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# THE EFFECT OF MISUNDERSTANDING ON CONTRACT FORMATION AND REFORMATION UNDER THE RESTATEMENT OF CONTRACTS SECOND

George E. Palmer\*

THE presence of misunderstanding at the time of an apparent agreement creates difficult problems in the law of contract formation and equally difficult problems when the apparent agreement is in writing and reformation is sought. The rules formulated in the original *Restatement of Contracts* are unsatisfactory in both areas. The preparation of the *Restatement Second*, which is now under way for contracts, includes changes in the rules of contract formation but the changes emerging are no more satisfactory than the original rules. The current version of the *Restatement Second*, contained in *Tentative Draft No. 1*,<sup>1</sup> accepts the objective theory of contract formation,<sup>2</sup> as did the original *Restatement*,<sup>3</sup> but the attempt to formulate general rules based on that theory contains two principal shortcomings that seem almost at cross purposes. In one aspect it limits doctrine too narrowly, so as to lead to the conclusion that there is no contract in some situations in which a contract should and almost certainly will be found. In another aspect it extends doctrine beyond permissible limits, so as to lead to a finding of contract in instances where there should be none.

For immediate purposes each of these statements is best explained by an example:

(1) If A, the owner of two tracts of land, intends to offer Blackacre for sale to B, but by mistake his writing transmitting the offer describes Whiteacre, and B accepts in the honest belief that the offer means what it says, there should be a valid contract to sell Whiteacre and there undoubtedly is under most modern decisions.<sup>4</sup> Yet a

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1. RESTATEMENT (SECOND), CONTRACTS (Tent. Draft No. 1, 1964) [hereinafter cited as TENTATIVE DRAFT].

2. *Id.* § 2, comment *b*: "The phrase 'manifestation of intention' adopts an external or objective standard for interpreting conduct; it means the external expression of intention as distinguished from undisclosed intention."

3. RESTATEMENT, CONTRACTS § 20, comment *a* (1932): "Not mutual assent but a manifestation indicating such assent is what the law requires."

4. An example of the general approach is furnished by *Kipe Offset Process Co. v. United States*, 122 F. Supp. 343 (S.D.N.Y. 1954). In cases involving misunderstanding as to the identity of land described in a contract of sale, it has usually been assumed that there was a contract and the case has turned on whether the mistaken party

literal application of the *Tentative Draft* would lead to the conclusion, probably unintended, that there is no contract. In part, the fault lies in a failure to take sufficient account of the effects of mistake, a fault that appears also in the efforts of leading writers to formulate general rules governing contract formation.<sup>5</sup>

(2) If A intends to and does offer to sell Blackacre to B, but B accepts in the belief that the offer describes Whiteacre and A knows of this belief, A cannot hold B to a contract for the sale of Blackacre. Nor is there a contract for the sale of Whiteacre under the present *Restatement*, a position believed to be preferable as a general formulation of contract doctrine, although the facts of a particular case may justify holding A to such a contract on the basis of estoppel. In the *Tentative Draft* of the *Restatement Second*, however, the rules are so formulated as to lead to the automatic finding of a contract to sell Whiteacre. This may represent an attempt to bring about a correspondence between the rules relating to contract formation and those relating to reformation, for, under the present *Restatement*, there is a striking lack of correspondence. As will be suggested later, the proper corrective is to change the rules governing reformation.<sup>6</sup>

Both of these shortcomings in the *Tentative Draft* seem to stem in part from an unwise and fruitless attempt to eliminate all legal distinctions between ambiguous and unambiguous language, or at least all distinctions phrased in those terms.

## I. THE NEED FOR EXTENDING THE SCOPE OF CONTRACT

### A. *The Restatement Second*

In section 21A of the *Tentative Draft*, the first subsection reads in part as follows: "There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and . . . neither party knows or has reason to know the meaning attached by the other."<sup>7</sup> In the first example

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(that is, the party whose understanding differed from that clearly expressed) was entitled to rescission. In the following cases rescission was denied: *Beebe v. Birkett*, 109 Mich. 663, 67 N.W. 966 (1896); *Wheeler v. Holloway*, 276 S.W. 653 (Tex. Comm'n App. 1925). In *Fleischer v. McGehee*, 111 Ark. 626, 163 S.W. 169 (1914), rescission was granted. In *Goodrich v. Lathrop*, 94 Cal. 56, 29 Pac. 329 (1892), it was held that the mistaken party was entitled to rescission unless he was negligent.

5. 1 CORBIN, CONTRACTS § 106 (1963); see note 13 *infra*.

6. See text accompanying notes 62-74 *infra*.

7. The full text of § 21A is as follows:

(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

used above, A did not know that B meant to buy Whiteacre, and in order to bind A to a contract for the sale of that tract, it would be necessary under the proposed rule to find that A had "reason to know" of B's understanding. In fact, A is bound in accordance with B's understanding because he used words that clearly and unambiguously had the meaning B gave to them. There is no need to carry the matter any further on the issue of contract formation. This has been generally settled in American law for a long time; as the Massachusetts court said in 1880, a "party cannot escape the natural and reasonable interpretation which must be put on what he says and does, by showing that his words were used and his acts done with a different and undisclosed intention."<sup>8</sup> In some instances a party's undisclosed intent differs from that expressed because of a mechanical error in communication, as in the first example. But the same misunderstanding can occur in other ways, with the same result, as where the writing clearly describes Whiteacre but the purchaser has looked at the wrong lot and thinks he is buying Blackacre. The rule formulated in the *Tentative Draft*, in terms of "reason to know," is wholly inappropriate in such cases.

An attempt is made in the *Tentative Draft* to give meaning to the "reason to know" test, by stating that a person "has reason to know a fact, present or future, if he has information from which a person of ordinary intelligence would infer that the fact in question does or will exist."<sup>9</sup> This presupposes a knowledge of facts which is lacking when a party is acting under the influence of mistake. In the first example, A's mistake meant that he did not possess the necessary information from which a person of ordinary intelligence would infer that B intended to purchase Whiteacre. There is no sensible meaning that can be given to the words "reason to know" so as to find a basis for contract within the scope of the rule stated in section 21A; yet, as previously suggested, such a reading of the rule is probably not intended. This is indicated by the following illustration used in the *Tentative Draft*: "A writes an offer to B, which he encloses in an envelope, addresses and stamps.

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(b) each party knows or each party has reason to know the meaning attached by the other.

(2) The manifestations of the parties are operative in accordance with the meaning attached to them by one of the parties if

(a) that party does not know of any different meaning attached by the other, and the other knows the meaning attached by the first party; or

(b) that party has no reason to know of any different meaning attached by the other, and the other has reason to know the meaning attached by the first party.

8. *Stoddard v. Ham*, 129 Mass. 383, 385-86, 37 Am. Rep. 369, 370 (1880).

9. TENTATIVE DRAFT § 21, comment b. Compare RESTATEMENT (SECOND), AGENCY § 9, comment d (1958); RESTATEMENT (SECOND), TORTS § 12, comment a (1965).

Shortly afterwards, he decides not to send the offer, but by mistake he deposits it in the mail. It is delivered to B, who accepts the offer. There is a contract unless B knows or has reason to know of A's error."<sup>10</sup> The conclusion is entirely proper but it cannot be reached under any sensible meaning of the "reason to know" formula. Yet, under the *Tentative Draft*, the situation must be worked out in terms of that formula.<sup>11</sup> Again, the offeror (A) lacks the relevant information that would give him reason to know, and again the stated rule fails to take sufficient account of the effects of mistake.

The proper inquiry in the last illustrative case, in the Blackacre-Whiteacre illustration, and in cases of misunderstanding generally, is whether one party should be held to the understanding of the other, or whether each is entitled to adhere to his own version of the situation. In the two illustrations, there was an appearance of mutual assent to terms containing no ambiguity, and A's conduct caused B's belief that the reality corresponded with this appearance, whereas no act of B contributed to A's opposite belief. In such circumstances there is a contract and if the mistake has any legal significance it is to provide a basis for rescission. Rescission in such cases is kept within narrow limits.<sup>12</sup>

This language of the *Tentative Draft* is wholly new for cases involving no ambiguity. A "reason to know" test is used in the present *Restatement*, but it is limited to instances of ambiguity or uncertainty. The proposed change shows the influence of Corbin's writings, and seems to be the product of a misguided effort to formulate doctrine and solve actual problems without reference to whether the words and acts serving as means of communication between the parties were ambiguous or unambiguous. Thus Corbin states that, in cases of misunderstanding, one party will be held to the understanding of the other "if (and only if) the one party knew or had reason to know the intention and understanding of the other and the latter had no reason to know that a difference existed."<sup>13</sup>

10. TENTATIVE DRAFT § 21, Illustration 3.

11. The illustration is used under § 21 of the TENTATIVE DRAFT, which formulates the general rule as follows: "(2) The conduct of a party is not effective as a manifestation of his assent unless he intends to engage in the conduct and knows or has reason to know that the other party may infer from his conduct that he assents." As applied to the illustration, A is not bound under the language of section 21 unless he has "reason to know" that B may infer assent from his conduct. In fact, he is bound in any event unless, as the illustration states, B knows or has reason to know that A did not intend to contract.

12. PALMER, MISTAKE AND UNJUST ENRICHMENT 45 (1962), and cases cited note 4 *supra*.

13. 1 CORBIN, CONTRACTS § 106, at 476 (1963). Essentially the same position is stated in slightly different phrasing in §§ 104 and 107. In § 107 it is said that if "there has in fact been no such 'meeting of the minds,' the court will not hold a party bound

The statement that there is a contract if such circumstances are present will be examined in Part II. The statement that there is a contract *only* if they are present is not supported by the cases and is in conflict with good policy.

If a person intends to offer property for sale for \$1,000 but due to the error of a clerk in his office the telegram transmitting the offer reads \$800, an acceptance by the offeree without suspicion of mistake will form a contract for a price of \$800.<sup>14</sup> To say that this is because the offeror had "reason to know" the offeree's understanding is to make the supposed requirement meaningless. The controlling fact is that the offeree gave the words or symbols their usual meaning; on the issue of contract formation the offeror will be held to that meaning.

The "reason to know" concept is sometimes useful, but its role needs to be understood. If the *offeree* had "reason to know" that a mistake had been made in the telegraphed offer, this would lead a court to hold either that there was no contract,<sup>15</sup> or that the offeror was entitled to rescind the contract for mistake.<sup>16</sup> The concept may be significant also when language can reasonably be given more than one meaning and the parties followed different meanings; one of them may be held to the sense in which the other used

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by a contract varying from his own understanding unless his words and conduct were such that he had reason to know that the other party would be and was in fact misled." As the universal rule which it purports to be, this is not acceptable. No cases are cited in direct support of either this statement or that quoted in the text above, but a similar statement in § 104 is accompanied by a citation of nine cases, none of which provides the necessary support. *Id.* § 104 n.79.

The influence of Corbin on the *Tentative Draft* is suggested in recent articles by both Professor Corbin and Professor Braucher, who is the Reporter for the *Restatement of Contracts Second*. Braucher, *Offer and Acceptance in the Second Restatement*, 74 *YALE L.J.* 302 (1964); Corbin, *Sixty-Eight Years at Law*, 13 *KAN. L. REV.* 183, 187 (1964).

14. *Cargill Comm'n Co. v. Mowery*, 99 Kan. 389, 161 Pac. 634 (1916); *Ayer v. Western Union Tel. Co.*, 79 Me. 493, 10 Atl. 495 (1887). Whether the contract will be rescinded at suit of the party harmed by the error is another matter. In the *Cargill* case, the court intimated that rescission would have been available except for the fact that the other party had changed position in reliance on the contract. A seller used the wrong code words in offering to sell wheat so that the telegram as transmitted to and accepted by the buyer offered 30,000 to 35,000 bushels, whereas the seller intended to offer 3,000 to 3,500 bushels. Because the buyer had in turn sold a like amount of wheat in reliance on the contract, it was held that the offer as transmitted was binding on the seller. Except for the change of position, the court said that the error "could have been corrected." There is no basis for correction in the law of reformation; presumably the court had in mind accomplishing the same result by rescinding unless the buyer agreed to a correction.

15. *Mummenhoff v. Randall*, 19 Ind. App. 44, 49 N.E. 40 (1898); 1 *WILLISTON, CONTRACTS* § 94 (3d ed. 1957); see note 11, *supra*.

16. *Hudson Structural Steel Co. v. Smith & Rumery Co.*, 110 Me. 123, 85 Atl. 384 (1912).

the words if he had reason to know of it.<sup>17</sup> The presence of a reason to know is not requisite, however, to a finding of contract in cases where there is no significant ambiguity. Professor Corbin's attempt to universalize the "reason to know" test so as to cover cases in which there is no ambiguity seems to arise from a refusal to recognize that there are circumstances in which, for the purpose at hand, language has only one reasonable meaning. "That assumption is not made herein," he says in his treatise,<sup>18</sup> although in fact at several points he states legal propositions in exactly those terms.<sup>19</sup> One may recognize that language has meaning only in the minds of men and yet insist that there are circumstances in which the words "eight hundred dollars" have only one reasonable meaning, found for example in standard usage. When this occurs and one party adopts that meaning, the other will be held to it even though, because of mistake or for some other reason, he had a different understanding.

At other points in his treatise Corbin follows the direction suggested by Wigmore, who sought to formulate contract doctrine by analogy to the law of tort through attributing liability to fault.<sup>20</sup> Thus Corbin writes that in cases of misunderstanding it is "very clear that no contract should be held to exist unless one of the parties so negligently expressed himself that the other was caused reasonably to believe that agreement existed."<sup>21</sup> In fact, it is very

17. 1 WILLISTON, CONTRACTS § 95 (3d ed. 1957). Some uses of the concept in this setting are discussed in the text accompanying notes 43-51 *infra*.

18. 1 CORBIN, CONTRACTS § 104 n.79 (1963).

19. In the text of § 104 Corbin writes: "If the meaning that either one of them gave to the words was the only reasonable one under the existing circumstances, as the other party has reason to know, the latter is bound by that meaning and there is a contract accordingly." 1 *id.* § 104, at 464. If the "reason to know" qualification were omitted, the statement would be in accord with the views expressed herein. In § 599, Corbin again recognizes that a single meaning may be "the only reasonable one under the circumstances." 3 *id.* § 599, at 597.

20. Wigmore concluded that one party should be held to the understanding of the other when that understanding was "the consequence, reasonably to have been anticipated under all the circumstances" of the first party's acts of expression. The test, he added, is that of "*negligence, i.e.* responsibility resting on a volition having consequences which ought reasonably to have been foreseen." 9 WIGMORE, EVIDENCE § 2413, at 39 (3d ed. 1940).

21. 3 CORBIN, CONTRACTS § 599, at 593 (1960). There is a temptation to accept the negligence test as a universal because it serves to explain the decisions holding there is no contract where a party signing an instrument is mistaken as to its essential nature. In *Ricketts v. Pennsylvania R.R.*, 153 F.2d 757, 760 (2d Cir. 1946), Judge Learned Hand explained the theory of liability this way: "The theory upon which a document binds one who signs it, but who does not read it, is that either he accepts it whatever may be its contents, or that he has been careless in choosing his informant." Whatever may be the merits of this theory, these cases have been dealt with in their own terms, and the statement does not provide an adequate general theory of contract liability. PALMER, *op. cit. supra* note 12, at 79-80.

clear that contract is not this narrowly limited, unless one is prepared to say that a party is necessarily negligent when he makes a mistake. The equation is not acceptable, but if it were accepted this would merely eliminate negligence as an independent requirement. When one party expresses assent to the terms as written and the normal meaning of the terms is also the meaning intended by the other party, this ordinarily will be sufficient to result in a contract having that meaning. The first party is held to the justified expectation that his act created in the other, nor is this limited to cases in which he was careless, or had reason to know of that expectation, or reasonably should have anticipated it. This is not to say that negligence is irrelevant, for clearly this is not true; but negligence is not a necessary condition of liability as Corbin's statement would make it. Wigmore's insight is important, but it is no universal solvent. Contract doctrine is based less on moral considerations than on a need for security of business arrangements.

The *Tentative Draft of the Restatement Second*, in explaining its blackletter rules phrased in terms of reason to know, discloses the same inadequacy as Corbin's text by asserting that the "basic principle governing material misunderstanding is . . . [that] no contract is formed if neither party is at fault . . ." <sup>22</sup> This is not an acceptable principle, basic or otherwise. There are times when misunderstanding of ambiguous terms means there is no contract, and if it is useful to do so the cases could be described by saying neither party was at fault. But there are other times when neither party was at fault yet a contract will be found because in the circumstances one party will be held to the understanding of the other, although he did not share it. The most important circumstance is the degree of clarity and definiteness in the words and acts constituting the communications between the parties. The attempt to formulate doctrine without reference to this factor is bound to fail. <sup>23</sup>

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22. TENTATIVE DRAFT § 21A, comment *d*.

23. The distinction between clear and ambiguous language is so widely recognized that full documentation is unnecessary. One recent case will illustrate the point. In an apparent agreement for the sale of "chicken" the parties had given different meanings to the word, the buyer intending broilers and the seller intending chicken in the generic sense, including stewing chicken. When different usages were established, the court decided that the buyer could not hold the seller to a contract to sell broilers. But it would have been otherwise, Judge Friendly observed, if the word had the single meaning asserted by the buyer: the seller's "subjective intent would not be significant if this did not coincide with an objective meaning of 'chicken.'" *Frigalimont Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116, 121 (S.D.N.Y. 1960).



### B. *The Present Restatement*

The present *Restatement* divides situations involving misunderstanding into two categories, those in which the relevant words and acts have only one reasonable meaning in the circumstances, and those in which they have more than one reasonable meaning.<sup>24</sup> The latter are described as cases in which the manifestations of intention are "uncertain or ambiguous,"<sup>25</sup> and for convenience will be referred to here as cases of ambiguity. The categories are drawn too sharply and because of this some of the consequences are unsatisfactory.

Where the words and acts have only one reasonable meaning in the circumstances, the *Restatement* asserts that there is a contract in accordance with that meaning unless one party "knows that the other does not intend what his words or other acts express."<sup>26</sup> This is satisfactory if the first party intends the "one reasonable meaning," but the rule is not so limited. The section is drawn with extreme rigidity, by providing that, where language is unambiguous, the undisclosed intention of a party is immaterial, the *only* exception being when the other party knows of the discrepancy between language and intention. The application of this rule would produce a number of curious and quite unacceptable results. For example, if one party had one unreasonable meaning and the other had a different but equally unreasonable meaning, the rule would produce a contract that neither of them intended. In situations involving mistake in expression, this result is not as unlikely as it sounds. If, for example, A intends to sell Blackacre and B intends to buy Whiteacre, but the writing in which they attempt to express their supposed agreement mistakenly describes Greenacre, there is a valid contract for the sale of Greenacre under the language of the *Restatement*. It is not likely that a court would carry the objective theory this far, since the reasons underlying that theory are not present and the result makes no sense in a controversy between the parties.<sup>27</sup> The theory aims to protect the just expectations of

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24. RESTATEMENT, CONTRACTS § 71 (1932).

25. *Id.* § 71(a).

26. *Id.* § 71(c).

27. Corbin uses this example and observes that such a decision would "hold justice up to ridicule." 3 CORBIN, CONTRACTS § 539, at 81 (1960). The conclusion in the text is forced not only by the language of § 71, but seems also the result contemplated under § 230, which deals with integrated contracts, where it is said in comment *a* that "the objective viewpoint of a third person" is the standard for interpretation of such contracts. Although the blackletter rule is put in terms of interpretation, the first illustration under the section shows that the rule is meant to apply to instances of misunderstanding. This follows the position taken by Williston who wrote:

parties to an attempted contract, but neither party expected a contract for the sale or purchase of Greenacre. Under the proposed *Restatement Second*, this defect in the present *Restatement* is eliminated, and, in the case supposed, there would be no contract.

When the relevant words and acts are ambiguous the present *Restatement* provides that, if one party "has no reason to know that they may bear a different meaning to the other party from that which he himself attaches to them, his manifestations are operative in the formation of a contract only in the event that the other party attaches to them the same meaning."<sup>28</sup> The draftsmanship is inadequate since it is only by implication that the statement is limited to cases in which the "other party" actually has a different meaning—limited, that is, to cases of misunderstanding as distinguished from those in which there is mere lack of agreement. Thus, where the parties reach apparent agreement on the sale of goods shipped from Bombay on the steamer "Peerless" and there are two steamers of that name, the existence of a contract does not depend upon an agreement on steamer number one. If one party has number one in mind, whereas the other knows nothing about either and does not care which steamer the goods arrive on, there is almost certainly a contract if the court can give meaning to the ambiguous language (or, alternatively, find that the specific ship was not a vital part of the contract). Only in the case of misunderstanding is there a serious issue of validity,<sup>29</sup> and there was no misunderstanding on the facts just described, merely a lack of agreement on one element. One of the meanings of the objective theory is that there need not be agreement in such a case. The parties intended a contract, there was an expression of mutual assent, and it is enough that the law is able to give a reasonable meaning to the expression. This shortcoming in the present *Restatement* is reme-

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Where there is such a justifiable difference of belief concerning the sense in which the parties used the words as would prevent the existence of a contract had the negotiations been informal . . . [in an integrated contract] the court will interpret the writing and give the meaning to it which under the circumstances the court conceives the language ought locally to bear. This meaning conceivably may be different from that which either party justifiably attached to the words.

3 WILLISTON, CONTRACTS § 607, at 1741, 1743 (rev. ed. 1936). In this broad form the statements are unacceptable. See generally 3 CORBIN, CONTRACTS § 539 (1960).

28. RESTATEMENT, CONTRACTS § 71(a) (1932).

29. The facts are of course based on the well-known case of *Raffles v. Wichelhaus*, 2 H. & C. 906, 159 Eng. Rep. 375 (Ex. 1864). The facts are used hypothetically in the *Restatement* as illustration 1 under § 71, with no attempt to limit discussion to instances of misunderstanding.

died in the *Tentative Draft of the Restatement Second*, in which the relevant section applies only to cases of misunderstanding.<sup>30</sup>

The rule of the present *Restatement* applies to all instances of ambiguity without recognition of the possible significance of differences in degree. There is only one basic division: that between words and acts having only one reasonable meaning and those having more than one reasonable meaning. Linguistically the two categories cover everything, but as a description of human experience they are inadequate. There are degrees of reasonableness or unreasonableness in the meanings that may be given to words or other acts. As doubts increase over whether the meaning given them by a party was the only reasonable meaning in the circumstances, other factors are sought out in determining whether the other party should be held to that meaning when he did not share it. The court may say that A had reason to know B's understanding when all it means is that, although the words and acts were not as clear as they might have been, they pointed strongly enough in the direction of B's understanding to make it controlling.<sup>31</sup> The court may take into account which party used the words<sup>32</sup> and the type of transaction in which they were used.<sup>33</sup>

In a New York case, *United States Rubber Co. v. Silverstein*,<sup>34</sup> a father told the plaintiff that he would be "good for any sales" the plaintiff made to his son Louis, who had recently gone into business. The plaintiff made sales to Louis and billed them to the father in a statement that also included charges for goods sold to the father.<sup>35</sup> When the father's second son, Moses, also went into business on his own, the plaintiff made sales to him, and at first charged them directly to Moses. The father was not satisfied with the bills submitted to him that included goods sold to Louis, and wrote plaintiff the following letter:

Enclosed find check for the three above bills. Please do not send my statements and my son's statements together. Send him his and

30. See TENTATIVE DRAFT § 21A, which is the proposed substitute for the present § 71.

31. *C. W. Craig & Co. v. Thomas S. Jones & Co.*, 200 Ky. 113, 252 S.W. 574 (1923). See also *Castor v. Coppock*, 211 F.2d 136 (8th Cir. 1954); *Star-Chronicle Pub. Co. v. New York Evening Post, Inc.*, 256 Fed. 435 (2d Cir. 1919).

32. *United States Rubber Co. v. Silverstein*, 229 N.Y. 163, 128 N.E. 123 (1920).

33. *St. Lucie County Bank & Trust Co. v. Aylin*, 94 Fla. 528, 114 So. 438 (1927). The question was to determine the scope of a contract. A bank loan agreement was construed strictly against the bank because it drew the agreement and was in a position to dictate its terms.

34. 229 N.Y. 163, 128 N.E. 123 (1920).

35. This appears somewhat more clearly in the opinion of the trial court. *United States Rubber Co. v. Silverstein*, 161 N.Y. Supp. 369 (Sup. Ct. 1916).

me mine. They do business for themselves (*sic*), and therefore send them separate statements, but I am good for what they buy.<sup>36</sup>

The plaintiff thereafter sold goods to Moses on credit in the belief that he was covered by the father's guaranty, and when payment was not made suit was brought against the father. The father testified that he intended the word "they" to refer to Louis and his sister, who were in business together. It was held that the case was one for the jury, and the jury's finding for the plaintiff was sustained.

If the testimony was believed there was a misunderstanding existing at the time the guaranty was made or acted upon. Strictly, no problem of validity of the contract was presented, only its scope, but the solution and the factors bearing on it should be the same in either event. From a reading of the letter against its background it seems evident that the letter cannot properly be regarded as having only "one reasonable meaning." This would pin a great deal on the use of the word "they," but, as Judge Cardozo once said, "in construing the common speech of man, [the law] is not so nice in its judgments" as this.<sup>37</sup> Under the logic of the *Restatement*, therefore, the letter falls within the category of "uncertain or ambiguous" language.<sup>38</sup> If the issue were one of misunderstanding going to the validity of the contract, it would be necessary under the *Restatement* to determine whether either party knows or has "reason to know" that the words are "uncertain or ambiguous," or whether both do. In this case it seems that the parties are in the same boat: either they both know or have "reason to know" or neither does. If neither, there is no contract. If both, there is no contract. Clearly there is something wrong with this system. It fails to take account of degrees of ambiguity as well as other factors that may be relevant to the decision.

For cases involving ambiguity the *Tentative Draft*, with one exception,<sup>39</sup> offers about the same solutions as the present *Restatement*. The draft does not mention ambiguity as a relevant factor, but that does not eliminate its occurrence—it merely means that there is no intelligent effort to deal with the occurrence. The rules formulated apply to instances of ambiguity whether or not the Re-

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36. 229 N.Y. at 169-70, 128 N.E. at 123.

37. *Moran v. Standard Oil Co.*, 211 N.Y. 187, 197, 105 N.E. 217, 221 (1914).

38. § 71, comment *a*.

39. The exception is a case in which one party knows the understanding of the other, whereas the latter does not know but only has "reason to know" the understanding of the first. Under the *Tentative Draft*, there is a contract in accordance with the understanding of the second party. In the present *Restatement* the situation seems to be uncovered, although possibly § 71(c) would be read to mean that there is no contract.

stators recognize its existence or relevance. The present *Restatement* at least recognizes the relevance of ambiguity, but, as already pointed out, ignores the significance of differences in degree. The *Tentative Draft* produces the same lack of discrimination by ignoring ambiguity entirely.

In the *Silverstein* case, nothing had occurred before the letter was sent to suggest to the father that the plaintiff was expecting a guaranty of the second son's obligations, from which one might well conclude that neither party had "reason to know the meaning attached by the other" to the father's promise. If this were the conclusion there would be no contract under the *Tentative Draft*, which contains the language just quoted.<sup>40</sup> Very little room is left under this formula for finding that in the whole context the plaintiff's understanding was more reasonable than that of the defendant, and that this may be enough to justify holding the defendant to the plaintiff's understanding, especially when this is combined with the fact that the misleading words were used by the defendant.<sup>41</sup> The court in *Silverstein* repeated the "reason to know" formula found in earlier New York opinions, but the basic approach of the court is revealed in Judge Cardozo's statement that the "jury were to fix the meaning in the light of all the circumstances."<sup>42</sup>

The "reason to know" test, whether as formulated in the present *Restatement* or in the *Tentative Draft*, is inadequate even for cases of ambiguity. It becomes seriously deficient when, as in the *Tentative Draft*, it is extended to *all* cases of misunderstanding, without regard to the clarity of the communications between the parties, and is made almost the sole test of contract liability.

### C. "Reason to Know"—Its Development in New York Cases

It will be useful to consider some of the applications of the "reason to know" formula in a single jurisdiction. In 1843, a New York court advanced "Dr. Paley's rule" for the interpretation of contracts: "Where the terms of a promise admit of more senses than one, the promise is to be performed in that sense in which the

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40. TENTATIVE DRAFT § 21A(1)(a). The statement in the text assumes that in *Silverstein* the issue went to the existence of the contract rather than its scope.

41. If it were decided that the father did have reason to know the plaintiff's understanding, the *Tentative Draft* contains a significant change since the test it proposes is whether the plaintiff also had reason to know the meaning attached by the father to the words he used. TENTATIVE DRAFT § 21A(1)(b). If the plaintiff did have reason to know, there is again no contract, but at least there is some opportunity to find otherwise. The test of § 71(b) of the present *Restatement* is whether each party had reason to know that the words were ambiguous, and, as suggested earlier, both parties seem to be in the same position on this question.

42. 229 N.Y. at 171, 128 N.E. at 124.

promiser apprehended at the time the promisee received it."<sup>43</sup> Some twenty years later the Court of Appeals restated Dr. Paley's rule in the form still found in the New York decisions: "It is a rule of law, as well as of ethics, that where the language of a promisor may be understood in more senses than one, it is to be interpreted in the sense in which he had reason to suppose it was *understood* by the promisee."<sup>44</sup> In this formulation Dr. Paley's rule was extended beyond knowledge or apprehension to include "reason to suppose" and as so modified it is now offered in the *Tentative Draft* as a universal solution for cases of misunderstanding. In the process of adaptation, however, the *Tentative Draft* has omitted the qualification that the language "may be understood in more senses than one."

Although no exhaustive search has been made, nearly all of the New York cases found in which the "reason to know" formula is repeated have been viewed as raising only a question of interpretation of the contract rather than a question of initial validity or invalidity due to misunderstanding.<sup>45</sup> In most situations involving interpretation no issue of contract formation is presented, simply because there is no evidence that there was misunderstanding when the contract was made. When controversy arose thereafter it was because the parties were then in disagreement as to the meaning of the contract, but if the disagreement goes no further than this it presents only a question of interpretation. In these circumstances the principal usefulness of a distinction between ambiguous and unambiguous language is that the "apparent" or "clear" or "unequivocal" or "plain" or "unambiguous" meaning will doubtless control unless in the whole context a different meaning is more reasonable. A rule rejecting the use of extrinsic evidence in such a case is not to be countenanced, despite the frequency of its assertion. This, however, has nothing to do with the question of contract formation where there is misunderstanding.

But Dr. Paley's rule seems to presuppose a situation in which

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43. *Potter v. Ontario & Livingston Mut. Ins. Co.*, 5 Hill 147, 149 (N.Y. Sup. Ct. 1843). Evidently the person referred to was William Paley, an eighteenth century English theologian.

44. *Hoffman & Place v. Aetna Fire Ins. Co.*, 32 N.Y. 405, 413 (1865). In *Silverstein*, Judge Cardozo said: "The promise, if uncertain, was to be taken in the sense 'in which the promisor had reason to suppose it was understood by the promisee.'" 229 N.Y. at 171, 128 N.E. at 124.

45. *United States Rubber Co. v. Silverstein*, 229 N.Y. 168, 128 N.E. 123 (1920); *Moran v. Standard Oil Co.*, 211 N.Y. 187, 105 N.E. 217 (1914); *Nellis v. Western Life Indem. Co.*, 207 N.Y. 320, 100 N.E. 1119 (1913); *White v. Hoyt*, 73 N.Y. 505 (1878); *Hoffman & Place v. Aetna Fire Ins. Co.*, 32 N.Y. 405 (1865); *Barlow v. Scott*, 24 N.Y. 40 (1861).

the promisee understood the promise in a certain way at the time it was made, and the promisor had reason to know of that understanding.<sup>46</sup> This gets closer to the question of contract formation, and the presence or absence of ambiguity becomes a factor of inescapable significance. If the meaning of the words is clear, judged by the appropriate standard, and the promisee followed this meaning, the promisor will be held to it whether the issue is one of interpretation or of contract formation. Where meaning is uncertain Dr. Paley's rule may have some value, but the attempt to make it a universal test is not acceptable. A study of the New York cases in which the test is stated provides sufficient support for this conclusion. In every case the court construed the contract against the party who used the words in question.<sup>47</sup> This is a factor of known importance, yet it is wholly ignored in the blackletter rule of the *Tentative Draft*. In some cases the court construed the language in the light of the purposes of the contract,<sup>48</sup> and in others its construction was aided by a desire to avoid a one-sided contract.<sup>49</sup> About all that can be said of the cases as a group is that relevant factors of this sort led the courts to give each contract the meaning that seemed most reasonable in the circumstances.

In the case that first asserted Dr. Paley's rule,<sup>50</sup> a fire insurance policy provided that, if the insured obtained other insurance on the same building, this additional insurance must be "acknowledged and approved" by the first insurer, otherwise the policy "shall cease and be of no further effect." The insured took out other insurance,

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46. Chancellor Kent used this qualification in formulating a rule similar to Dr. Paley's. He wrote: "The true principle of sound ethics is, to give the contract the sense in which the person making the promise believed the other party to have accepted it, if he in fact did so understand and accept it." 2 KENT, COMMENTARIES \*557. In some of the cases purporting to apply the reason to know test, however, this fact is neither stated nor suggested by the evidence. In such cases the test has no significance. The decision rests instead on the court's conclusion that a meaning favoring the promisee is more reasonable in the circumstances than any other meaning claimed for the words. An example is *Hoffman & Place v. Aetna Fire Ins. Co.*, 32 N.Y. 405 (1865).

47. See the cases cited in notes 43-45 *supra*. In *Moran v. Standard Oil Co.*, 211 N.Y. 187, 105 N.E. 217 (1914), Judge Cardozo said: "Since the language is the defendant's we must construe it, if its meaning is doubtful, most favorably to the plaintiff." *Id.* at 196, 105 N.E. at 220.

48. *Hoffman & Place v. Aetna Fire Ins. Co.*, 32 N.Y. 405 (1865); *Potter v. Ontario & Livingston Mut. Ins. Co.*, 5 Hill 147 (N.Y. Sup. Ct. 1843).

49. *Moran v. Standard Oil Co.*, 211 N.Y. 187, 105 N.E. 217 (1914). The written contract obligated the plaintiff to work for the defendant for five years, but the defendant, which had drawn the contract, took the position that it was not bound to employ the plaintiff for five years or any other period. In construing the contract favorably to the plaintiff, the opinion suggests an inclination to find that the "plaintiff's obligation to serve and the defendant's to employ were correlative and equal." *Id.* at 198, 105 N.E. at 221.

50. *Potter v. Ontario & Livingston Mut. Ins. Co.*, 5 Hill 147 (N.Y. Sup. Ct. 1843).

sent the insurer written notice, and received in reply a letter stating: "I have received your notice of additional insurance." Nine days later the building was destroyed by fire. The court held the policy was in force. The insurer's letter constituted not only acknowledgment but also acceptance within the meaning of the policy. The words of the letter were chosen by the insurance company, which could have made it clear that it was not accepting the insured's act if that was its intention; the objectives of the notice and acceptance requirement were sufficiently satisfied; and the consequence of invalidating the policy after a loss had occurred was one that the court found unacceptable. Any attempt to sum all of this up in a "reason to know" requirement seriously overburdens that requirement.

The "reason to know" test is doubtless sometimes useful in the process of deciding whether one party is bound to the understanding of the other, but the position of Corbin and the *Tentative Draft* that he is so bound *only* if he has reason to know the other's understanding is not acceptable.

## II. THE NEED FOR LIMITING THE SCOPE OF CONTRACT

Both the original *Restatement* and the *Tentative Draft* of the *Restatement Second* use the following illustration of a misunderstanding:<sup>51</sup>

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 two versions are agreed that there is no contract for the sale of the horse, even though that is what B intended to buy,<sup>52</sup> and this conclusion is surely unassailable. The parties did not actually agree to such a contract. There was an apparent expression of agreement, but the reasons for holding A to the terms expressed are not present since B was not misled. They would be present, however, if B were unaware of A's slip of the tongue and gave the words their normal meaning.<sup>53</sup>

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51. RESTATEMENT, CONTRACTS § 71, Illustration 2 (1932); TENTATIVE DRAFT § 21A, Illustration 5.

52. In the original *Restatement*, a literal reading of the illustration, including the statement that there "is no contract for the sale of either the horse or the cow," would mean that there was no contract for the cow even though B intended to buy the cow. The conclusion is surely unacceptable; there would be an actual agreement for sale of the cow in such a case, with no discernible reason for refusing to recognize it. This conclusion would of course be changed under the *Tentative Draft*, since, as will be seen hereinafter, it proposes to hold B to a contract for the cow even though he intended to buy the horse.

53. This of course is another example of the problem discussed in Part I, and



The original *Restatement* took the position that there is no contract for sale of the cow but this is changed in the *Tentative Draft*, which asserts that there is such a contract. This is an application of the rule stated in the second subsection of section 21A, reading in part as follows: "The manifestations of the parties are operative in accordance with the meaning attached to them by one of the parties if . . . that party does not know of any different meaning attached by the other, and the other knows the meaning attached by the first party." Like the first subsection the generalization ignores all distinction between ambiguity and lack of ambiguity in the words and other acts constituting the means of communication.

Although the matter is by no means free of doubt, it is believed that this new position exemplified in the horse-cow case is both unwise and largely unsupported in the decisions. If it be assumed that B preferred the horse to the cow, possibly because it was worth more than \$100 whereas the cow was not, his acceptance was an attempt to take unfair advantage of A and it is clear that he will not be allowed that advantage. But the question is whether his inequitable conduct will result in his disadvantage by holding him to a contract he never intended to make. If the words were ambiguous B would be held to A's meaning,<sup>54</sup> and it is not immediately evident why the result should be different because the words used are regarded as unambiguous.<sup>55</sup> Nonetheless, the distinction should be drawn. When the words are unambiguous neither of the generally accepted bases of contract formation is present. There has been neither actual agreement nor expression of agreement for the sale of the cow.

To say that the language used expresses such an agreement because A intended to offer to sell his cow would tend to obliterate the distinction between what a person says and what he intends to say. The distinction is sometimes difficult to apply, yet it is fundamental both in common experience and in our legal system. Where there is mistake in integration, it produces the difference between

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under the *Tentative Draft* a valid contract would depend on a finding that A had "reason to know" the meaning attached by B. There is no basis for such a finding, but there is a contract nonetheless.

54. *E.g.*, *Barlow v. Scott*, 24 N.Y. 40 (1861).

55. In some circumstances the situation should be judged not only by the words used but also by other conduct expressive of A's intent. Thus, if the communication took place while the parties were examining the cow, the context in which the words were used and the other acts of the parties would justify a decision that there was a contract to sell the cow regardless of B's undisclosed intent to purchase the horse.

matters that can be dealt with through interpretation and those that must be left for reformation, a difference that becomes of vital importance in connection with wills, since courts do not assert the power to reform a will.<sup>56</sup> The distinction is of vital importance also in connection with inter vivos transactions. Thus, if a donor intends to convey Blackacre as a gift but the words of the deed mistakenly describe Whiteacre, he is entitled to rescind the conveyance of Whiteacre because of mistake, nor does the intended donee have any enforceable claim against him to compel completion of the intended gift of Blackacre.<sup>57</sup> A court would reject out of hand a claim by the donee that the deed should be construed to cover Blackacre because this was what the donor intended. In short, a distinction would be recognized between what the grantor intended to express and what in fact he did express by the language of the deed.

The consequences of the rule proposed in the *Tentative Draft* are also undesirable. The rule is formulated at a high level of abstraction. Horse and cow are used merely as symbols, so that the rule really comes to this: If A offers X when he means Y and B accepts knowing that A means Y, B is held to a contract for Y even though he intended X. This is not an intelligent way to formulate contract doctrine because it ignores a critical element—the possible differences between X and Y. The consequence may be a considerable hardship on B and an equally large enrichment of A, but seemingly nothing would be done about this if the position of the *Tentative Draft* were accepted. Some examples may help to demonstrate the shortcomings of the proposed rule.

If the horse in the *Restatement's* illustration was worth \$1,000, the cow was worth \$300, and A's offer was to sell the horse (meaning cow) for \$600, a decision that B is contractually liable to pay \$600 for the cow inflicts on him a punishment that does not fit the wrong. For a second example, assume that A owns two adjoining tracts of land: Blackacre, which is worth about \$100,000 largely because of standing timber, and Whiteacre, which has been logged and is worth about \$25,000. B wishes to buy both tracts, A is willing to sell Blackacre for \$110,000 and Whiteacre for \$50,000, but B has told A that he is not interested at these prices. A few days later A sends B a letter in which he intends to offer Whiteacre at \$40,000, but by mistake the letter describes Blackacre. B accepts by return mail. It is evident that B knew A did not intend to offer Black-

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56. *Patch v. White*, 117 U.S. 210 (1886).

57. *Marvin v. Kelsey*, 373 Ill. 589, 27 N.E.2d 469, 128 A.L.R. 1299 (1940); *DAWSON & PALMER, CASES ON RESTITUTION* 865-69 (1958).

acre for \$40,000 and almost equally evident that he knew A meant Whiteacre. Under the *Tentative Draft* there is a contract for the sale of Whiteacre for \$40,000, which is \$15,000 more than it is worth. This is not an acceptable result. It neither corresponds to the general theories that have guided judicial decision in this area, nor is it a just solution of the problem. Yet once a contract is found there is little possibility of relief to B through avoidance as a means of preventing unjust enrichment. In order to avoid unjust enrichment, courts sometimes grant restitution to a party who has breached his contract, but there seems to be no authority for allowing a party guilty of inequitable conduct to rescind a contract imposed on him because of that conduct.<sup>58</sup>

If there are circumstances in which it seems preferable to hold B to the terms intended by A, this can be done through estoppel. Thus, if A intends to offer his cow for sale for \$300, a fair price, but by a slip of the tongue he says \$200, and B accepts knowing that A meant \$300, it is fair to hold B to a contract at that price. Where B has received the goods with knowledge of the price A is demanding, courts have held him liable at that price;<sup>59</sup> but even though the transaction is wholly executory this seems a proper case for holding that B is estopped to assert that he did not agree to pay the price he knew A intended. Since it is a fair exchange this will not unjustly enrich A.

The use of estoppel provides a needed flexibility that is lacking once we accept the mathematical formula proposed in the *Tentative Draft*. There is an openness in the concept of estoppel that has served courts well for many centuries in working out equitable solutions to situations that do not fit neatly into an established mold.<sup>60</sup> There is no comparable opportunity through use of the

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58. In comment *d* to § 21A of the *Tentative Draft*, the offeree (B) is described as the party at fault with the suggestion that "he may be guilty of fraud." The possibility of rescission at the instance of the innocent party is mentioned, but it is evident that no one supposes the guilty party might be entitled to rescission.

59. *Germain Fruit Co. v. Western Union Tel. Co.*, 137 Cal. 598, 70 Pac. 658 (1902); *Mummenhoff v. Randall*, 19 Ind. App. 44, 49 N.E. 40 (1898); *Estey Organ Co. v. Lehman*, 132 Wis. 144, 111 N.W. 1097 (1907). Liability could also be based on unjust enrichment and in some of the cases it is not altogether clear whether the theory was contract or quasi contract. In *Mutual Sales Agency, Inc. v. Hori*, 145 Wash. 236, 259 Pac. 712 (1927), restitution was denied the buyer after he had paid the price demanded by the seller.

60. This is not the same as the suggestion sometimes made that contract requires actual agreement, and that all other situations normally covered by the objective theory are to be worked out in terms of estoppel. Williston considered and rejected this approach in an important article. Williston, *Mutual Assent in the Formation of Contracts*, 14 ILL. L. REV. 85 (1919).

principles of unjust enrichment if the point of departure is a contract found by application of the proposed formula.

### III. REFORMATION WHERE THERE IS MISUNDERSTANDING

It may be that one reason for the proposed extension of contract doctrine as just discussed is to eliminate an existing discrepancy in the *Restatement* between the principles governing contract formation and those governing reformation. This cannot be said with certainty by one not involved in the preparation of the *Restatement Second*, since, as yet, there has been no public submission of any new rules governing reformation. Under the present *Restatement* reformation is sometimes called for so as to put into effect a contract the parties never made, as tested by its rules for contract formation. This departs from the generally accepted role of reformation. If the presently stated rules for reformation are to be continued in the *Restatement Second*, the proposed changes discussed in Part II will eliminate the discrepancy, but will do so by an unwarranted expansion of the scope of contract. The proper corrective is to limit the scope of reformation more narrowly than it is now in section 505 of the *Restatement*, which reads:

If one party at the time of the execution of a written instrument knows not only that the writing does not accurately express the intention of the other party as to the terms to be embodied therein, but knows what that intention is, the latter can have the writing reformed so that it will express that intention.

The statement is too broad. It is one of those generalizations that seems to be supported by many decisions when in fact it does not contain the limitations implicit in those decisions. There are many cases involving mistake of one party known to the other in which reformation was granted, but only after finding an agreement to reform to, a limitation not contained in section 505. One group consists of cases in which actual agreement was reached but the writing failed to express the agreement correctly and this was known to the defendant.<sup>61</sup> He knew the writing did not "accurately express the intention" of the plaintiff, and he knew what that intention was, all as provided in section 505, but reformation went on the narrower ground that he knew the writing did not express the *agreement* they had reached and meant to embody in the writing.<sup>62</sup>

61. *E.g.*, *Chelsea Nat'l Bank v. Smith*, 74 N.J. Eq. 275, 69 Atl. 533 (Ch. 1908).

62. An unusually clear analysis to this effect appears in *Welles v. Yates*, 44 N.Y. 525 (1871).

In a second group are cases in which there was no actual agreement to provide a standard for reformation, but the application of the objective theory of contract formation provided the agreement to serve as the standard. An example is the case in which an insurer in issuing a policy intentionally departed from the terms of the insured's application for insurance.<sup>63</sup>

All of these cases are within the generally accepted objective of reformation: to put into effect an agreement found in accordance with the rules of law pertaining to the formation of contracts. But section 505 requires no search for an agreement to provide the basis for reformation. Although there are instances of reformation not so limited,<sup>64</sup> the section does not state an acceptable principle operating independently of the law of contract.

If A intends to offer goods for sale for \$2,000 but through error writes \$1,000, and B accepts the offer knowing A has made an error in the price, there is no contract at the price of \$1,000. If B also knows that A intended the offering price to be \$2,000 there is still no contract under the present *Restatement*; on these bare facts A cannot on contract principles hold B to an agreement to buy for \$2,000. As suggested earlier, in proper circumstances a court might hold that B was estopped to deny that he had contracted at the higher price, but if the market value of the goods were \$1,200 this would not be a proper case to invoke estoppel. To hold B to an obligation to pay A \$2,000 would result in an undesirable enrichment of A.<sup>65</sup> Yet under section 505, if the same transaction were integrated in a writing, A would be entitled to reformation so as to hold B to a price of \$2,000. There is no rational basis for such a difference in results, dependent on whether the agreement was or was not integrated in a writing, nor do the decisions support such a distinction. If there are circumstances that would cause a court to hold that B is estopped to deny that there was a contract on the terms intended, when the issue is one of contract formation, the same circumstances would support reformation when the issue arises that way. But B's knowledge of A's intention, standing alone, is not sufficient reason for an estoppel.

If it may be assumed that the rule now stated in section 505 is to be continued in the *Restatement Second*, the changes proposed

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63. *Connecticut Fire Ins. Co. v. Oakley Improved Bldg. & Loan Co.*, 80 F.2d 717 (6th Cir. 1936).

64. See the text accompanying notes 72 & 73 *infra*.

65. The problem is different if the parties reached agreement on a price of \$2,000, but the writing erroneously read \$1,000, and B was aware of the error whereas A was not. It is just in these circumstances to reform so as to hold B to a price of \$2,000 since he had agreed to that price, even though the agreement was not to become effective until execution of the writing.

in the rules relative to contract formation will eliminate the present inconsistency in the *Restatement*, but in the wrong manner. In the case just described B would be held to a contract at \$2,000, although the goods were worth only \$1,200, whether the issue was one of contract formation or reformation.

Cases presenting this general problem in connection with reformation are not usually as clear-cut as the situation just discussed. In some, the search for an agreement to provide the standard for reformation carries the court into dealings between the parties that preceded the writings, and the stuff out of which an agreement may be constructed will often be acts as well as words. This is true of *Hugo v. Erickson*,<sup>66</sup> where the court reformed a contract to sell land so as to include an entire lot having a depth of 130 feet, instead of merely the front eighty-five feet described in the writing. It was clear to the vendor, who was present when the purchaser examined the lot, that the purchaser thought the entire lot was being offered for sale and the vendor's conduct was a cause of this belief. The words used at this stage to describe the subject matter were of less importance than other acts. Contract rules formulated primarily with respect to writings, stressing the ambiguity or lack of ambiguity of the language used, have little to do with such a case. If the facts in *Hugo v. Erickson* were viewed through the eyes of a disinterested observer, virtually everything that occurred during the period when an apparent understanding was shaped pointed in the direction of a sale of the entire lot. When this was combined with the fact that the vendor was aware of the purchaser's understanding, contract ideas fully warranted holding the vendor to that understanding.

In other situations, the words used during the period when agreement was shaped play a larger role. In *Russell v. Shell Petroleum Corp.*,<sup>67</sup> N and B owned jointly a tract of 150 acres, and pursuant to a partition agreement N delivered to B a deed of the south part which accurately defined by metes and bounds and effectively conveyed 75 acres. The deed included, however, the descriptive words, "the south one-half of the northeast quarter." This included only 70 acres; the northerly five acres were in fact in the north one-half of the quarter-section. The plaintiff obtained a lease from B of the "south one-half," believing that this comprised all the land owned by B in the quarter-section, and B knew of the plaintiff's mistaken belief. In refusing reformation of the lease, the court stayed within traditional limits. The only agreement reached was the one expressed in the writing, and the lessor's inequitable

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66. 110 Neb. 602, 194 N.W. 723 (1923).

67. 66 F.2d 864 (10th Cir. 1933).

conduct was at most a ground for rescission. Mistake of one party coupled with fraud or inequitable conduct of the other provides a ground for reformation, the court said, only where "the written instrument fails to express the real agreement or transaction."<sup>68</sup> Throughout the negotiations the land had been referred to as the "south half," but the sense in which the plaintiff used the words could vary with the circumstances. The words have a conventional meaning, as descriptive of an area identified through a survey, and the plaintiff apparently was dealing by reference to the tract description. If so, the agreement made was the one the plaintiff intended to make, although not the one it would have made had it been better informed. There was no mistake in expression, only in underlying assumptions. If, however, the plaintiff had inspected the land, and had in mind a tract with geographical boundaries that corresponded to the land owned by the lessor, the same words for it would have referred to that land and reformation would be called for. This would not rest on the broad principle that the other party knew the terms the plaintiff intended should be embodied in the writing (the test of the *Restatement*),<sup>69</sup> but rather on the ground that, under accepted contract rules, the other party's knowledge would operate to bind him to the plaintiff's understanding. This is the aspect in which the case would differ from the one previously discussed, where the offeree was aware of the mistake in an offer to sell property for \$1,000. The words or other symbols used there did not carry any meaning other than the one normally given them.

Even in the case just mentioned, reformation to the intended price of \$2,000 would be appropriate if the offeree's conduct was such that the other was reasonably entitled to believe he was consenting to a price of \$2,000. This would be likely to occur only where there were prior negotiations looking to that price. The possibilities are illustrated by *Trenton Terra Cotta Co. v. Clay Shingle Co.*,<sup>70</sup> where the defendant, owner of a patent for the manufacture of clay shingles, negotiated with the plaintiff for manufacturing under a license. The defendant submitted a form of proposed contract providing for a royalty of fifty cents for each "square" manufactured, an advance royalty payment of \$2,000, and a promise by the plaintiff to manufacture at least 3,000 squares a year begin-

68. *Id.* at 866; *accord*, *McConnell v. Pickering Lumber Corp.*, 217 F.2d 44 (9th Cir. 1954).

69. It is assumed that § 505 of the *Restatement*, in speaking of a mistake as to "terms," is not meant to limit reformation to cases in which the mistake was as to the words used in the writing. It is settled generally that reformation is available where the mistake is as to the meaning or significance or legal effect of known words.

70. 80 Fed. 46 (C.C.D.N.J. 1897).

ning in 1893 or to pay a royalty on that amount. The plaintiff by letter objected to the \$2,000 advance royalty and to the time when the guaranteed minimum royalty was to start. The defendant replied by letter, withdrawing its demand for an advance payment and stating that it would agree to commencing the minimum royalty in 1894. The plaintiff then sent a letter containing the following critical passage: "Draw up your lease, leaving out the advance royalty, and make no restrictions as to amount of shingles we must make during '92 and '93. After '93 can make it 30,000 squares . . ." The figure "30,000" was an error; plaintiff intended to write "3,000." But the error was repeated in the written contract, and after its discovery the plaintiff sued for and obtained reformation to conform to his intention. The court did not inquire into the defendant's state of mind. The result would be the same, it said, whether or not the plaintiff's mistake was shared by or known to the defendant. It is a wise decision, not based however on any principle peculiar to reformation; in the circumstances the defendant should be held to the plaintiff's understanding of the term in question whether the issue arises as one of reformation or of contract formation.

When the defendant accepted the plaintiff's offer the latter was reasonably entitled to believe from this act that the defendant was consenting to a minimum royalty based on 3,000 squares. No other figure had been mentioned during the course of their negotiations. Conceivably the defendant did not read beyond the first sentence of the letter containing plaintiff's offer, since that dealt with the only matters in dispute, or he may have read the second sentence to say 3,000, since that was what he was expecting to read. In either case the conclusion would be virtually inescapable that he intended the amount to be 3,000 and there would be a contract at that figure based on actual assent. Conceivably he noticed the error but did not intend to take advantage of it: the analysis would be the same. Conceivably he read the amount correctly and thought the plaintiff was proposing a new term, but in the circumstances there was no reasonable basis for such belief,<sup>71</sup> whereas there *was* reasonable basis for the plaintiff's belief that the defendant was consenting to the 3,000 figure. Again, the defendant should be bound to that amount. Conceivably he read the figure correctly, knew that the plaintiff intended 3,000, and meant to take advantage of the error. This would bring the facts within the language of section 505, but the important point is that reformation does not depend on this.

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71. The court considered this possibility and rejected it. *Id.* at 48.



It would be granted in any event, because the plaintiff intended 3,000 squares as the measure of the minimum royalty, he believed that the defendant had the same intention, this belief was fully justified by the defendant's conduct, and the circumstances did not reasonably support a belief by the defendant that the plaintiff was consenting to 30,000 squares, even if the defendant held that unlikely belief.

Although the general objective of reformation is that heretofore suggested, that is, to put into effect the contract the parties intended to put into effect, measured by accepted contract principles, there is a heterogeneous collection of cases in which reformation is given with little or no attempt to bring the situation within these traditional boundaries. The common link among the cases seems to be that the facts call for some relief and the only satisfactory relief available is a decree in the nature of reformation, even though this binds the defendant to a contract to which he would not be bound under accepted contract doctrine. Many examples involve insurance policies where the issue arises after loss has occurred,<sup>72</sup> but the solution appears in other situations as well.<sup>73</sup> This is not the occasion for a full discussion of such decisions.

#### IV. CONCLUSIONS

Two distinct types of cases have been discussed: first, those involving true misunderstanding, in the sense that the parties were in disagreement without being aware of it; and, second, those in which the parties intended to contract on different terms but one of them knew this to be the case whereas the other did not.

In the first situation, contract rules should be formulated by reference to the need for stability and finality of business arrangements. Usually, each party believes a contract has been made but they have different conceptions of its terms. Occasionally, one party believes there is a contract whereas the other does not. In either case a finding of contract involves a choice whereby the expectations of one party will be realized, at least potentially, while the expectations of the other will be defeated or impaired. There should be persuasive reasons for favoring the expectations of one party and these reasons must be found largely in the fact, where it is a fact, that his expectations are clearly more reasonable than those of the other party. Such a determination requires the applica-

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72. *Heake v. Atlantic Cas. Ins. Co.*, 15 N.J. 475, 105 A.2d 526 (1954).

73. *E.g.*, *Town of Essex v. Day*, 52 Conn. 483, 1 Atl. 620 (1885); *Thomas v. Satfield Co.*, 363 Mich. 111, 108 N.W.2d 907 (1961); *Brandwein v. Provident Mut. Life Ins. Co.*, 3 N.Y.2d 491, 146 N.E.2d 693, 168 N.Y.S.2d 964 (1957).

tion of some standard of meaning or usage, and sometimes a choice between two standards where the misunderstanding arose from the fact that the parties were following different standards.

When the question of meaning turns largely on the language used in expressing agreement, there are polar differences on the scale from ambiguity to clarity. At one end, words sometimes bear a single reasonable meaning in the particular context, and when this is true there is normally a contract in accordance with that meaning. At the other end, words sometimes carry a double meaning, with each meaning having a fairly equal claim to recognition—the “equivocation” as it is known in the law of wills.<sup>74</sup> In this situation there will be no contract unless there is some compelling reason for favoring one meaning over the other. If there is such a reason it must be provided by factors outside the language, such as which party chose the language and the extent to which he was in a position to dictate the choice.

When the case is not at either extreme, solution may turn on whether one meaning is clearly more reasonable than the other, but extrinsic factors become even more important in deciding whether one party should fairly be held to the understanding of the other. Recently it has been suggested that a finding of no contract because of misunderstanding should be limited to cases of equivocation or double meaning,<sup>75</sup> but the suggestion has little to commend it. It rests on an exaggerated estimate of the destructive effects of a wider rule, as is indicated in the statement that the limitation is necessary “so that countless agreements to which the courts routinely give effect will not be rendered unenforceable.”<sup>76</sup> This fails to take sufficient account of the fact that in most of these “countless cases” there probably was no evidence of a clear misunderstanding when the contract was made—they are typical cases in which disagreement arose later and the issue is one of interpretation, nothing more.<sup>77</sup>

There is value, however, in the same writer’s suggestion that account be taken of the factor of vagueness, although it is believed

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74. 9 WIGMORE, EVIDENCE § 2472 (3d ed. 1940).

75. Young, *Equivocation in the Making of Agreements*, 64 COLUM. L. REV. 619, 646 (1964).

76. *Ibid.*

77. In other cases the term will not be vital enough to justify upsetting the entire arrangement, or will be so related to the rest of the arrangement that its excision will not prevent giving effect to what remains. This aspect of the problem is wholly ignored in the present *Restatement*, § 71, and largely so in the *Tentative Draft*, § 21A. In the latter the blackletter rule provides generally that there is no contract if the parties “attach materially different meanings to their manifestations.” Presumably there could be materially different meanings on an unimportant point.

that he separates vagueness much too sharply from other kinds of ambiguity or uncertainty. There are times when, because of the generality or vagueness of the language chosen, misunderstanding will not prevent the formation of a contract despite the fact that the different understandings of the parties are equally reasonable. For example, if parties should agree on the construction of a dam, "to be completed within a reasonable time from the date of this contract," the court might find the contract invalid for indefiniteness as to an essential term. It is much more likely, however, to uphold the contract and determine what is a reasonable time if that becomes necessary.<sup>78</sup> This would be true even though, when the contract was signed, one party thought a reasonable time was not more than twelve months, whereas the other thought it was at least eighteen months. Such a case involves two levels of understanding. On one level the parties had different intentions but on another level they expressed their agreement by using words of indeterminate meaning. Interpretation of those words and enforcement of the contract as so interpreted gives effect to a term to which they assented and meant to put into effect. In agreeing to an indefinite term it is as though they had agreed to leave the matter open for judicial determination should that become necessary.<sup>79</sup>

In the second situation, where the parties intended to contract on different terms but one of them was aware of their variant intentions, the inequitable conduct of one party will of course be taken into account, whether the issue arises in connection with contract formation or reformation. Reasonable differences of meaning that would lead to a finding of no contract in the first situation will here be resolved in favor of the innocent party. But it is unwise to adopt an inflexible rule that, regardless of the circumstances, one party will be held to the understanding of the other merely because he knows of it. There needs to be enough play in contract doctrine that the factor of enrichment of the innocent party can be taken into account, especially where, because of mistake, he uses or assents to words that do not have the meaning he intended in any realm of discourse relevant to the case.

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78. *Neenan v. Otis Elevator Co.*, 180 Fed. 997 (C.C.S.D.N.Y. 1910), *aff'd*, 194 Fed. 414 (2d Cir. 1912).

79. Because of the exigencies of the particular situation, the parties were deliberately silent as to price; and thus they imported into their contract the standard of reasonableness which the law implies in a contract mute as to price and providing no mode or standard for the fixation of the price. . . . [E]quity will by some appropriate method determine what is a fair and reasonable price under all the circumstances.  
*Mantell v. International Plastic Harmonica Corp.*, 141 N.J. Eq. 379, 387-88, 55 A.2d 250, 255-56 (Ct. Err. & App. 1947).