The Main Rule in Icelandic Contract Law Regarding Mistaken Assumptions and the Recalculation of Unlawful Exchange-Rate Loans

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1 Introduction

Icelandic borrowers were offered loans in the early 2000s that were tied to the exchange rates of foreign currencies, referred to as "exchange-rate loans." The borrowers considered these loans advantageous because they were offered at a much lower interest rate than that applicable for general loans. The borrowers also expected the exchange rate of the foreign currencies (e.g. EUR, YEN, CHF) to remain stable with respect to the Icelandic krona. These loans were mostly granted to borrowers financing the purchases of homes or automobiles.

The exchange rate of the Icelandic krona fell steadily against foreign currencies in 2008. This affected the value of the loans in different ways, as the loans were based either on the exchange rate of a single specified currency or a calculation unit, in which specified currencies had different weights (currency basket). Some loan balances more than doubled. At the same time, the lawfulness of linking such loans with foreign currency exchange rates began to be questioned. The basis for this questioning was a prohibition contained in the Act on Interest and Price Indexing, No. 38/2001, as loan agreements in the Icelandic currency indexed by the exchange rates of foreign currencies. Litigation resulted, and in several cases, *SC 16 June 2010, Case no. 92/2010* and *SC 16 June 2010, Case no. 153/2010,* the Icelandic Supreme Court found that the domestic loans involved were prohibited from being indexed with exchange rates of foreign currencies under the mandatory provisions of Sections 13 and 14, see Section 2 of the Act on Interest and Price Indexing, No. 38/2001. Several other issues were not addressed in the judgments, and uncertainty about various aspects of the loan agreements and their settlement remained.

In *SC 16 September 2010, Case no. 471/2010*, the dispute concerned the settlement following the rescission of a loan agreement for an automobile purchase that charged low interest (Libor) and was indexed with exchange rates of foreign currencies in a "currency basket". The loan agreement had been rescinded, the automobile returned, and the parties disputed only the rate of interest to be used for their settlement. The Supreme Court's judgment stated that since there was a direct and non-severable connection between the provisions in the agreement concerning exchange-rate indexing and the interest rate, it was impossible to rely either on the interest rate provisions of the agreement as they stood or construe them as having a different meaning. The provisions in the agreement concerning interest were therefore completely ignored, and it was deemed that the facts of the case corresponded to the parties having agreed to pay interest on the monetary claims without having specified what the interest was to be. It was therefore found that the lender's claim for interest be decided on Section 4, see Section 3 of Act no. 38/2001, i.e., interest equal to that which the Central Bank of Iceland decides, taking into account the lowest interest on general non-indexed loans at lending institutions and published in accordance with Section 10 of that act.

In order to eliminate the uncertainty that had arisen regarding the calculation of exchange-rate loans, a Parliamentary Bill was introduced to the Althingi, the National Parliament of Iceland, amending the Act on Interest and Price Indexing, No. 38/2001, which later became Act no. 151/2010. The new Section

18 of the Act on Interest and Price Indexing stated how loans indexed in this prohibited manner ought to be recalculated. This by and large followed the above precedent of the Supreme Court in *SC 16 September 2010, Case no. 471/2010*, although a distinction was made for loan agreements having periods shorter than five years, see Section 18(1), or periods longer than five years, see Section 18(2). These rules aim at how the loans ought to be handled in the future; there the balance of the loans on the date of settlement is the criterion. Section 18(5) contains instructions on how to calculate the balance of loan agreements on the settlement date, stating that the amounts of interest paid up to the settlement date ought to be deducted from the principal and interest due, along with any kind of unpaid assessments and payments, based on each payment date, and thus, the calculated amount would produce a new debt balance.

2 Mistaken Assumptions as Addressed by Icelandic Contract Law

Loans have been recalculated in accordance with the above rules as stated in Act no. 38/2001, see Act no. 151/2010. Since the interest rate used in recalculating the loans was higher than the interest rates of the agreements on exchange-rate loans, such recalculations on the basis of the act have in some instances led to unpaid balances of payments being added to the loan principal, even though borrowers have made payment in full and in accordance with the original loan agreement concerning individual payment dates. In other instances, overpayments have been deemed to have occurred on individual payment dates, and they have then been applied towards the loan principal.

One part of this settlement procedure will be particularly examined below. More specifically, the validity of payment receipts will be discussed in connection with loan agreements in Icelandic law, taking into account the rule on mistaken assumptions in Section 32(1) of the Act on Contracts, Agency and Void Legal Instruments ("Contracts Act") no. 7/1936.[2]

2.1 Generally

If mistakes occur when drafting an agreement, the question is whether the intent of the party drafting the agreement should be considered or the reliance that the other party may have placed on any statement by the drafter. Should the drafter of a legal instrument be responsible, or should the recipient of the legal instrument benefit from the drafter's mistake? Here two fundamental theories of contract law are assessed as against each other: the will theory, on

2 Act no. 11/1986 moved Section 31(1) of the Contracts Act, and it therefore was assigned a new number, Section 32(1) of the Contracts Act, without any amendment to the wording of the provision. Here, reference will be made to Section 32(1) even though judgments are cited that were handed down before the entry into force of Act no. 11/1986.

one hand, and the reliance theory, on the other.[3] In Iceland, the enactment of the Contracts Act in 1936 formalised a rule that was previously shaped by the courts. The precedents of other Nordic countries that had previously adopted contracts acts were also followed.[4] The legislative preparatory works accompanying the Parliamentary Bill of the Contracts Act worded the question as follows: "Which counts more, intent or words? Is a [drafter] bound by what he said or only by what he wished?"[5] Since it was deemed that the reliance theory better suited the needs of business, in addition to the belief that it had been deemed to apply previously in Icelandic law, it was relied on and is clearly reflected in Section 32(1) of the Contracts Act. That section states as follows:

> A legal instrument, which because of a mistake in writing or other mistake made by its drafter, has become different from that which was intended, is not binding on the drafter if the person to whom the legal instrument was directed knew or ought to have known that a mistake was made.

A drafter generally bears the risk of a statement stemming from him being incorrect. He must therefore abide by it and fulfil such a statement if its recipient is in good faith. This therefore involves weak grounds for invalidation as the determinative criterion each time is the other party's good faith.[6]

2.2 What are Mistaken Assumptions under Icelandic Contract Law?

When clarifying Section 32(1) of the Contracts Act, a distinction must be made between mistaken assumptions, on one hand, and failed assumptions, on the other. In actuality, however, there are no clear boundaries between these two kinds of assumptions.[7] It generally has been deemed that mistaken assumptions in contract law pertain to instances where a drafter makes a statement that he either did not want to make, or he has mistaken ideas about the substance of the statement he has made.[8] The former instance falls under the wording of Section 32(1). Here, a drafter has made a mistake because his intent was to have a legal instrument of a different content. The latter instance is different, for it involves

3 Ussing, Henry, *Aftaler paa formuerettens omraade*, Copenhagen 1945, pp. 151-155.

4 Iceland was the last of the Nordic countries to pass the Contracts Act. Such acts had been passed before, i.e., in 1915 in Sweden, 1917 in Denmark, 1918 in Norway and 1929 in Finland.

5 Record of Althingi, National Parliament of Iceland, A-Department 1935, p. 799.

6 In setting the Icelandic rule, the presentation of the other Nordic contracts acts was examined although the Icelandic rule did not follow the Norwegians' example of restricting the rule to "feilskrift eller anden lignenende feiltagelse". The rule in Section 32(1) uses the wording "because of a mistake in writing or other mistake", which is similar to the Danish provision in this regard, *see* "som ved fejlskrift eller anden fejltagelse".

7 Örlygsson, Thorgeir, Bogason, Benedikt and Gunnarsson, Eyvindur G., *Kröfuréttur I*, Reykjavík 2010, pp. 165-167.

8 Sigurdsson, Páll, *Samningaréttur*, Reykjavík 1987, pp. 296-297.

the drafter having incorrect ideas about the statement issuing from him. In other words, the mistake lies not in the statement itself or in any mistakes in drafting it, but rather in the underlying ideas of the drafter.[9] The boundaries between these two kinds of mistakes in drafting an agreement are not always clear, but the latter type of statement generally has been deemed to not fall within the wording of Section 32(1). As later addressed, Icelandic courts have nevertheless included such instances under this provision through use of legal analogy.

When a drafter has given a promise he bases on grounds that have nevertheless not been made conditions to the agreement, this falls under the rule of failed assumptions. From this it can be inferred that the main difference between the rule on failed assumptions and mistaken assumptions, in the meaning of Section 32(1), is the occurrence of a discrepancy between will and statements, i.e., when a misstatement or misspelling by the drafter causes him to write something other than that which he wished, and that which can be inferred from the actual legal instrument.[10]

2.3 What Statements fall under Contracts Act Section 32(1)?

Section 32(1) covers legal instruments deviating in substance from the intent of the drafter because of the drafter's mistake.[11] The legislative preparatory works to the Parliamentary Bill for the Icelandic Contracts Act stated that the bill departed from that in the Danish and Norwegian contracts acts, where the concept "ugyldige viljeserklæringer" (invalid statements of intent) was used. It was stated that the concept of legal instrument covered all statements of intent that were meant to create, alter or abolish a right, without regard to whether the statements in each individual instance would have the legal effect they were intended to have.[12] Since oral legal instruments are as valid as written legal instruments,[13] nothing prevents including the former under the provision. Therefore, although the provision is first directed at a mistake in writing, which by its nature can only refer to written statements, in addition, it is stated there that the provision covers other mistakes that can easily occur when oral legal instruments are involved.

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9 Örlygsson, Thorgeir, Bogason, Benedikt and Gunnarsson, Eyvindur G., *Kröfuréttur I*, Reykjavik 2010, pp. 166-167. Jørgensen, Stig, Kontraktsret 1. bind, aftaler, Copenhagen 1971, p. 141. Lynge Andersen, Lennart, *Aftaleloven med kommentarer 5. útgáfa*, Copenhagen 2008, p. 208.

10 Jørgensen, Stig, *Kontraktsret 1. bind, aftaler*, Copenhagen 1971, p. 142.

11 Ussing, Henry, *Aftaler paa formuerettens omraade*, Copenhagen 1945, p. 156.

12 Record of Althingi, National Parliament of Iceland, A-Department 1935, pp. 796-797. The legislative preparatory works stated that the Danes and Norwegians did not wish to use the concept "retshandling" (legal instrument) since it was deemed to imply almost that the statement was valid under law. On the other hand, this was the route taken with the enactment of the Icelandic act.

13 Sigurdsson, Páll, *Samningaréttur*, Reykjavík 1987, p. 40.

The burden of proof in establishing whether mistaken assumptions are involved lies with the party arguing that mistakes were made in the drafting of the legal instrument. The basis is always the legal instrument involved, but it must be construed with the traditional rules of construction and explanation of Icelandic contract law, see *SC 1933, p. 30*.[14] It can often be difficult to prove such mistakes by the drafter, especially long after the legal instrument was drafted, see *SC 1984, p. 49*, where it was argued that in a rental agreement, dated 4 January 1944, the payment date of the rental had been mistakenly written, and that it ought to have been 31 December, not 31 January. The Court did not find that a mistake in a writing was involved, as simply citing another agreement made in 1944 with another named lessee, where the payment date decided was 31 December, was not deemed sufficient proof.

Cases have been submitted to the Icelandic courts disputing whether Section 32(1) was applicable. The mistakes involved are of various kinds. The clearest examples of mistakes falling under Section 32(1) Act are those involving simple mistakes in writing or typographical errors. Such a risk is often present when drafting agreements, for example, when an incorrect product price is given, or the year and/or beginning date are incorrectly written. Here, *SC 1978, p. 166,* may be cited, where the issue was whether the interest on mortgage bonds issued in connection with the sale of real estate should be calculated from 25 May 1973 or 25 May 1972. In *SC 1998, p. 2180*, the issue was also whether the commencement date for interest on a mortgage bond issued in connection with the sale of real estate had been incorrectly written and ought to have been calculated from 28 October 1993, rather than from 28 October 1994, as stated in the documents for the sale.

Other kinds of mistakes can easily occur when drafting an agreement. For example, various kinds of provisions can slip into legal instruments that the drafter would not have put in the agreement if he had noticed them. One of the first cases of this kind after the enactment of the Contracts Act involved a dispute over whether a drafter knew of provisions put into a rental agreement upon its renewal, i.e., in *SC 1947, p. 535*, where a provision was added on vacating an apartment after the passage of just over three months from the renewal of the rental agreement. In *SC 1969, p. 188*, the issue was whether an insurance company was bound by conditions on the insurance certificate, where a proviso had been omitted regarding the damage that the insurance did not compensate. In the above judgments, resolved on the basis of Section 32(1), the mistake made by the drafter in renewing an agreement, was, in the former instance, corrected with a new provision, while in the latter instance, the provision that had been found in the previous insurance certificate was stricken. In both cases, the parties could prove that they had made mistakes in drafting a legal instrument, and that the mistakes were based on specified points they had expected when drafting the legal instrument. In the first instance, continuing rental was involved, and the second involved insurance with specified conditions. However, this is not relevant when an agreement is imprudently drafted. Such instances have generally not been deemed to fall

14 Lynge Andersen, Lennart and Bo Madsen, Palle, *Aftaler og Mellemmænd*, 5th edition, Copenhagen 2006, p. 178.

under Section 32(1), but might fall under other provisions of the Contracts Act, *e.g.*, Sections 33 or 36.[15]

A similar issue was resolved in *SC 1976, p. 974* and *SC 14 February 2008*, Case no. 325/2007. The issue in *SC 1976, p. 974* was whether the settlement of a salvage award ought to be based on an invoice that the Icelandic State Shipping Company had sent by mistake, on behalf of the Icelandic Coast Guard, which had previously made a claim for payment of a much higher salvage award and had also filed a lawsuit for that purpose. In *SC 14 February 2008*, Case no. 325/2007, the issue was whether a provision in an agreement concerning settling a real estate purchase ought to be invalidated since the outstanding balance was said to be ISK 1,000,000 lower than it in fact was.

Issues can also arise when a lasting contractual relationship is involved. When executing such agreements, various kinds of statements and announcements are sometimes issued. Some examples are receipts for payment on payment dates, collection slips or delivery notes for the receipt of goods and services. Various things can go wrong, and mistakes in issuing such statements can fall under Section 32(1). Mistakes can occur in various ways, either in the preparation of such statements, or when the statement is issued, based on an incorrect understanding of the substance of the original agreement. Icelandic courts have placed such instances under Section 32(1), as can be inferred from *SC 1998, p. 1653*. The dispute there was whether a commercial bank had to abide by payment receipts issued upon full payment of three instalments paid on a bond. The mistake made was that on each of the three payment dates, only one-ninth of the payment was collected instead of one-third. The case was resolved on the basis of Sections 32(1) and 33 of the Contracts Act.

2.4 Do other Utterances fall under Section 32(1)?

The discussion above concerned instances where a drafter has argued that a statement issued by him is different in substance than he intended, more often than not because of mistakes made by the drafter or his agent when drafting the agreement. These are instances falling under Section 32(1), i.e., when a legal instrument is different in substance than intended because of mistake in writing or other mistakes.

It has been argued that other instances also fall under Section 32(1), i.e., when a drafter intends to make one statement, but later it comes to light that when he made the statement, he misunderstood its content.[16] Scholars have argued that these instances also fall under Section 32(1), with an extensive interpretation or by legal analogy to the provision.[17] This kind of statement of intent is not as clear as the former, and here it is a short path to deeming, in retrospect, that the assumptions of the drafter failed, and then the field of failed

15 Lynge Andersen, Lennart and Bo Madsen, Palle, *Aftaler og Mellemmænd*, 5th edition, Copenhagen 2006, p. 175.

16 Ussing, Henry, *Aftaler paa formuerettens omraade*, Copenhagen 1945, p. 156.

17 Sigurdsson, Páll, *Samningaréttur*, Reykjavík 1987, p. 296-297.

expectations in contract law has been entered. *SC 1947, p. 293*, can be mentioned here as an example. There an agreement concerning road repair had been made between two farms, and the cost of the road repair was to be divided between the owners of the farms; in addition, the owner of one of the farms was supposed to see to the maintenance of the road. The dispute was over whether one of the owners had realised the great financial obligation entailed in the provision of the agreement; it was argued that he had mistaken assumptions regarding this cost during drafting of the agreement. In *SC 1983, p. 2134*, the issue was about the validity of a prenuptial agreement entered into by a couple, which made their real estate the wife's personal property. The husband argued that he had incorrectly understood the application of the prenuptial agreement and had only thought it would apply upon the death of one, or both of them, but not upon their divorce. Also, in *SC 2003, p. 1107, (443/2002)*, the issue was over the validity of an attorney's signature regarding a final settlement in connection with accident compensation. It later came to light that in drafting the agreement, the settlement of compensation for a temporary work disability was based on the incorrect premise that deducted payments from the State Social Insurance Administration were because of the victim's disability pension and disability payments and not because of per diem, as later came to light.

The above instances do not fit the wording of Section 32(1) very well. In *SC 1947, p. 293*, the invalidation of an agreement provision was based on an analogy to Section 32(1). In addition, the judgment specified that the drafter was 78 years old when he signed the agreement, and that the payment for the road construction was large and far in excess of his expectations, however, without the conclusion being otherwise based on the exploitation provision of Section 31 or the dishonesty provision of Section 33 of the Contracts Act. Also, invalidation of the prenuptial agreement in *SC 1983, 2134* was not granted even though the judgment of the Supreme Court stated that the parties might have misunderstood the legal validity of the legal instrument involved. The judgment of the lower court there was overturned, which had found that the prenuptial agreement was invalid under the basic reasoning of Sections 32 and 33 of the Contracts Act.[18] Also, the agreement between the parties in *SC 2003, p. 1107, (443/2002)* was based on incorrect information as to the type of payments the victim had accepted from the State Social Insurance Administration although the parties actually agreed regarding this. Therefore, the victim's receipt for payment was not submitted as proof since it had been issued, based on mistaken assumptions; the issue was then resolved with an explanation of the relevant rule on deduction in the Tort Damages Act, no. 50/1993. In comparison, reference can also be made to *SC 1960, p. 447*, where a demand was made for invalidation of a statement on hereditary farm tenancy on the grounds of legal analogy to Section 32(1), where the tenancy was actually intended to grant the other party authority to mortgage the farm because of construction costs. This was not granted, and the matter was resolved on other grounds.

18 A judgment of the Supreme Court of Denmark may also be mentioned: UfR 1972, p. 568 H.

However, invalidation of legal instruments based on mistaken assumptions is not precluded on the grounds of other provisions in the Contracts Act on invalidation.[19] This was the course taken in *SC 1998, p. 1653*, where a debtor on a mortgage bond had gotten payment receipts on three of the bond's payment dates; in addition, the bond had been sent to the debtor upon completion of the third payment, endorsed as being paid in full. The payment slips were invalidated on the grounds of Section 32(1), and it was also held that the debtor could not plead the endorsement of payment in full on the bond on the grounds of Section 33 of the Contracts Act.[20]

3 The Good Faith of the Other Party

3.1 Generally

The effect of Section 32(1) is that a drafter is bound by his statement, and the other party may rely on that statement as the final intent of the drafter. However, this is clearly not relevant if the other party knows of the mistake in writing or other mistake. From this it follows that such a statement is not binding on the one making it if the one to whom the legal instrument was directed knew or ought to have known that a mistake had occurred, as emerges from the wording of Section 32(1).

Whether Section 32(1) is applicable, or whether a binding statement of the drafter is involved, is often an issue. The boundaries can be unclear because the conduct of the other party can often indicate that he has not acted in good faith when receiving the statement; thus, it has not been possible to view the statement or offer as being binding.[21] Regarding Icelandic judicial precedent, *SC 1941, p. 210* can be mentioned, where the issue was the construction of a provision in a deed in a bankruptcy estate, transferring a 50 % ownership share

19 Lynge Andersen, Lennart and Bo Madsen, Palle, *Aftaler og Mellemmænd*, 5th edition, Copenhagen 2008, p. 210.

20 In comparison, *see SC 1954, p. 433.* The issue was the validity of a mother's statement that had been issued to the father of her child on 29 December 1948, where she ceded all rights she might have against him regarding support payments for their child. A minority of the Supreme Court thought that the statement ceding overdue support payments could be invalidated on the grounds of Sections 32(1) and 33 of the Contracts Act. The majority of the Supreme Court based its conclusion on other grounds.

21 Here, UfR 1985, p. 877 H, may be cited. *See* Bryde Andersen, Mads, *Grundlæggende aftaleret*, Copenhagen 2005, p. 405. A discussion of UfR 1985, p. 877 H can be found in Mols, Else, *UfR 1986 B, pp. 43-44.* There, among other things, the author calls attention to the fact that both the majority and minority of the Danish Supreme Court took as given that a binding offer had been involved although there had been a mistake on the price label of a product in a store window. On the other hand, there was a dispute regarding whether the other party had been in good faith, in the meaning of Section 32(1) of the Danish Contracts Act. It was also pointed out that the judgment provided guidelines regarding the point in time when the good faith of the other party is evaluated, *see* Section 38 of the Contracts Act. Lynge Andersen, Lennart, *Aftaleloven med kommentarer 5th edition*, Copenhagen 2008, p. 209.

in real estate. In addition to the receiver, the co-owner of the real estate had signed the deed. The Supreme Court concluded that the parties had not fully realised what the words of the deed entailed. Nevertheless, the issue was not resolved on the grounds of Section 32(1), but on the grounds of what the parties could expect their deed to entail, based on its wording, other documents related to it and their knowledge of the agreement. In *SC 8 February 2007, Case no. 335/2006*, there had been a mistake in issuing a game programme of Icelandic Sweepstakes, where a game had been advertised between two Spanish football teams. The programme stated that the game would be on 25 August, but it had actually been played the day before. In the case, a holder of 15 receipts that had all been bought after the game had been played, and its outcome had become clear, demanded that the winnings be paid in accordance with the game's odds. Icelandic Sweepstakes based its argument on failed assumptions in addition to Sections 32(1) and 33 of the Contracts Act since the nature of lotteries was that it would not be possible to guess on a game after it had begun or been played. The demand for payment of the winnings was not granted. The Supreme Court's judgment stated that the aforementioned game was based, by its nature, on the main premise that the expected outcome of sporting events would be guessed before their conclusion, in accordance with section 2 of the Act on Lotteries, no. 59/1972, and Regulation no. 543/1995. The claim for payment of the winnings therefore was not granted. In the above case, the Supreme Court's judgment did not cite Section 32(1) although doing so could have been relevant.[22]

Here, a comparable dispute can also be mentioned that was handled by the *Committee on Purchases of Goods and Services* (now Consumer Rights Division of the Consumer Agency), Case no. *61/2009*. There, an individual had purchased a sweater on sale, where the discount was said to be 50%, and the individual paid ISK 9495 for the sweater. The price tag stated that the original price of the sweater had been ISK 14,990, and it would therefore have cost ISK 7495, based on the stated discount. The Consumer Rights Division granted the claim for reimbursement, among other things, based on the rules on price tags and other pricing information, no. 725/2008, on the requirement that product price tags be clear, accessible and evident. The Consumer Rights Division did not think that the individual should have been allowed to pay more for the sweater than ISK 7495. The store owner's argument that the price of the sweater had been increased shortly before the sale was also not accepted. The outcome therefore seems to be based on there having been a binding offer since the individual's knowledge of the increased price of the product before the sale had not been proved.[23]

Finally, it should be mentioned that if both parties, both the drafter and the other party, agree on giving a legal instrument a different meaning, Section

22 *See* also UfR 1942, p. 269 H, where the issue was the validity of a betting ticket for a horse race. A discussion of the judgment can be found in Gomard, Bernhard and Skovgaard, Henning, *Tipning og obligationsret*, UfR 1979 B, p. 245 (p. 253).

23 *See* also the Consumer Rights Division's Case no. 143/2010, where it was argued that a buyer had been demanded to pay a higher price for a product than the advertised price. The seller agreed to a demand for reimbursement.

32(1) is not relevant. Consideration can, however, be given to evaluating such a legal instrument based on the rules of Section 34 of the Contracts Act on *pro forma* statements.[24]

3.2 Requirements Applied by the Icelandic Courts

A legal instrument's external form, i.e., as it appears to the other party, can show clear signs of benefits that the drafter did not intend to cede. However, the drafter will have to honour such a legal instrument unless he can prove that the other party did not act in good faith when the legal instrument became known to him. This results from the main rule on the binding nature of agreements and the wording of Section 32(1). In other words, the other party may rely on the statement he gets unless he knew or ought to have known of the mistake.

This can be inferred from *SC 1923, p. 400*, and *SC 1932, p. 647*. In these cases, the issue was about a provision in contracts of carriage, where payment had been granted for extra waiting days because of the offloading of salt cargo in Iceland. In *SC 1923, p. 400*, a provision in the charter required loading of the vessel in five weekdays, and the same applied to offloading, but there was an additional provision regarding charges for extra waiting days. It was therefore argued that a mistake had been made in drafting the agreement since there ought to have been a provision in the agreement requiring that loading and unloading ought to occur in their usual turn, and the demand for payment for extra waiting days was therefore rejected. During the case quite a few telegrams were introduced that had passed between the parties in the lead-up to the agreement. From the telegrams it could be inferred that the provision on the charge for extra waiting days had been important to the charterer, and that the telegram, dated 27 April 1920, finally agreed to the charterer's demands. It was therefore held that it ought to have been clear to the vessel owner that when a contrary provision was later inserted into the charter party, it must then have been a misunderstanding by those finishing the agreement. The payment for extra waiting days was therefore not granted. There was another outcome in *SC 1932, p. 647*, where a charterer argued that it had actually been agreed upon, regarding the counting of offloading days in the Westman Islands, that only days ought to be counted when it was possible to offload because of weather, and that it was also heedlessness and oversight not to have stricken out the words "per running day" in the printed form that the contract of carriage was written on and replace them with "per weather working day". This was not granted, for in the case the vessel owner had specifically protested that something else had been agreed upon. It could also be inferred from the telegrams passing between the parties before the charter party was signed that the vessel owner had insisted on the condition that a certain quantity of cargo would be offloaded per lay day of the vessel, without regard to weather.

24 Jørgensen, Stig, *Kontraktsret 1. bind, aftaler*, Copenhagen 1971, p. 141. *See* also Ólafsdóttir, Ása, *Málamyndagerningar (Pro forma statements)*, Rannsóknir í félagsvísindum IX, Lagadeild, Reykjavík 2008, pp. 13-14.

In the above judgments, the Supreme Court's conclusions were based on the knowledge of the contractual parties of the alleged mistakes, founded, for example, on what passed between the parties in the lead-up to the agreement. This is also the main rule when construing Section 32(1) because from the provision it can be inferred that the test is whether the other party knew or ought to have known that the drafter made a mistake or intended to put his statement differently. On the other hand, the other party is generally not required to know what the drafter intended to put into his statement.[25] The knowledge is therefore related to the mistaken assumptions, i.e. the mistakes; see *SC 1981, p. 1323*.

More specifically, Section 32(1) discusses two cases when assessing whether the other party acts in good faith. The first case involves when the other party knows of the mistakes of the drafter. Here, in addition to the rule in Section 32(1), arguments may also be based on other provisions in the Contracts Act because, when apropos, and when the other party wishes, despite this, to assert his statement regarding the drafter, doing so has to be dishonest as well as a violation of Section 33 of the Contracts Act.[26] In addition, the provision directs that when the other party ought to have known of the mistake of the drafter, such can often be difficult to prove after-the-fact, but in assessing this Section 38 of the Contracts Act can be taken into account.

Sometimes, however, both parties agree regarding an incorrect assumption, see *SC 1996, p. 3639* and *SC 2003, p. 1107 (443/2002)*. On the other hand, if the other party argues that he acted in good faith, all of the traditional perspectives otherwise relevant in contract law pertain to the assessment. This assessment involves whether the other party in the relevant circumstances ought to have seen mistakes in the drafting of the legal instrument. It has been pointed out that there is no reason to apply too strict requirements in this regard when assessing what the other party knew or should have known.[27] The weight of the requirements may also vary, depending on the position of the relevant recipient of the legal instrument. For example, greater requirements appear to be made of those with expertise in a relevant field or those benefiting from such in drafting the agreement, such as attorneys or other specialists, than, for example, others not having such expertise when agreements are involved in the field that a party's expertise covers.[28] Here, it also enters into the assessment which of the parties was better situated to correct the mistakes or be responsible for them, as well as how much would have been required to avoid such mistakes. More often the other party's lack of expertise is deemed to support his good faith regarding mistakes; thus, the one making the mistakes must abide by the legal instrument drafted in this manner. The conclusion can however be different if functions are divided between parties, such that the

25 Lynge Andersen, Lennart and Bo Madsen, Palle, *Aftaler and Mellemmænd*, 5th edition, Copenhagen 2006, p. 179. Lynge Andersen, Lennart and Bo Madsen, Palle, *Aftaler and Mellemmænd*, 5th edition, Copenhagen 2008, p. 215.

26 Arnholm, Carl Jacob, *Lærebok i avtalerett,* Oslo 1978, p. 247.

27 Ussing, Henry, *Aftaler paa formuerettens omraade*, Copenhagen 1945, p. 125.

28 Bryde Andersen, Mads, *Grundlæggende aftaleret, 2nd edition* Copenhagen 2005, p. 407.

other party or his agent has more knowledge than the drafter, see *SC 1978, p. 166* and *SC 1998, p. 2180*.[29]

From the Icelandic judgments dealing with the other party's good faith in connection with Section 32(1), it can be inferred that consideration is given to various factors when assessing the knowledge of the recipient of a legal instrument. The agreement's content is considered, and this is examined, based on the position of the parties and what they could have expected during drafting of the agreement. This can be inferred, in part, from *SC 1947, p. 535*, where the issue was a provision in a renewed rental agreement, dated 5 February 1947, calling for a vacating of an apartment before 14 May 1947. The renter argued that he had made a mistake in making the rental agreement since he had not noticed the provision. The Supreme Court's judgment noted that the termination provision had not been discussed during renewal of the rental agreement, and no special attention was called to it during drafting of the agreement. It was also difficult to discern the hand-written date of the agreement's provision on vacating. The Supreme Court invalidated the provision on the basis of Section 32(1) also citing that the renter was poor and had children to care for; in addition, he had previously tried to avoid termination of the housing since it was difficult for him to rent other housing. It was therefore deemed that it ought to have been clear to the lessor that it was unlikely that the renter would agree to such a provision.[30]

When evaluating the good faith of the parties to an agreement, consideration may also be given to which party is to blame for the mistakes. If the other party is directly to blame for the mistakes, it has to be found that he must have been in bad faith regarding the mistakes,[31] see *SC 14 February 2008, Case no. 325/2007*. In this case, the buyer demanded compensation from the seller of real estate because of defects in the real estate. When drafting the agreement concerning the settlement of damages and outstanding payments on the purchase price, the buyer stated that the outstanding payments on the purchase price were ISK 1,500,000, and this was assumed in the agreement. The court agreed with the seller that a mistake in calculation was involved that could be attributed to the buyer’s involvement and to insufficiency of information at the realtor's during the drafting of the agreement concerning settlement. The court did not agree with the buyer of the real estate that the seller had conceded this amount for the purpose of adjusting his share; in addition, it was argued that before the meeting the buyer's attorney had sent a letter stating that the outstanding payments on the purchase price were ISK 2,500,000. Therefore,

29 In some instances, it has also been argued that there is even less reason to protect the other party who is in good faith when specified legal instruments are involved, such as donor pledges and other instruments of largesse. Ussing, Henry, *Aftaler paa formuerettens omraade*, Copenhagen 1945, pp. 126-127 and p. 158. Arnholm, Carl Jacob, *Lærebok I Avtalerett*, 4th edition, Oslo 1978, p. 253. See, however, *SC 1982, p. 613*, dealing with the invalidation of a gift on the basis of failed assumptions. Invalidation of the gift was not granted, and it cannot be seen from the judgment that previously stated perspectives were considered in the court's conclusions.

30 This judgment is discussed in Sigurdsson, Páll, *Samningaréttur*, Reykjavík 1987, p. 298.

31 Jørgensen, Stig, *Kontraktsret 1. bind, aftaler*, Copenhagen 1971, pp. 144-145.

the statement stated in the agreement concerning unpaid balances on the purchase price was invalid on the grounds of Section 32(1).

Mistakes can often occur when there has been some lead-up to an agreement. During the purchase of real estate, the parties, for example, may have exchanged offers and counter-offers; in addition, errors can slip into documents during their finalisation, as discussed in *SC 1978, p. 166*. There a majority of the Supreme Court concluded that a mistake had occurred when the commencement date for interest on a mortgage was specified to be 25 May 1973 instead of 25 May 1972, in a real-estate purchase agreement. Consideration was given to the fact that the buyer himself should have noted it was probable a mistake had been made when the commencement date for interest was specified in the purchase agreement because even though the first payment date was decided exactly a year after delivery of the real estate, the buyer could not also have expected interest to be calculated from that time, and that a large share of the purchase price should have been free of interest for one year. Also, it would have been very easy for the buyer to ask the seller or real estate agent for explanations of what he himself regarded as being at odds with what had gone on between the parties during the offer and acceptance process; in addition, there was even more occasion to do so since it was mentioned at the signing of the purchase agreement that the purchaser did not have to pay interest on the purchase agreement payments that he was supposed to make before a title was issued for the purchase of the real estate. The provision on the commencement date for interest was therefore set aside on the basis of Section 32(1).

A different conclusion was reached in *SC 1998, p. 2180,* where a holder of a right of pre-emptive purchase had intervened in an agreement to purchase a farm. In the purchase agreement and mortgage, the payment date of the mortgage was stated as 28 October 1994, but the original purchaser and seller both asserted that the interest ought to have been calculated from 28 October 1993. The pre-emptive purchase right holder's knowledge regarding the start date of interest as being 28 October 1993 was not proved, and it was deemed that he had acted in good faith regarding the commencement date of interest when he decided to exercise the pre-emptive purchase right. For example, he had observed that the interest on the bond was unusually high, relative to the fact that an indexed debt was involved (15 %); in addition, it was not deemed to have been proven that he had received a summary of the loan's debt service burden from the seller.

In assessing whether the recipient of a legal instrument had acted in good faith, both of the above judgments considered the substance of the agreement and the documents that had passed between parties. For example, it was asserted that in assessing whether the other party was in good faith, consideration may be given to whether there is such doubt regarding the intent of the drafter that the other party has a right to ask the drafter for a more detailed explanation to eliminate all doubt.[32] It can only be seen that this point was determinative in *SC 1978, p. 166,* where the other party took the initiative

32 Jørgensen, Stig, *Kontraktsret 1. bind, aftaler*, Copenhagen 1971, p. 144.

in drafting the agreement, including preparing an agreement offer and actually noticing when drafting the agreement that its provisions had changed in his favour, but made no further enquiries regarding this or requesting explanations of it. In *SC 1998, p. 2180*, the facts were somewhat special since the parties originally involved in the agreement both agreed that a mistake had been made. On the other hand, the lack of good faith of the other party (a holder of a right of pre-emptive purchase) was not proven in the case, and it was therefore decided to allow the provision to remain unchanged. In both cases, it was also assumed, in support of the request to void, that the other party ought to have known better since there was a custom on specific points when drafting agreements in this area. This, for example, has been argued when unclear agreement provisions are involved that perhaps have not been specifically discussed when drafting the agreement. In the above judgments, on the other hand, the existence of such a custom had not been proven to the extent that it prevailed over agreement provisions to the contrary, and the conclusion was the same in *SC 1932, p. 647*.

In *SC 1969, p. 188*, the insured had demanded compensation from the insurer on a policy that the insured's employer had taken out for his benefit. The issue was whether a mistake in writing had occurred with the issue of the insurance certificate. It was undisputed that, with the issue of the insurance certificate, a proviso had dropped out that the insurer would not compensate damages that the insured caused by gross negligence. Such an exemption had first been put into the insurance certificate in effect from 25 March 1963 to 24 March 1964, but it had not been in certificates issued after the insured accepted the insurer's offer in 1954. The insurer based its argument on the claim not being based on the terms of the insurance certificate in force when the accident occurred since the terms of insurance had been changed at a meeting of the company's Board of Directors on 28 July 1961. The judgment of the district court stated that notice of the decision at the insurer's board meeting had not been given to the insured. Although the terms of the insurance certificates were broader than those of other companies, it was assumed that this stemmed from the policyholder's having gone to other companies and requested offers on insurance. This, along with other factors, could have played a part in the insurer's offer having initially been accepted. The Supreme Court's judgment confirmed this judgment. *SC 1976, p. 974*, which can also be cited here, where it was held that a vessel operator's owner could not have failed to see that the Coast Guard would not reconcile itself to payment of a salvage award in accordance with an invoice from the Icelandic State Shipping Company since the Coast Guard had previously made a much higher demand, including by issuing a summons, and had also rejected a settlement offer that was higher than the amount on the disputed invoice.

In executing agreements, receipts or statements are often issued that are based on the original agreement. Many things can go wrong here, but in evaluating whether the other party can rely on such statements, the substance of the legal instrument and the conduct of the recipient of the legal instrument when the statement was received are examined. *SC 1998, p. 1653* can be cited here. In this case, a bond for settlement of street construction fees had been

issued. The bond was to be paid on three payment dates, but it did not carry interest and was not indexed. The mistake made on entering the bond in the computer system of the bank that had undertaken collections on it was that the first payment of the bond was recorded as the principal of the loan. The bond was collected in accordance with this, and the debtor received a demand for only one-ninth of the loan on the agreed upon payment dates and received a receipt for full payment on each of the payment dates. Upon completion of the last payment when one-third of the original principal had been paid, the bond was sent to the debtor with an endorsement for payment in full. Upon payment of the second payment slip, the debtor had asked the bank whether the payment was correctly specified since she had not found documents showing that the date had been paid off more quickly, and she was then told that the information on the payment slip was correct. It was held that the debtor ought to have known about the bank's mistake since it could not be seen that she had reason to suppose that the bond had been paid off more quickly; in fact it carried no interest or indexing. In addition, the debtor had reported the bond in accordance with its correct substance on her tax return, dated 29 May 1994. The payment slips for fully paid payments were held to be invalid on the grounds of Section 32(1), and the endorsement of payment in full of the bond was invalidated on the grounds of Section 33 of the Contracts Act.

It can be inferred from the above judgments that the Supreme Court endeavours to verify the knowledge of the other party regarding the agreement by examining its substance, considering the status of the parties and their lawful expectations regarding the agreement. It is only in special instances that invalidation of provisions on the grounds of Section 32(1) is granted. More often agreement provisions have been left alone, and the parties to an agreement have had to bear responsibility for any mistakes they made in drafting the agreement.

4 The Legal Effect of Mistaken Assumptions in Icelandic Contract Law

As stated above, Section 32(1) is regarded as one of the rules of invalidation in contract law,[33] albeit in a somewhat special manner – because although it can be inferred from the wording of the section that such mistakes are not binding on the drafter if the other party acts in bad faith, and the conditions of the provision are otherwise relevant; this nevertheless does not always lead to the legal instrument being entirely void. This depends on the facts and mistakes involved in each case.

If the other party knows of the mistakes, but neither knew nor ought to have known how the drafter intended to express its statement, it has been argued that the statement is to be entirely invalid.[34] However, it has not always been so that Section 32(1) leads to invalidation of a legal instrument as a whole. In some

33 Matthíasson, Viðar Már, *Fasteignir og fasteignakaup,* Reykjavík 2008, pp. 214-215.

34 Ussing, Henry, *Aftaler paa formuerettens omraade,* Copenhagen 1945, p. 160.

instances, it has led to using this as a basis for the contents that the drafter intended for the legal instrument from the beginning. In some instances, where points are involved that are not of significant importance, this can lead to an unnatural conclusion of cancelling a legal instrument in its entirety;[35] in addition, it must be kept in mind that legal instruments can consist of many mutual duties of the parties to the agreement.[36] Here *SC 1978, p. 166* can be mentioned, where the only issue was whether the interest start date had been a mistake in the writing.

In some instances, it is possible to verify the original intent of the drafter; thus, the substance intended for a legal instrument, had the mistake not occurred, is available. When such exists, Icelandic courts have stricken out the incorrect statement and brought the legal instrument into accord with the original plan of the drafter, see *SC 14 February 2008, Case no. 325/2007* and *SC 2003, p. 1107 (443/2002)*, see *SC 1923, p. 400.*[37] When it can be assumed that the other party ought to have known that the source of a legal instrument intended specific content for its statement, which was a mistake in the writing when drafting the legal instrument, it has been assumed that such a legal instrument is valid, and that it will be fulfilled in accordance with the general rules of contract law, see also *SC 14 February 2008, Case no. 325/2007*.[38] Here it is assumed that the original drafter has shown his intent in drafting the agreement, and may have declared that he wishes to obligate himself as he had originally intended, sf. SC 2003, p. 1107 (443/2002) and SC 1923, p. 400.

5 Conclusion

Section 32(1) is grouped within the invalidation rules of contract law. Nevertheless, the rule enjoys special status amongst these rules since it primarily entails a hint on the construction of legal instruments. It can be inferred from the provision that even though a mistake has been made in drafting a legal instrument, it is generally binding when the other party acts in good faith.[39]

At the beginning of this article, reference was made to recent amendments of the Act on Interest and Price Indexing, No. 38/2001, see Act no. 151/2010. No position will be taken here on whether it was right to amend the loan

35 Lynge Andersen, Lennart, *Aftaleloven med kommentarer 5th edition,* Copenhagen 2008, p. 217.

36 Lynge Andersen, Lennart, *Aftaleloven med kommentarer 5th edition,* Copenhagen 2008, p. 217.

37 Bryde Andersen, Mads, *Grundlæggende aftaleret, 2nd edition,* Copenhagen 2005, pp. 306-407.

38 Ussing, Henry, *Aftaler paa formuerettens omraade,* Copenhagen 1945, p. 161. There it is argued that the main rule is that a legal instrument is invalid, and only in exceptional instances will an agreement be fulfilled, and then when involving attributes not of main importance for the drafter.

39 Jørgensen, Stig, *Kontraktsret1. bind, aftaler,* Copenhagen 1971, p. 145.

agreements of Icelandic borrowers as to the future. On the other hand, we can pause here and examine whether it was correct to recalculate loan agreements from the beginning in the manner provided for in Section 18(5) of the act, especially when it is unfavourable to borrowers. It has been explained that the differences in the terms offered to borrowers when taking loans, on one hand, and the terms to be used when recalculating exchange-rate loans, on the other, has led in some instances to it being deemed that borrowers have not paid particular payments in full on the payment dates involved, and that difference were thus added to the principal of the debt, increasing it. When collecting on these loans, the borrower received written notice by mail, where a payment along with interest was calculated, based on the Icelandic krona's exchange rate on the date of payment. Both parties, borrower and lender, incorrectly believed that loan payments were paid correctly on payment dates, until the Supreme Court held that the indexing provisions of the loan agreements were invalid in *SC 16 June 2010, Case no. 92/2010* and *SC 16 June 2010, Case no. 153/2010*.

The question becomes compelling whether lenders, in light of Section 32(1), were not obligated to abide by the receipts issued in carrying out loan agreements until exchange-rate indexing was held to be unlawful. Evaluating this first requires considering whether the information involved falls within Section 32(1). This was the conclusion in *SC 1998, p. 1653*, where payment receipts issued upon instalments on a bond being paid were invalid on the grounds of Section 32(1). It can only be seen that the same will apply regarding the receipts borrowers received upon making instalment payments on exchange-rate loan agreements. Second, it must be considered whether the payment receipts involved here were a mistake in the writing, or whether other mistakes were made in issuing them, in the meaning of Section 32(1). As related above, Icelandic courts have, by analogy, slotted incidents under Section 32(1) involving mistakes made in the drafting of a legal instrument, on the grounds that the drafter misunderstood the substance of the statement, such as in *SC 1947, p. 293,* see *SC 2003, p. 1107 (443/2002).* The payment receipts involved here were issued on the incorrect premise that the agreed upon exchange-rate indexing was valid. It can only be seen that these incidents fall under Section 32(1), i.e., up until indexing was held to be illegal. The incorrect premise was that an agreement concerning valid indexing had been made, and the payment receipts were issued for payment in full for each instalment. Finally, it must be considered whether borrowers acted in good faith regarding the mistakes made, i.e., that a receipt for payment in full of individual instalments was issued by mistake, since it is forbidden to agree on indexing of loan agreements with reference to foreign currencies.

It is established that both parties, borrower and lender, intended to index the loan agreements, for an index for this purpose was chosen that was forbidden under the Act on Interest and Price Indexing, No. 38/2001. In making this assessment, it must be considered that an agreement is involved between a lender, on one hand, with expertise in the field of finance and business, and a borrower, on the other, who in most instances was a consumer. The general perspective emerged previously from judgments of the Supreme Court that a stringent requirement of meticulousness and caution in business rests on banks and financial institutions. *SC 1995, p. 453*, may be mentioned as an example,

referring to a bank's expertise in securities trading. The district court's judgment also stated that banks must have guidelines of reasonableness and honesty in dealings with borrowers. It has to be regarded as unlikely to deem that individuals have knowledge of the unlawfulness of the indexing agreed upon in exchange-rate loan agreements and the mistakes made in issuing payment receipts for collections on the loan agreements. When the position of the contracting parties is considered, as well as the expertise of financial companies proposing the unlawful terms, seeing to the drafting of agreements and execution of collections on the loan agreements, it has to be deemed unlikely to believe that their payment receipts were invalid although they could have been issued on mistaken assumptions regarding validity of exchange-rate indexing.

The question therefore arises whether the legislative body, by passing Act no. 151/2010, see Act no. 38/2001, intervened retroactively in the civil contractual relationship of lenders and borrowers, contravening Section 32(1), especially where borrowers have made payment in full and in accordance with the original loan agreement concerning individual payment dates.[40]

40 On 15 February 2012, /SC 15 February 2012, Case no. 600/2011), shortly before this article went into print, the Icelandic Supreme court held that this retroactive recalculation was not binding on borrowers of such loans, when they had received payment receipts and paid their instalments in full.

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