Chapter 9 – Contractual Capacity

Section 9 -1

Contractual Capacity – ability to understand the consequences of a contract

This concept is not about whether the contracting party really does understand the terms of a specific contract – only that:
- They possess the potential ability to understand them

While sounding contradictory its possible.

Ex. Remember Bill our car buyer from the chapter on Genuine Assent, he didn’t fully understand the contract terms (had to pay sales tax) but he certainly had the potential ability to understand the terms.
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In contracting, some parties are assumed, by definition, to lack “Capacity”. They are:

- Minors (who a minor is varies by state)
- Intoxicated (drugs or alcohol)
- Mentally Impaired (could include impairment due to illness)

These groups are all said to be incapacitated, and can’t be legally bound by a contract
Minors:
- You must have reached the age of majority to have capacity

The age of majority – when you are deemed to be old enough to handle your own affairs, including contracting – varies

In most states it is 18 – some it is 19 or 21
In Illinois it is age 18
What do you think the proper protection for those that are incapacitated (lack capacity)?

So far we have seen circumstances in which contracts are:
- Voidable (the parties can ignore their contractual obligations)
- Subject to rescission (everything goes back the way it was)

When someone is incapacitated, the contracts are considered voidable. The protection the incapacitated person can seek is called - disaffirmance
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<table>
<thead>
<tr>
<th>Voidable</th>
<th>Rescission</th>
<th>Disaffirmance</th>
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<tbody>
<tr>
<td>Like the contract never happened (Party can ignore there contractual obligations)</td>
<td>Contract was executed/ratified but we do our best to put everything back to how it was pre-contract</td>
<td>Voidable and the incapacitated party gets back whatever they put into the contract, but they are not obligated to put things right for the other party</td>
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What’s going on – why is the law so unfair to the people contracting with incapacitated?
Contracts – Capacity

Under **disaffirmance**, some unusual outcomes can occur:

- Minors can be encouraged to contract, and take advantage of disaffirmance rules
- Others will not want to contract with those lacking capacity, like a minor, fearing they will later disaffirm the contract, and not pay for things

There are special provisions in the rules to protect against this:

**Necessaries vs. Unnecessaries**

Under this rule, the incapacitated can’t contract for **certain** things and then disaffirm. If buying **Necessary items; food, clothing, shelter** they are required to pay reasonable value for what they got.

Ex. #1 - Minor contracts for a $5,000 fur coat. They later disaffirm (don’t pay) the contract, keeping the coat. Under the law they must pay at least a reasonable amount for the coat – say $200, the cost of a good cloth coat.
Contracts – Capacity (Necessaries)

Example #2:

Nash, a tailor on Madison Avenue, entered into a contract to supply Rico (a UIC undergraduate student) with 6 custom T-shirts, costing $35 each. Rico was a minor. Nash sought payment from Rico, who claimed he was a minor and would disaffirm the contract and keep the T-shirts.

How might the judge find?

These are clothes (necessaries), so Rico should have to pay at least a reasonable amount for the T-shirts. Perhaps $10 a shirt vs. the custom cost of $35 a shirt.
Why is Disaffirmance allowed?

The rules are set up to protect both sides.

1) The incapacitated – Under the law, we don’t want people who are vulnerable to be taken advantage of when contracting
   - Under the Necessaries rule, they can’t be tricked into paying for expensive things or things they don’t need

2) The other contracting party – Adding the necessaries rule, allows for contracting on important items. The other party can be assured they’ll get paid
   - It is not meant to protect those trying to sell and contract for Unnecessary items
Case #1 – Clare’s Grocery Bill

Clare was age 17, a minor in her state, when she bought a week’s worth of groceries at a local supermarket. Later she discovered she spent too much money and was going to be over the weekly food budget. So she took the groceries back and asked for her money back. The store refused, citing its no return policy.

If she sues, will she get her money back?
Another Rule related to Capacity

Recall the act of *ratification* under a contract. Ratification says the contracting party loses the right to void (in this case disaffirm) a contract, if they take action under the contract.

This usually applies for a minor. A minor can disaffirm while they remain incapacitated (still a minor).

Upon reaching majority and acting under the contract, the opportunity to void and disaffirm the contract is lost.
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Example #3 - Imagine a 17 year old minor named Roberto goes to the Apple store, buys an iPhone X and a one year contract, with cancellation fees. Later that week he drops the phone and cracks the screen.

Can he go back to the store and demand his money back? (The courts don’t think about cell phones as necessary.)

Does he have to return the phone?

Answer: As a minor, if the phone is not considered “necessary” then Roberto can disaffirm and avoid future payments. He gets his money back and the Apple store only gets the damaged phone back.
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Example 3 (continued). Let’s assume Roberto has now turned 18 (past the age of minority). Roberto makes several monthly contractual payments. He drops the phone and cracks the screen. What happens to Roberto’s right to void the contract as a minor?

Answer: Even though he bought the phone as a minor, he loses the ability to disaffirm the contract, because he ratified it. His act of making monthly payments after turning 18 was his ratification.
Emancipation. What event do we think of to define Emancipation? It simply means freedom.

Technically minor children live under a Parent/Guardian – Child Relationship

It is possible to be legally “freed” (sever the parent – child relationship) before we reach the age of majority.
Formal and Informal Emancipation

Formal – Parent and Child agree to have a court decree that the minor is emancipated.

Informal (there is evidence that the relationship has already ceased):
- Cease support
- Leave home
- Get Married
- Join the Armed Forces
- Give birth
- Take on full time employment

How you are treated from this point depends on the state.
Contracts - Capacity

Lying about your age?

Even if you lie – as a minor you are still allowed to disaffirm the contract

(But may have to deal with the crime of misrepresentation if damage occurs)

The concept is represented well in this movie clip, from the movie “Liar, Liar”

https://www.bing.com/videos/search?q=youtube%2c+liar+liar%2c+courtroom+scene%2c+lied+about+her+age&docid=608003253743718176&mid=3E1A061DA3795ECE46F33E1A061DA3795ECE46F3&view=detail&FORM=VIRE
Mentally Incapacitated

The definitions for what constitutes mental incapacity can vary a lot. It can relate to mental incapacity (sometimes temporary, the mentally underdeveloped, and disease or age related capacity). Court will often have to determine whether the person had the ability to understand the contract at the time it was entered into.
Emily was 88 years old when she contracted to sell her family home to her nurse, Gail, for about 15% of its fair value. At the time, she was being cared for by her nurse due to an advanced case of Alzheimer’s Disease and didn’t understand the consequences of the transaction. Two months later Emily died. Her will provided for all her property to be split equally among her four children. Emily’s children sued to have the sale set aside (undone) because Emily lacked the mental capacity to contract.

How do you think the court found and why?
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**Intoxication:**
The standard applied is often like that for Mental Incapacity – did the person have the ability to understand the terms of the contract when they entered into it.

Often disaffirmance is not allowed in intoxication cases, since its voluntary to be intoxicated.

Disaffirmance is usually only allowed if someone is so intoxicated they didn’t even know they entered into a contract. That goes something like – “I was where and promised to do what for who!!!”
Case #3 – June Buys Insurance

June stopped by a bar on the way home from work and drank three gin and tonics. Then she bought six-pack of beer at the local grocery store and drank three cans before her husband came home. June and her husband began drinking whiskey and water and each finished two drinks. A salesperson from Metropolitan Life Insurance came over and sold June a life insurance policy that cost $3,000 per year.

Is there any evidence that June may be able to disaffirm?
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**Scope of Authority**

In an organization, the authority or right to bind the company to a contract, is usually spelled out in a policy. Someone who has the right to contract is referred to as having that **Scope of Authority.** It can be subject to certain $ limits or types of purchases.

As the other party, you need to ensure the person who is signing the contract has authority as the signor for the company.

The Individual, and not the company, may be liable for the terms of the contract.