might never be caught; if the error is caught it might be costly to obtain relief; and so forth. And as in the case of mistaken payments, failure to allow computational errors to provide a basis for relief could lead to an inefficiently high level of precaution—triple- and quadruple-checking. Partly for this reason, and partly because of loss-aversion, it is highly likely that actors deciding from behind the veil would prefer a regime in which they could not take advantage of others’ known computational errors, and reciprocally others cannot take advantage of their known computational errors.

Moral considerations point in the same direction. Unlike a bargain promise based on an evaluative mistake, a bargain promise based on a computational error does not embody a demonstrative choice by the promisor, which he could be expected to stand behind as a matter of self-respect. Few if any actors regard computation as a process that demonstrates their intelligence and skill and symbolizes their capability to make a choice of the relevant kind. Everyone makes computational errors from time to time, and expects to do so. Accordingly, when a computational error is called to an actor’s attention in everyday life, the reaction is usually limited to “Oh, you’re right,” or the like, rather than regret or even significant embarrassment.29

Similarly, allowing computational errors to provide a basis for relief would neither drain the moral content from promises nor undercut the institution of contract—as is shown by the fact that such errors have long been recognized as a basis for relief with little if any protest from the profession, and indeed with the general endorsement of the judicial and academic sides of the profession.

Furthermore, in the paradigm case the mistaken party does not seek to back out of a contract because his knowledge, skill, and diligence in evaluation were less than that of the nonmistaken party. Correspondingly, a regime in which computational errors provided a basis for relief in the paradigm case would not deprive the promisee of an advantage earned by her skill, knowledge, and diligence in evaluation. Judge Posner’s analysis of an analogous case, in which a party seeks to take opportunistic

29. I recently had lunch with a friend who holds a Ph.D in Mathematics. He was having trouble totaling his bill and remarked casually, “I never could add,” the way one might say, “I never did like broccoli.”
advantage of a post-contract mistake about the contents of a contract, is applicable here:

[I]t is one thing to say that you can exploit your superior knowledge of the market—for if you cannot, you will not be able to recoup the investment you made in obtaining that knowledge.... It is another thing to say that you can take deliberate advantage of an oversight by your contract partner concerning his rights under the contract. Such taking advantage is not the exploitation of superior knowledge or the avoidance of unbargained-for expense; it is sharp dealing. Like theft, it has no social product, and also like theft it induces costly defensive expenditures, in the form of overelaborate disclaimers or investigations into the trustworthiness of a prospective contract partner, just as the prospect of theft induces expenditures on locks.30

It is true that in the case of a computational error, as in the case of a mistaken payment, normally the mistaken party is at fault. So, for example, if in a torts case an engineer had miscomputed the strength of a girder, with the result that a building collapsed, he would almost certainly be deemed negligent and therefore responsible for resulting injuries to person and property. In the paradigm contracts case, however, A’s fault does not harm B, because B knew of the mistake when she tried to conclude a contract based on the mistake. Of course, B might have formed an expectation that she could benefit from A’s mistake by concluding a contract. As a matter of morality, however, if that was B’s intention she would be viewed as improperly taking advantage of A, so that her expectation would be unjustified, like the expectation of a person who finds lost property and knows who the owner is, but thinks that she is entitled to benefit from the owner’s carelessness.

2. The Nonmistaken Party Had Reason to Know of the Error

Suppose that the nonmistaken party does not know of the computational error, but has reason to know. For example, suppose that A is one of six contractors bidding on a construction job for B. A’s bid is $500,000, and the remaining five contractors bid between $1,200,000 and $1,400,000. A reasonable person in B’s position would have had reason to know that A made some sort of computational error in assembling his bid, but B did not actually know that A made an error.

The efficiency considerations here are roughly the same as in the paradigm case. Actors have the same economic incentives to avoid making computational errors in this kind of case as they do in the paradigm case. Furthermore, if the nonmistaken party is allowed to take advantage of a

computational error when she had reason to know that such an error was made, actors may engage in too much precaution. And actors deciding from behind the veil would be highly likely to prefer a legal-relief regime in such cases, as a kind of mutual insurance against the impact of computational errors.

The moral analysis is not as clear. In the paradigm case, B knowingly attempts to take advantage of A’s mistake. In this variation, she does not. Nevertheless, although A is at fault for making the mistake, B is at fault for failing to realize that a mistake was made when a reasonable person would have done so.

Even apart from these considerations, reasons of administrability favor relief in this type of case. Only the nonmistaken party knows with certainty whether she actually knew of a computational error. Proving this actual knowledge may be too difficult a burden for the mistaken party to shoulder. Where the nonmistaken party had reason to know of a computational mistake, she probably did know. Accordingly, the reason-to-know case should be treated like the actual-knowledge case to protect the integrity of the rule that governs the actual-knowledge case.

3. The Nonmistaken Party Neither Knew Nor Had Reason to Know of the Error

Suppose the nonmistaken party neither knew nor had reason to know of a computational error. This kind of case presents two issues: First, should the mistaken party, A, be liable for reliance damages? Second, should the mistaken party be liable for expectation damages?

In the paradigm case, reliance by B should make no difference, because if B knows that A made a computational error, her reliance is unjustified. For the reasons just discussed, reliance should also be treated as unjustified where B had reason to know that A made a computational error. However, if B relies, neither knowing nor having reason to know that A made a computational error, then B’s reliance is justified, A’s fault has caused an injury to B, and A should compensate B for that injury.

Whether A should be liable for expectation damages in such a case is a more difficult issue. Older contract law took the position that a mechanical error (or, in the traditional nomenclature, a unilateral mistake) was not a defense against expectation damages unless the nonmistaken party either knew or had reason to know of the mistake. Thus Illustration 1 to Restatement (First) of Contracts § 503 stated:

A, in answer to an advertisement of B for bids for the construction of a building according to stated specifications, sends B a bid of $50,000. B accepts the bid. A, in the calculations that he makes prior to submitting his bid, fails to take into account an item of construction that will cost $5000. If B knows or, because of the
amount of the bid or otherwise, has reason to know that A is acting under a mistake, the contract is voidable by A; otherwise not.

In contrast, modern contract law takes the position that a computational error (and more generally, a mechanical error) is a defense to expectation damages, at least where the result of enforcing the contract through expectation damages would be "unconscionable"—a term that in this context effectively means a mistake such that expectation damages would have a severe impact on the mistaken party. Thus Illustration 2 to the Restatement (Second) of Contracts § 153 states:

In response to B’s invitation for bids on the construction of a building according to stated specifications, A submits an offer to do the work for $150,000. A believes that this is the total of a column of figures, but he has made an error by inadvertently omitting a $50,000 item, and in fact the total is $200,000. B, having no reason to know of A’s mistake, accepts A’s bid. If A performs for $150,000, he will sustain a loss of $20,000, instead of making an expected profit of $30,000. If the court determines that enforcement of the contract would be unconscionable, it is voidable by A.

The rule that the nonmistaken party, B, cannot recover expectation damages for a bargain based on the mechanical error of the mistaken party, A, is preferable to the older rule. Actors who addressed the issue from behind the veil would be highly likely to prefer the modern rule because it provides a kind of mutual insurance policy against casualty losses while protecting the nonmistaken party from loss through reliance. Furthermore, allowing relief for computational errors, even when the nonmistaken party neither knows nor should know of the error, does not undermine the integrity of contract. In the case of a computational error, the mistaken party is not attempting to withdraw from a contract because he made an evaluative error, nor is he attempting to redistribute a bargained-for risk, like a price shift. Indeed, if prices shift against the nonmistaken party between the time the contract was made and the time the mistaken party discovers and communicates that he has made a computational error, the mistaken party should be liable for the amount of that shift, because the shift is an opportunity cost that the nonmistaken party incurred as a result of the mistaken party’s fault.

Correspondingly, that B neither knew nor should have known of A’s computational error is a secondary consideration in this context. The important points here are that: a computational error does not embody a demonstrative choice; computational errors are not evaluative mistakes;

---

31. See, e.g., Restatement (Second) of Contracts § 153 (1981) [hereinafter Restatement Second].
32. See infra p. 1608.
allowing computational errors to serve as a defense to expectation damages does not drain the meaning of promise or undermine the institution of contract; actors deciding from behind the veil would be highly likely to prefer a regime in which computational errors provided a basis for relief from expectation damages; the advantage that B would receive from full enforcement of the contract is not earned by B’s knowledge, skill, and diligence; and A is not seeking to back out of the contract because his knowledge, skill, and diligence in evaluation were less than those of B. Indeed, A is not totally backing out of the contract, because he still must pay whatever reliance damages B has justifiably incurred based upon the error.

It is true that where B neither knows nor should know of the mistake, A is at fault, and B has formed a justified expectation as a result of A’s fault. That, however, is not dispositive. For example, where an actor negligently makes a mistaken payment, and the payee neither knows nor has reason to know that a payment is mistaken, then as a result of the payor’s fault the payee will form a justified expectation that the payment is hers to keep, but that expectation is not protected. Similarly, where an owner has negligently lost property and a finder reasonably believes that the property was abandoned, the finder forms a justified expectation that the property is now hers, but that expectation is not protected. As in those cases, the fact that the nonmistaken party in a computational-error case formed a justified expectation does not mean that she acts fairly in insisting on full enforcement of the contract after she understands that her counterparty had made such an error. On the contrary, just as a payee is morally obliged to return a payment once she learns it was mistaken, and a finder is morally obliged to make reasonable efforts to return property once she knows it was lost rather than abandoned, so too a party to a contract that is based on a mistaken computation would be morally overreaching if she insisted on full enforcement after she learned of the error.

C. Other Recurring Cases and the Present Legal Framework

The rules that govern mistaken payments and computational errors are instantiations of the principle that should and largely does govern mechanical errors as a class: a party who makes such an error should be able to avoid enforcement of the contract, recover the value of any benefit that he has conferred on the nonmistaken party, or both, except to the extent that the nonmistaken party has been injured by justified reliance on the

33. See, e.g., Glover v. Metro. Life Ins. Co., 664 F.2d 1101, 1105 (8th Cir. 1981). In all the circumstances, it would be unjust, in our view, for [an unknowing mistaken payee] to keep the money. This result disappoints an expectation on her part that she had every reason to believe, at one time, to be legitimate, but to decide otherwise would be intolerably unfair to [the mistaken payor].

Id.
contract. I have begun with the examples of mistaken payments and computational errors not because they are special cases, but because they present good foundations for exploring the relevant issues. I now explore some other recurring cases and some aspects of the present legal framework concerning mechanical errors. I will begin with cases in which at the time the contract was made the nonmistaken party knew or had reason to know that her counterparty had made a mechanical error, and then turn to cases where the nonmistaken party neither knew nor had reason to know.

1. The Nonmistaken Party Knew Or Had Reason to Know of the Error

The reasons of efficiency and morality that apply to cases in which a nonmistaken party knew or had reason to know that a payment was mistakenly made, or that a promise was based on a computational error, also apply to mechanical errors as a class. There are a number of these cases, some of which fall into recurring patterns. One such case concerns "an offer that is on its face too good to be true."34 The rule is that an offeree cannot snap up such an offer.35 Speckel v. Perkins36 is a good example. Speckel had been injured in an automobile accident involving a collision between a car driven by Perkins and a truck in which Speckel was a passenger. Perkins's attorney, Wheat, wrote to Speckel's attorney, Eckman, as follows:

In reviewing my file concerning this claim and the upcoming trial, I note that we have a demand in our file [from you for a settlement at the] policy limits of $50,000.00. While I agree that the case has some value, I cannot agree that this is a limits case.

At this point in time I have authority to offer you $50,000.00 in settlement of your claim against my client.... I would appreciate hearing from you at your earliest convenience and would be pleased to carry any offer you may wish to make back to my client's insurance company for their consideration.37

Eckman replied, "Your offer of $50,000 to settle this case... is hereby ACCEPTED."38

Perkins and the insurance company claimed that no contract had been formed. In support, Wheat gave an affidavit that he intended to offer a settlement of $15,000 in his letter, not $50,000. Wheat explained that he was engaged in a trial in another matter at the time, and dictated the letter to his assistant, who misheard the term that Wheat dictated, "$15,000," as

34. See 1 S. Williston, A TREATISE ON THE LAW OF CONTRACTS § 94 (2d ed. 1936); see also United States v. Braunstein, 75 F. Supp. 137, 139 (S.D.N.Y. 1947) (quoting WILLISTON, supra).
35. WILLISTON, supra note 34, § 94.
37. Id.
38. Id. at 892.
"$50,000." The assistant signed the letter on Wheat's behalf, so Wheat didn't notice the mistake.

The court properly held that no contract had been formed because Eckman should have known that it was not Wheat's intention to settle for $50,000:

Several aspects of the offer . . . negate its validity. A duty to inquire may be imposed on the person receiving the offer when there are factors that reasonably raise a presumption of error. An offeree "will not be permitted to snap up an offer that is too good to be true; no agreement based on such an offer can * * * be enforced by the acceptor."

In this case Wheat's letter is internally inconsistent. After stating that the case is not worth the policy limits, it proceeds to offer precisely that amount. We find that this internal inconsistency raises a presumption of error and imposed upon Eckman a consequent duty to inquire, particularly in this context—the policy limits, requested when negotiations began, were offered on the eve of trial when the parties were presumably prepared and circumstances had not changed. Finally, the letter expressly states that Wheat "would be pleased to carry any offer [Eckman] may wish to make back to [Wheat's] client's insurance company for their consideration." Despite offering the full amount of the demand, the language does not indicate that an acceptance is anticipated, but rather calls for a counter-offer. We cannot agree that it is an offer enforceable upon acceptance.39

In another recurring type of case, at the time a contract for the sale of a product is made the buyer knows or has reason to know that the product is mispriced as a result of a mechanical error. Perhaps the most well-known illustration of this kind of case is the Nolan Ryan Baseball Card case.40

In April 1990, Joe Irmen opened a baseball-card store named Ball-Mart. One of the cards Ball-Mart offered for sale was a 1968 Jerry Koosman/Nolan Ryan rookie card in almost perfect condition. A rookie card is the first published baseball card featuring a given player. The rookie card of a player who later becomes a superstar, like Nolan Ryan, normally commands a very high price. Irmen had obtained the card on consignment from its owner, and was required to pay the owner $1,000 if the card was

39. Id. at 893-94 (citations omitted) (alterations in original).
sold. A subsequent issue of a monthly price guide listed the price of a Nolan Ryan rookie card as $800-$1,200.

Bryan Wrzesinski was a twelve-year-old boy who had a collection of 40,000-50,000 baseball cards. On April 20, a few days after Ball-Mart had been opened, Bryan came into the Ball-Mart store. At that point, Irmen had more people in Ball-Mart than he could serve. Irmen owned a jewelry store next door to Ball-Mart, and he asked Kathleen Braker, a salesperson in that store, to help out. Braker had no knowledge of baseball cards. Bryan saw the Nolan Ryan card, showed it to Braker, and said, "Is this card worth twelve dollars?" According to a newspaper account of testimony Braker gave a year later, the Nolan Ryan card was marked "1200" but Braker was not sure, when she gave her testimony, "if the number contained other marks such as a comma, decimal, or dollar sign." Bryan said the card was marked "1200," without any other marks.

In response to Bryan's question whether the card was worth twelve dollars, Braker said yes, and Bryan bought the card for that amount. When Irmen found out what happened, he offered Bryan $100 for return of the card. Bryan declined, and Irmen sued to recover either the card or damages. The case was settled in mid-trial. The settlement provided that the card would be auctioned off and each party would donate his half of the proceeds to charity. (Because of the notoriety the card had acquired, by the time of the settlement the card was worth $3,000-$5,000 and possibly more. Accordingly, Irmen's tax deduction for his charitable contribution might have approached or exceeded his $1,000 cost. In addition, by this time Bryan had sued Irmen for libel on the ground that Irmen had stated publicly that Bryan had stolen the card. The settlement included a dismissal of the libel action.)

Because the case was settled, it did not result in an opinion. However, the case has been widely discussed and is a good launching-pad for discussion of the issue at hand.

43. Leptich, Finally, It's Bottom of 9th, supra note 40. Leptich reports the following sequel: Kathleen Braker, the clerk from Irmen's jewelry store who sold Wrzesinski the disputed card and quit two weeks later because she was "humiliated," is back on the job.

One of her projects is a T-shirt which bears Ryan's likeness on front and a Topps 40th anniversary logo on back.

Below the Topps logo, the shirt reads: "Home of the Nolan Ryan Rookie Card 1200 Ball Mart Baseball Cards & Coins" and gives the store's telephone number.

The price?
You guessed it, $12.

Id.
Suppose first that the Nolan Ryan card was marked "$1,200" or "1,200." The case is then pretty easy: Bryan would then have actively misled Braker about the price.

Suppose next that the card was marked "$1200" or "1200." As the owner of 40,000-50,000 baseball cards, Bryan almost certainly knew or should have known that in this context "1200" did not mean "12.00." On these facts too, therefore, Bryan probably would have misled Braker if he said to her, "Is this card worth $12.00?"

Suppose, finally, that the card was marked "$12.00" or "12.00." Given the size of Bryan’s collection and the true value of the card, Bryan would almost certainly have known that the $12.00 price was based on a mechanical error, not an evaluative error, and therefore on these facts as well, Bryan should not have been able to retain the card.

2. The Nonmistaken Party Neither Knew Nor Had Reason to Know of the Error

For the reasons discussed in connection with the mistaken-payment and computational-error cases, the principle that a mechanical error should furnish a ground for relief, except to the extent that the nonmistaken party suffered a loss by justifiably relying on the contract, applies not only where the nonmistaken party knew or had reason to know of the mistake, but also where she neither knew nor had reason to know.

This principle is embodied in Restatement Second and modern cases, such as Donovan v. RRL Corp., decided by the California Supreme Court in 2001. There, Brian Donovan noticed a full-page advertisement placed by Lexus of Westminster in a local newspaper, the Daily Pilot. The advertisement promoted a "PRE-OWNED COUP-A-RAMA SALE!! 2-DAY PRE-OWNED SALES EVENT" and listed sixteen used automobiles, including a 1995 Jaguar XJ6 Vanden Plas. The advertisement described the color of this car, included the car’s vehicle identification number, and stated a price of $25,995. The next day, Donovan and his wife drove to Lexus of Westminster, found the 1995 Jaguar, test-drove it, and after discussion told the salesperson, "Okay. We will take it at your price, $26,000." When the salesperson did not respond, Donovan showed him the advertisement. The salesperson immediately said, "That’s a mistake." Westminster’s sales manager also told Donovan that the price listed in the advertisement was a mistake, apologized, and offered to pay for Donovan’s fuel, time, and effort in traveling to the dealership to examine the automobile. Donovan declined, and asked what price the sales manager wanted.

45. 27 P.3d 702 (Cal. 2001).
46. Id. at 707.
47. Id.
48. Id.
Westminster had paid $35,000 for the car. Based on that price, the sales manager said that he would sell the car to Donovan for $37,016. Donovan responded, "No, I want to buy it at your advertised price, and I will write you a check right now." The sales manager again said that he would not sell the car at the advertised price. Donovan brought suit. Westminster later sold the car to a third party for $38,399.50

At the trial, it was shown that Westminster's advertising manager regularly compiled information for advertisements in local newspapers, including the Daily Pilot.51 As originally prepared by the advertising manager, the advertisement listed a 1995 Jaguar XJ6 Vanden Plas but did not specify a price. Instead, the word "Save" (that is, save for later specification) appeared in the space where the price ordinarily would be specified. Thereafter, Westminster's sales manager instructed the advertising manager to delete the 1995 Jaguar from all advertisements, and to substitute in its place a 1994 Jaguar XJ6, with a price of $25,995. The advertising manager gave this information to the Daily Pilot. However, because of typographical and proofreading errors made by Daily Pilot employees, the newspaper inserted the price of $25,995 in place of the word "Save" but failed to change the description of the car from a 1995 Jaguar to a 1994 Jaguar. Therefore, the April 26 Daily Pilot erroneously advertised the 1995 Jaguar XJ6 Vanden Plas at a price of $25,995. No Westminster employee reviewed a proof sheet of the revised advertisement before it was published, and Westminster was unaware of the mistake until Donovan attempted to purchase the Jaguar.

The day before he went to Lexus of Westminster, Donovan had shopped for a Jaguar at a Jaguar dealer, whose prices were $8,000-$10,000 higher than the price Westminster listed in the advertisement. However, Westminster's Jaguar had some visible defects. Furthermore, Donovan remarked to the Westminster salesperson that the price in the Daily Pilot advertisement looked "really good," and the salesperson responded that because Westminster was a Lexus dealer it might offer better prices for a Jaguar than a Jaguar dealer would. Accordingly, the court treated it as given that Donovan neither knew nor should have known that the price in the advertisement was incorrect. Nevertheless, the court held that Westminster was not liable to Donovan for expectation damages. The court's opinion emphasized the way in which contract law on this issue had changed over time:

Under the first Restatement of Contracts, unilateral mistake did not render a contract voidable unless the other party knew of or caused the mistake. . . .

49. Id.
50. Id. at 708.
51. Id.
...[1] In M. F. Kemper Const. Co. v. City of L. A. (1951) [and in Elsinore Union etc. Sch. Dist. v. Kastorff (1960)]... we acknowledged but rejected a strict application of the foregoing Restatement rule regarding unilateral mistake of fact....

The decisions in Kemper and Elsinore establish that California law does not adhere to the original Restatement's requirements for rescission based upon unilateral mistake of fact—i.e., only in circumstances where the other party knew of the mistake or caused the mistake. Consistent with the decisions in Kemper and Elsinore, the Restatement Second of Contracts authorizes rescission for a unilateral mistake of fact where "the effect of the mistake is such that enforcement of the contract would be unconscionable."... Although the most common types of mistakes falling within this category occur in bids on construction contracts, § 153 of the Restatement Second of Contracts is not limited to such cases....

Because the rule in... the Restatement Second of Contracts, authorizing rescission for unilateral mistake of fact where enforcement would be unconscionable, is consistent with our previous decisions, we adopt the rule as California law. As the author of one treatise recognized more than 40 years ago, the decisions that are inconsistent with the traditional rule "are too numerous and too appealing to the sense of justice to be disregarded." (3 Corbin, Contracts (1960) § 608...) We reject Donovan's contention... that, because [Donovan] was unaware of [Westminster's] unilateral mistake, the mistake does not provide a ground to avoid enforcement of the contract. 52

Other modern cases take this same position. 53 This position is correct in general. However, there are two problems with the details of the

52. Id. at 715-16. There is a traditional rule of offer-and-acceptance law that an advertisement is not an offer. Under that rule, Westminster Lexus would have prevailed even if there had been no mistake. However, the status of the traditional rule is in serious doubt. See Lefkowitz v. Great Minneapolis Surplus Store, 86 N.W.2d 689 (Minn. 1957); Melvin Aron Eisenberg, Expression Rules in Contract Law and Problems of Offer and Acceptance, 82 CALIF. L. REV. 1127, 1166-72 (1994). In its opinion, the California Supreme Court acknowledged both the traditional rule and its doubtful status, but finessed the issue by holding that an advertisement by an automobile dealer to sell a car was an offer under the California Vehicle Code. Accordingly, Westminster could win only if it could establish a defense of mistake. Donovan, 27 P.3d at 709-13.

53. For example, in Colvin v. Baskett, 407 S.W.2d 19 (Tex. Civ. App. 1966), Baskett listed with Colvin, for sale by Colvin, three bags of uncirculated coins. One of these bags of coins was owned by Jess Crow, on whose behalf Baskett was acting. On the same day, Baskett's son-in-law also listed a bag of uncirculated coins with Colvin. This was the same bag of Jess Crow's coins that Baskett had listed. Apparently, neither Baskett nor his son-in-law realized that the other was listing the bag of Jess Crow's coins. Apparently too, Colvin knew only that Baskett had listed three bags of uncirculated coins and that Baskett's son-in-law had listed one bag, and didn't know that both had listed the same bag. When Baskett realized that he and his son-in-law had inadvertently both listed the same bag of uncirculated coins, he asked Colvin to sell only two bags of coins, not three. Colvin sued, and the court held that Baskett had a right to rescind his contract with Colvin.
formulation of the position employed in Donovan, other modern cases, and Restatement Second.

The first problem is that the formulation turns on whether there has been a "unilateral mistake." This term leads to a lack of clarity in the law by diverting attention from the real issue, that is, whether the relevant mistake is a mechanical error. A unilateral mistake is a mistake made by only one party. Some kinds of mistake made by only one party will constitute a defense. Others will not. Whether a mistake will constitute a defense turns not (or not only) on whether it was made by only one party, but on the character of the mistake.

The second problem with the formulation in Donovan, other modern cases, and Restatement Second is that under this formulation, where the nonmistaken party neither knew nor had reason to know of a "unilateral mistake," the mistake will serve as a defense to expectation damages only if enforcement would be "unconscionable." Traditionally, unconscionability refers to certain kinds of fault by a promisee at the time of contract formation. This fault may consist of an improper bargaining process, like including a clause into a form contract that the promisee knows the promisor does not realize is in the contract and wouldn't agree to if he did know.

Obviously, the concept of unconscionability, as it is applied to "unilateral mistakes" in Restatement Second and cases like Donovan, means something other than fault at the time of contract-formation: By hypothesis, we are dealing with cases in which the nonmistaken party neither knew nor had reason to know of the mechanical error at that time, and therefore was not at fault in any way in making the contract. Accordingly, unconscionability in the context of mechanical errors can only refer to the idea that it is "unconscientious" or exploitive to attempt to hold a party to a promise that was based on a mechanical error where the result of the error was a significant difference between the actual contract price and the price that would have been offered if the mistake had not been made.

But if that is so—as it is—then in any case in which a nonmistaken party attempts to enforce the letter of a contract made on the basis of a significant mechanical error, as opposed to attempting to enforce the contract to the extent of her reliance, that party will act exploitively and therefore unconscionably. And if that is so—as it is—then there is no need to

Similarly, in Hall v. United States, 19 Ct. Cl. 558 (1990), the Air Force had a jet-engine part worth $167,553 that it intended to send to a repair depot. Instead, the engine part was mistakenly put up for auction, and Hall purchased the part at the auction for $15. The court held that the contract was unenforceable. See also Beatty v. Depue, 103 N.W.2d 187 (S.D. 1960) (rescission granted where buyer of a ranch mistakenly believed that the seller owned all of the ranch, when in fact a few important portions of the ranch were owned by the government).

54. The Restatement (Second) of Contracts does not use the term "unilateral mistake," but it uses a synonym, "mistake of one party." Restatement Second, supra note 31, § 153.

determine whether enforcement would be unconscionable: The only need is to determine whether the impact of the error was significant. If it was, then it will always follow that seeking full enforcement will be exploitive. In reality, therefore, in the context of mechanical errors "unconscionability" is a code word for economic significance. This is reflected in Donovan:

...[The general rule governing unconscionability] is inapplicable here, because unconscionability resulting from mistake does not appear at the time the contract is made. . . .

In the present case, enforcing the contract with the mistaken price of $25,995 would require [Westminster] to sell the vehicle to [Donovan] for $12,000 less than the intended advertised price of $37,995—an error amounting to 32 percent of the price [Westminster] intended. [Westminster] subsequently sold the automobile for slightly more than the intended advertised price, suggesting that that price reflected its actual market value. [Westminster] had paid $35,000 for the 1995 Jaguar and incurred costs in advertising, preparing, displaying, and attempting to sell the vehicle. Therefore, [if Westminster is required to sell the Jaguar to Donovan for $25,995, Westminster] would lose more than $9,000 of its original investment in the automobile. [Donovan], on the other hand, would obtain a $12,000 windfall if the contract were enforced, simply because he traveled to the dealership and stated that he was prepared to pay the advertised price. 56

In short, despite the language of "unconscionability," whether a mechanical error is a defense to expectation damages should and does depend solely on whether the impact of the mechanical error is significant. 57


57. Another recurring kind of case in which a nonmistaken party normally neither knew nor should have known that a mechanical error was made concerns promotional contests. For example, in one common type of promotional contest a seller promises to award prizes to persons who either find a winning game piece inside a package in which the seller's product is contained, or find matching game pieces inside two or more packages. See generally Mark B. Wessman, Is "Contract" the Name of the Game? Promotional Games as Test Cases for Contract Theory, 34 Ariz. L. Rev. 635 (1992). Inevitably, some of these promotional contests go awry as a result of a mechanical error, and too many game pieces are produced, so that if the seller sticks by the rules of the contest the total payoff would be much greater than was planned. See, e.g., id. at 640-43 (mechanical error in a contest exposed Kraft Food to potential liability of over $11 billion, when the total value of all prizes but for the error would have been only $63,000).

When mechanical errors occur in a promotional contest, the persons who had apparently become entitled to prizes before the mistake was discovered and publicized normally neither knew nor should have known of the mistake. Nevertheless, an error of this sort should provide a defense to expectation damages, for much the same reasons that apply to computational errors. However, the promotional-contest case is more complex than other mechanical-error cases. Because a seller promotes a contest to get the benefit of increased sales, a mistaken seller must have originally calculated that the short- or long-term profits generated by the increased sales would equal or exceed the expected cost of the
IV

MISTRANSCRIPTIONS

Suppose that A and B make an oral bargain, and agree that A will transcribe the bargain into a written contract. Due to a mistake in transcription—a mistranscription—by A, the written contract does not correspond to the bargain. Both parties then sign the written contract, mistakenly believing that the writing accurately reflects the bargain. What rule should govern this kind of case?

Mistranscriptions are a special case of mechanical errors: A intends the writing to incorporate the bargain, and by virtue of a mechanical error it does not. If we stopped there, mistranscriptions, like other mechanical errors, would be pretty easy to deal with. Indeed, they would be even easier to deal with than most mechanical errors, because a mistranscription is a mistake that does not affect the terms of the bargain. The only bargain the parties have made is the oral bargain. In a mistranscription, the mistake occurs after the bargain has been made.

Accordingly, the general principle that should be applied to mistranscriptions is the same as the general principle that should be applied to other mechanical errors: the error should provide a basis for relief. The precise nature of the relief, however, needs to reflect the special characteristics of mistranscriptions.

To begin with, the appropriate relief for most mechanical errors is to give the mistaken party a defense, either in whole or in part, against damages. In the case of mistranscriptions, however, the appropriate relief is to amend the writing so that it correctly embodies the real bargain.

Next, mistranscription cases tend to give rise to special evidentiary problems. Unlike most other mechanical errors, mistranscriptions are often not discovered quickly. Typically, the parties assume that the writing is an accurate transcription of their bargain and file it away. Only much later does one or both of the parties realize that a mistranscription has occurred. This time lag can cause significant problems of proof. Furthermore, if a contest. By the time the mistake is discovered and made known to the public, the seller may have received much or even most of the expected benefit. Accordingly, a mistaken seller should be obliged to distribute in prizes at least as much as it planned to distribute. Most sellers will probably do even more, either to retain good will, by way of a settlement, or both.

Still another recurring mechanical-error case occurs when a machine makes an error. One possible error of this type would be an error in a calculator or computer that caused a bid to be mistakenly computed. There is no reason why such an error should be treated differently than a transient human computational error. Similarly, a transient error in a gambling device—usually a slot machine—may cause the device to mistakenly show a huge win. Mistaken jackpots have reached millions of dollars. Normally, the casino refuses to pay in such cases. See Sengal v. IGT, 2 P.3d 258 (Nev. 2000) (casino not required to pay). However, Harrah’s paid a mistaken $330,000 jackpot after the winner retained a lawyer who generated a barrage of critical media coverage and showed that Harrah’s had improperly failed to immediately call in the state gambling commission. See Christina Binkley, Bad Luck: Glitches Can Make One-Armed Jackpots Evaporate, WALL ST. J., July 1, 1998, at B1.
written instrument can be defeated on the ground that it mistakenly mistranscribed an oral agreement, there is a danger that a party to a losing contract might avoid liability by perjuriously convincing a jury that a mistranscription has occurred when in fact it has not.

The law addresses these administrability concerns in two ways. First, a person who claims that a mistranscription has occurred must request the remedy of reformation to make the writing conform to the bargain. Because reformation is an equitable remedy, jury trial is not permitted. Second, reformation is granted only if the party who requests the remedy proves his case by clear and convincing evidence, or some comparable standard, rather than merely by a preponderance of the evidence. As stated by Judge Posner, "[s]ince reformation is an equitable doctrine and... requires 'clear and satisfactory proof'... the danger of facile invocations... is limited. The party [seeking reformation] must convince the judge, and convince him clearly."58

What if A intentionally, rather than negligently, mistranscribes the parties' bargain? In that case we have only one mistake—B’s mistake concerning the content of the writing—rather than two, and only one mistaken party. However, the result should be the same. If B can enforce the actual bargain in the case of a careless mistranscription by A, surely he can also do so in the case of a deliberate mistranscription.

V

INTERPRETIVE MISTAKES

A major sector of the law of interpretation concerns cases in which contracting parties employed an expression—words, conduct, or both—to which each subjectively attaches a different meaning.59 In such cases, issues of mistake are both salient and sharply posed, although, with one important exception, these cases traditionally have not been viewed as involving issues of mistake. I will refer to such cases as interpretive mistakes.

Interpretive mistakes are of two kinds. First, one or both parties may mistakenly believe that the other party subjectively attaches to the expression the same meaning that he attaches. This is not a mistake about meaning, but a mistake about the other party's subjective belief. Second, one party may mistakenly believe that the meaning that he attaches to the expression is the most reasonable meaning, when it is not, or each party may

58. Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 746 (7th Cir. 1988).
59. Contract-interpretation problems (including the interpretation of an element of a contract, such as an offer or an acceptance) can fall into two other categories, neither of which I discuss in this Article. In one category, at the time the contract is made the parties do not advert to an issue that can, and later does, arise. In a second category, the parties jointly fail to think through the intended implications of an expression that they employ. Cases in these two categories lie on a continuum, rather than in sharply divided compartments, but that is not a problem for present purposes.
mistakenly believe that the expression is unambiguous and therefore susceptible to only one meaning—the meaning that he attaches—when in fact the expression is ambiguous and susceptible to two equally reasonable meanings.

Interpretive mistakes differ from evaluative mistakes because they do not involve changes in preferences or changes in the subjective or objective evaluation of the performances to be rendered under a contract. Interpretive mistakes differ from mechanical errors, because typically they are not caused by a blunder that results from a transient error in the mechanics of an actor's mental or physical machinery. Indeed, an actor who has made an interpretive mistake may persist in viewing his interpretation as correct even after he has been presented with strong evidence that under the standards of the relevant community his interpretation is less reasonable than that of his counterparty.

Most interpretive mistakes fall into one of three paradigms, each of which involves both a mistake concerning the meaning that the other party attaches to an expression and a mistake concerning the most reasonable meaning of the expression. The paradigms vary according to the exact nature of the mistake and whether the mistake is made by one or both parties.

Paradigm 1—The meanings that the parties attach to an expression are equally reasonable, and neither party knows the other attaches a different meaning.

Paradigm 1 can be exemplified as follows. A and B enter into a bargain that includes Expression E. A subjectively attaches the meaning Alpha to Expression E. B subjectively attaches the meaning Beta. Given the context in which Expression E was used, Alpha and Beta are equally reasonable meanings. A does not know that B attaches the meaning Beta to Expression E. B does not know that A attaches the meaning Alpha.

Of the cases considered in this Part, traditionally the law has conceived only Paradigm 1 cases as mistake cases. The category of mistake into which Paradigm 1 cases have traditionally been put is misunderstanding. As elsewhere in the law of mistake, this is not a functional label; other kinds of interpretation cases, discussed below, also involve misunderstandings.

In Paradigm 1 cases, normally each party mistakenly believes that a relevant expression is unambiguous and that the meaning he attaches to the expression is therefore the only meaning that could be attached. In fact, however, the expression is ambiguous and each party's meaning is equally reasonable. The rule that should govern such cases is that neither party should be held to the other's interpretation, because both parties are equally at fault (or, rarely, neither is at fault), and neither has taken advantage of the other. This is the position the law has taken in a long line of authorities,
MISTAKE IN CONTRACT LAW

beginning with Raffles v. Wichelhaus,\(^6\) the Peerless case. There, Seller agreed to sell to Buyer 125 bales of Surat cotton to arrive at Liverpool ex ship Peerless from Bombay. There were, however, two ships named Peerless that sailed from Bombay. One sailed in October, and one in December. Seller meant the December Peerless, and shipped Surat cotton on that ship. Buyer meant the October Peerless, and refused to accept the cotton shipped on the December Peerless. Seller sued for breach of contract. The court held for Buyer on the ground that no contract had been formed.

This leaves the question of liability. The traditional rule, following Peerless, is that no contract is formed in Paradigm 1 cases, and therefore neither party is liable to the other. However, the no-liability conclusion does not follow from the no-contract premise. Contract is a ground of liability, but it is not the only ground. The issue is not whether a contract is formed, but whether liability should be imposed. In Paradigm 1 cases, characteristically both parties are at fault, and equally at fault, in mistakenly believing that the expression they used was unambiguous. This characteristic is illustrated by the Peerless case itself. Both parties in this case thought that the term “Peerless” was unambiguous. Both were mistaken. A.W.B. Simpson has determined that at the time it was a common practice for ships to share the same name and at least eleven ships were named “Peerless.”\(^6\) Given a common practice of using the same name for more than one ship, both parties in Peerless were at fault in thinking that the term “Peerless” was unambiguous.

Where, in Paradigm 1 cases like Peerless, both parties are at fault and equally at fault, a comparative-fault regime should prevail. Accordingly, in such cases (and most Paradigm 1 cases will be such cases) if one party has less out-of-pocket costs in reliance on the contract than the other, he should be required to pay the other an amount that will equalize the wasted costs. The same result should follow even in cases where neither party was at fault in recognizing that the expression they used was ambiguous. As Dan Dobbs says, “[I]f equally innocent parties have set out to sail the same boat, to require them to share the chore of bailing water when it begins to sink is not necessarily all bad.”\(^6\)

---

\(^6\) 159 Eng. Rep. 375 (Ex. D. 1864); see, e.g., Restatement Second, supra note 31, § 20(1):
There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and
(a) neither party knows or has reason to know the meaning attached by the other; or
(b) each party knows or each party has reason to know the meaning attached by the other.


Paradigm 2—The meaning that one party attaches to an expression is more reasonable than the meaning that the other party attaches, and neither party knows that the other attaches a different meaning.

Paradigm 2 can be exemplified as follows. A and B enter into a contract that includes Expression F and A subjectively attaches the meaning Alpha to Expression F. B subjectively attaches the meaning Beta. Given the context in which Expression F was used, Beta is a more reasonable meaning than Alpha. A does not know that B attaches the meaning Beta to Expression F, and B does not know that A attaches the meaning Alpha.

The rule that should and does govern Paradigm 2 cases is that if the parties subjectively attach different meanings to an expression, neither knows that the other attaches a different meaning, and the two meanings are not equally reasonable, the more reasonable meaning prevails. This rule is largely based on fault. If A and B engage in making a contract, A is at fault if he uses an expression that he should realize would lead a reasonable person in B's position to understand that A means Beta, when in fact he means Alpha. (In contrast, in Paradigm 1 cases neither party is at fault or both are equally at fault.)

A difficult issue in such cases is how compensation should be measured. At a minimum, B should be entitled to recover reliance damages. By hypothesis, A was at fault for mistakenly attaching a less reasonable meaning to the expression than B. If A's fault has caused injury to B, A should compensate B for that injury.

But should B get expectation damages? In the case of a mechanical error the nonmistaken party should not be entitled to expectation damages, and under modern law generally he is not so entitled, even where he has formed a legitimate expectation as a result of A's fault. Why if at all should the remedy be different in the case of an interpretative mistake?

One possible reason to treat the interpretive mistake made in Paradigm 2 differently from mechanical errors is that in the case of a mechanical error, normally the reliance and expectation measures will significantly diverge. In Paradigm 2 cases, the situation may well be different. What may happen is that at a certain stage of performance A renders performance Alpha, which B rejects not because performance Beta has greater market value, but because Alpha is not what B needs and reasonably expects to get. Reliance in such a case is likely to be an opportunity cost equal to the difference between the price of Beta at the time the contract was made...

---

63. See, e.g., Restatement Second, supra note 31, § 201(2)(b):

Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made...

(b) that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party.
was made and the current price. This opportunity cost would be hard to separately price, and would in most cases be pretty close if not identical to expectation damages. Accordingly, even if it was theoretically desirable to limit damages to reliance in Paradigm 2 cases, the expectation measure would often be a good surrogate for reliance.

A related reason for awarding expectation rather than reliance damages in Paradigm 2 cases is based on the way in which the mistake characteristically unfolds. In the case of mechanical errors, characteristically the error is caught very soon after the contract is made. Donovan and the Baseball Card case are good examples. So are cases in which a contractor miscomputes his bid, wins the contract, and within a day or two realizes that he has made an error. In contrast, interpretive mistakes frequently do not surface until well after the contract is made. At some point in performing the contract, A renders or proposes to render performance Alpha, and B claims that performance Beta is due. Only then do the parties realize that their interpretations of the contract differ. Because in a Paradigm 2 case the price that B agrees to pay for A's promise will impound B's reasonable interpretation of the relevant expression, if B has been performing the contract then limiting B's damages to reliance would give B less than the amount that B has paid for A's performance by rendering her own performance. Furthermore, the farther out the parties go from the time of contract formation, and the deeper the parties get into performance, the harder it would be to calculate reliance damages, because by that time each party is likely to have relied in complex and difficult ways. Accordingly, awarding expectation damages may be the best and only way to achieve a fair result.

Finally, and perhaps most importantly, expectation damages in Paradigm 2 cases are justified by linked considerations of administrability and efficiency. Normally it is relatively easy to determine by objective evidence whether a mechanical error was made. Because of the ambiguity of purposive language, however, it is often relatively easy for an actor to falsely claim that he subjectively attached to an expression a meaning that was favorable to him. Since only the actor knows whether he really attached that meaning to the expression, contracts would be rendered unduly insecure if any plausible interpretation could be set up as a defense to expectation damages. To put this differently, if Paradigm 2 mistakes were a defense to expectation damages, an actor who has made an evaluative mistake might easily seek to mask the real reason for nonperformance or nonconforming performance by claiming that he made an interpretive mistake.

A different problem is whether damages in Paradigm 2 cases should be made proportional to the relative strength of each party's interpretation,
on analogy to comparative negligence.\textsuperscript{64} Under present law this is not an issue. That is partly because the courts in interpretation cases typically analyze Paradigm 2 cases through a binary approach, under which one party's interpretation is deemed reasonable and the other party's interpretation unreasonable. In reality, however, typically both parties' interpretations are reasonable but one party's interpretation is more reasonable than the other's. To put this differently, the reasonability of meanings—the reasonability of the interpretations of an expression—is normally continuous rather than binary.

A good illustration is \textit{Lawson v. Martin Timber Co.}\textsuperscript{65} Lawson owned timber-bearing land. On October 14, 1948, he entered into a contract with Martin Timber that provided that Martin Timber had two years to cut and remove as much timber from his land as it wanted. In the event of high water during the two-year period, Martin Timber was to get a one-year extension of the right to cut and remove timber. As it turned out, there was high water on Lawson's land during half of the two-year period, but Martin Timber could easily have cut and removed the remaining timber during the other half. Instead, Martin Timber cut and removed timber from Lawson's land after the basic two-year period had expired, but within three years from the time the contract was made. Lawson brought an action to recover the value of that timber, on the ground that under the circumstances the extension provision was inapplicable. In its initial opinion the Louisiana court held, four to three, that the extension provision was applicable because there had in fact been high water on Lawson's land during the basic two-year period. Justice Simon dissented on the ground that

\ldots [T]he words in the clause standing alone are meaningless. But when taken in context with the preceding language of the contract wherein it is stated that the defendant is given two years in which to cut and remove all of said timber, this clause can have but one objective meaning. \ldots It is manifest that, taking the clause as written with the language preceding, it can only mean that if there existed any overflow or high water during the period of two years which would have \textit{prevented} the cutting and removal of this timber within the stated primary term, then the defendant enjoyed the right of so doing during the period of one additional year \ldots \textsuperscript{66}

On rehearing, the court adopted Justice Simon's position.\textsuperscript{67}

The meaning that the court gave to the contract on rehearing may well have been better—may well have been more reasonable—than the meaning the court gave to the contract in its initial opinion. However, Justice Simon's statement that the expression used by the parties could "have but
one objective meaning" is belied by both the language of the provision and the fact that four out of seven judges of a state supreme court originally interpreted the provision in exactly the opposite way. There was not one and only one reasonable meaning of the contract.

But even though the reasonability of meanings is often continuous rather than binary, a comparative-fault regime for Paradigm 2 cases would be undesirable. The application of a comparative-fault regime assumes that both parties were at fault. However, just because the meaning that A attaches to an expression has some degree of reasonability does not mean that B was at fault in attaching a more reasonable meaning. It is true that in Paradigm 2 cases B may have been at fault for thinking that Expression E was unambiguous. Alternatively, however, B may have correctly thought that Expression E was ambiguous but that Beta was the best meaning to attach to it.

An intermediate solution to the problem raised by the continuous nature of the reasonability of interpretation is to apply the Peerless rule—that neither party is entitled to expectation damages if their interpretations were equally reasonable—expansively, to cover cases where one interpretation was only marginally more reasonable than the other. In reading cases in which the Peerless rule is applied, it sometimes seems as if that is just what happens.68

Paradigm 3—The meaning that one party, A, attaches to an expression is more reasonable than the meaning attached by the other party, B, but A knows that B attaches a different meaning.

Paradigm 3 can be exemplified as follows. A and B enter into a contract that includes Expression G. A subjectively attaches the meaning Alpha to Expression G. B subjectively attaches the meaning Beta. Given the context in which Expression G was used, Beta is a more reasonable meaning than Alpha. However, B knows that A attaches the meaning Alpha to Expression G, while A does not know that B attaches the meaning Beta.

In this kind of case, A is mistaken while B is not. A mistakenly believes either that Expression G is unambiguous or that his interpretation of Expression G is the most reasonable interpretation. In contrast, B correctly believes that Expression G is ambiguous (because she knows that she and A interpret the expression differently) and correctly attaches the more reasonable meaning to Expression G.

The rule that should and does govern Paradigm 3 mistakes is that the mistaken party, A, should be protected by giving effect to the meaning that he attaches to the expression, even though that meaning is less reasonable

than the meaning attached by B.\textsuperscript{69} It is true that A is at fault in believing that Expression G is unambiguous, in attaching to Expression G a less reasonable meaning than that attached by B, or both. However, B is not injured by A's fault, because B knew of A's mistake before purporting to conclude the contract. Furthermore, B's fault, in trying to take advantage of A's mistake, is greater than A's fault. Knowing to try to take advantage of another's interpretive mistake is a wrong in the same way as knowingly trying to take advantage of another's mistaken payment or computational error. In \textit{Paradigm 3} cases B has acquired her advantage by the unfair exploitation of A's ignorance. Recall again Judge Posner's statement that to "take deliberate advantage of an oversight by your contract partner concerning his rights under the contract...is not the exploitation of superior knowledge...; it is sharp dealing. Like theft, it has no social product."

It might be argued that the law should permit B to knowingly take advantage of A's interpretive mistake in \textit{Paradigm 3} cases because doing so would serve efficiency by providing actors with an incentive to improve their interpretive skills. Even if this argument was convincing, the likely efficiency gain would be too slight to outweigh the exploitive character of B's conduct in such cases. In any event, the argument is not convincing. Actors who engage in contracting already have great incentives to do their best in interpreting the contractual expressions they employ, both because of the costs of litigation if the interpretation turns out to be problematic, and because unless the case falls under \textit{Paradigm 3}, a more reasonable interpretation will trump a less reasonable interpretation. As stated in \textit{S.T.S. Transport Service, Inc. v. Volvo White Truck Corp.} in a related context, "No incentives exist to make such mistakes; all the existing incentives work, in fact, in the opposite direction."\textsuperscript{71} Therefore, it is highly unlikely that holding actors to the meaning of the nonmistaken party in \textit{Paradigm 3}

\textsuperscript{69} See, e.g., Perez v. Maine, 760 F.2d 11 (1st Cir. 1985); Merced County Sheriff's Employees' Ass'n v. County of Merced, 233 Cal. Rptr. 519 (Cal. Ct. App. 1987); Mayol v. The Weiner Cos., 425 N.E.2d 45 (Ill. App. Ct. 1981); Exxon Corp. v. Bell, 695 S.W.2d 788 (Tex. Ct. App. 1985). This is the position taken in the Restatement (Second) of Contracts § 201(2):

Where the parties have attached different meanings to a promise or agreement or a term thereof, it is interpreted in accordance with the meaning attached by one of them if at the time the agreement was made

(a) that party did not know of any different meaning attached by the other, and the other knew the meaning attached by the first party. . . .

See also Restatement Second, supra note 31, § 20 cmt. d, illus. 5:

A says to B, "I offer to sell you my horse for $100." B knowing that A intends to offer to sell his cow for that price, not his horse, and that the word "horse" is a slip of the tongue, replies, "I accept." The price is a fair one for either the horse or the cow. There is a contract for the sale of the cow and not of the horse.

In contrast, the Restatement (First) of Contracts § 71, illus. 2 concluded on the same facts that there was no contract for the sale of either the horse or the cow.

\textsuperscript{70} Mkt. St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991).

\textsuperscript{71} 766 F.2d 1089, 1093 (7th Cir. 1985).
cases would provide an incentive that would lead actors to learn to interpret better.

Furthermore, the rule that A's interpretation will prevail where B knows the meaning that A attaches, and A does not know the meaning that B attaches, has favorable information-forcing qualities, at least where one or both parties realize that there is some uncertainty about the meaning of an expression they have employed. As Howard Loo states:

Because B cannot take advantage of A's interpretive mistake if B is aware of the mistake, A has an incentive to communicate information to B regarding any interpretations that A makes that are not straightforward. For example, A has an incentive to tell B, "This Expression, F, is unclear. I wanted to let you know that I'm assigning the meaning Alpha to it." A has an incentive to do this because, by letting B know, Alpha will attach if B does not clarify. In this way, the rule is information forcing. So, even if actors already use their best interpretive skills, the rule (allowing Alpha to attach if B knows that A attaches Alpha, even though Alpha is less reasonable than Beta) nevertheless encourages clarifications prior to formation.72

The information-forcing quality of the rule that governs Paradigm 3 cases also works, separately, on the nonmistaken party, B. Under the rule B has an incentive to communicate to A that she attaches the meaning Beta to Expression G, because if she does so, a court will give Expression G that meaning, since it is the most reasonable meaning.

In short, the rule that should and does govern Paradigm 3 cases has information-forcing qualities that are likely to reduce the chances that one party will exploit the other's ignorance and that parties will enter into inefficient bargains.

In summary, the general principle that should govern interpretive mistakes is that if both parties are equally at fault, losses should be shared. However, if one party is more at fault than the other, the interpretation of the party who is less at fault should prevail over the interpretation of the party who is more at fault. If the party who is more at fault insists on her own interpretation, she should be deemed in breach and made liable for expectation damages. One party may be more at fault than the other either because his interpretation is less reasonable than the other's, or because he knows that the other attaches a different meaning to the relevant expression than he does and he does not make the other party aware of their different interpretations.

72. Comments by Howard Tony Loo (Feb. 19, 2002).
VI

SHARED MISTAKEN FACTUAL ASSUMPTIONS

Another important type of mistake in contract law consists of a mistaken factual assumption about the present state of the world outside the mind of the actor who holds the assumption. Mistaken factual assumptions differ from evaluative mistakes both because they do not concern evaluations of future states of the world and because they are made by an actor who is, by hypothesis, not well-informed. They differ from mechanical errors because they do not involve blunders that result from transient errors in a party's mental or physical machinery. They differ from mistranscriptions, because they do not turn on whether a writing is erroneous. They differ from interpretive mistakes, because they do not turn on the meaning of an expression.

A mistaken factual assumption may either be shared by both parties to a contract or held by only one of the parties. These two categories raise very different issues. I consider shared mistaken factual assumptions in this Part. I consider unshared mistaken factual assumptions in a companion article. 73

Traditionally, shared mistaken factual assumptions have been treated under the heading of mutual mistake, meaning a mistake that is shared by both parties. This terminology fails to differentiate shared mistakes according to their functional characteristics. Some kinds of shared mistakes should provide a basis for relief, while others should not. Even shared mistakes that should provide a basis for relief fall into different categories that require differing treatment. For example, in mistranscription cases the parties both mistakenly believe that the writing properly transcribes the bargain. In many interpretive-mistake cases the parties both mistakenly believe that an expression is unambiguous or that each party attaches the same meaning to the expression.

In short, that a mistake is shared is relevant but it is not critical. What is critical is the character of the shared mistake. That character is captured in the term shared mistaken factual assumptions. This Part deals with such assumptions (which for ease of exposition I will often refer to simply as shared mistaken assumptions). In Part VI.A, I develop the general principle that should govern such assumptions. In Part VI.B, I develop four important limitations on the general principle.

A. The General Principle

In analyzing shared assumptions from the perspective of mistake, it is useful to begin with shared assumptions that are made explicit in a contract. If a contract is explicitly based on a shared assumption that turns out

73. Eisenberg, supra note 4.
to have been mistaken, normally the mistake should furnish a basis for relief under a relatively straightforward interpretation of the language of the contract. This point can be illustrated by hypothetical variations on two leading cases, Griffith v. Brymer and Lenawee County Board of Health v. Messerly.

In Griffith v. Brymer, Edward VII was to be crowned in Westminster Abbey on June 26, 1902, following a coronation procession from Buckingham Palace to the Abbey. Brymer had a room on St. James’s Street that overlooked the route of the procession. On June 24, Griffith entered into an oral agreement with Brymer’s agents to take the room for the purpose of viewing the procession, at the price of £100, and handed over his check for that amount. Unbeknown to either party, that morning Edward’s physicians had decided that he required surgery, and as a result the coronation and procession had been postponed. Griffith sued to recover the £100.

The contract in this case did not specifically spell out the parties’ assumption that the coronation and procession was still on. But suppose it did. In particular, suppose that the contract explicitly stated, “This agreement is made on the assumption that the coronation and procession are still on as of this moment.” It could then be concluded, under a straightforward interpretation of the language of the contract, that if the assumption was incorrect Griffith would recover his payment. (Interpretation, although straightforward, would be required, because the hypothetical provision does not explicitly state that Griffith will recover his payment if the assumption is incorrect.)

In Lenawee County Board of Health v. Messerly, the Messerlys owned a three-unit apartment building, located on a 600-square-foot property, which they used as an income-producing investment. Unbeknown to the Messerlys, a predecessor in interest had installed a septic tank on the property without a permit and in violation of the applicable health code. The Messerlys offered the apartment building for sale, and Carl and Nancy Pickles bought it for $25,500, under an installment contract, as an income-producing investment. Five or six days later, when the Pickleses went to introduce themselves to their tenants, they discovered raw sewage seeping out of the ground. Tests conducted by a sanitation expert indicated that the sewage system was inadequate. Subsequently, the County Board of Health condemned the property and obtained a permanent injunction proscribing habitation until the property was brought into conformance with the County sanitation code. Even assuming ideal soil conditions, 750 square

74. 19 T.L.R. 434 (K.B. 1903).
76. 331 N.W.2d 203 (Mich. 1982).
feet of property was mandated for a septic system for a one-family home and 2,500 square feet was mandated for a three-family dwelling. Therefore, it was impossible to remedy the illegal septic system within the confines of the 600-square-foot parcel on which the apartment building was located. As a result, the only way the apartment building could be put to residential use was to pump and haul the sewage, which would have cost twice the income that the property generated. Accordingly, the value of the supposed income-producing property was negative: the property could not possibly produce income in excess of costs.

When the Pickleses learned these facts, they stopped making payments. The Messerlys then sought foreclosure, sale of the property, and a deficiency judgment. The Pickleses countersued for rescission. The contract did not explicitly refer to whether the apartment building could legally be used as an income-producing property. But suppose it did. Specifically, suppose that the contract had explicitly provided that “This agreement is based on the assumption that the apartment building constitutes a lawful income-producing property.” Again, relief would have been justified under a relatively straightforward interpretation of the language of the contract.

Now suppose a shared mistaken assumption is tacit rather than explicit. The concept of a tacit assumption has been explicated as follows by Lon Fuller:

Words like “intention,” “assumption,” “expectation” and “understanding” all seem to imply a conscious state involving an awareness of alternatives and a deliberate choice among them. It is, however, plain that there is a psychological state that can be described as a “tacit assumption”, which does not involve a consciousness of alternatives. The absent-minded professor stepping from his office into the hall as he reads a book “assumes” that the floor of the hall will be there to receive him. His conduct is conditioned and directed by this assumption, even though the possibility that the floor has been removed does not “occur” to him, that is, is not present in his conscious mental processes.

77. Lon L. Fuller & Melvin Aron Eisenberg, Basic Contract Law 744 (7th ed. 2001); see also Randy E. Barnett, Contracts: Cases and Doctrine 1163 (2d ed. 1999):

As computer researchers struggling to develop “artificial intelligence” have painfully realized, beginning in infancy every person learns far more about the world than she could possibly articulate—even to herself. Any parent can testify to the untold number of questions that children ask eliciting information that adults unconsciously take for granted. Until subjected to the barrage, one cannot fully appreciate the immense store of knowledge one possesses. One is also struck by one’s inability to articulate what one knows perfectly well.

Each of us brings [virtually infinite] knowledge and skill to every interpersonal interaction and much, perhaps most, of this knowledge we hold in common. For example, even persons who have never conceived of the concept of gravity know that to build a tower out of toy blocks we have to begin at the bottom, not at the top. (An elaborately programmed computer used for one artificial intelligence experiment did not “realize” this basic fact and responded to a command to stack blocks by starting at the top. It then had to be reprogrammed with this basic assumption.) This vast repository of shared knowledge about
A more colloquial expression that captures the concept of tacit assumptions is the phrase "taken for granted." As this expression indicates, tacit assumptions are as real as explicit assumptions. Tacit assumptions are not made explicit, even where they are the basis of a contract, just because they are taken for granted and therefore don't need to be expressed. They are so deeply embedded that it simply doesn't occur to the parties to make them explicit—any more than it occurs to Fuller's professor to think to himself, every time he is about to walk through a door, "Remember to check my assumption that the floor is still in place."

The general principle that should govern such cases is that if a mistake concerning a shared factual assumption would provide a basis for relief to the adversely affected party if the assumption was explicit, so too should the assumption provide a basis for relief to the adversely affected party if the assumption is tacit, provided that the assumption is material (by which I mean, for this purpose, an assumption that is the basis or foundation of the contract or, as an opinion in the House of Lords put it, "an underlying assumption without which the parties would not have made the contract they in fact made"). The reason for this principle is that in such cases the contract implicitly allocates away from the adversely affected party the risk that the assumption was mistaken. By the adversely affected party, I mean a party who would suffer a loss if the contract was enforced, because due to the mistake, either (1) the performance he is to receive is worth much less than he agreed to pay and reasonably expected the performance would be worth, or (2) his own performance would cost much more than the price he is to be paid and the costs he reasonably expected to incur.

So, for example, it is pretty clear that the parties in Griffith v. Brymer operated on the tacit assumption—took for granted—that the coronation and procession were still on when they made their contract, and that this assumption was material. Accordingly, if relief would have been justified if the parties had made this assumption explicit, so too was it justified when, as was actually the case, the assumption was tacit. Indeed, this was just the result. The court held that Griffith was entitled to a return of his money on the ground that "the agreement was made on the supposition by both parties that nothing had happened which made performance impossible. This was a missupposition of the state of facts which went to the whole root of the matter."

Similarly, in Lenawee it is pretty clear that the parties operated on the tacit assumption—took for granted—that the property could be used for the world and how it works is often referred to as "common sense." Common sense makes communication by means of a common language possible.

---

78. Cf. Lee B. McTurnan, An Approach to Common Mistake in English Law, 41 Canadian B. Rev. 1, 51 (1963) (employing the formulation, "an unquestioning faith in the existence of a fact").
80. 19 T.L.R. 434 (K.B. 1903).
income-producing purposes, and that this assumption was material. If relief would have been justified if the parties had made that assumption explicit, so too would it have been justified if the assumption was tacit. Accordingly, the court held that but for a clause in the contract, which the court interpreted to put the risk on the Pickleses ("Purchaser has examined this property and agrees to accept same in its present condition"), rescission would have been appropriate:

[R]escission is indicated when [a] mistaken belief relates to a basic assumption of the parties upon which the contract is made, and which materially affects the agreed performances of the parties. . . .

All of the parties to this contract erroneously assumed that the property . . . was suitable for human habitation and could be utilized to generate rental income. The fundamental nature of these assumptions is indicated by the fact that their invalidity [frustrated, indeed precluded, the Pickleses’] intended use of the real estate. . . . Thus, the parties’ mistake as to a basic assumption materially affects the agreed performances of the parties.82

Accordingly, shared mistaken tacit assumptions are unlike mechanical errors not only in the character of the mistake, but in the way the mistake plays out. In the case of a mechanical error, the party who seeks relief wants to be excused from, or reverse a performance that he rendered pursuant to, a contract that he has actually made. In contrast, in the case of a shared mistaken tacit assumption, the party who seeks relief wants to depart only from the literal words of the contract, not from the contract itself, which includes the tacit assumption.

It is sometimes suggested that shared mistaken assumptions that are not explicitly spelled out in the contract should not justify legal relief because contracts should be interpreted literally.83 This argument is incorrect for several reasons.

First, a literalist approach undermines the purpose of contract law. That purpose is to effectuate the objectives of parties to promissory transactions, provided that appropriate conditions, such as enforceability, are satisfied, and subject to appropriate constraints, such as unconscionability. The objectives of contracting parties, and the contracts in which these objectives are embodied, are not limited to the words that the parties utter or

81. 331 N.W.2d at 211.
82. Id. at 209-10. Lenawee is representative of a number of real estate cases in which courts have granted relief on the basis of a shared mistaken tacit assumption that the relevant property could be lawfully used either in the way it was then being used or in the way both parties understood the buyer intended to use it. See, for example, the cases discussed infra note 93.
write. As modern contract law recognizes, a contract is "the total legal obligation which results from the parties' agreement"—which means "the agreement of the parties in fact as found in their language or by implication from other circumstances." Among these circumstances are the parties' shared tacit assumptions.

Indeed, even the words that the parties utter or write must be interpreted in a way that effectuates the parties' demonstrated objectives. As stated in Restatement Second, "It is sometimes said that extrinsic evidence cannot change the plain meaning of a writing, but meaning can almost never be plain except in a context." "Words, written or oral, cannot apply themselves to the subject matter. The expressions and general tenor of speech used in negotiations are admissible to show the conditions existing when the writing was made . . . ."

Second, literalism is an incoherent theory, because it cannot possibly be applied to all expressions, and there are no metaprinciples that could tell us which expressions can sensibly be literally interpreted and which cannot. The classic explication of this point is Lieber's famous passage, "fetch some soupmeat":

Let us take an instance of the simplest kind, to show in what degree we are continually obliged to resort to interpretation. . . .

Suppose a housekeeper says to a domestic: "fetch some soupmeat," accompanying the act with giving some money to the latter; he will be unable to execute the order without interpretation, however easy and, consequently, rapid the performance of the process may be. Common sense and good faith tell the domestic, that the housekeeper's meaning was this: 1. He should go immediately, or as soon as his other occupations are finished; or, if he be directed to do so in the evening, that he should go the next day at the usual hour; 2. that the money handed him by the housekeeper is intended to pay for the meat thus ordered, and not as a present to him; 3. that he should buy such meat and of such parts of the animal, as, to his knowledge, has commonly been used in the house he stays at, for making soups; 4. that he buy the best meat he can obtain, for a fair price; 5. that he go to that butcher who usually provides the family, with whom the domestic resides, with meat, or to some convenient stall, and not to any unnecessarily distant place; 6. that he return the rest of the money; 7. that he bring home the meat in good faith, neither adding any thing disagreeable nor injurious; 8. that he fetch the meat for the use of the family and not for himself. Suppose, on the other hand, the housekeeper, afraid of being misunderstood, had mentioned

84. U.C.C. § 1-201(11) (2002).
85. Id. § 1-201(3).
86. RESTATEMENT SECOND, supra note 31, § 212 cmt. b.
87. Id. § 214 cmt. b.
these eight specifications, she would not have obtained her object, if it were to exclude all possibility of misunderstanding. For, the various specifications would have required new ones. Where would be the end? We are constrained then, always, to leave a considerable part of our meaning to be found out by interpretation, which, in many cases must necessarily cause greater or less obscurity with regard to the exact meaning, which our words were intended to convey.88

Lieber’s illustration makes clear that even the simplest expression cannot sensibly be limited to the words that comprise it. So, for example, under literalist theory the servant would be obedient to the instruction “fetch some soupmeat” if, for example, he went for the soupmeat a week later, purchased soupmeat of a kind the family never used, or fetched soupmeat and ate it himself.

Or take an illustration that is even more directly applicable to shared mistaken tacit assumptions. Suppose that Jesse is an Orthodox Jew, who keeps strictly Kosher, and Rebecca is a Reform Jew, who does not. Rebecca knows that Jesse keeps strictly Kosher. Jesse and Rebecca meet periodically for dinner at the Star Delicatessen, a Kosher restaurant. On Monday, they agree to meet for dinner at the Star on Wednesday night. Unbeknown to either of them, on the previous Thursday the local Rabbinate had declared that the Star’s method of preparing food did not satisfy Kosher rules. Jesse learns of this development on Tuesday, calls Rebecca, explains the situation, and says, “I can’t have dinner with you at the Star. Let’s have dinner somewhere else.” Rebecca replies, “No, you agreed to have dinner at the Star; if you don’t meet me there tomorrow you will be breaking your promise.” Isn’t it clear that Rebecca’s position is untenable? Jesse has not broken his promise, because the agreement, and therefore his promise, was based on the shared mistaken tacit assumption that the Star was Kosher.

Or suppose that Albert, a ballet dancer, meets Brenda at an early-afternoon art opening in New York City, and they agree to go jogging together in Central Park in two days. Unbeknown to Albert, he has a tiny stress fracture, which is discovered later that afternoon when his foot begins to hurt and he sees an orthopedist. The orthopedist tells Albert that jogging once for a short time would not necessarily make the fracture worse; in fact, many people with stress fractures don’t realize the cause of their pain and therefore continue their normal activities. However, jogging would be at least somewhat painful. Moreover, the most important treatment for a stress fracture is six to eight weeks of rest, and continued stress on the foot could possibly lead to a complete fracture and even to improper healing and consequent bone deformation. That evening, Albert calls

Brenda, explains the situation, and says, "I can't go jogging with you the day after tomorrow. Let's have breakfast instead." Brenda replies, "No, you agreed to go jogging in the Park the day after tomorrow, and from what you tell me it isn't impossible for you to do so. If you don't go jogging with me tomorrow morning you will be breaking your promise." Isn't it clear that Brenda's position is untenable? Albert has not broken his promise, because the agreement, and therefore his promise, was based on the shared mistaken tacit assumption that both Albert and Brenda had no physical affliction that would make jogging painful and risky.

*Griffith v. Brymer* and *Lenawee* do not differ from these cases. Griffith’s promise was based on the tacit assumption, which he shared with Brymer, that the coronation was on. The Pickleses’ promise was based on the tacit assumption, which they shared with the Messerlys, that the apartment building was suitable for human habitation and legally capable of producing income. Neither Jesse, nor Albert, nor Griffith, nor the Pickleses broke a promise when each insisted that their contracts included the shared tacit assumption.

In short, every contract includes explicit terms, implied terms, implicit terms, usages, and tacit assumptions, and every contract must be interpreted in the context of the purpose for which, and the circumstances in which, the contract was made. Where a tacit assumption is material, the agreement also includes an implied understanding that, subject to certain limitations, the risk that the assumption is mistaken is allocated away from the adversely affected party. Accordingly, the principle that a shared mistaken tacit assumption normally provides a basis for relief does not undercut the agreement of the parties. Rather, that principle, if properly applied, *carries out* the agreement of the parties. So in *Griffith v. Brymer*, if the agreement is construed to include the parties’ shared tacit assumption that when the contract was made the coronation was on, then the agreement itself justifies relief for Griffith. If, in a situation like *Lenawee*, the agreement is construed to include the parties’ shared tacit assumption that when the contract was made there was no existing legal barrier to using the property to produce income, then the agreement itself justifies relief for the purchaser.

Does it make any difference that a contract is in writing? Not the slightest. Lieber’s “fetch some soupmeat” hypothetical would apply equally if the housekeeper’s instruction was in writing. Likewise, Jesse and Albert would no more have broken their promises if the promises were in writing than if they were oral.

It might be argued that if parties have a written contract, and they wanted the accuracy of a shared assumption to be a condition to the obligation to perform, they would have put the assumption in the contract. That, however, is a factual question to be decided case by case. In any event, it is
the most natural thing in the world to leave tacit assumptions out of a contract, oral or written. That is precisely the point of Lieber’s hypothetical. The housekeeper is acting naturally, and with complete rationality, when she doesn’t add to her instruction, “Go immediately, purchase the soupmeat the family usually uses, don’t eat the soupmeat yourself,” and so forth. Jesse is acting naturally, and with complete rationality, when he doesn’t add to his agreement with Rebecca, “unless even as we speak the Star is no longer Kosher.” Albert is acting naturally, and with complete rationality, when he doesn’t add to his agreement with Brenda, “unless even as we speak one of us has an unknown physical condition that would make jogging painful and risky.”

Of course, if actors had infinite time and no costs, then they could ransack their minds to think through every one of their tacit assumptions and make each of those assumptions explicit. But actors do not have infinite time and they do have costs. It would be irrational to take the time and incur the costs to determine and make explicit every tacit assumption, because the time and costs of doing so would often approach or exceed the expected profit from the contract. It would also normally be virtually impossible to make such a determination. As Randy Barnett has stated:

[When we add] to the infinity of knowledge about the present world the inherent uncertainty of future events... we immediately can see that the seductive idea that a contract can... articulate every contingency that might arise before... performance is sheer fantasy. For this reason, contracts must be silent on an untold number of items. And many of these silent assumptions that underlie every agreement are as basic as the assumption that the sun will rise tomorrow. They are simply too basic to merit mention.9

In short, in contracting, as in other parts of life, some things go without saying. And a central characteristic of things that go without saying is—they are not said.

All of this can be put more generally. A contract consists of the promises of which it is comprised. Promise is a social institution, not a legal institution. The law may or may not enforce a promise, but it does not make the promise. If a contract consists in part of a promise that is expressly qualified, the contract should not be enforced if the qualification has come into play. The same thing is true if a contract consists in part of a promise that is implicitly qualified, whether by usage, tacit assumptions, or other elements. One way to determine the meaning of a promise is to ask, if the promisor does not perform according to the literal words of the promise and the promisee requests an explanation, what answer would the promisor give? If the promisor's only answer is, “My preferences changed,” or “My

89. Barnett, supra note 77, at 1163.
valuations of the performances due under the contract changed," he has not offered an adequate justification. If the promisor thinks these are sufficient reasons not to perform, he doesn’t understand what a promise is. But if the promisor’s answer is, “My promise was implicitly conditioned on the tacit assumption, which we shared, that the present state of the world was X, and in fact the state of the world was Not-X,” most people would think this was an adequate justification, at least prima facie. Indeed, most people would go further, and say that the person who is acting improperly in such a case is not the promisor, but the promisee, for trying to hold the promisor to the literal words of a promise when, under a tacit assumption shared by both parties, the literal words were not the whole promise. To think differently is to approach the world in the totemic way that children sometimes do, looking only at the literal meaning of words.90

B. Four Limitations on the General Principle

There are four important limitations on the general principle that if a mistake concerning a shared factual assumption would provide a basis for relief to the adversely affected party if the assumption was explicit, so too should it provide a basis for relief to that party if the assumption is tacit. In large part, these limitations are implicit in the general principle itself. The first limitation concerns cases in which the adversely affected party is consciously aware of the risk that the assumption is mistaken or recklessly disregards facts that put him on notice of that risk. The second concerns cases in which the risk that the assumption is mistaken is contractually allocated to the adversely affected party. The third concerns cases in which one contracting party is in position to have clearly superior information about the risk that the assumption is mistaken. The fourth concerns cases in which the result of the mistake is a windfall rather than a loss.

90. A popular children’s book series, Amelia Bedelia, draws on children’s literalistic approach to language. Amelia Bedelia goes to work for Mr. and Mrs. Rogers. When Amelia is asked to dust the furniture, she sprinkles dust on the furniture. When she is asked to draw the curtains, she sketches the curtains. When she is asked to measure two cups of rice, she determines that two cups of rice measure 4 ½ inches. And so forth. PEGGY PARRISH, AMELIA BEDELIA (1963). I owe this reference to Debra Krauss. See also CHARLES FRIED, CONTRACT AS PROMISE 66 (1981):

[A] set of confused attitudes lurks behind the notion that if an agreement is expressed in general words, and if those general words appear to cover a surprising specific case, then the burden of this surprise should lie where it will fall as a result of taking those general words as covering that specific case, even when neither party meant them to. . . . [W]hy should we take those words to include the unintended, surprising, specific result? The general words might usually imply this specific result. But in the instance of this contract and these parties, by hypothesis neither party meant or foresaw that these general words should cover this specific case.
The Adversely Affected Party Is Consciously Aware of the Risk that the Assumption Is Mistaken or Recklessly Disregards Facts that Put Him on Notice of that Risk

In some cases, a party who would be adversely affected by the risk that a shared assumption is mistaken is consciously aware of that risk. This phenomenon is sometimes described in terms of the actor being consciously aware that he has only limited knowledge with respect to a fact, but treating his limited knowledge as sufficient. In such cases, the actor is characterized as being "consciously ignorant." The general principle that governs shared mistaken tacit assumptions does not justify relief in such cases, for three related reasons. First, the assumption is conscious, not tacit. Second, under the circumstances the adversely affected party impliedly assumes the risk that the assumption is mistaken. As put in Comment c to Restatement Second § 154:

Even though the mistaken party did not agree to bear the risk, he may have been aware when he made the contract that his knowledge with respect to the facts to which the mistake relates was limited. If he was not only so aware that his knowledge was limited but undertook to perform in the face of that awareness, he bears the risk of the mistake.91

Third, as stated by Lee McTurnan, "when parties contract aware of an uncertainty, the natural inference is that they estimated the probabilities and fixed the price accordingly."92

The concept of conscious ignorance should not be carried too far. In particular, it should not be extended to exclude relief on the ground that the parties could have disabused themselves of their shared mistaken tacit assumption through an unbounded search. In most and perhaps almost all cases involving shared mistaken tacit assumptions, the adversely affected party could have determined he was mistaken if he had undertaken such a search. For example, in Lenawee an unbounded search, including an inspection by a sewage engineer, probably would have revealed the defect in the sewage system. In Griffith v. Brymer an unbounded search would have included sending a runner to the Palace just before finalizing the agreement, to make sure that the coronation was still on.

In these and many other cases, the courts have held that a shared mistaken tacit assumption justified relief to the adversely affected party even though an unbounded search would have disabused both parties of their

91. Restatement Second, supra note 31, § 154 cmt. c; see also McTurnan, supra note 78, at 15-16 ("contracting while consciously ignorant of a fact tends to show an intention to assume the risk of non-existence [of the fact] and to be bound irrespective of that possibility").

92. McTurnan, supra note 78, at 16.
mistake. These holdings are proper, because it is often completely rational for actors not to conduct an unbounded search to verify a tacit assumption. If the costs of searching for information were zero, then every actor contemplating a decision would make an unbounded search for all relevant information. In reality, of course, searching for information does involve costs in the form of time, energy, and often money. Most actors either do not want to expend the resources required for an unbounded search or recognize that an unbounded search could not be achieved at any realistic cost. Accordingly, decision making is always bounded by limited search and information. Therefore, a bounded search is fully rational, and actors will regularly make decisions in a state of rational ignorance of alternatives and consequences that they could have discovered and considered if their search and processing was unbounded. The first way in which any actor will bound his search is to not investigate an assumption the actor takes for granted. In fact, because the actor takes an assumption for

---

93. For example, in Dover Pool & Racquet Club v. Brooking, 322 N.E.2d 168, 169-71 (Mass. 1975), Dover had contracted to purchase from Brooking a fifty-acre parcel of land, located partly in the Town of Medfield, to use as a tennis and swim club. The parties had previously inquired into the relevant zoning laws, which allowed such a use. Unbeknown to the parties, after Dover made its inquiries, but just before the contract was signed, the Town of Medfield published a notice of public hearing on a zoning-law amendment that would require a special permit for Dover’s planned use. If the special-permit amendment was adopted (as it subsequently was) it would be effective retroactively to the time of publication—and therefore to a time before the contract was signed—with the result that the parcel might lose most of its value to Dover. An unbounded search would have included sending an agent to be at the Medfield Town Hall one minute before the contract was signed, to ensure that no notice of a proposed zoning-law amendment had been published at the very last moment. Such a search would have revealed that the parties’ shared assumption, that the property could freely be used for a tennis and swim club, was mistaken. Such a search was not conducted. Nevertheless, the court properly held that Dover could rescind that the property could be freely used for a tennis and swim club.

In Bar-Del, Inc. v. Oz, Inc., 850 S.W.2d 855, 856-57 (Ky. Ct. App. 1993), the buyer had contracted to purchase a tavern from the seller. Unbeknown to the parties, the property was not zoned for tavern use, even though the seller had operated the tavern for many years. An unbounded search would have found zoning laws and maps that showed that the parties’ shared assumption, that the property could lawfully be used as it had long been used, was mistaken. Such a search was not conducted. Nevertheless, the court properly held that the buyer could rescind.

In In re Macrose Industries, 186 B.R. 789, 793 (E.D.N.Y. 1995), the buyer had contracted to purchase a parcel of real estate from the seller, subject to obtaining all the municipal approvals that were necessary to realize the buyer’s plans for the property. The contract gave the buyer one year to secure these approvals. Subsequently, the buyer discovered that the process of obtaining one of the required permits could take up to two years. An unbounded search of the relevant law and practice before the contract was signed would have shown that the parties’ shared assumption, that one year would suffice to acquire the necessary permits, was mistaken. Such a search was not conducted. Nevertheless, the court properly held that the buyer could rescind.

In Reilly v. Richards, 632 N.E.2d 507, 508-09 (Ohio 1994), the buyer had contracted to purchase a parcel of real estate upon which to build a house. Subsequently, the buyer discovered that part of the property was located in a flood-hazard area and as a result was unfit for construction. An unbounded search of flood-plain records would have shown that the parties’ shared assumption, that a house could be built on the property, was mistaken. Such a search was not conducted. Nevertheless, the court properly held that the buyer could rescind.
granted—because the assumption is so deeply embedded—typically it will not even enter the actor's mind to make a search concerning its accuracy.

On the other hand, the adversely affected party should bear the risk of a shared mistaken assumption, even if he is not actually conscious of the risk, where he recklessly disregards facts that would put a reasonable person on notice that the assumption is clearly risky and requires investigation, or otherwise fails to conduct an investigation that is reasonable under the circumstances (such as a termite inspection in an area where such inspections are customary). For example, if the purchasers in *Lenawee* had seen raw sewage seeping up before they made the contract, they would have been reckless in assuming that the property was being lawfully used for purposes of habitation without investigating further. In such cases, the adversely affected party should bear the risk that his assumption was wrong, because a reasonable person in the party's position would have either known or discovered that it was wrong—or to put it differently, because a reasonable person would have conducted a more extensive search.

2. *The Risk that the Assumption Is Mistaken Is Contractually Allocated to the Adversely Affected Party*

Next, the risk that a shared mistaken assumption is mistaken will not justify legal relief where the contract allocates that risk to the adversely affected party. This requirement was developed in a notable article by Edward Rabin\(^94\) and then embodied in *Restatement Second* § 154, which provides that "A party bears the risk of a mistake when (a) the risk is allocated to him by agreement of the parties . . . ."\(^95\) In a sense, this is not a limitation of the general principle that governs shared mistaken assumptions, but merely a corollary. Under the general principle, the risk of a shared mistaken assumption is implicitly allocated by the contract away from the adversely affected party. That implication is overridden, however, if the risk that an assumption is mistaken is allocated by the contract to the adversely affected party. Indeed, in such a case the parties did not have a shared mistaken tacit assumption. Instead, they had an explicit assumption which they realized might be mistaken, and they allocated the risk that the assumption was mistaken to the adversely affected party. In this kind of case, giving relief to that party on the basis of the mistake would defeat rather than effectuate the parties' agreement.

The exception for cases in which the risk of a mistaken assumption is contractually allocated to the adversely affected party is straightforward, but its application can sometimes be difficult, because the contract may

---

allocate the risk to the adversely affected party implicitly rather than explicitly. This is exemplified by Illustration 1 to Restatement Second § 154:

A contracts to sell and B to buy a tract of land. A and B both believe that A has good title, but neither has made a title search. The contract provides that A will convey only such title as he has, and A makes no representation with respect to title. In fact, A's title is defective. The contract is not voidable by B, because the risk of the mistake is allocated to B by agreement of the parties.

Here, the provision concerning title does not explicitly allocate to B the risk of a defect in title, but it does allocate that risk implicitly. The Illustration involves, not a tacit assumption that A has title, but an explicit recognition that there is a risk that A does not have title, and an implicit allocation of that risk to B. As this Illustration suggests, there is often little or no difference between conscious ignorance of the risk that a shared assumption is mistaken, on the one hand, and an implicit agreement that this risk is allocated to the adversely affected party, on the other, because conscious ignorance frequently constitutes an implied allocation of the risk.

Like a determination that the parties were under a shared mistaken tacit assumption, a determination that the risk of the mistake is contractually allocated to the adversely affected party is often based not on the language of the contract, but on the background of the contract and the circumstances surrounding its formation. This is exemplified by two further illustrations in the Restatement Second. Here is the first of these illustrations:

A contracts to sell and B to buy a tract of land, on the basis of the report of a surveyor whom A has employed to determine the acreage. The price is, however, a lump sum not calculated from the acreage. Because of an error in computation by the surveyor, the tract contains ten per cent more acreage than he reports. The contract is voidable by A...96

Here is the second:

The facts being otherwise as stated in [the above illustration], A proposes to B during the negotiations the inclusion of a provision under which the adversely affected party can cancel the contract in the event of a material error in the surveyor's report, but B refuses to agree to such a provision. The contract is not voidable by A, because A bears the risk of the mistake.97

Even if the contract does not explicitly allocate to the adversely affected party the risk that a shared assumption is mistaken, and such an allocation cannot clearly be inferred from the language of the contract or the circumstances surrounding its formation, that risk should nevertheless be

96. Id. § 152 cmt. b, illus. 2.
97. Id. § 154 cmt. c, illus. 2.
deemed to have been contractually allocated to the adversely affected party if either: (i) the risk was clearly impounded into the price paid to the adversely affected party, or (ii) the risk clearly induced the party who was not adversely affected to enter into the contract, as the other party either knew or should have known. (The second test may seem odd. Why would a risk induce a party to enter into a contract? The answer is that a risk may be either downside or upside, and the prospect that an upside risk will pay off may induce a party to enter into a contract.)

Take, for example, the famous case of Sherwood v. Walker. Sherwood was a banker, but he also had a farm where he raised the best breeds of livestock. He wanted to buy some polled Angus cattle. The Walkers were importers and breeders of such cattle. They told Sherwood they had a few polled Angus cows at one of their farms, but that in all probability the cows were sterile and would not breed. Sherwood went to the farm, saw the cows, and expressed his interest in purchasing one of them, Rose 2d of Aberlone. Two days later, it was agreed that Sherwood would buy Rose for 5 1/2¢ per pound. Before the date on which Sherwood was scheduled to pick up Rose, the Walkers found out that she was pregnant. The Walkers then claimed that the contract was voidable because it was based on the mistaken assumption that Rose was sterile.

Relief for the Walkers was unjustified, for two related reasons. First, there seemed to be no mistaken assumption in this case. The Walkers thought that the cow was probably barren. That was not a mistake. She was probably barren. "Probably barren" is not the same as "definitely barren." On the contrary, "probably barren" strongly implies "but possibly not barren."

Second, it seems highly likely that Sherwood entered into the contract because of the upside risk that Rose was fertile. To put this differently, it seems highly likely that Sherwood did not take it for granted that Rose was infertile, and that the Walkers knew or had reason to know that Sherwood did not take Rose’s infertility for granted. It is true that Sherwood paid a price calculated in cents per pound, which is presumably the way a beef cow, not a breeder, is priced; and it is likely that the 5 1/2¢ per pound price was the market price for beef at the time. Accordingly, the upside risk that Rose might be fertile may not have affected the contract price. However, this upside risk almost certainly induced Sherwood to enter into the contract, as the Walkers either knew or should have known. Sherwood was a banker and a gentleman farmer, not a butcher. He originally went to Walkersville to purchase breeding cattle. Almost undoubtedly, he figured that he would purchase Rose for her upside value, and that if she did not

98. 33 N.W. 919 (Mich. 1887).
99. Id. at 924 (Sherwood, J., dissenting). The facts are taken from the dissenting opinion, but are consistent with, although a bit more expansive than, the facts stated by the majority.
prove fertile he could re-sell her for approximately the beef value that he paid, so that he would lose only the cost of maintaining her in the interim. The Walkers, for their part, almost undoubtedly sold Rose at her beef value because no one would pay more than that, and they were no longer willing, as Sherwood was, to pay the cost of maintaining her. Accordingly, Sherwood v. Walker is a good illustration of a case in which in all likelihood the upside risk that an assumption was mistaken induced a party to make a contract, as the other party knew or should have known. (In fact, the Michigan Supreme Court incorrectly decided the case in favor of the Walkers, over a vigorous dissent. The Court held that the general issue was whether there was a difference "as to the substance of the thing bargained for," on the one hand, or only as to "some quality or accident," on the other. It concluded that the case fell into the former category, because "[a] barren cow is substantially a different creature than a breeding one." The substance/accident test is now widely discredited, and Sherwood itself was overruled by the Michigan Supreme Court in Lenawee.

An even easier case is City of Everett v. Estate of Sumstad. The Mitchells owned a small secondhand store. They frequently shopped Alexander's Auction to obtain merchandise for their own use and for use as inventory in their business. In August 1978, the Mitchells purchased at the auction, for $50, a used safe with a locked door. According to the Mitchells:

[W]e saw that the top outermost door with a combination lock was open, and that the inner door was locked shut. That inner door required a key to open, and we learned that the safe would have to be taken to a locksmith to get the inner door opened because no key was available. We also learned that the combination for the outer lock was unknown. The auctioneer told the bidders that both this and [another] safe had come from an estate, that both were still locked, that neither had been opened, and that the required combinations and key were unavailable for either.

Several days after the auction, the Mitchells took the safe to a locksmith to have the locked door opened. The locksmith found $32,207 inside, and Alexander's Auction claimed the money. The court held for the Mitchells. This was correct. Anyone in the position of the Mitchells would have been partly induced to enter into the contract by the upside risk that there was something of value in the locked safe, as Alexander's knew or should have known. Indeed, that risk was probably impounded into the price the Mitchells paid to Alexander's.
Here is another, hypothetical, example. Buyer agrees to purchase a still-life painting from Seller, who runs a secondhand shop, for $100. Buyer has the painting reframed, and when he does so he discovers it is an Old Master, worth $200,000. Seller hears the news, and seeks to rescind. On the facts, the upside risk that the painting was an Old Master may not have been impounded into the $100 price, but was likely to have been a factor that induced Buyer to make the purchase. People who buy paintings in a secondhand shop often have in the back of their mind a hope that the painting may turn out to be very valuable. As in Sherwood v. Walker, Buyer was likely induced to buy the painting because at the least she would get a painting for $100 that she valued at that price or more, and at best she would get a painting worth a lot more.104

3. One Contracting Party Is in a Position to Have Clearly Superior Information About the Risk that the Assumption Is Mistaken

Another limitation on the general principle that governs shared mistaken assumptions is that where one contracting party is in a position to have clearly superior information concerning the risk that the assumption is mistaken, that party should be deemed to take the risk in the absence of agreement to the contrary.

In part this is an information-forcing rule, because it forces the party who is in a position to have clearly superior information about the risk that the assumption is mistaken, A, either to say nothing and accept the risk, or point out the risk to the other party, B. At that point, B, now conscious of the risk, can demand that A explicitly accept the risk, agree to accept the risk himself, or propose some intermediate solution.

Restatement Second §154, Illustration 6, presents a case of this kind:

A contracts with B to build a house on B's land. A and B believe that subsoil conditions are normal, but in fact some of the land must be drained at an expense that will leave A no profit under the contract. The contract is not voidable by A.

The result in the Illustration is justified. Although the parties share the mistaken assumption that subsoil conditions are normal, A, as a contractor, is clearly more knowledgeable about the risk of unexpected subsoil conditions than B. If A does not want to take that risk he should be obliged to bring the risk to B's attention and deal with it contractually. If A does not do that, he should bear the risk.

In many cases, the clearly-superior-informational-position rule can be justified on the alternative but overlapping ground that in appropriate circumstances, a party who is in a clearly superior informational position may

104. See Peter Maller, Flower Power: Painting Transcends Garage-Sale Past, Brings $882,500 at Auction, MILWAUKEE J. SENTINEL, May 27, 1999, at 1 (describing how a painting purchased for $29 at an estate sale turned out to be a valuable painting by American painter Martin Johnson Heade).
be deemed to make a representation concerning the subject matter of the shared assumption. This aspect of the rule is illustrated by *McRae v. Commonwealth Disposals Commission.*105 A, an instrumentality of the Australian government, believed that a tanker was wrecked on Jourmaund Reef, and proceeded to sell the tanker to the highest bidder, B. B set out to salvage the tanker. In fact, the tanker did not exist, and B sued for breach of contract. A defended on the ground that both parties were mistaken. The court properly held for B. A was in a position to know, as B was not, whether the wrecked tanker existed. Because of A’s clearly superior informational position, A’s tender implicitly represented that the tanker existed. If A was less than confident that the tanker existed, it should have made this clear.

4. *Windfalls*

Recall again the general principle that a shared mistaken tacit assumption justifies relief to the adversely affected party. By an adversely affected party, I mean a party who would suffer a loss if the contract was enforced, in the sense that due to the mistake he would be less well off than he had reasonably expected to be. In contrast, in some shared-mistaken-tacit-assumption cases the issue is how to allocate a *windfall*—by which I mean a surprising and unlikely element of value whose allocation to either party will not leave the other party less well off than he had expected to be under the contract.

For example, in *In re Seizure of $82,000 More or Less,*106 Missouri State Highway policemen had stopped and searched a 1995 Volkswagen for speeding and following too closely. The search indicated that there was fresh silicone on the car’s undercarriage. The car was brought to the police garage, and agents of the United States Drug Enforcement Agency (DEA) found $25,000 in drug proceeds contained in plastic bags in the battery case. The car was therefore forfeited to the United States under statute. Subsequently, the United States General Services Administration advertised the car for bids. The successful bidders were Helen and Jeffrey Chappell, mother and son. After they purchased the car, the Chappells noticed that it had a fuel problem. Jeffrey took the car to a mechanic to have the problem fixed. While working on the car, the mechanic found more bundles of money wrapped in plastic and floating in the fuel tank. He reported his find to the DEA. The DEA seized the money, which totaled around $82,000, and the parties disputed its ownership.

This was a windfall case: there was an element of value to the Volkswagen that was surprising and unlikely, and whose allocation to either party would not make the other party less well off than it had expected.

105. (1951) 84 C.L.R. 377 (Austl.).
to be under the contract. If the money was allocated to the Government, the Chappells would still have the Volkswagen at the price they thought it was worth. If the money was allocated to the Chappells, the Government would still have the money it expected to get for the Volkswagen.

In another kind of windfall case, often discussed by commentators, Farmer 1 sells his farm to Farmer 2. After the sale, oil is found under the farm. Such a case is of no special interest if oil is not uncommon in the area, because it can then be fairly assumed that the parties were aware of the possibility of oil, and that this possibility was impounded into the market price of local farmland. Assume, however, that oil deposits had never been found or suspected in the area.

Or suppose that, in a variation of the still-life-painting hypothetical discussed above, the still life itself has no special value, but the buyer gets the painting reframed, and when he does, a very valuable Old Master pen-and-ink landscape sketch is found hidden underneath the still life.

At first glance, these hypotheticals and the gas-tank case may look like Sumstead, the locked-safe case, but actually they are very different. Sumstead is an easy case, because the upside risk that there was something valuable in the safe undoubtedly induced the buyers to purchase the safe, and the expected value of that risk was probably impounded into the price the buyers paid. In contrast, it is highly unlikely that the upside risk of a windfall like cash secreted in a used car, oil located beneath a farm in an area where oil deposits are unknown and unsuspected, or a valuable sketch hidden underneath an inexpensive painting will either induce a buyer to purchase the car, the farm, or the painting, or be impounded into the price the buyer pays.

There are several good reasons why in shared-mistaken-assumption cases the law might treat windfalls differently than losses (assuming that the windfall is not contractually allocated to one of the parties).

Begin with loss-aversion. As pointed out in Part III, actors disvalue losses more than they value forgone gains of an equal amount. Accordingly, a principle that protects actors against the risk of a loss of much or all of a contract's value due to a shared mistaken assumption will probably reflect what the parties would have agreed upon if they had addressed the issue. It is usually much less clear, however, how contracting parties would

---

107. See, e.g., E. Allan Farnsworth, Contracts 629 (3d ed. 1999); Rabin, supra note 94, at 1295. For an actual case along these lines, see Tetenman v. Epstein, 226 P. 966 (Cal. Dist. Ct. App. 1924).

108. Carol Vogel, Inside Art—Rembrandt Face to Face, N.Y. TIMES, July 11, 2003, at B27. Vogel describes how a Rembrandt self-portrait dated 1634 was hidden for more than 300 years under layers of paint applied by one of Rembrandt's pupils, who transformed the painting into "a study of a flamboyantly dressed Russian aristocrat with a tall red hat, long hair, earrings, and a mustache." ld. In the mid-1900s, the then owner had the painting cleaned and much of the overpainting came off. Successive cleanings over time revealed the entire underpainted self-portrait. On July 11, 2003, the self-portrait was sold for $11.3 million. ld.
have dealt with allocating the prospect of a windfall that resulted from such a mistake. As stated by Michael Trebilcock, "Treating wipe-outs differently from windfalls may be justifiable on the grounds either that risk aversion... is more apposite to prospective losses than prospective gains or, on a related Rawlsian difference principle; that people generally would prefer a legal regime that shields them from catastrophic losses."\textsuperscript{109}

There is also a structural difference in the way that cases involving losses and windfalls tend to arise. In loss cases, like \textit{Lenawee}, typically it is the buyer who wants relief, because the value of the seller's performance is unexpectedly much less than it would have been if the mistaken assumption had been true. In contrast, in windfall cases, like the gas-tank case, typically it is the seller who wants relief, because the value of the seller's performance is unexpectedly much greater than the price that the buyer contracted to pay.

With that background, four possible rules could be adopted to govern windfalls in shared-mistaken-assumption cases.

One possible rule is that a windfall should always be allocated to the seller. This rule might be defended on the ground that the seller sold something different than he "intended" to sell. That theory, however, would substitute, for a functional analysis, arguments about essences—the kind of approach used in \textit{Sherwood v. Walker} and now discredited. Furthermore, an analysis based on intention can equally well be put in terms of what the buyer intended to purchase. In the still-life hypothetical, for example, the seller may not have intended to sell an Old Master, but the buyer intended to purchase the still life that he saw and liked. Similarly, in the farm hypothetical, Farmer 1 might not have intended to sell oil-bearing land, but Farmer 2 intended to purchase Farmer 1's farm.

A rule that windfalls should always be allocated to sellers would raise three other significant problems. First, such a rule would often raise a problem of reliance. Losses tend to become apparent almost immediately, as in \textit{Griffith v. Brymer} and \textit{Lenawee}. In contrast, windfalls may not become apparent for some time after possession has shifted, as in the oil-under-the-farm hypothetical. During that time, the buyer may have integrated the relevant property into his business or lifestyle in a way that is hard to unwind. Second, such a rule often would involve a kind of infinite regression, because if the seller can recover a windfall from the buyer, then the seller's seller can recover the windfall from the buyer, and so on up the line. Third, in many cases the buyer will contribute to the windfall element of value, because that element will be discovered as a result of the buyer's

\textsuperscript{109.} \textit{Trebilcock, supra} note 83, at 146.
knowledge, skill, and diligence in examining the contracted-for commodity after he has acquired it.\textsuperscript{110}

For these or like reasons, a rule that a windfall should always be allocated to the seller would not find much modern support. For example, the general consensus on the farm hypothetical case is that the buyer, not the seller, should get the benefit of oil found after the farm is sold,\textsuperscript{111} and in the gas-tank case the court allowed the Chappells to keep the money found in the gas tank (albeit on the somewhat quirky theory that the Chappells were the finders of abandoned property).\textsuperscript{112}

A second possible rule is that a windfall should always be allocated to the buyer. Such a rule could be supported on the theory that since there is no sufficiently strong reason to give a windfall to the seller, a windfall may be one of those rare cases in which luck is decisive, and the person who is lucky is the buyer. This theory does not seem compelling.\textsuperscript{113}

A third possible rule is that a windfall should always be shared equally between the seller and the buyer. A sharing rule, however, would also threaten the security of possession, because in many cases (such as the still-life or oil-under-the-farm hypotheticals), the buyer would have to either give the seller a half-interest in the relevant commodity or sell the commodity to pay off the buyer’s half-interest. Furthermore, a sharing rule would involve the same infinite regression as a rule that allocated windfalls to sellers: if the seller would be entitled to share with the buyer, then the seller’s seller would be entitled to share with the seller and so on up the line. Finally, a sharing rule does not take into account which party discovered the windfall.

A fourth possible rule is that a windfall normally should be allocated to the party who is in possession when the windfall is discovered, unless the upside risk of the windfall has been explicitly or implicitly allocated to one of the parties by the contract, as in \textit{Sherwood v. Walker}. Such a rule would be preferable on several grounds. To begin with, this rule would not involve the problems of reliance and infinite regression.

\textsuperscript{110} In some cases, before the contract is made, a buyer uses his knowledge, skill, and diligence to determine that there is an element of value in the seller’s property of which the seller is unaware. Such cases, which I will consider in a companion article, \textit{Disclosure in Contract Law}, supra note 4, do not involve windfalls, but do raise other problems.

\textsuperscript{111} \textit{Farnsworth}, supra note 107, at 249.

\textsuperscript{112} In re Seizure of $82,000 More or Less, 119 F. Supp. 2d 1013, 1019-21 (W.D. Mo. 2000).

\textsuperscript{113} For simplicity of exposition, I am assuming that the transaction at issue is a typical sale in which one party, the seller, exchanges a commodity, and the other party, the buyer, pays or promises to pay cash. If both parties exchange commodities, then each party can be considered both a buyer and a seller for purposes of the analysis in this section. By a \textit{commodity}, I mean anything that can be purchased or sold—for example, goods, land, intangible property, or services—except cash or equivalents. \textit{Cash}, for these purposes, does not include coins or currency or pieces of paper currency that have a special value above their face value.
Next, in the general run of cases the discovery of the windfall element of value is likely to result, in large or small part, from some action of the party in possession. For example, in *In re Seizure of $82,000 More or Less*, the United States could have taken the car to a mechanic, who would have discovered the money in the gas tank. It did not. The Chappells did. As the court pointed out:

[T]he Chappells would never have acquired an interest in this $82,000 if the Government had found the currency during the years that the Volkswagen Golf was in its possession. The reason the car was seized in the first place was the recent work that had been done on the undercarriage. This, plus the fact that the gas gauge always registered empty, might have inspired a search of the gas tank before the car was sold at auction. As early as the 1970s when "Easy Rider" was aired, the Government was on notice that drug dealers use gas tanks to hide their contraband. While the equities do not weigh in the Chappells’ favor since the $82,000 is a windfall, neither do the equities weigh in favor of the Government.\(^{114}\)

Similarly, in the cases of the sketch behind the painting, or the oil beneath the farm, the windfall is discovered on the buyer’s watch, and is probably due, if only in very small part, to some action by the buyer.

A possession rule would normally favor the buyer, but would not invariably do so. For example, suppose that in *Sherwood v. Walker* the buyer had been a butcher, whose only interest in Rose was as beef, rather than a gentleman farmer like Sherwood, whose interest in Rose was the possibility that she might be fertile. If the fact that Rose was fertile was discovered before possession had changed, then under a possession rule the Walkers could keep Rose as against Sherwood-the-butcher, although they would be obliged to pay damages if the market price for beef at the time Rose was to be delivered exceeded the contract price.

### VII

**Conclusion**

The problem of mistake in contract law has resisted clear analysis. This has resulted from a failure to articulate the social propositions that apply to this area, and from categorizations that do not address the character of the mistakes that are salient in contract law.

The latter defect is well illustrated by the failure of the *Restatement (Second) of Contracts* to come to grips with mechanical errors. No provision of *Restatement Second* addresses such errors. Section 153—"When Mistake of One Party Makes a Contract Voidable"—provides that a contract is voidable on the basis of a mistake by one party as to a basic

\(^{114}\) 119 F. Supp. 2d at 1021.
assumption on which the contract is made if enforcement would be uncon-
scionable, or if the nonmistaken party either had reason to know of the mis-
take or caused the mistake by her own fault.\(^\text{115}\) On its face, this provision
has little or no application to mechanical errors, which concern the proc-
esses of an actor's mental or physical machinery, not the substance of the
actor's assumptions concerning the outside world. Restatement Second
\(\S\) 154 supplements section 153 by providing that relief is not available to a
mistaken actor if the risk of the mistake was allocated to the actor by
agreement, if the actor was consciously ignorant of the risk, or if the risk is
allocated to the actor by the court "on the ground that it is
reasonable in the circumstances to do so."\(^\text{116}\) This provision also has no
realistic application to mechanical errors: the risk of mechanical errors is
seldom if ever allocated by agreement, and an actor who makes a mechani-
cal error is seldom if ever in a state of conscious ignorance concerning the
risk of such an error. The exception for judicial allocation of the risk to the
mistaken party where "it is reasonable in the circumstances to do so" can
be disregarded, because it is a black hole, not a rule.

To a large extent, Restatement Second \(\S\) 153 reflects the traditional
concept of unilateral mistake. However, that concept, which the
Restatement re-labels as a "mistake of one party," is virtually useless for
analytical purposes, because some mistakes made by only one party should
give rise to relief, but others should not. Section 153 attempts to address
that problem by restricting relief for mistakes made by only one party to
unshared mistaken assumptions. The attempt miscarries in two different
directions. Not only does section 153 fail to address mechanical errors; it
fails even to provide an appropriate rule for the kind of mistake—unshared
mistaken assumptions—that it purports to address. (I discuss the latter is-
ssue in a companion article.\(^\text{117}\))

The traditional concept of mutual mistake, like the concept of unilat-
eral mistake, is also virtually useless for analytical purposes, for the same
reason. Some mistakes made by both parties should give rise to relief, but
others should not. The real issue is not whether a mistake is mutual, but
whether it concerns a mistaken tacit assumption and, if it does, whether the
general rule that should govern such mistakes, or an exception to the rule,
should be applied in any given case.

Despite these defects, the law of mistake is not in complete shambles.
The reason is that in this area the courts say one thing and do another. Most
of the cases that courts categorize as unilateral mistakes actually involve
mechanical errors. Most of the cases that the courts categorize as mutual
mistakes actually involve shared mistaken tacit assumptions. Because what

\(^{115}\) Restatement Second, supra note 31, \(\S\) 153.
\(^{116}\) Id. \(\S\) 154.
\(^{117}\) Eisenberg, supra note 4.
the courts do in these cases is different from what they say, they often muddle through despite the lack of a sound analytical apparatus. The same thing is largely true in cases involving interpretative mistakes.

But the law of mistake can and should do better than muddling through. Many courts fail to muddle through, and in any event muddling through creates unpredictable law. The law of mistake should be put on a firm foundation by defining the kinds of mistake that are relevant in contract law in terms of their character, and articulating the propositions of efficiency, social morality, and experience that should underlie the rules in this area. Only when those objectives are accomplished is it possible to formulate the general rules that should govern various kinds of mistakes, the exceptions that should be carved out from the general rules, and the remedies that should be available when a party has made a given kind of mistake that should give rise to legal relief. This Article has been directed to achieving those objectives by developing the general rules, exceptions, and remedies that should govern mistake in contract law.