

7.3: Capacity and Legality

For a contract to be legally binding, the parties entering into the contract must have the **capacity** to do so. As a legal matter, there are certain classes of people who are presumed to have no capacity to contract. These include legal minors, the mentally ill, and those who are intoxicated. If people meeting these criteria enter into a contract, the agreement is considered voidable. If a contract is **voidable**, then the person who lacked capacity has the choice to either end the contract or continue with it as agreed upon. This design is meant to protect the party lacking capacity.

Following are some examples of the application of these rules.

Minors Have No Capacity to Contract

In most states, minors under the age of 18 lack the capacity to make a contract and may therefore either honor an agreement or void the contract. However, there are a few exceptions to this rule. In most states, a contract for necessities (i.e. food and clothing) may not be voided. Also, in most states, the contract can no longer be voided when the minor turns 18.

✓ Example 7.3.1

Mary, 16, an athlete, signs a long-term endorsement deal with a well-known brand and is compensated for several years. At age 20, she decides she wants to take a better endorsement deal, so she tries to void the agreement on the grounds that it was made when she was a minor and that she lacked capacity at that time. Mary will not likely succeed in having her agreement voided, as she has passed the period of incapacity.

Mental Incapacity

If a person lacks the mental capacity to enter a contract, then either he or she, or his or her legal guardian, may void it, except in cases where the contract involved necessities. In most states, mental capacity is measured against the “cognitive standard” of whether the party understood its meaning and effect.

✓ Example 7.3.2

Mr. Williams contracted to sell a patent. Later, however, he claimed that he lacked capacity to enter the agreement. He, therefore, sought to have the contract voided. Williams based his claim on the fact that he had been diagnosed as manic-depressive and had received treatment from a variety of mental hospitals for this condition. His doctor stated that he was unable to properly evaluate business opportunities and contracts while in a “manic” state. A California Court of Appeals, evaluating a similar situation, refused to terminate the contract and stated that even in his manic state, the party was capable of contracting, as his condition may have impaired his judgment but not his understanding of the contract. With other mental conditions, a different legal conclusion could be reached.

Voluntary Intoxication – Drugs and Alcohol

Courts generally do not find lack of capacity to contract for people who are voluntarily intoxicated. The rationale for this decision is found in the reasoning that individuals should not be allowed to side-step their contractual obligations by virtue of their self-induced states. By another token, however, courts also seek to avoid the undesirable result of allowing the sober party to take advantage of the other person’s condition. Therefore, if a party is so inebriated that he or she is unable to understand the nature and consequences of the agreement, then the contract may be voided by the inebriated party.

✓ Example 7.3.3

In the late 1900s, the owner of a significant amount of stock went on a three-month drinking binge. A local bank that was aware of his consistent inebriation hired a third party to contract with him. The third party succeeded in getting him to sell his stock for about 1.5% of the worth of its total value. When the duped seller ended his binge a month later, he learned that the third party had sold the stock to the local bank behind the deal. He then sued the third party. Ultimately, the case was decided by the U.S. Supreme Court, which found that the agreement was void because both the bank and the third party knew that the plaintiff was unaware of what he was doing when he entered the contract. The bank was required to return the shares to the plaintiff, minus the 1.5% amount of real value that he had been paid for the shares.

Legality

Contracts must be created for the exchange of legal goods and services to be enforced. An agreement is void if it violates the law, or is formed for the purpose of violating the law. Contracts may also be found voidable if they are found violative of public policy, although this is rarer. Typically, this conclusion is only invoked in clear cases where the potential harm to the public is substantially incontestable, eluding the idiosyncrasies of particular judges.

For a contract to be binding, it must not have a criminal or immoral purpose or go against public policy. For example, a contract to commit murder in exchange for money will not be enforced by the courts. If performing the terms of the agreement, or if formation of the contract, will cause the parties to engage in activity that is illegal, then the contract will be deemed illegal and will be considered void or “unenforceable,” similar to a nonexistent contract. In this case, there will not be any relief available to either party if they breach the contract. Indeed, it is a defense to a breach of contract claim that the contract itself was illegal.

✓ Example 7.3.4

In a state where gambling is illegal, two parties enter into an employment contract for the hiring of a blackjack dealer. The contract would be void because the contract requires the employee to perform illegal gambling activities. If the blackjack dealer tries to recover any unpaid wages for work completed, his claim will not be recognized because the courts will treat the contract as if it never existed.

By contrast, parties enter a contract that involves the sale of dice to a known dealer in a state where gambling is unlawful. The contract would not be considered void because the act of selling dice, in and of itself, is not illegal.

Some examples of contracts that would be considered illegal are contracts for the sale or distribution of illegal drugs, contracts for illegal activities such as loansharking, and employment contracts for the hiring of undocumented workers.

An understanding of the several theories outlined herein for establishing (or challenging) capacity and legality in contract law is essential to this area of law.

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