*Chapter 9*

**Capacity, Legality,**

**and Enforceability**

Answers to Learning Objectives/

Learning Objectives Check Questions

at the Beginning and the End of the Chapter

**Note that your students can find the answers to the even-numbered *Learning Objectives Check* questions in Appendix E at the end of the text. We repeat these answers here as a convenience to you.**

**1A.** ***Does a minor have the capacity to enter into an enforceable contract? What does it mean to disaffirm a contract?*** A minor can enter into any contract that an adult can en­ter into, except a contract prohibited by law for minors. Generally, a contract en­tered into by a minor is voidable at the minor’s option. Disaffirmance is the legal avoidance, or setting aside, of a contractual obligation. The minor can disaffirm the contract by indicating an intent not be bound to it.

**2A.** ***Under what circumstances will a covenant not to compete be enforced? When will such covenants not be enforced?*** A covenant not to compete can be enforced:

**1.** If it is ancillary (secondary) to an agreement to sell an ongoing business, thus enabling the seller to sell, and the purchaser to buy, the goodwill and reputa­tion of the business.

**2.** If it is contained in an employment contract and is reasonable in terms of time and geographic area.

A covenant not to compete will be unenforceable if it does not protect a legitimate business interest or is broader than necessary to protect a legitimate interest. This is because such a covenant would unreasonably restrain trade and be contrary to public policy.

**3A.** ***What is an exculpatory clause? In what circumstances might exculpatory clauses be enforced? When will they not be enforced?*** An exculpatory clause releases a party from liability in the event of monetary or physical injury, no matter who is at fault. An exculpatory clause may be en­forced if a party seeking its enforcement is not involved in a business consid­ered important to the public interest. An exculpatory clause will not be en­forced if a party seeking its enforcement is involved in a business that is impor­tant to the public interest.

**4A.** ***What is the difference between a unilateral and a bilateral mistake?*** A unilateral mistake occurs when only one party is mistaken as to a material fact underlying the contract. Normally, the contract is enforceable even if one party made a mistake, unless an exception applies. A bilateral, or mutual, mistake occurs when both parties are mistaken about the same material fact. When the mistake is mutual, the contract can be rescinded, or canceled, by either party.

**5A.** ***What contracts must be in writing to be enforceable?*** Contracts that are normally required to be in writing or evidenced by a written memorandum include:

**1.** Contracts involving interests in land.

**2.** Contracts that cannot by their terms be performed within one year from the day after the date of formation.

**3.** Collateral contracts, such as promises to answer for the debt or duty of another; Promises made in consideration of marriage.

**4.** Contracts for the sale of goods priced at $500 or more.

Answers to Critical Thinking Questions

**in the Features**

**Adapting the Law to the Online Environment—Critical Thinking**

***So far, victims of catfishing have had little success in the courts. Under what circumstances might a person be able to collect damages for fraudulent misrepresentation involving online impersonations?*** Online impersonation of a professional—such as an accountant, securities broker, adviser, nutritionist, or therapist—might lead to liability for fraudulent misrepresentation. Someone posing as some type of professional would likely have a LinkedIn account and a Facebook page with lots of “likes” and a big following on Twitter. If that person gave advice or other services for a fee, there would be a contract and a commercial transaction. The victim who paid the fee and relied on the advice to his or her detriment might then be able to prove fraud because of the commercial aspect of it.

**Beyond Our Borders—Critical Thinking**

***If a country does not have a Statute of Frauds and a dispute arises over an oral agreement, how can the parties substantiate their positions?*** The proof might be no different than it is under the current law. Parties could offer written documents, oral testimony, and evidence of conduct to prove agreements and their terms.

Answers to Critical Thinking Questions

**in the Cases**

**Case 9.1—Critical Thinking—Legal Consideration**

***Could PAK Foods successfully contend that S.L.’s minority does not bar enforcement of the arbitration agreement because medical expenses are necessaries? Discuss.*** No, PAK Foods could not succeed in contending that S.L.'s minority does not bar enforcement of the arbitration agreement because medical expenses are necessaries. Of course, minors may be held liable on a contract to furnish necessaries. And necessaries are generally considered to be items like food, lodging, clothing, medicine, and medical attention, and may include attorney's fees in some circumstances. But the contract at issue in the *PAK Foods* case concerns a minor's employment and the resolution of disputes arising during that employment—the contact is not for the provision of necessaries.

**Case 9.2—Critical Thinking—Social Consideration**

***At the time Holmes had signed the release, KSDK had not yet become a sponsor of the event. Should this fact have rendered the clause unenforceable? Explain.*** No. At the time that Holmes signed the release, KSDK had not yet become a sponsor of the event, but that fact did not make the clause unenforceable. As the court stated in its opinion, the release of “any Event sponsors” clearly released all sponsors without exclusion. The release is not ambiguous because it does not specifically indicate that it applies to sponsors who had not signed a sponsorship agreement at the time the release was executed.

In this case, the exculpatory clause was a release of claims for any injury or accident “that may occur during my participation in this Event or while on the premises of this Event.” Thus, the clause specifically governed liability for injuries or accidents arising out of a participant's participation in and presence at the event. The clause released “any Event sponsors.” KSDK was a sponsor of the event. The release of “any Event sponsors” plainly released all sponsors without exclusion. This plain language cannot reasonably be interpreted to release only those sponsors who had signed a sponsorship agreement before a participant signed the release.

**Case 9.3—Critical Thinking—Legal Consideration**

***Did Shivley’s misrepresentations rise to the level of fraud? Explain.*** Yes. Shivley's misrepresentations to Cronkelton that he had taken the appropriate steps to winterize the property rose to the level of fraud. The elements of fraud are (1) the misrepresentation of a material fact, (2) an intent to deceive, (3) an innocent party’s justifiable reliance on the misrepresentation, and (4) to collect damages, the innocent party must have been harmed as a result of the misrepresentation.

In the *Cronkelton* case, Shivley’s statements were (1) misrepresentations of material fact, (2) made (or concealed) with the intent to mislead, (3) justifiably relied on by Cronkelton, and (4) the cause of damage to Cronkelton. Shivley told Cronkelton that the property would be winterized. When this was not done sufficiently, Shivley did not inform Cronkelton. Cronkelton relied on Shivley’s statements and did not further inspect the property until after the sale when he discovered the damage that freezing had done to the building and equipment.

Answers to Questions in the Reviewing Feature

at the End of the Chapter

**1A.** ***Capacity***

Beaver did not have the capacity to enter into a contract whether or not it included an exculpatory clause because she was a minor, or, more accurately, she could enter into the contract but she could opt to disaffirm it. Her parents were not minors, however, and could be held to their contracts, including the contract at issue in this problem if it otherwise meets all of the legal requirements.

**2A.** ***Disaffirmance or ratification***

To disaffirm a contract, a minor must express an intent by words or conduct not to be bound. Here, the filing of a suit would certainly indicate an intent not to be bound. If Beaver had reached the age of eighteen a reasonable time before attempting to disaffirm, however, she could be held to have impliedly ratified the contract.

**3A.** ***Age of majority***

Beaver’s misrepresentation of age would not usually affect her right to disaffirm the contract, but in some states, the opposite is true—she would be bound to the clause.

Answer to Debate This Question in the Reviewing Feature

at the End of the Chapter

***Many countries have eliminated the Statute of Frauds except for the sale of real estate.  The United States should do the same.*** Certainly, unfair situations arise concerning the enforceability of contracts or contract modifications because they were not evidenced by a writing or record.  By eliminating the defense provided by the Statute of Frauds, there would be fewer unjust decisions that are based on the lack of a writing or record.

In contrast, the requirement of a writing or record for certain contracts to be enforceable does avoid the “she said, I said” arguments that could be used after the fact when a simple oral contract was made.  In other words, unjust judicial decisions are avoided, too, if the Statute of Frauds is a requirement before certain contracts can be enforced.

Answers to Issue Spotters

at the End of the Chapter

**1A.** ***Sun Airlines, Inc., prints on its tickets that it is not liable for any injury to a passenger caused by the airline’s negligence. If the cause of an accident is found to be the airline’s negligence, can it use the clause as a defense to liability? Why or why not?*** No. Generally, an exculpatory clause (a clause attempting to absolve parties of negligence or other wrongs) is not en­forced if the party seeking its en­forcement is in­volved in a business that is important to the public as a matter of practical necessity, such as an air­line. Because of the essential nature of such ser­vices, the parties have an ad­vantage in bargaining strength and could insist that anyone contracting for its ser­vices agree not to hold it liable.

**2A.** ***My-T Quality Goods, Inc., and Nu! Sales Corporation orally agree to a deal. My-T’s president has the essential terms written up on company letterhead stationery and the memo is filed in My-T’s office. If Nu! Sales later refuses to complete the transaction, is this memo a sufficient writing to enforce the contract against it? Explain your answer.*** No, this memo is not a sufficient writing to enforce the contract against Nu! Sales because it does not include Nu!’s signature. If My-T had been the party refusing to complete the deal, however, the memo would be considered a sufficient writing to enforce the contract against it. Letterhead stationery can constitute a signature. If the memo names the parties, the subject matter, the considera­tion, and the quantity involved in the transaction, it may be sufficient to be enforced against the party whose letterhead appears on it.

Answers to Questions and Case Problems

**at the End of the Chapter**

**Business Scenarios and Case Problems**

**9–1A. *Contracts by minors***

A contract for shelter for a minor can be classified as a necessary if the con­tract meets three criteria: (a) the item contracted for is absolutely necessary for the minor’s existence, (b) the item contracted for is within the station (in­cluding financial) of life the minor is accustomed to, and (c) the minor is not under the care of a parent or guardian who is required to supply these neces­saries. When these three criteria are met, minors can disaffirm their contrac­tual liability, although they continue to be liable for the reasonable value of any contracted‑for item based on use. In this case, Kalen made a contract for shel­ter, which appears to be of a type suitable for his station in life. He is self‑supporting, having removed himself from the care of his parents. The lease is a contract for a necessity, and, although Kalen can disaffirm the lease con­tract, he is liable in quasi contract for the reasonable value based on use. Thus, the landlord can keep the four months’ rent paid by Kalen (assuming that $450 per month is a fair market value), but the landlord cannot hold Kalen liable for the balance on the lease.

**9–2A. *Duress***

Undue influence arises from a relationship in which one party can, through unfair persuasion, greatly influence or overcome the free will of another. Any contract entered into under excessive or undue influence lacks genuine assent and is therefore voidable. Here, the influence of Philip over his Uncle Jerome is greatly enhanced by Jerome’s reliance on Philip for his support. Although Jerome cannot claim duress, the domination of Philip over Jerome’s decisions results in undue influence. The contract is primarily for the benefit of Philip, and Philip used unfair persuasion in securing the contract from Jerome. Jerome can have the contract set aside.

**9–3A. Business Case Problem with Sample Answer—*Unconscionable contracts or clauses***

In this case, the agreement that restricted the buyer’s options for resolution of a dispute to arbitration and limited the amount of damages was both procedurally and substantively unconscionable. Procedural unconscionability concerns the manner in which the parties enter into a contract. Substantive unconscionability can occur when a contract leaves one party to the agreement without a remedy for the nonperformance of the other.

Here, GeoEx told customers that the arbitration terms in its release form were nonnegotiable and that climbers would encounter the same requirements with any other travel company. This amounted to procedural unconscionability, underscoring the customers’ lack of bargaining power. The imbalance resulted in oppressive terms, with no real negotiation and an absence of meaningful choice. Furthermore, the restriction on forum (San Francisco) and the limitation on damages (the cost of the trip)—with no limitation on GeoEx’s damages—amounted to substantive unconscionability.

In the actual case on which this problem is based, the court ruled that the agreement was unconscionable.

**9–4A. *Mental incompetence***

No. Contracts made by mentally incompetent persons can be void, voidable, or valid. Mentally incompetent persons not previously so adjudged by a court may enter voidable contracts if they do not know they are entering into a contract or if they lack the mental capacity to comprehend its subject matter, nature, and consequences. Whenever there is no prior adjudication of mental incompetence, most courts examine whether the party was able to understand the nature, purpose, and consequences of his or her act at the time of the transaction.

In this problem, Dorothy suffered from dementia and chronic confusion at the time that the residency agreement was executed. In fact, she needed an assisted living facility precisely because she was unable to manage her own affairs, including decisions about medical and financial matters. Under other circumstances, a party who accepts services and living quarters—as Dorothy did—can be said to have accepted the benefits of the agreement and thus manifested assent. Here, however, Dorothy’s acceptance of benefits cannot amount to assent to a contract, because she lacked the capacity to give her assent.

In the actual case on which this problem is based, the court denied the facility’s request to compel arbitration.

**9–5A. *Statute of Frauds***

Yes. A writing to satisfy the Statute of Frauds can consist of any order confirmation or other document, alone or in combination with other items, in hard copy or electronic copy, including e-mail. The item or items need only contain the essential terms of the contract to bind both parties to the writing. This includes the names of the parties, the subject matter, the consideration, and the quantity, and in the case of a contract involving an interest in land, the location, price, and description of the property. The party against whom enforcement is sought must have signed the writing. An electronic signature, such as a party’s name typed at the bottom of an e-mail note, satisfies the signature requirement.

In this problem, the e-mails between the parties included messages sent under the landlord’s name. Among those messages was a copy of the agreement to pay Newmark’s commission with a demand to pay the amount in installments. Newmark e-mailed a revised version of the agreement that set out all of the essential terms to the landlord, who did not object to it. This met the requirements of a writing under the Statute for Frauds. Thus, Newmark was entitled to the payment of its commission.

In the actual case on which this problem is based, the landlord did not pay the commission. In Newmark’s later suit to collect, a court ordered the landlord to pay the broker.

**9–6A. *Minors***

No, a minor does not so lack the capacity to contract that he or she cannot enter into a binding settlement without court approval. The general rule is that a minor can enter into any contract an adult can, unless the contract is prohibited by law for minors (for example, the sale of tobacco or alcoholic beverages). A contract entered into by a minor, however, is voidable at the option of that minor. An adult who enters into a contract with a minor cannot avoid his or her contractual duties on the ground that the minor can. Unless the minor exercises the option to disaffirm the contract, the adult party normally is bound by it.

In this problem, it is clear that a contract existed at the time of D.V.G.’s death. As a minor, she did not lack the capacity to enter into a binding settlement of her potential claims. She would not have been liable on the contract, however, if she had chosen to avoid the deal. But she was the only party to the settlement that had this option. At the time that the settlement was agreed to, the contract was binding on Nationwide, notwithstanding that it was voidable at D.V.G.’s option.

In the actual case on which this problem is based, Nationwide asked a federal district court to declare that there was no settlement. The question was certified to the Alabama Supreme Court, which held that Nationwide was bound to the agreement.

**9–7A. Business Case Problem with Sample Answer—*Fraudulent misrepresentation***

Yes, the facts in this problem evidence fraud. There are three elements to fraud: (1) the misrepresentation of a material fact, (2) an intent to deceive, and (3) an innocent party’s justifiable reliance on the misrepresentation. To collect damages, the innocent party must suffer an injury.

Here, Pervis represented to Pauley that no further commission would be paid by Osbrink. This representation was false—despite Pervis’s statement to the contrary, Osbrink continued to send payments to Pervis. Pervis knew the representation was false, as shown by the fact that she made it more than once during the time that she was continuing to receive payments from Osbrink. Each time Pauley asked about commissions, Pervis replied that she was not receiving any. Pauley’s reliance on her business associate’s statements was justified and reasonable. And for the purpose of recovering damages, Pauley suffered an injury in the amount of her share of the commissions that Pervis received as a result of the fraud.

In the actual case on which this problem is based, Pauley filed a suit in a Georgia state court against Pervis, who filed for bankruptcy in a federal bankruptcy court to stay the state action. The federal court held Pervis liable on the ground of fraud for the amount of the commissions that were not paid to Pauley, and denied Pervis a discharge of the debt.

**9–8A. *Promises made in consideration of marriage***

No, the court did not interpret the Heidens’ prenuptial agreement correctly. A unilateral promise to make a monetary payment or to give property in consideration of marriage must be in writing. And this requirement applies to prenuptial agreements, which may define each partner’s ownership rights in their separate and joint property. In interpreting these agreements, basic contract principles apply. The terms must be enforced as written, and unambiguous words and phrases should be construed according to their plain and ordinary meaning.

The prenuptial agreement between Linda and Gerald Heiden provided that “no spouse shall have any right in the property of the other spouse, even in the event of the death of either party.” The description of Gerald's separate property included a settlement from a personal injury suit. On their divorce, the court interpreted the agreement to apply only in the event of death, not divorce, and entered a judgment that included a property division and spousal support award reflecting this interpretation. But the court was not correct. The use of the word “even” indicated that the Heidens intended to keep their property separate in all events, including death and, in the circumstances here, divorce. Thus, the property division and spousal support award should not have taken into account Gerald's settlement from a personal injury suit.

In the actual case on which this problem is based, on the Heidens’ divorce, the court interpreted and applied the prenuptial agreement as stated in the facts. A state intermediate appellate court reversed, on the reasoning set out above.

**9–9A. A Question of Ethics—*Bilateral mistake***

**1.** The court held that the contract was void due to mutual mistake and issued a judgment in the defendant’s favor. The lower court determined, among other things, that a mutual mistake of fact existed as to the divisibility of lot five—in other words, that the property was entitled to a free split.

BRJM appealed this ruling to a state intermediate appellate court, which re­versed the lower court’s judgment and remanded the case for a new trial. The appellate court explained that a mutual mistake requires a mutual misunderstanding between the contracting parties as to a *material* fact and “effects a result that neither intended.”

The court acknowledged that both parties were mistaken about the availability of a free split for lot five. But the court reasoned that “this mistake was not material to their bargain. .  .  . [T]he necessity of obtaining prior approval did not render the prop­erty incapable of being subdivided; rather, the only consequence was that Kepple would have to file an application with the [town] and undergo the approval process in order to subdivide the property. Additionally, any claim that a free split was material to the par­ties' agreement is fatally undermined by the fact that the parties did not include a pro­vision to this effect in their agreement.” The clause that mentioned a free split had been removed from their contract on Engelsen’s request.

Besides, “the fact that it was later determined that approval would be necessary in order to subdivide the property adversely affected the plaintiff, as purchaser, not the defendant, as seller. The defendant cannot seek to invalidate the agreement by asserting the defense of mutual mistake on this basis because the defendant is not the party ad­versely affected by the mistake.”

**2.** As noted in the answer to the previous question, the court held that the contract was void due to mutual mistake and issued a judgment in the defendant’s fa­vor. The court found in part the existence of a mutual mistake in the parties' reliance on an inaccurate appraisal that resulted in a below market purchase price for the property.

On BRJM’s appeal, the state intermediate court reversed this judgment and re­manded the case for a new trial. The appellate court pointed out that “necessary for a finding of mutual mistake is that both parties relied on the same mistaken information in entering into a contract.” In this case “the mistake in establishing a below market purchase price for the property was a unilateral one made by Engelsen, acting on behalf of the defendant, in reliance on the inaccurate appraisal.”

The court reasoned, “[T]he appraisal inaccurately valued the property as a result of appraiser error with respect to the size of the property and whether it could be subdi­vided. The mistakes of the appraiser, made while acting on behalf of the seller, and the seller's subsequent reliance thereon cannot be imputed to the plaintiff, as purchaser. There was no evidence .  .  . that Kepple, acting on behalf of the plaintiff, relied on the ap­praisal. The evidence, in fact, supports the opposite conclusion, that Engelsen, acting on behalf of the defendant, obtained the appraisal in order to ascertain the value of the property and subsequently relied on the appraisal's inaccurate valuation in establish­ing the purchase price.” Engelsen reviewed the appraisal before signing the contract, but Kepple had no similar opportunity. The appraisal itself stated that it “was intended to be used solely by [Engelsen] as an estimate of market value.” Kepple was not given a copy and there was no evidence that he was otherwise “privy to the information on which the appraisal was based or that he relied on the appraised value in accepting the counteroffer.”

**Critical Thinking and Writing Assignments**

**9–10A. Business Law Critical Thinking Group Assignment**

**1.** The parties had an enforceable contract. Meade would not have to prove the existence of a contract, despite its terms being part of an oral agreement, because—based on the facts stated in the problem—she would assert it in her complaint and Novell would admit to its existence in his answer and presumably at trial. They disagree only about its terms.

**2.** The parties’ oral agreement falls within the admissions exception to the Statute of Frauds. The pleadings—in which Meade would assert, and Novell would admit, the existence of a contract would establish that at the time the parties formed an oral contract.

**3.** This is the amount that Novell contended Meade was entitled to. Meade would counter that she was entitled to more and would have to prove it.