

Mistake

Premised on voluntary undertakings and mutual assent, parties' contractual obligation presumes the absence of mistaken beliefs, misunderstandings, or trickery with respect to the agreement. Thus, under the doctrine of mistake, a mistaken belief about the world by both parties concerning a material aspect of a contract may undermine the formation of the contract or excuse parties' performance.

According to Restatement (Second) of Contracts § 151, a mistake is "a belief that is not in accord with the facts" at the time the contract is made. Mistaken beliefs can take the form of incorrect factual assumptions or drafting errors, to name a few examples. Mistakes can also be prompted by another's misrepresentations. The defense of mistake applies only to a mistake of fact and does not extend to promises, predictions, or opinions, though some courts allow the defense with respect to existing law, treating it as part of the facts at the time of the agreement.

Sherwood v. Walker and Lenawee County Board of Health v. Messerly, below, consider the parties' mutual mistakes.

Sherwood v. Walker

66 Mich. 568, 33 N.W. 919 (Supreme Court of Michigan 1887)

MORSE, J.

... The defendants reside at Detroit, but are in business at Walkerville, Ontario, and have a farm at Greenfield, in Wayne county, upon which were some blooded cattle supposed to be barren as breeders. The Walkers are importers and breeders of polled Angus cattle. The plaintiff is a banker living at Plymouth, in Wayne county. He called upon the defendants at Walkerville for the purchase of some of their stock, but found none there that suited him. Meeting one of the defendants afterwards, he was informed that they had a few head upon this Greenfield farm. He was asked to go out and look at them, with the statement at the time that they were probably barren, and would not breed. May 5, 1886, plaintiff went out to Greenfield and saw the cattle. A few days thereafter, he called upon one of the defendants with the view of purchasing a cow, known as "Rose 2d of Aberlone." After considerable talk, it was agreed that defendants would telephone Sherwood at his home in Plymouth in reference to the price. The second morning after this talk he was called up by telephone, and the terms of the sale were finally agreed upon [based on the cow's weight]....

[A few days later, after discovering that the cow was pregnant, the defendant refused to either accept payment from the plaintiff or deliver the cow]

It appears from the record that both parties supposed this cow was barren and would not breed, and she was sold by the pound for an insignificant sum as compared with her real value if a breeder. She was evidently sold and purchased on the relation of her value for beef, unless the plaintiff had learned of her true condition, and concealed such knowledge from the defendants. Before the plaintiff secured possession of the animal, the defendants learned that she was with calf, and therefore of great value, and undertook to rescind the sale by refusing to deliver her. The question arises whether they had a right to do so. The circuit judge ruled that this fact did not avoid the sale, and it made no difference whether she was barren or not. I am of the opinion that the court erred in this holding. I know that this is a close question, and the dividing line between the adjudicated cases is not easily discerned. But it must be considered as well settled that a party who has given an apparent consent to a contract of sale may refuse to execute it, or he may avoid it after it has been completed, if the assent was founded, or the contract made, upon the mistake of a material fact,—such as the subject-matter of the sale, the price, or some collateral fact materially inducing the agreement; and this can be done when the mistake is mutual....

If there is a difference or misapprehension as to the substance of the thing bargained for, if the thing actually delivered or received is different in substance from the thing bargained for and intended to be sold, then there is no contract; but if it be only a difference in some quality or accident, even though the mistake may have been the actuating motive to the purchaser or seller, or both of them, yet the contract remains binding. “The difficulty in every case is to determine whether the mistake or misapprehension is as to the substance of the whole contract, going, as it were, to the root of the matter, or only to some point, even though a material point, an error as to which does not affect the substance of the whole consideration.” *Kennedy v. Panama, etc., Mail Co.*, L. E. 2 Q. B. 580, 588. It has been held, in accordance with the principles above stated, that where a horse is bought under the belief that he is sound, and both vendor and vendee honestly believe him to be sound, the purchaser must stand by his bargain, and pay the full price, unless there was a warranty.

It seems to me, however, in the case made by this record, that the mistake or misapprehension of the parties went to the whole substance of the agreement. If the cow was a breeder, she was worth at least \$750; if barren, she was worth not over \$80. The parties would not have made the contract of sale except upon the understanding and belief that she was incapable of breeding, and of no use as a cow. It is true she is now the identical animal that they thought her to be when the contract was made; there is no mistake as to the identity of the creature.

Yet the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them for all purposes of use as there is between an ox and a cow that is capable of breeding and giving milk. If the mutual mistake had simply related to the fact whether she was with calf or not for one season, then it might have been a good sale; but the mistake affected the character of the animal for all time, and for her present and ultimate use. She was not in fact the animal, or the kind of animal, the defendants intended to sell or the plaintiff to buy. She was not a barren cow, and, if this fact had been known, there would have been no contract. The mistake affected the substance of the whole consideration, and it must be considered that there was no contract to sell or sale of the cow as she actually was. The thing sold and bought had in fact no existence. She was sold as a beef creature would be sold; she is in fact a breeding cow, and a valuable one. The court should have instructed the jury that if they found that the cow was sold, or contracted to be sold, upon the understanding of both parties that she was barren, and useless for the purpose of breeding, and that in fact she was not barren, but capable of breeding, then the defendants had a right to rescind, and to refuse to deliver, and the verdict should be in their favor.

The judgment of the court below must be reversed, and a new trial granted, with costs of this Court to defendants.

SHERWOOD, J. (dissenting)

I do not concur in the opinion given by my brethren in this case. I think the judgments before the justice and at the circuit were right....

There is no question but that the defendants sold the cow representing her of the breed and quality they believed the cow to be, and that the purchaser so understood it. And the buyer purchased her believing her to be of the breed represented by the sellers, and possessing all the qualities stated, and even more....

It is claimed that a mutual mistake of a material fact was made by the parties when the contract of sale was made. There was no warranty in the case of the quality of the animal. When a mistaken fact is relied upon as ground for rescinding, such fact must not only exist at the time the contract is made, but must have been known to one or both of the parties. Where there is no warranty, there can be no mistake of fact when no such fact exists, or, if in existence, neither party knew of it, or could know of it; and that is precisely this case. If the owner of a Hambletonian horse had speeded him, and was only able to make him go a mile in three minutes, and should sell him to another, believing that was his greatest speed, for \$300, when

the purchaser believed he could go much faster, and made the purchase for that sum, and a few days thereafter, under more favorable circumstances, the horse was driven a mile in 2 min. 16 sec., and was found to be worth \$20,000, I hardly think it would be held, either at law or in equity, by any one, that the seller in such case could rescind the contract. The same legal principles apply in each case.

In this case neither party knew the actual quality and condition of this cow at the time of the sale.... The defendants sold the cow for what they believed her to be, and the plaintiff bought her as he believed she was, after the statements made by the defendants. No conditions whatever were attached to the terms of sale by either party....

Lenawee Cty. Bd. of Health v. Messerly

417 Mich. 17, 331 N.W.2d 203 (Supreme Court of Michigan 1982)

RYAN, Justice.

In March of 1977, Carl and Nancy Pickles, appellees, purchased from appellants, William and Martha Messerly, a 600-square-foot tract of land upon which is located a three-unit apartment building. Shortly after the transaction was closed, the Lenawee County Board of Health condemned the property and obtained a permanent injunction which prohibits human habitation on the premises until the defective sewage system is brought into conformance with the Lenawee County sanitation code.

We are required to determine whether appellees should prevail in their attempt to avoid this land contract on the basis of mutual mistake and failure of consideration. We conclude that the parties did entertain a mutual misapprehension of fact, but that the circumstances of this case do not warrant rescission.

I.

The facts of the case are not seriously in dispute. In 1971, the Messerlys acquired approximately one acre plus 600 square feet of land. A three-unit apartment building was situated upon the 600-square-foot portion. The trial court found that, prior to this transfer, the Messerlys' predecessor in title, Mr. Bloom, had installed a septic tank on the property without a permit and in violation of the applicable health code. The Messerlys used the

building as an income investment property until 1973 when they sold it, upon land contract, to James Barnes who likewise used it primarily as an income-producing investment.¹

Mr. and Mrs. Barnes, with the permission of the Messerlys, sold approximately one acre of the property in 1976, and the remaining 600 square feet and building were offered for sale soon thereafter when Mr. and Mrs. Barnes defaulted on their land contract. Mr. and Mrs. Pickles evidenced an interest in the property, but were dissatisfied with the terms of the Barnes-Messerly land contract. Consequently, to accommodate the Pickleses' preference to enter into a land contract directly with the Messerlys, Mr. and Mrs. Barnes executed a quit-claim deed which conveyed their interest in the property back to the Messerlys. After inspecting the property, Mr. and Mrs. Pickles executed a new land contract with the Messerlys on March 21, 1977. It provided for a purchase price of \$25,500. A clause was added to the end of the land contract form which provides:

17. Purchaser has examined this property and agrees to accept same in its present condition. There are no other or additional written or oral understandings.

Five or six days later, when the Pickleses went to introduce themselves to the tenants, they discovered raw sewage seeping out of the ground. Tests conducted by a sanitation expert indicated the inadequacy of the sewage system. The Lenawee County Board of Health subsequently condemned the property and initiated this lawsuit in the Lenawee Circuit Court against the Messerlys as land contract vendors, and the Pickleses, as vendees, to obtain a permanent injunction proscribing human habitation of the premises until the property was brought into conformance with the Lenawee County sanitation code. The injunction was granted, and the Lenawee County Board of Health was permitted to withdraw from the lawsuit by stipulation of the parties.

When no payments were made on the land contract, the Messerlys filed a cross-complaint against the Pickleses seeking foreclosure, sale of the property, and a deficiency judgment. Mr. and Mrs. Pickles then counterclaimed for rescission against the Messerlys, and filed a third-party complaint against the Barneses, which incorporated, by reference, the allegations of the counterclaim against the Messerlys. In count one, Mr. and Mrs. Pickles alleged failure of consideration. Count two charged Mr. and Mrs. Barnes with willful concealment and

¹ James Barnes was married shortly after he purchased the property. Mr. and Mrs. Barnes lived in one of the apartments on the property for three months and, after they moved, Mrs. Barnes continued to aid in the management of the property.

misrepresentation as a result of their failure to disclose the condition of the sanitation system. Additionally, Mr. and Mrs. Pickles sought to hold the Messerlys liable in equity for the Barneses' alleged misrepresentation. The Pickleses prayed that the land contract be rescinded.

After a bench trial, the court concluded that the Pickleses had no cause of action against either the Messerlys or the Barneses as there was no fraud or misrepresentation. This ruling was predicated on the trial judge's conclusion that none of the parties knew of Mr. Bloom's earlier transgression or of the resultant problem with the septic system until it was discovered by the Pickleses, and that the sanitation problem was not caused by any of the parties. The trial court held that the property was purchased "as is", after inspection and, accordingly, its "negative * * * value cannot be blamed upon an innocent seller". Foreclosure was ordered against the Pickleses, together with a judgment against them in the amount of \$25,943.09.³

Mr. and Mrs. Pickles appealed from the adverse judgment. The Court of Appeals unanimously affirmed the trial court's ruling with respect to Mr. and Mrs. Barnes but, in a two-to-one decision, reversed the finding of no cause of action on the Pickleses' claims against the Messerlys. It concluded that the mutual mistake between the Messerlys and the Pickleses went to a basic, as opposed to a collateral, element of the contract,⁵ and that the parties intended to transfer income-producing rental property but, in actuality, the vendees paid \$25,500 for an asset without value.⁷

We granted the Messerlys' application for leave to appeal. 411 Mich. 900 (1981).⁸

³ The parties stipulated that this amount was due on the land contract, assuming that the contract was valid and enforceable.

⁵ Mr. and Mrs. Pickles did not appeal the trial court's finding that there was no fraud or misrepresentation by the Messerlys or Mr. and Mrs. Barnes. Likewise, the propriety of that ruling is not before this Court today.

⁷ The trial court found that the only way that the property could be put to residential use would be to pump and haul the sewage, a method which is economically unfeasible, as the cost of such a disposal system amounts to double the income generated by the property. There was speculation by the trial court that the adjoining land might be utilized to make the property suitable for residential use, but, in the absence of testimony directed at that point, the court refused to draw any conclusions. The trial court and the Court of Appeals both found that the property was valueless, or had a negative value.

⁸ The Court of Appeals decision to affirm the trial court's finding of no cause of action against Mr. and Mrs. Barnes has not been appealed to this Court and, accordingly, the propriety of that ruling is not before us today.

II.

We must decide initially whether there was a mistaken belief entertained by one or both parties to the contract in dispute and, if so, the resultant legal significance.⁹

A contractual mistake “is a belief that is not in accord with the facts.” 1 Restatement Contracts, 2d, § 151. The erroneous belief of one or both of the parties must relate to a fact in existence at the time the contract is executed. *Richardson Lumber Co. v. Hoey*, 219 Mich. 643, 189 N.W. 923 (1922); *Sherwood v. Walker*, 66 Mich. 568, 580, 33 N.W. 919 (1887) (Sherwood, J., dissenting). That is to say, the belief which is found to be in error may not be, in substance, a prediction as to a future occurrence or non-occurrence. *Henry v. Thomas*, 241 Ga. 360, 245 S.E.2d 646 (1978); *Hailpern v. Dryden*, 154 Colo. 231, 389 P.2d 590 (1964). But see *Denton v. Utley*, 350 Mich. 332, 86 N.W.2d 537 (1957).

The Court of Appeals concluded, after a de novo review of the record, that the parties were mistaken as to the income-producing capacity of the property in question. 98 Mich. App. 487–488, 295 N.W.2d 903. We agree. The vendors and the vendees each believed that the property transferred could be utilized as income-generating rental property. All of the parties subsequently learned that, in fact, the property was unsuitable for any residential use.

Appellants assert that there was no mistake in the contractual sense because the defect in the sewage system did not arise until after the contract was executed. The appellees respond that the Messerlys are confusing the date of the inception of the defect with the date upon which the defect was discovered.

This is essentially a factual dispute which the trial court failed to resolve directly. Nevertheless, we are empowered to draw factual inferences from the facts found by the trial court....

An examination of the record reveals that the septic system was defective prior to the date on which the land contract was executed. The Messerlys’ grantor installed a nonconforming septic system without a permit prior to the transfer of the property to the Messerlys in 1971. Moreover, virtually undisputed testimony indicates that, assuming ideal soil conditions, 2,500 square feet of property is necessary to support a sewage system adequate to serve a three-family dwelling. Likewise, 750 square feet is mandated for a one-family home. Thus, the division of the parcel and sale of one acre of the property by Mr. and Mrs. Barnes in 1976

⁹ We emphasize that this is a bifurcated inquiry. Legal or equitable remedial measures are not mandated in every case in which a mutual mistake has been established.

made it impossible to remedy the already illegal septic system within the confines of the 600-square-foot parcel.

Appellants do not dispute these underlying facts which give rise to an inference contrary to their contentions.

Having determined that when these parties entered into the land contract they were laboring under a mutual mistake of fact, we now direct our attention to a determination of the legal significance of that finding.

A contract may be rescinded because of a mutual misapprehension of the parties, but this remedy is granted only in the sound discretion of the court. *Harris v. Axline*, 323 Mich. 585, 36 N.W.2d 154 (1949). Appellants argue that the parties' mistake relates only to the quality or value of the real estate transferred, and that such mistakes are collateral to the agreement and do not justify rescission, citing *A & M Land Development Co. v. Miller*, 354 Mich. 681, 94 N.W.2d 197 (1959).

In that case, the plaintiff was the purchaser of 91 lots of real property. It sought partial rescission of the land contract when it was frustrated in its attempts to develop 42 of the lots because it could not obtain permits from the county health department to install septic tanks on these lots. This Court refused to allow rescission because the mistake, whether mutual or unilateral, related only to the value of the property. "There was here no mistake as to the form or substance of the contract between the parties, or the description of the property constituting the subject matter. . . ." 354 Mich. 693–694, 94 N.W.2d 197.

Appellees contend, on the other hand, that in this case the parties were mistaken as to the very nature of the character of the consideration and claim that the pervasive and essential quality of this mistake renders rescission appropriate. They cite in support of that view *Sherwood v. Walker*, 66 Mich. 568, 33 N.W. 919 (1887), the famous "barren cow" case. In that case, the parties agreed to the sale and purchase of a cow which was thought to be barren, but which was, in reality, with calf. When the seller discovered the fertile condition of his cow, he refused to deliver her. In permitting rescission, the Court stated:

"It seems to me, however, in the case made by this record, that the mistake or misapprehension of the parties went to the whole substance of the agreement. If the cow was a breeder, she was worth at least \$750; if barren, she was worth not over \$80. The parties would not have made the contract of sale except upon the understanding and belief that she was incapable of breeding, and of no use

as a cow. It is true she is now the identical animal that they thought her to be when the contract was made; there is no mistake as to the identity of the creature. Yet the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them for all purposes of use as there is between an ox and a cow that is capable of breeding and giving milk. If the mutual mistake had simply related to the fact whether she was with calf or not for one season, then it might have been a good sale; but the mistake affected the character of the animal for all time, and for her present and ultimate use. She was not in fact the animal, or the kind of animal, the defendants intended to sell or the plaintiff to buy. She was not a barren cow, and, if this fact had been known, there would have been no contract. The mistake affected the substance of the whole consideration, and it must be considered that there was no contract to sell or sale of the cow as she actually was. The thing sold and bought had in fact no existence. She was sold as a beef creature would be sold; she is in fact a breeding cow, and a valuable one.

The court should have instructed the jury that if they found that the cow was sold, or contracted to be sold, upon the understanding of both parties that she was barren, and useless for the purpose of breeding, and that in fact she was not barren, but capable of breeding, then the defendants had a right to rescind, and to refuse to deliver, and the verdict should be in their favor.” 66 Mich. 577–578, 33 N.W. 919.

As the parties suggest, the foregoing precedent arguably distinguishes mistakes affecting the essence of the consideration from those which go to its quality or value, affording relief on a per se basis for the former but not the latter. See, e.g., *Lenawee County Board of Health v. Messerly*, 98 Mich. App. 478, 492, 295 N.W.2d 903 (1980) (Mackenzie, J., concurring in part).

However, the distinctions which may be drawn from *Sherwood* and *A & M Land Development Co.* do not provide a satisfactory analysis of the nature of a mistake sufficient to invalidate a contract. Often, a mistake relates to an underlying factual assumption which, when discovered, directly affects value, but simultaneously and materially affects the essence of the contractual consideration. It is disingenuous to label such a mistake collateral. *McKay v. Coleman*, 85 Mich. 60, 48 N.W. 203 (1891). Corbin, Contracts (One Vol ed.), § 605, p. 551.

Appellant and appellee both mistakenly believed that the property which was the subject of their land contract would generate income as rental property. The fact that it could not be

used for human habitation deprived the property of its income-earning potential and rendered it less valuable. However, this mistake, while directly and dramatically affecting the property's value, cannot accurately be characterized as collateral because it also affects the very essence of the consideration. "The thing sold and bought [income generating rental property] had in fact no existence". *Sherwood v. Walker*, 66 Mich. 568, 33 N.W. 919.

We find that the inexact and confusing distinction between contractual mistakes running to value and those touching the substance of the consideration serves only as an impediment to a clear and helpful analysis for the equitable resolution of cases in which mistake is alleged and proven. Accordingly, the holdings of *A & M Land Development Co.* and *Sherwood* with respect to the material or collateral nature of a mistake are limited to the facts of those cases.

Instead, we think the better-reasoned approach is a case-by-case analysis whereby rescission is indicated when the 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. *Denton v. Utley*, 350 Mich. 332, 86 N.W.2d 537 (1957); *Farhat v. Rassey*, 295 Mich. 349, 294 N.W. 707 (1940); *Richardson Lumber Co. v. Hoey*, 219 Mich. 643, 189 N.W. 923 (1922). 1 Restatement Contracts, 2d, §§ 152, 154, pp. 385–386, 402–406. Rescission is not available, however, to relieve a party who has assumed the risk of loss in connection with the mistake. *Denton v. Utley*, 350 Mich. 344–345, 86 N.W.2d 537; *Farhat v. Rassey*, 295 Mich. 352, 294 N.W. 707; Corbin, Contracts (One Vol ed.), § 605, p. 552; 1 Restatement Contracts, 2d, §§ 152, 154, pp. 385–386, 402–406.¹²

All of the parties to this contract erroneously assumed that the property transferred by the vendors to the vendees 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 changed the character of the property transferred, thereby frustrating, indeed precluding, Mr. and Mrs. Pickles' intended use of the real estate. Although the Pickleses are disadvantaged by enforcement of the contract, performance is advantageous to the Messerlys, as the property at issue is less valuable absent its income-earning potential. Nothing short of

¹² "§ 154. When a Party Bears the Risk of a Mistake

"A party bears the risk of a mistake when

(a) the risk is allocated to him by agreement of the parties, or
 (b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or
 (c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so."

rescission can remedy the mistake. 'Thus, the parties' mistake as to a basic assumption materially affects the agreed performances of the parties.

Despite the significance of the mistake made by the parties, we reverse the Court of Appeals because we conclude that equity does not justify the remedy sought by Mr. and Mrs. Pickles.

Rescission is an equitable remedy which is granted only in the sound discretion of the court. *Harris v. Axline*, 323 Mich. 585, 36 N.W.2d 154 (1949); *Hathaway v. Hudson*, 256 Mich. 694, 239 N.W. 859 (1932). A court need not grant rescission in every case in which the mutual mistake relates to a basic assumption and materially affects the agreed performance of the parties.

In cases of mistake by two equally innocent parties, we are required, in the exercise of our equitable powers, to determine which blameless party should assume the loss resulting from the misapprehension they shared.¹³ Normally that can only be done by drawing upon our "own notions of what is reasonable and just under all the surrounding circumstances."¹⁴

Equity suggests that, in this case, the risk should be allocated to the purchasers. We are guided to that conclusion, in part, by the standards announced in § 154 of the Restatement of Contracts 2d, for determining when a party bears the risk of mistake. . . . Section 154(a) suggests that the court should look first to whether the parties have agreed to the allocation of the risk between themselves. While there is no express assumption in the contract by either party of the risk of the property becoming uninhabitable, there was indeed some agreed allocation of the risk to the vendees by the incorporation of an "as is" clause into the contract which, we repeat, provided:

"Purchaser has examined this property and agrees to accept same in its present condition. There are no other or additional written or oral understandings."

That is a persuasive indication that the parties considered that, as between them, such risk as related to the "present condition" of the property should lie with the purchaser. If the "as is" clause is to have any meaning at all, it must be interpreted to refer to those defects which were

¹³ This risk-of-loss analysis is absent in both *A & M Land Development Co.* and *Sherwood*, and this omission helps to explain, in part, the disparate treatment in the two cases. Had such an inquiry been undertaken in *Sherwood*, we believe that the result might have been different. Moreover, a determination as to which party assumed the risk in *A & M Land Development Co.* would have alleviated the need to characterize the mistake as collateral so as to justify the result denying rescission. Despite the absence of any inquiry as to the assumption of risk in those two leading cases, we find that there exists sufficient precedent to warrant such an analysis in future cases of mistake.

¹⁴ *Hathaway v. Hudson*, 256 Mich. 702, 239 N.W. 859, quoting 9 C.J., p. 1161.

unknown at the time that the contract was executed.¹⁵ Thus, the parties themselves assigned the risk of loss to Mr. and Mrs. Pickles.¹⁶

We conclude that Mr. and Mrs. Pickles are not entitled to the equitable remedy of rescission and, accordingly, reverse the decision [of] the Court of Appeals.

WILLIAMS, C.J., and COLEMAN, FITZGERALD, KAVANAGH and LEVIN, JJ., concur.

RILEY, J., not participating.

Notes and Questions

1. Mistake cases often raise two (related) questions: First, which types of mistakes allow a party to rescind the contract? Second, how can the risk be allocated between the parties? *Sherwood* focuses on the first question, although the second is relevant as well. When a contract is avoided for mistake, the court is effectively deciding who bears the risk of mistake. Did the buyer in *Sherwood* assume the risk of a mistake regarding the cow? Did the seller? Did the judges consider it? Which party was best positioned to avoid the mistake (and is that a relevant inquiry)?
2. In *Allen v. Hammond*, 36 U.S. 63 (1837), a case cited by both the majority and the dissent in *Sherwood* (in omitted parts of those opinions), the Supreme Court asked, “[i]f a horse be sold, which is dead, though believed to be living by both parties, can the purchaser be compelled to pay the consideration?” *Id.*, at 71. The *Allen* court answered in the negative. Do you agree? How is this hypothetical compared to the other horse-themed example in *Sherwood*? The majority states that when the buyer and seller think a purchased horse is strong and it turns out to be weak, the contract is enforceable. The dissent suggests that when a racing horse is sold and starts to run faster (and is therefore

¹⁵ An “as is” clause waives those implied warranties which accompany the sale of a new home, *Tibbitts v. Openshaw*, 18 Utah 2d 442, 425 P.2d 160 (1967), or the sale of goods. M.C.L. § 440.2316(3)(a); M.S.A. § 19.2316(3)(a). Since implied warranties protect against latent defects, an “as is” clause will impose upon the purchaser the assumption of the risk of latent defects, such as an inadequate sanitation system, even when there are no implied warranties.

¹⁶ An “as is” clause does not preclude a purchaser from alleging fraud or misrepresentation as a basis for rescission. See 97 A.L.R. 849. However, Mr. and Mrs. Pickles did not appeal the trial court's finding that there was no fraud or misrepresentation, so we are bound thereby.

significantly more valuable), the contract is enforceable. Agree? Are those examples comparable to the facts of *Sherwood*?

3. Note the treatment of the precedents invoked in *Lenawee County*. The court rejects the distinction in the common law between contractual mistakes concerning value and those concerning the substance of the deal as “an impediment to a clear and helpful analysis,” looking instead to the framework of the Restatement (Second). Does that distinction make sense? Do you agree with the *Lenawee County* court’s approach of a “case-by-case analysis whereby rescission is indicated when the 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”? More basically, do you think there was agreement on the material aspects of the contract by the parties when they entered the deal? If the property was valueless, was consideration, a basic contractual element, absent in this deal?
4. In contrast to the approach in *Sherwood*, in the case of *Wood v. Boynton*, 25 N.W. 42 (Wisc. 1885), the court rejected the claim of mutual mistake. In this case, Wood sold a stone to a jewelry business for one dollar, thinking it was a topaz, only to learn later that it was an uncut diamond allegedly valued around \$700. There was no evidence that Boynton, the jeweler-buyer, knew of the stone’s value or nature; the jeweler testified that he had never seen an uncut diamond and that the possibility did not occur to him at the time of the deal. The court treated this as a bad bargain, which cannot be repudiated, rather than a mutual mistake as to the substance of the deal. The court noted that Wood “chose to sell [the stone] without further investigation as to its intrinsic value to a person who was guilty of no fraud or unfairness.” However, Wood testified that a few months after being approached by Boynton to sell the stone, she “needed money pretty badly, and thought every dollar would help.” The opinion recounts her testimony:

“I took it back to Mr. Boynton and told him I had brought back the topaz, and he says, ‘Well, yes; what did I offer you for it?’ and I says, ‘One dollar;’ and he stepped to the change drawer and gave me the dollar, and I went out...Before I sold the stone I had no knowledge whatever that it was a diamond. I told him that I had been advised that it was probably a topaz, and he said probably it was.”

Only then, according to the court, Wood tried to investigate. What else could she have done? What actions are incentivized by the doctrine of mistake?

5. As *Wood* suggests, mistake doctrine operates against a background that presumes that agreements are voluntary and courts will not excuse or reform contracts on the basis of a badly struck deal. In *Watkins & Son v. Carrig*, 21 A.2d 591 (N.H. 1941), the parties entered into a contract to excavate a cellar for an agreed price. When the digging began, the excavator struck solid rock, which seems to have surprised the parties. Noting that the plaintiff excavator's "manager made no inquiry or investigation to find out the character of the ground below the surface, no claim [was] made that the defendant misled him, and the contract contain[ed] no reservations for unexpected conditions," the court found that the defense of mutual mistake was "not available" to the parties. The court pointed to the language of the contract that provided "that 'all material' shall be removed from the site" and noted the absence of any qualification of the obligation "to excavate." Echoing *Wood*, the court asserted, "If the plaintiff was unwise in taking chances, it is not relieved on the ground of mistake from the burden incurred in being faced with them." Though *Wood* and *Watkins* take a similar approach to the issue of mistake, do you see any basis to argue for distinguishing between the two? Can we distinguish them from *Sherwood*?
6. In *Simkin v. Blank*, 968 N.E.2d 459 (NY 2012), the New York Court of Appeals considered a claim of mutual mistake concerning a divorce settlement agreement between two lawyers. The agreement divided marital property, including investment accounts, and released or discharged the parties of any debts or future claims against each other. The court explained that although the agreement stated that the property division was "fair and reasonable," it failed to state explicitly "that the parties intended an equal distribution or other designated percentage division of the marital estate." *Id.* at 460. At the time the parties entered into the agreement, one of the husband's brokerage accounts was maintained by Bernard Madoff, the financier later found to have perpetrated the largest Ponzi scheme in history, estimated at around \$65 billion. According to the husband, the parties believed their brokerage account to be valued at \$5.4 million at the relevant valuation date for marital assets and, thereafter, he withdrew funds to pay a portion of the distribution he owed his wife under the agreement. Following the divorce, the husband continued to invest in the account for a couple of years until the exposure of the "colossal Ponzi scheme." *Id.* at 461.

Seeking reformation of the settlement agreement on the basis of mutual mistake, the husband asserted that the intent of the agreement was to equally divide the couple's marital assets, including an even split of the Madoff account. This intention "was frustrated because both parties operated under the 'mistake' or misconception as to the

existence of a legitimate investment account with Madoff which, in fact, was revealed to be part of a fraudulent Ponzi scheme.” *Id.* Reinstating the trial court’s dismissal, which had been reversed on appeal, the New York Court of Appeals held that there was no mutual material mistake of fact. The court rejected the husband’s argument that account was “nonexistent” along with the analogy to a case in which “parties are under a misimpression that they own a piece of real or personal property but later discover that they never obtained rightful ownership.” Emphasizing the timing, the court pointed to the lack of evidence that the husband could not have withdrawn all or part of his investment prior to the unravelling of the scheme two years later: “Given that the mutual mistake must have existed at the time the agreement was executed in 2006 ... the fact that husband could no longer withdraw funds years later is not determinative.” *Id.* at 464.

The oral argument before the New York Court of Appeals, discussing the question of mutual mistake, can be seen here: https://www.nycourts.gov/ctapps/arguments/2012/Feb12/Feb12_OA.htm

Do you view this case as consistent with the approach in *Wood*? The opinion also notes that the law favors marital settlement agreements. Do you think this case would come out differently in a different contractual context?

7. With respect to the issue of risk allocation, the court in *Lenawee County* looks at the allocation of risk between the parties as expressed in the provisions of the contract. An “as is” clause would not preclude a claim by the buyer of misrepresentation on the part of the seller and in *Lenawee County* there was no allegation of misrepresentation or fraud. Even so, much of the court’s reasoning hangs on this provision in this case. Do you find the court’s reasoning persuasive? Specifically, do you agree that by virtue of the “as is” provision, the contract allocated the risk to the party best positioned to bear or avoid it? In light of their acceptance of the “as is” contract provision, what might Mr. and Mrs. Pickles have done differently to avoid the risk of loss? If the “as is” provision had not been included in the contract, how do you think the case would be decided?
8. Notwithstanding *Sherwood* courts tend to allow a buyer to keep a windfall as a result of a mistake. *Lenawee County* invokes Restatement (Second) § 154 (see footnote 12 in the *Lenawee County*, opinion). Pursuant to §152 of the Restatement (Second), when there is a mutual mistake by the parties “as to a basic assumption on which the contract was made [that] has a material effect on the agreed exchange of performances,” a contract is “voidable by the adversely affected party,” unless that party bears the risk pursuant

to § 154. As such, §154 allocates the risk of mistake to a party when that allocation reflects the agreement between the parties (§ 154(a)), when the party is aware of “his limited knowledge but treats ...[it] as sufficient” (§ 154(b)), or when the court finds “it is reasonable in the circumstances to do so” (§ 154(c)). Comment (a) explains, “A party also bears the risk of many mistakes as to existing circumstances even though they upset basic assumptions and unexpectedly affect the agreed exchange of performances. For example, it is commonly understood that the seller of farm land generally cannot avoid the contract of sale upon later discovery by both parties that the land contains valuable mineral deposits, even though the price was negotiated on the basic assumption that the land was suitable only for farming and the effect on the agreed exchange of performances is material.” What do you think this approach is designed to achieve?

The case below engages the issue of risk allocation and the related issue of when parties assume the risk of remaining uninformed, or what the Restatement calls “conscious ignorance.”

Nelson v. Rice

198 Ariz. 563, 12 P.3d 238 (Court of Appeals of Arizona 2000)

ESPINOSA, Chief Judge.

Plaintiff/appellant the Estate of Martha Nelson, through its copersonal representatives Edward Franz and Kenneth Newman, appeals from a summary judgment in favor of defendants/appellees Carl and Anne Rice in the Estate’s action seeking rescission or reformation of the sale of two paintings to the Rices. The Estate argues that these remedies are required because the sale was based upon a mutual mistake. The Estate also contends that enforcing the sale “contract” would be unconscionable. We affirm.

Facts and Procedural History

We view the evidence and all reasonable inferences therefrom in the light most favorable to the party opposing the summary judgment. *Hill-Shafer Partnership v. Chilson Family Trust*, 165 Ariz. 469, 799 P.2d 810 (1990). After Martha Nelson died in February 1996, Newman and Franz, the copersonal representatives of her estate, employed Judith McKenzie–Larson to appraise the Estate’s personal property in preparation for an estate sale. McKenzie–Larson told them that she did not appraise fine art and that, if she saw any, they would need to hire an additional appraiser. McKenzie–Larson did not report finding any fine art, and relying on her silence and her appraisal, Newman and Franz priced and sold the Estate’s personal property.

Responding to a newspaper advertisement, Carl Rice attended the public estate sale and paid the asking price of \$60 for two oil paintings. Although Carl had bought and sold some art, he was not an educated purchaser, had never made more than \$55 on any single piece, and had bought many pieces that had “turned out to be frauds, forgeries or ... to have been [created] by less popular artists.” He assumed the paintings were not originals given their price and the fact that the Estate was managed by professionals, but was attracted to the subject matter of one of the paintings and the frame of the other. At home, he compared the signatures on the paintings to those in a book of artists’ signatures, noticing they “appeared to be similar” to that of Martin Johnson Heade. As they had done in the past, the Rices sent pictures of the paintings to Christie’s in New York, hoping they might be Heade’s work. Christie’s authenticated the paintings, *Magnolia Blossoms on Blue Velvet* and *Cherokee Roses*, as paintings by Heade and offered to sell them on consignment. Christie’s subsequently sold the paintings at auction for \$1,072,000. After subtracting the buyer’s premium and the commission, the Rices realized \$911,780 from the sale.

Newman and Franz learned about the sale in February 1997 and thereafter sued McKenzie–Larson on behalf of the Estate, believing she was entirely responsible for the Estate’s loss. The following November, they settled the lawsuit because McKenzie–Larson had no assets with which to pay damages. During 1997, the Rices paid income taxes of \$337,000 on the profit from the sale of the paintings, purchased a home, created a family trust, and spent some of the funds on living expenses.

The Estate sued the Rices in late January 1998, alleging the sale contract should be rescinded or reformed on grounds of mutual mistake and unconscionability. In its subsequent motion for summary judgment, the Estate argued the parties were not aware the transaction had involved fine art, believing instead that the items exchanged were “relatively valueless, wall decorations.” In their opposition and cross-motion, the Rices argued the Estate bore the risk of mistake, the doctrine of laches precluded reformation of the contract, and unconscionability was not a basis for rescission. The trial court concluded that, although the parties had been mistaken about the value of the paintings, the Estate bore the risk of that mistake. The court ruled the contract was not unconscionable, finding the parties had not negotiated Carl’s paying the prices the Estate had set. Accordingly, the court denied the Estate’s motion for summary judgment and granted the Rices’ cross-motion. The Estate’s motion for new trial was denied, and this appeal followed

Mutual Mistake

The Estate first argues that it established a mutual mistake sufficient to permit the reformation or rescission of the sale of the paintings to the Rices.² A party seeking to rescind a contract on the basis of mutual mistake must show by clear and convincing evidence that the agreement should be set aside. *Emmons v. Superior Court*, 192 Ariz. 509, 968 P.2d 582 (App.1998). A contract may be rescinded on the ground of a mutual mistake as to a “ ‘basic assumption on which both parties made the contract.’ ” *Renner v. Kehl*, 150 Ariz. 94, 97, 722 P.2d 262, 265 (1986), quoting Restatement (Second) of Contracts § 152 cmt. b (1979). Furthermore, the parties’ mutual mistake must have had “ ‘such a material effect on the agreed exchange of performances as to upset the very bases of the contract.’ ” *Id.*, quoting Restatement § 152 cmt. a. However, the mistake must not be one on which the party seeking relief bears the risk under the rules stated in § 154(b) of the Restatement. *Emmons*; Restatement § 152.

In concluding that the Estate was not entitled to rescind the sale, the trial court found that, although a mistake had existed as to the value of the paintings, the Estate bore the risk of that mistake under § 154(b) of the Restatement, citing the example in comment a. Section 154(b) states that a party bears the risk of mistake when “he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient.” In explaining that provision, the Washington Supreme Court stated, “In such a situation there is no mistake. Instead, there is an awareness of uncertainty or conscious ignorance of the future.” *Bennett v. Shinoda Floral, Inc.*, 108 Wash.2d 386, 739 P.2d 648, 653–54 (1987); *see also State Farm Fire & Cas. Co. v. Pacific Rent–All, Inc.*, 90 Hawai‘i 315, 978 P.2d 753 (1999).

The Estate contends neither party bore the risk of mistake, arguing that § 154 and comment a are not applicable to these facts. In the example in comment a, the risk of mistake is allocated to the seller when the buyer discovers valuable mineral deposits on property priced and purchased as farmland. Even were we to accept the Estate’s argument that this example is not analogous, comment c clearly applies here and states:

²Reformation is not an available remedy under these facts. It is a remedy to correct a written instrument that fails to express the terms agreed upon by the parties and “is not intended to enforce the terms of an agreement the parties never made.” *Isaak v. Massachusetts Indem. Life Ins. Co.*, 127 Ariz. 581, 584, 623 P.2d 11, 14 (1981); *see also Ashton Co., Inc., Contractors & Engineers v. State*, 9 Ariz. App. 564, 454 P.2d 1004 (1969) (contractor not entitled to reform contract in absence of showing it did not express parties’ real agreement).

Conscious ignorance. 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. It is sometimes said in such a situation that, in a sense, there was not mistake but “conscious ignorance.”

Through its personal representatives, the Estate hired two appraisers, McKenzie–Larson and an Indian art expert, to evaluate the Estate’s collection of Indian art and artifacts. McKenzie–Larson specifically told Newman that she did not appraise fine art. In his deposition, Newman testified that he had not been concerned that McKenzie–Larson had no expertise in fine art, believing the Estate contained nothing of “significant value” except the house and the Indian art collection. Despite the knowledge that the Estate contained framed art other than the Indian art, and that McKenzie–Larson was not qualified to appraise fine art, the personal representatives relied on her to notify them of any fine art or whether a fine arts appraiser was needed. Because McKenzie–Larson did not say they needed an additional appraiser, Newman and Franz did not hire anyone qualified to appraise fine art. By relying on the opinion of someone who was admittedly unqualified to appraise fine art to determine its existence, the personal representatives consciously ignored the possibility that the Estate’s assets might include fine art, thus assuming that risk. *See Klas v. Van Wagoner*, 829 P.2d 135, 141 n. 8 (Utah App.1992) (real estate buyers not entitled to rescind sale contract because they bore risk of mistake as to property’s value; by hiring architects, decorators, and electricians to examine realty, but failing to have it appraised, purchasers executed sale contract knowing they “had only ‘limited knowledge’ with respect to the value of the home”). Accordingly, the trial court correctly found that the Estate bore the risk of mistake as to the paintings’ value.³

The Estate asserts that the facts here are similar to those in *Renner*, in which real estate buyers sued to rescind a contract for acreage upon which they wished to commercially grow jojoba after discovering the water supply was inadequate for that purpose. The supreme court concluded that the buyers could rescind the contract based upon mutual mistake because both the buyers and the sellers had believed there was an adequate water supply, a basic assumption underlying formation of the contract. The parties’ failure to thoroughly investigate the water supply did not preclude rescission when “the risk of mistake was not allocated among the parties.” 150 Ariz. at 97 n. 2, 722 P.2d at 265 n. 2. The Estate’s reliance on *Renner* is unavailing

³In view of our conclusion that the Estate bore the risk of any mistake in the paintings’ value, we need not address the remainder of its mutual mistake arguments.

because, as stated above, the Estate bore the risk of mistake based on its own conscious ignorance.⁴

Furthermore, under Restatement § 154(c), the court may allocate the risk of mistake to one party “on the ground that it is reasonable in the circumstances to do so.” In making this determination, “the court will consider the purposes of the parties and will have recourse to its own general knowledge of human behavior in bargain transactions.” Restatement § 154 cmt. d. Here, the Estate had had ample opportunity to discover what it was selling and failed to do so; instead, it ignored the possibility that the paintings were valuable and attempted to take action only after learning of their worth as a result of the efforts of the Rices. Under these circumstances, the Estate was a victim of its own folly and it was reasonable for the court to allocate to it the burden of its mistake.

Unconscionability

The Estate also argues that enforcement of the “contract” to sell the paintings is unconscionable. . . .

In refusing to rescind the sale on the basis of unconscionability, the trial court stated that, “[w]hile the results of the transaction may seem unconscionable to the [Estate] in hindsight, the terms of the contract certainly were not.” We agree. . . .

Affirmed. In our discretion, we deny the Rices’ request for attorney’s fees on appeal.

CONCURRING: JOSEPH W. HOWARD, Presiding Judge, and WILLIAM E. DRUKE, Judge.

Notes and Questions

1. Consider a recent story in the New York Times about an antiques collector of Americana, such as nineteenth-century “grocery store products, old gas station signs and advertising,” who paid \$6,000 for “two large round windows that were covered in grime and encased high in the stone walls” of a dilapidated Philadelphia church

⁴In its reply brief, the Estate argues that a party’s negligence does not bar avoidance or reformation of a contract for mutual mistake, claiming that § 157 of the Restatement requires bad faith or gross negligence. This argument is waived by the Estate’s failure to raise it in its opening brief. *General Motors Corp. v. Arizona Dep’t of Revenue*, 189 Ariz. 86, 938 P.2d 481 (App.1996); *Wasserman v. Low*, 143 Ariz. 4, 691 P.2d 716 (App.1984).

undergoing a renovation. The collector, noticing the windows' unique purple color and round shape, spent an additional \$15,000 to remove them. According to an appraiser and to the collector's surprise, the windows were created at the turn of the twentieth century by the celebrated firm, Tiffany Studios, and valued between \$150,000 and \$250,000 apiece. The senior pastor of the church said he had no idea of the provenance or value of the windows and had directed that they be disposed of because they looked unsalvageable. He said, "I feel like, because I didn't have a knowledgeable team, my ignorance was taken advantage of." Given the value of the windows and the economic needs of the church, the pastor said, "I would have kept them if I had known that." Michael Levenson, *Sold For a Song, a Church's Windows Turned Out to Be Tiffany*, N.Y. Times (May 11, 2023). Would the pastor be able to make a case for rescission? Given the goals of the law, do you think he should be able to do so? How does this compare to *Nelson v. Rice* above?

2. Parties can invoke the mistake defense when they had a mistaken belief about facts at the time they entered the contract, but not when they've made a mistaken prediction about future events. Instead, when a party errs in predicting events expected to transpire during the term of the contract, the party may try to invoke one of the excuses to performance, such of impracticability or frustration of purpose. As we will see in the chapter on performance, those excuses rarely exempt performance.

Contract doctrine distinguishes between mutual and unilateral mistake. Unlike the situation presented by the court in *Lenawee County*, a unilateral mistake involves an incorrect belief by only one of the parties. Traditionally, under the common law, a contract is more likely to be voidable for a mutual mistake, whereas it is more difficult for a party to obtain relief in a case of unilateral mistake. The Restatement (Second) incorporates this distinction. In contrast to § 152, which establishes, as discussed above, that mutual mistake makes a contract voidable, absent the explicit or circumstantial risk allocation enumerated in § 154, § 153 requires an additional element—either “(a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or (b) the other party had reason to know of the mistake or his fault caused the mistake.”

In practice, however, the distinction between mutual and unilateral mistake is not always clear. At the very least, bidding mistakes, when one side makes an offer that involves a technical error such as a typo or mistaken calculation that is accepted by the other party, are considered unilateral mistakes.

Wil-Fred's Inc. v. Metro. Sanitary Dist. of Greater Chicago

57 Ill.App.3d 16, 372 N.E.2d 946 (Appellate Court of Illinois 1978)

PERLIN, Justice.

In response to an advertisement published by the Metropolitan Sanitary District of Greater Chicago (hereinafter Sanitary District) inviting bids for rehabilitation work at one of its water reclamation plants, Wil-Fred's Inc. submitted a sealed bid and, as a security deposit to insure its performance, a \$100,000 certified check. After the bids were opened, Wil-Fred's, the low bidder, attempted to withdraw. The Sanitary District rejected the request and stated that the contract would be awarded to Wil-Fred's in due course. Prior to this award, Wil-Fred's filed a complaint for preliminary injunction and rescission. After hearing testimony and the arguments of counsel, the trial court granted rescission and ordered the Sanitary District to return the \$100,000 bid deposit to Wil-Fred's. The Sanitary District seeks to reverse this judgment order.

The Sanitary District's advertisement was published on November 26, 1975, and it announced that bids on contract 75-113-2D for the rehabilitation of sand drying beds at the District's West-Southwest plant in Stickney, Illinois, would be accepted up to January 6, 1976. This announcement specified that the work to be performed required the contractor to remove 67,500 linear feet of clay pipe and 53,200 cubic yards of gravel from the beds and to replace these items with plastic pipe and fresh filter material. Although plastic pipes were called for, the specifications declared that "all pipes * * * must be able * * * to withstand standard construction equipment."

The advertisement further stated that "(t)he cost estimate of the work under Contract 75-113-2D, as determined by the Engineering Department of the * * * Sanitary District * * * is \$1,257,000.00."

A proposal form furnished to Wil-Fred's provided:

The undersigned hereby certifies that he has examined the contract documents * * * and has examined the site of the work, * * *.

The undersigned has also examined the Advertisement, the 'bidding requirements,' has made the examinations and investigation therein required, * * *.

The undersigned hereby accepts the invitation of the Sanitary District to submit a proposal on said work with the understanding that this proposal will not be cancelled or withdrawn.

It is understood that in the event the undersigned is awarded a contract for the work herein mentioned, and shall fail or refuse to execute the same and furnish the specified bond within thirteen (13) days after receiving notice of the award of said contract, then the sum of One Hundred Thousand Dollars (\$100,000.00), deposited herewith, shall be retained by the Sanitary District as liquidated damages and not as a penalty, it being understood that said sum is the fair measure of the amount of damages that said Sanitary District will sustain in such event.

On December 22, 1975, the Sanitary District issued an addendum that changed the type of sand filter material which was to be supplied by the contractor. During the bidding period the District's engineering department discovered that the material originally specified in the advertisement was available only out of state and consequently was extremely expensive. This addendum changed the filter material to a less expensive type that could be obtained locally.

On January 6, 1976, Wil-Fred's submitted the low bid of \$882,600 which was accompanied by the \$100,000 bid deposit and the aforementioned proposal form signed on behalf of the company by Wil-Fred's vice president. Eight other companies submitted bids on January 6. The next lowest bid was \$1,118,375, and it was made by Greco Contractors, Inc.

On January 8, 1976, Wil-Fred's sent the Sanitary District a telegram which stated that it was withdrawing its bid and requested return of its bid deposit. This telegram was confirmed by a subsequent letter mailed the same day.

On January 12, 1976, Wil-Fred's, at the request of the Sanitary District, sent a letter setting forth the circumstances that caused the company to withdraw its bid. The letter stated that upon learning the amount by which it was the low bidder, Wil-Fred's asked its excavating subcontractor, Ciaglo Excavating Company, to review its figures; that excavation was the only subcontracted trade in Wil-Fred's bid; that the following day Ciaglo informed Wil-Fred's that there had been a substantial error in its bid, and therefore it would have to withdraw its quotation since performing the work at the stated price would force the subcontractor into bankruptcy; that Wil-Fred's then checked with other excavation contractors and confirmed that Ciaglo's bid was in error; that Wil-Fred's had used Ciaglo as an excavating subcontractor on many other projects in the past, and Ciaglo had always honored its previous quotations; that Ciaglo had always performed its work in a skillful fashion; that because of these facts Wil-

Fred's acted reasonably in utilizing Ciaglo's quoted price in formulating its own bid; and that with the withdrawal of Ciaglo's quotation Wil-Fred's could not perform the work for \$882,600.

On February 2, 1976, Wil-Fred's received a letter from Thomas W. Moore, the Sanitary District's purchasing agent. Moore's letter stated that in his opinion the reasons cited in Wil-Fred's letter of January 12 did not justify withdrawal of the bid. For this reason Moore said that he would recommend to the Sanitary District's general superintendent that the contract be awarded to Wil-Fred's at the original bid price.

At a February 20 meeting between representatives of the Sanitary District and Wil-Fred's, the company was informed that the District's board of trustees had rejected its withdrawal request, and that it would be awarded the contract. In response to this information, Wil-Fred's filed its complaint for preliminary injunction and rescission on February 26, 1976. The complaint alleged that the company would be irreparably injured if required to perform the contract at such an unconscionably low price or if forced to forfeit the \$100,000 bid deposit. The hearing on this complaint commenced on March 10, 1976.

At the hearing William Luxion, president of Wil-Fred's, testified that the company had been in business for 18 years; that Wil-Fred's did 13 to 14 million dollars worth of business in 1975; that 95% Of the company's work was done on a competitive bid basis; that Wil-Fred's never had withdrawn a competitive bid in the past; and that he personally examined the company's bid prior to its submission. Luxion further stated that he told Wil-Fred's chief estimator to review the company's quotation immediately after he was notified on January 6 that Wil-Fred's bid was more than \$235,000 below the next lowest bid. At this time he also requested that Ciaglo Company review its figures.

The reexamination by the chief estimator revealed that there was no material error in the portion of the bid covering work to be done by Wil-Fred's. However, the president of Ciaglo contacted Luxion on January 8 and stated that his bid was too low on account of an error and that, because of this, he was withdrawing his quotation. Upon receiving this information, Luxion sent the Sanitary District the telegram and letter in which he informed the District of this error, withdrew Wil-Fred's bid and requested a return of the company's bid deposit.

Lastly, Luxion testified that a loss of the \$100,000 security deposit would result in the company's loss of bonding capacity in the amount of two to three million dollars; that Wil-Fred's decided not to attempt to force Ciaglo to honor its subcontract because the company felt that Ciaglo was not financially capable of sustaining a \$150,000 loss; and that he was aware of the Sanitary District's cost estimate before Wil-Fred's submitted its bid. However, Luxion

stated that he took the addendum changing the filter material into account when calculating the price of the bid and concluded that this alteration would result in a cost savings of over \$200,000.

Dennis Ciaglo, president of Ciaglo Excavating, Inc., also testified on behalf of Wil-Fred's and stated that prior to January 6, 1976, his company submitted a quote of \$205,000 for the removal of the existing material in the sand beds, for digging trenches for the new pipe and for spreading the new filter materials. Ciaglo further stated that a representative of Wil-Fred's called him on January 6 and asked him to review his price quotation. During his examination the witness discovered that he underestimated his projected costs by \$150,000. Ciaglo said that this error was caused by his assumption that heavy equipment could be driven into the beds to spread the granular fill. Although he was aware that plastic pipes were to be used in the beds, Ciaglo still presumed that heavy equipment could be employed because the specifications called for the utilization of standard construction equipment. Ciaglo first learned that the plastic pipes would not support heavy equipment when, as part of his review of the price quote, he contacted the pipe manufacturer.

Ciaglo testified additionally that his company probably would have to file for bankruptcy if forced to take a \$150,000 loss; that Ciaglo Excavating Co. had never before withdrawn a price quotation given to Wil-Fred's or any other company; and that in his opinion the change in the filter material called for by the second addendum would cause a \$300,000 reduction in "the cost of the material for the bids * * *."

Only one witness testified for the Sanitary District. Leslie Dombai, a registered structural engineer for the District, stated that the Sanitary District's cost estimate was based directly upon the expense of the material specified in the advertisement, and he confirmed that the filter material was changed because the type initially called for was expensive and was not available locally. However, Dombai claimed that this substitution increased the District's original cost estimate by \$40,000.

By bidding on the Sanitary District's rehabilitation project, Wil-Fred's made a binding commitment. Its bid was in the nature of an option to the District based upon valuable consideration: the assurance that the award would be made to the lowest bidder. The option was both an offer to do the work and a unilateral agreement to enter into a contract to do so. When the offer was accepted, a bilateral contract arose which was mutually binding on Wil-Fred's and the Sanitary District. (*People ex rel. Department of Public Works and Buildings v. South East National Bank of Chicago* (1st Dist. 1971), 131 Ill.App.2d 238, 240, 266 N.E.2d 778, 779-80; 11 Williston on Contracts s 1441 (3rd ed. Jaeger 1968).) When Wil-Fred's attempted to

withdraw its bid, it became subject to the condition incorporated in the proposal form furnished by the Sanitary District. Under this condition, the company's bid deposit was forfeited when it refused to execute the contract within the specified time period.

The principal issue, therefore, is whether Wil-Fred's can obtain rescission of its contract with the Sanitary District because of its unilateral mistake. Wil-Fred's argues that the mistake was material to the contract; that this error was directly caused by the Sanitary District's misleading specifications; that the Sanitary District did not alter its position in reliance upon the erroneous bid because the company promptly notified the District of the mistake; and that under these circumstances it would be unconscionable to enforce the contract or to allow the Sanitary District to retain the security deposit.

As a general rule, it is often said that relief will not be granted if but one party to a contract has made a mistake. (*Department of Public Works and Buildings v. South East National Bank*; Restatement of the Law of Contracts s 503 (1932).) However, Professor Williston in his treatise on contracts indicates that unilateral mistake may afford ground for rescission where there is a material mistake and such mistake is so palpable that the party not in error will be put on notice of its existence. 13 Williston on Contracts s 1578 (3rd ed. Jaeger 1970).

In Illinois the conditions generally required for rescission are: that the mistake relate to a material feature of the contract; that it occurred notwithstanding the exercise of reasonable care; that it is of such grave consequence that enforcement of the contract would be unconscionable; and that the other party can be placed in statu quo. (*Department of Public Works and Buildings v. South East National Bank*.) Evidence of these conditions must be clear and positive. *Winkelman v. Erwin* (1929), 333 Ill. 636, 640, 165 N.E. 205, 207.

If Ciaglo's misestimation was established by competent evidence, it is apparent that the error was material. This determination is based on the fact that the \$150,000 mistake represents approximately 17% Of Wil-Fred's bid. See *Department of Public Works and Buildings v. South East National Bank*.

However, the Sanitary District contends that Wil-Fred's failed to support its claim of materiality with clear and positive evidence. The District points out that neither of the plaintiff's two witnesses described the proper method for spreading the new filter material on the plastic pipes, and it argues that because of this omission Wil-Fred's failed to introduce sufficient evidence to substantiate Dennis Ciaglo's conclusion that the correct procedure would have cost \$150,000 more than the system he had planned to use.

We do not find this argument persuasive. It is manifest from the trial court's judgment order that the trier of fact decided that Ciaglo's mistake related to a material feature of the rehabilitation contract and that this condition was supported by clear and positive evidence. After carefully examining the record, we are in agreement with this finding.

Dennis Ciaglo testified that he gave Wil-Fred's a price quotation of \$205,000 for his work allotment, and he indicated that the amount of this bid was based directly upon his incorrect assumption that heavy trucks could be driven into the sand drying beds and onto the plastic pipes. This testimony is corroborated by the subcontractor's price estimate sheet which was introduced into evidence by the Sanitary District.

. . . Ciaglo's conclusion stands uncontradicted.

Furthermore, it is our opinion that the accuracy of the estimated error is supported by the fact that Ciaglo had eight years experience in the excavating business and by the fact that he confirmed this figure by checking with other contractors who had submitted bids on the same portion of the project. Under these particular circumstances we feel that Wil-Fred's produced sufficient evidence to sustain its claim of a \$150,000 error.

In addition to satisfying the first condition for rescission, Wil-Fred's has decidedly fulfilled two of the three remaining requirements. The consequences of Ciaglo's error were grave. Since the subcontractor was not capable of sustaining a \$150,000 loss, Wil-Fred's stood to lose the same amount if it performed the contract for \$882,600. Wil-Fred's will forfeit \$100,000 if the contract is enforced. A loss of \$100,000 will decrease the plaintiff's bonding capacity by two to three million dollars. It is evident, therefore, that either deprivation will constitute substantial hardship. The Sanitary District was not damaged seriously by the withdrawal of the bid. When the subcontractor's mistake was discovered 48 hours after the bid opening, Wil-Fred's promptly notified the District by telegram and declared its intention to withdraw. The rehabilitation contract had not been awarded at this time. Accordingly, the District suffered no change in position since it was able, with no great loss other than the windfall resulting from Ciaglo's error, to award the contract to the next lowest bidder, Department of Public Works.

The central question, therefore, is whether the error occurred despite the use of reasonable care. The Sanitary District asserts that the mistake itself evidences Wil-Fred's failure to use ordinary care in the preparation of its bid and argues that rescission is not warranted under such circumstances.

We cannot agree with this contention. Wil-Fred's unquestionably exercised due care when it selected Ciaglo Excavating Company as its subcontractor. Ciaglo Excavating Company had been in business for five years; its president had eight years experience in the excavating field; the company had worked for Wil-Fred's on 12 previous occasions; it had never failed to honor a prior quotation; and it had always performed its assignments in a highly skilled manner. Also, Dennis Ciaglo testified that prior to submitting his bid to Wil-Fred's, he inspected the jobsite and carefully examined the specifications with plaintiff's estimators. Taking into account the experience and preparations of the subcontractor, the prior business dealings between the two companies and the high quality of Ciaglo Excavating Company's past performance, we conclude that Wil-Fred's was justified in relying on the subcontractor's quotation in formulating its own bid.

Similarly, we feel that Wil-Fred's exercised reasonable care in the preparation of its portion of the total bid. The plaintiff made two separate reviews of its price quotation. The first was conducted prior to the bid's submission, and it took into account the addendum that substituted a cheaper filter material for the type originally called for by the specifications.³ The second examination was made immediately after Wil-Fred's president learned that his company's bid was the lowest quotation. It revealed that plaintiff had not erred in estimating expenses for its part of the rehabilitation project.

The question of due care is a factual question to be determined by the trial court, and such determination will not be disturbed unless it is against the manifest weight of the evidence. (*Santucci Construction Co. v. County of Cook* (1st Dist. 1974), 21 Ill. App.3d 527, 532, 315 N.E. 2d 565, 569.) For the aforementioned reasons we feel that the record supports the trial court's finding of due care on the part of Wil-Fred's.

The Sanitary District asserts that even if due care was exercised by Wil-Fred's, Illinois courts have granted relief only in cases where the bid has contained a clerical or mathematical error. Defendant argues that the trial court's grant of rescission should not be upheld because Ciaglo's mistake was not a factual error but an error in business judgment.

³ We believe that the change in filter material explains why the Sanitary District's cost estimate was \$374,000 higher than Wil-Fred's quotation. Plaintiff's witnesses testified that the substitution of cheaper material would result in a cost savings of \$200,000 to \$300,000. Additionally, the Sanitary District's engineer stated that the District's estimate was based directly upon the cost of the material specified in the advertisement, and he admitted that the initial type of filter material was very expensive because it was not available locally. In view of this testimony we must conclude that the large discrepancy would not necessarily have alerted Wil-Fred's president to the fact that there was a substantial error in his company's bid.

Regarding the District's argument, it is the opinion of this court that Ciaglo's error amounts to a mixed mistake of judgment and fact. Ciaglo's belief that the plastic pipes would support heavy trucks was judgmental in nature and in this narrow sense his mistake was one of business judgment. However, his belief was predicated on a misunderstanding of the actual facts occasioned, at least in part, by his reliance on the Sanitary District's misleading specifications which stated that all pipes had to be able to withstand standard construction equipment.

Generally, relief is refused for errors in judgment and allowed for clerical or mathematical mistakes. (Annot. 59 A.L.R. 827; 80 A.L.R. 586; 52 A.L.R. 2d 792.) Nonetheless, we believe, in fairness to the individual bidder, that the facts surrounding the error, not the label, *i.e.* "mistake of fact" or "mistake of judgment," should determine whether relief is granted. *White v. Berrenda Mesa Water District of Kern County* (1970), 7 Cal.App.3d 894, 907, 87 Cal. Rptr. 338, 347-348.

The testimonial evidence reveals that Wil-Fred's acted in good faith and that Ciaglo's error occurred notwithstanding the exercise of reasonable care. Furthermore, it was established that Wil-Fred's quotation was \$235,775 lower than the next lowest bid. It is apparent that such a sizable discrepancy should have placed the Sanitary District on notice that plaintiff's bid contained a material error. Accordingly equity will not allow the District to take advantage of Wil-Fred's low offer.

We are aware of the importance of maintaining the competitive bidding system which is used in the letting of municipal construction contracts. Consequently we do not mean to imply by affirming the trial court's order that a bidder who has submitted the lowest quotation on a municipal contract may cavalierly disregard the contract's irrevocability clause and seek rescission. Allowing such action would be unfair to the other bidders and would result in the destruction of the system's integrity. However, we are certain that the courts of this state are capable of preventing such a result by refusing to grant rescission where, unlike the present circumstances, the facts do not justify relieving the lowest bidder from his bid. See *Calnan Co. v. Talsma Builders, Inc.* (1977), 67 Ill. 2d 213, 10 Ill. Dec. 242, 367 N.E. 2d 695, in which our supreme court, although not dealing with a municipal construction contract, recently denied rescission of a plumbing subcontract where the subcontractor failed to include the cost of the entire water supply system in its bid, a concededly material feature of the subcontract. The supreme court held that the subcontractor had not exercised reasonable care by failing to utilize its own bid preparation review system and by not discovering its error until four months after acceptance of its bid. The court also found that the general contractor could not be placed in status quo since work had begun and the general contractor had no options; it either had to

account for the error (\$31,000) or had to negotiate another subcontract, at a greater cost with lack of continuity in work.

We note but do not consider the Sanitary District's other arguments which we find to be without merit.

For the above stated reasons, the trial court's order granting rescission and the return of Wil-Fred's security deposit is affirmed.

Affirmed.

STAMOS, P. J., and PUSATERI, J., concur.

Notes and Questions

1. Reread section 153 of the Restatement and compare it to the test used in *Wil-Fred's Inc.* Which approach makes more sense? If the court applied the Restatement (Second) provisions would the outcome of the case been the same? While there are significant variants in the exact tests that courts use in considering unilateral mistake claims, they all apply high thresholds, which means that the mistaken party rarely wins. How might you explain this tendency on the part of courts?
2. What role did the language of the bidding contract play in this case? Would you have drafted that contract differently? How would you compare the court's treatment of the liquidated damages provision in the agreement to the treatment of the "as is" provision in *Lenawee County*?
3. What are the potential risks of allowing bidders to withdraw their erroneous bids? Specifically, will such a rule encourage or discourage bidding?