

# Week 6: Capacity

## Introduction to Capacity

- Rules are there to protect the weak and less capable
- Generally need to consider the following categories:
  - Minors (under 18) – Generally do not have capacity... but
  - Mental incapacity – Mental Capacity Act 2005
  - Intoxication – **Matthews v Baxter (1873)**;  
**Imperial Loan v Stone (1892)**



## Minors

- In most states, a person is no longer a minor for contractual purposes at the age 18.
- A minor can enter into any contract that an adult can.
- A contract entered into by a minor is voidable at the option of that minor.

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## Disaffirmance

- A contract can be disaffirmed at any time during minority or for a reasonable period after the minor comes of age.
- Minor must disaffirm the entire contract.
- Disaffirmance can be expressed or implied.

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## Minor's Obligation on Disaffirmance

- In most states, minor need only return the goods (or other consideration) subject to the contract, provided the goods are in the minor's possession or control.
- In increasing number of states, the minor must restore the adult to the position held before the contract was made.

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## Exceptions to Minor's Right to Disaffirm

- Misrepresentation of Age.
  - Generally, minor can STILL disaffirm the contract even if he lied about his age.
  - But some states prohibit disaffirmance and hold the minor liable in such cases.
- Contracts for Necessaries.
  - Contracts for food, clothing, shelter may be disaffirmed by minor, who remains liable for the reasonable value of goods or services.

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## Exceptions to Minor's Right to Disaffirm

- Insurance.
  - Not viewed as necessities, so minor can disaffirm contract and recover all premiums paid.
- Loans.
  - Seldom considered to be necessities.
  - Exception:
    - Loan to a minor for the express purpose of enabling the minor to purchase necessities.

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## Ratification

- Occurs when a minor, on or after reaching majority, indicates (expressly or impliedly) an intention to become bound by a contract made as a minor.

## Intoxicated Persons



- Lack of contractual capacity at the time the contract is being made.
- Contract can be either voidable or valid.
  - Courts look at **objective indications** to determine if contract is voidable.
- If voidable:
  - Person has the option to disaffirm, or
  - Person may ratify the contract expressly or impliedly.

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**Chapter 3****CAPACITY****3.1 INTRODUCTION**

Any person can enter into a contract. In order to make an enforceable contract, however, the contracting parties must have capacity in law to enter into the agreement. The reason for the requirement of capacity is the need to protect vulnerable contracting parties from themselves, or to safeguard against exploitation due to their mental state. In this regard certain classes of contracting parties are considered to have limited capacity: (1) minors; (2) mentally incapacitated persons; (3) the intoxicated; and (4) corporations.

**3.2 MINORS**

A minor is considered to be any person under the age of 18 years (s. 1 Family Law Reform Act 1969). The general rule is that while contracts with minors are not enforceable against them, they are enforceable against the other party and are voidable at the minor's petition. This can lead to those who have invested time and money in the minor's career being left without any redress, either against the minor or any third party with whom the minor subsequently enters into a contract. Accordingly, exceptions to the general rule exist and these exceptions are considered below.

**3.3 VALID CONTRACTS**

These are as follows:

**3.3.1 CONTRACTS FOR NECESSARY GOODS AND SERVICES**

Contracts for necessary goods and services are valid and enforceable against minors as long as they have a utility value and are not mere indulgences. In other words, contracts for necessities are binding if they confer an overall benefit on the minor. Contracts will not be binding, however, where the terms are such that, taken as a whole, the contract is not of general benefit to the minor (*Fawcett v Smethurst* (1914) 84 LJKB 473).

**Common law:**

At common law, the courts tend to adopt a broad interpretation as to what is considered "necessary". The status of the minor is an important consideration and the courts tend to be more sympathetic towards what the particular minor is accustomed to as "necessary". An important factor, therefore, is the minor's standard of living. A "mere luxury", however, rather than a "luxurious article of utility", will not be regarded as necessary, nor will items bought as gifts for others be so regarded (*Ryder v Wombwell* (1868) LR 4 Exch 32). In *Peters v Fleming* (1840) 151 ER 314, a gold ring and watch chain were held to be necessities for the child of a Member of Parliament (MP). A claim by a tailor to enforce payment for the supply of 11 fancy waistcoats to a dandy Cambridge undergraduate did not succeed because the claimant failed to prove that the waistcoats supplied did not suit the dandy's actual requirements at the time of their sale and delivery, even though they were suitable to the minor's particular lifestyle (*Nash v Inman* [1908] 2 KB 1). The court reached the same conclusion based on similar facts in

*Barnes & Co v Toye* (1884) 13 QBD 410, despite the supplier being unaware of the minor's sartorially satisfied situation.

**Statute:**

Section 3(3) of the Sale of Goods Act (SOGA) 1979 verifies the common law's approach to goods by defining contracts for necessary goods as those "...suitable to the condition in life of the minor... and to his actual requirements at the time of the sale and delivery...". While SOGA does not apply to necessary services (e.g. cosmetic treatment), the statute follows the common law by requiring the minor to pay a reasonable price.

**3.3.2 CONTRACTS WHICH ARE BENEFICIAL TO THE MINOR**

Contracts of employment, education or training may be enforceable if, on the whole, they are beneficial to the minor, having regard to all the circumstances. Thus, in *Roberts v Gray* [1913] 1 KB 520, a young aspirant agreed to accompany a professional billiards player on a world tour in order to advance the minor's fledgling career in the sport. The minor withdrew after a dispute arose between him and the professional and the minor refused to go. The court awarded damages to the professional player, since the instruction the minor would have received would have been for the minor's benefit. The court reached an opposite conclusion, however, where a minor agreed to be bound by apprenticeship deed to a dance instructor for seven years in order to learn the art of stage dancing (*De Francisco v Barnum* (1892) LR 43 CH D 165). Although the contract was on the face of it for the minor's benefit, the court considered the terms of the contract to be unreasonable; for example, while the minor was bound not to marry during the term of her apprenticeship and forbidden from accepting any professional engagements without the instructor's consent, the instructor, on the other hand, was not bound to maintain or provide the minor with any work. The contract was held to be unenforceable.

The employment of minors between 13 and 16 years of age is now restricted by statute, e.g.: s. 18(1) Children and Young Persons Act 1933; s. 1(3) Employment of Children Act 1973; and Reg. 2(1) Children (Protection at Work) (No.2) Regulations (SI 2000/2548).

**3.4 OTHER CONTRACTS RELATED TO EARNING A LIVING**

The rules about beneficial contracts of service also apply to contracts that govern the way in which the minor earns a living. In *Doyle v White City Stadium* (1935) 1 KB 110, for example, a contract between a boxer who was a minor and the British Boxing Board of Control, where the boxer was granted a licence in return for complying with the Board's rules, was held to be enforceable, despite the contract operating to the disadvantage of the minor. This decision was followed in *Chaplin v Leslie Frewin* [1966] Ch 71; [1965] 3 All ER 764, where the claimant's attempt to repudiate the contract for his autobiography failed (it allegedly portrayed him as a "depraved creature"), on the grounds that the contract was both lucrative and advanced his career as an author.

The contract must, however, serve the purpose of enabling the minor to earn a living. In *Proform Sports Management Ltd v Proactive Sports Ltd* [2006] EWHC 2903 (Ch); [2007] 1 All ER 542, Proform presented a claim against Proactive. It asserted that the representation agreement into which Proform entered with the footballer Wayne Rooney, when he was 15 years old, was binding on him and that Proactive wrongfully procured a minor to breach the Proform contract. His Honour Judge Hodge, sitting as a Judge of the High Court in the Chancery Division, Manchester, found that a contract with a sports agent was not necessary for services. Rather, Rooney was already registered with Everton FC, which subsequently employed him. The contract was, therefore, voidable, since it was the contract with Everton that provided his employment and training.

### 3.5 VOIDABLE CONTRACTS

Examples of voidable contracts include: buying shares in a company; entering into a partnership and buying or leasing property. These contracts tend to be of a continuous or permanent nature. They are considered valid unless the minor repudiates them, either during minority, or within a reasonable time of attaining majority. This is so even if the minor is unaware of his right to repudiate (*Edwards v Carter* [1893] AC 360).

A contract is enforceable against a minor until its repudiation by the minor. Accordingly, liability attaches to a minor for rent until the lease is forfeited (*Blake v Concannon* IR 4 CL 323 (1870)). Similarly, a minor is liable for calls on shares until they are repudiated. In *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452, the claimant repudiated a contract after being unable to meet future calls on shares she had acquired. The claimant's pleadings to have her name removed from the share register and for recovery of the money already paid failed, because there had not been a total failure of consideration, since the allocation of the shares had conferred a benefit on her as they were of some value. A minor's partner, however, is not liable for debts suffered by the partnership, but neither is the partner entitled to share in the partnership assets until its debts are cleared (*Lovell and Christmas v Beauchamp* [1894] AC 607).

In relation to interests in land, it should be noted that s. 1(6) of the Law of Property Act 1925 prevents a minor from holding a legal estate in land. The interests concerned will therefore always be equitable.

### 3.6 REMEDIES

There may have been some performance of a contract with a minor which is either non-binding unless ratified or binding unless repudiated.

#### 3.6.1 RECOVERY OF MONEY PAID BY MINORS

A minor cannot recover money paid or property transferred by the minor under a contract unless the minor can show that there was a total failure of consideration. In other words, the minor must prove that he or she did not receive any benefit whatsoever under the contract. Proving total failure of consideration is no straightforward matter (see *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452).

#### 3.6.2 REMEDIES AGAINST MINORS

These are as follows:

##### 3.6.2.1 Liability in Restitution

Although a minor who is not obliged to execute a contract may still be liable to make restitution to an adult with regard to any enrichment resulting from the adult's performance of the contract, the general approach of the law has been "to safeguard the weakness of [minors] at large, even though here and there a juvenile knave slipped through" (*R Leslie Ltd. v Sheill* [1914] 3 KB 607, per Lord Sumner at 612).

In this respect, the law seeks to avoid the indirect imposition of liability on an immature contracting party, such as where a minor is ordered to repay a loan (*R Leslie Ltd. v Sheill*) or to pay a reasonable price for non-necessary goods and services (*Lemprière v Lange* 12 Ch D 675 (1879)). The decisions on the question of the contractual liability of minors are difficult to

reconcile. In *R Leslie Ltd. v Sheill*, where a child fraudulently misrepresented his age to obtain a loan which he squandered, the court approved the narrow approach. Lawrence J stated that: "If when the action is brought both the property and the proceeds are gone, I can see no ground upon which a court of equity could have founded jurisdiction."

In the same case, Lord Summer expressed the view that:

"the whole current of decisions down to 1913, apart from *dicta* which are inconclusive, went to show that when an infant obtained an advantage by falsely representing himself to be of full age equity required him to restore his ill-gotten gains, or to release the party deceived from obligations or acts in law induced by the fraud, but scrupulously stopped short of enforcing against him a contractual obligation entered into while he was an infant, even by means of a fraud .... Restitution stopped where repayment began."

The contrary approach had been preferred in the earlier case of *Stocks v Wilson* [1913] 1 KB 235, where a minor who had obtained goods by misrepresenting his age, and had later sold them, was held accountable for the proceeds of sale. *Stocks v Wilson* illustrates the law's instinct to shield minors from the consequences of contractual liability, however, because the minor's obligation to restore funds only survived as long as the proceeds remained in the minor's hands.

### 3.6.2.2 Restitutory Liability under the Minors' Contracts Act 1987

Section 3(1) of the Minors' Contracts Act (MCA) 1987 provides a statutory method of ordering children to make restitution where the contract is not enforceable. Accordingly, "the court may, if it is just and equitable to do so", order the minor to transfer to any other party "any property acquired" by the child under the contract or "any property representing it". The minor must, therefore, offer up any goods acquired in exchange for non-necessary goods if ordered to do so by the Court, although the minor cannot be sued for the price. The tradesman recovers the goods in the state he finds them and may not demand that the minor pay compensation, even if the goods are damaged.

## 3.7 MENTALLY INCAPACITATED PERSONS

A person lacks capacity under s. 2 of the Mental Capacity Act (MCA) 2005 if he is "unable to make a decision for himself in relation to the matter because of an impairment of, or a disturbance in the functioning of, the mind or brain" at the time the contract is made, whether the impairment is permanent or temporary. Section 3(1) MCA 2005 defines this impairment in respect of the inability: (a) to understand the information relevant to the decision; (b) to retain that information; (c) to use or weigh that information as part of the process of making the decision; or (d) to communicate his decision (whether by talking, using sign language or any other means). The relevant information, according to s. 3(4) MCA 2005, includes information about the reasonably foreseeable consequences of: (a) deciding one way or another; or (b) failing to make the decision. Under s.7 MCA 2005, the mentally incapacitated party is liable to pay a reasonable price for necessary goods and services.

Under common law a contract made by a person who, by reason of mental abnormality, is incapable of understanding what he is doing, is valid unless he can prove: (a) he did not understand the nature of the contract; and (b) the other party was aware of his impairment. Accordingly, where a defendant argued that he was insane at the time of making a promissory note and that the claimant knew this, the court held that the defendant had to convince the court on both issues, not just that he was insane at the time (*Imperial Loan Co. v Stone* [1892] QB 599). This approach was followed by the Privy Council in *Hart v Connor* [1985] 2 All ER 880, where an agreement to sell land was affirmed even though the claimant was shown to be

mentally incapacitated, because his mental incapacity was not apparent to the buyer.

### **3.8 INTOXICATION**

The same principles that apply to mental incapacity apply to the fact of intoxication, whether through alcohol or other intoxicating substances. Therefore, a contract made by a person, who by reason of intoxication is incapable of understanding what he is doing, is valid unless he can prove: (a) he did not understand the nature of the contract; and (b) the other party was aware of his impairment.

Contracts are therefore voidable if one party knew of the other party's level of intoxication. Further, the mentally incapacitated party is liable to pay a reasonable price for necessary goods and services. Whilst it will not always be apparent that a person is of unsound mind, it will generally be obvious that a contracting party is drunk. It will generally be easier, therefore, for a drunken contracting party to avoid a contract made while intoxicated, because the other party is more likely to have realised this. As is the case with mentally incapacitated persons, if an intoxicated person ratifies the contract at any point, he will be bound by the contract, as long as he is capable of understanding what he is doing. Accordingly, where a claimant agreed to buy property from the defendant whilst drunk, and then subsequently ratified and confirmed the contract after sobering up, it was held that both parties were bound by the contract (*Matthews v Baxter* (1873) LR8 Exch 132).

### **3.9 CORPORATIONS**

A company on incorporation becomes a legal person. The power of a registered company is dictated by the objects clause of its memorandum of association.

#### **3.9.1 ULTRA VIRES RULE**

At common law, those acts or contracts beyond the powers conferred on a company by the memorandum of association were *ultra vires* and therefore void (see *Ashbury Railway and Carriage and Iron Co. v Riche* [1875] LR 7 HL 653). Such contracts are generally enforceable due to s. 35 Companies Act 1985 (now s. 39 Companies Act 2006).

#### **3.9.2 THE COMPANIES ACT**

The effects of ss. 39-42 Companies Act 2006 practically eliminate the doctrine of *ultra vires* in relation to a third party who deals in good faith with a company, making its contracts valid and enforceable. Only if a party that contracts with a company has acted in bad faith, knowing that a company exceeded its capacity, will a contract cease to be valid (s. 40 Companies Act 2006). Additionally, s. 31(1) Companies Act 2006 provides that unless "...a company's articles specifically restrict the objects of the company; its objects are unrestricted...". This has the effect that a company is considered to have unlimited objects, unless it opts for restrictions. A company, therefore, need not draft huge objects clauses.

Section 171 Companies Act 2006 imposes a statutory duty on the directors to comply with the company's constitution. A shareholder who disagrees with an action outside the company's objects must, therefore, sue the directors for any loss. The directors may be liable for a breach of duty if they fail to observe limitations in a company's capacity contained in the memorandum of association. The validity of a contract entered into by a company shall not be challenged because of lack of capacity by reason of anything in the company's constitution.

Sections 39 and 40 Companies Act 2006 (company's capacity and power of directors to bind company) do not apply to the acts of a company that is a charity except in favour of a person who: (a) does not know at the time the act is done that the company is a charity; or (b) gives full consideration in money or money's worth in relation to the act in question and does not know (as the case may be) (i) that the act is not permitted by the company's constitution, or (ii) that the act is beyond the powers of the directors.