IV.7.3 - Right to avoid the contract for mistake in fact or law

(a) A party may avoid a contract retrospectively based on a mistake of fact or law existing at the moment the contract was concluded if:

i) the mistake was caused by information given by the other party, or

ii) the other party knew or ought to have known of the mistake and it was contrary to good faith and fair dealing to leave the mistaken party in error, or

iii) the other party made the same mistake provided that the other party knew or ought to have known that a reasonable party in the same situation as the party in error would not have entered into the contract or would have concluded the contract on materially different terms.

(b) A party's right to avoid the contract for mistake is excluded if

i) the risk was assumed, or, under the particular circumstances, should be borne by it, or if

ii) it was grossly negligent in committing the mistake, or if

iii) the party, being aware of and reasonably capable of enforcing such a right, manifests an intention to confirm the transaction.

(c) Avoidance is effected by notice to the other party.

(d) Where the party who has the right to avoid a contract under this Principle confirms it, expressly or impliedly, after becoming aware of the relevant circumstances, or becoming capable of acting freely, that party may no longer avoid the contract.

Commentary:

1 The Principle provides the rather strict conditions under which a party may avoid the contract for mistake in fact or law, i.e. in cases in which that party erroneously assumed factual or legal circumstances at the moment the contract was concluded. In such a scenario, that party may avoid the contract only if the mistake is one of those listed in Subsection (a) i) to iii) and the objective/subjective standard provided for in the second part of Subsection (a) is met, showing that the mistake is of such a serious nature so as to justify the right to avoid as an exception to the general and fundamental Principle of sanctity of contracts.

2 While the three types of mistakes listed in Subsection (a) i) to iii) are rather clear-cut, the objective/subjective test refers to the objective Principle of reasonableness, which allows a flexible approach that takes into account the circumstances of the case in order to determine whether a reasonable person in the same situation as the party would have refused to enter into the contract or would have contracted under materially different terms had it known the correct state of the facts or the law.

3 Subsection (a) makes it clear that the legal consequence of avoidance is that the effects of the contract are eliminated retrospectively, i.e. the parties are considered to never have concluded the contract.

4 The incidents listed in Subsection (b) under which a party's right to avoid the contract for mistake in fact or law is excluded are based on the general Principle of good faith. An assumption of risk can happen as a unilateral act or by agreement between the parties. In any case, one has to make sure that it was the assumed risk which has materialized in the party's mistake.

5 Because of the severe consequences of avoidance, it must be declared by a clear and unambiguous notice to the other side. The term "avoidance" must not be used in such a notice as long as it is clear beyond doubt for the addressee of that
notice that the party sending the notice does not want to be bound by the contract any longer. Principle IV.4.2 applies to the notice.

6 A party may renounce its right to avoid the contract by express or implied confirmation of the contract, provided that party was aware of the circumstances (but not necessarily of the legal right which follows from these circumstances) which would have justified the avoidance of the contract when it issued such confirmation. Typically, such confirmation is addressed to the other side. However, it may also be effected through a public statement or act of confirmation.