Instructor Manual

Miller, Business Law Today – Comprehensive Edition: Text and Cases 13e 2022, 9780357634783; Chapter 13: Capacity and Legality

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# Purpose and Perspective of the Chapter

This chapter discusses policies and factors that outweigh the reasons for enforcing an agreement. Considered first is whether or not certain people—minors, in­competent persons, and intoxicated persons—have the capacity to contract (i.e., the le­gal ability to enter into a contractual relationship).

Chapter 13 also discusses how legality affects the validity of a con­tract. To be enforced in court, a contract must call for the performance of a legal act. It is a simple concept that courts will not enforce contracts that are con­trary to state or federal law (or to public policy). To allow a person to profit from his or her wrongdoing is clearly con­trary to the mores of society.

Cengage Supplements

The following product-level supplements provide additional information that may help you in preparing your course. They are available in the Instructor Resource Center.

* Transition Guide (provides information about what’s new from edition to edition)
* Test Bank (contains assessment questions and problems)
* Solution and Answer Guide (offers textbook solutions and feedback)
* PowerPoint (provides text-based lectures and presentations)
* Guide to Teaching Online (provides technological and pedagogical considerations and resources for teaching online)
* MindTap Educator Guide (describes assets in the MindTap platform with a detailed breakdown of activities by chapter with seat time)

# Chapter Objectives

The following objectives are addressed in this chapter:

1. Define capacity.
2. Summarize the capacity of a minor.
3. Define disaffirmance, emancipation, and ratification in the context of contract law.
4. Describe the impact of mental capacity in determining the validity of a contract.
5. Explain how intoxication affects capacity.
6. Explain the legality requirement in contract law.
7. Explain how fraud and undue influence affect a contract.

# Key Terms

**Adhesion contract:** a standard-form contract in which the stronger party dictates the terms.

**Age of majority:** the age (i.e., eighteen years, in most states) at which a person is granted by law the rights and responsibilities of an adult.

**Contractual capacity:** the required capacity by law for a party to enter into a contract, in order to be bound by that contract.

**Covenant not to compete:** a contractual promise of one party to refrain from conducting a similar business to that of another party for a certain period of time and within a specified geographical area.

**Disaffirmance:** the legal avoidance, or setting aside, of a contractual obligation.

**Emancipation:** in regard to minors, the act of being freed from parental control.

**Employment contract:** a contract between an employer and an employee in which the terms and conditions of employment are stated.

**Exculpatory clause:** a clause that releases a contractual party from liability in the event of monetary or physical injury, no matter who is at fault.

**Necessaries:** necessities required to maintain a standard of living, such as food, shelter, clothing, and medical attention.

**Ratification:** the acceptance or confirmation of an act, or agreement that gives legal force to an obligation that previously was not enforceable.

**Reformation:** a court-ordered correction of a written contract so that it reflects the true intentions of the parties.

**Unconscionable:** unscrupulous or grossly unfair; an unconscionable contract or clause is void on the basis of public policy because one party was forced to accept terms that are unfairly burdensome and that unfairly benefit the other party.

**Usury:** charging an illegal rate of interest.

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# What's New in This Chapter

The following elements are improvements in this chapter from the previous edition:

* **1 New Case:** 
  + *Kennedy v. Shave Barber Co.* (2018) – On whether reformation of the geographic scope of the noncompete provision was reasonable.
* **3 New Numbered Case Examples:**
  + on disaffirmance with a reasonable time (2019)
  + on covenants not to compete (2020)
  + on procedural unconscionability (2020)
* **Updated Managerial Strategy:** *Creating Liability Waivers That Are Not Unconscionable*, by adding new case example from 2020 and another from 2019.

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# Chapter Outline

*In the outline below, each element includes references (in parentheses) to related content. “PPT Slide #” refers to the slide number in the PowerPoint deck for this chapter (provided in the PowerPoints section of the Instructor Resource Center). Introduce the chapter and review objectives for Chapter 13 (PPT Slide 3).*

1. **13-1 Contractual Capacity** (PPT Slides 5-10)

**Contractual capacity** is the legal ability to enter into a contractual relationship. Courts generally presume the existence of contractual capacity, but in some situations, capacity is lacking or may be questionable.

* 1. **Minors**
     1. The **age of majority** is the at age which the US legal system no longer recognizes a person as a minor child. For contractual purposes the age of majority in the US is 18 years of age. Some states provide for the termination of minority upon marriage.
     2. **Disaffirmance –** The legal avoidance, or setting aside, of a contractual obligation is referred to as **disaffirmance**.
        1. To disaffirm, a minor must express, through words or conduct, the intent not to be bound to the contract.
           + The minor must disaffirm the entire contract, not merely a portion of it.
           + ***See* Spotlight on KFC: Case 13.1: *PAK Foods Houston, LLC v. Garcia***
        2. ***Disaffirmance within a Reasonable Time.*** A minor can ordinarily disaffirm a contract at any time during minority, or for a reasonable time after reaching the age of majority.
        3. ***A Minor’s Obligations on Disaffirmance.*** All states’ laws permit minors to disaffirm contracts, including executed contracts.
           + State laws differ on the extent of a minor’s obligations on disaffirmance.
           + A growing number of states require the minor to restore the adult party to a position that existed before the contract was entered. ***See* Example 13.1**
     3. **Exceptions to the Minor’s Right to Disaffirm –** State courts and legislatures have carved out several exceptions to the minor’s right to disaffirm.
        1. Some contracts, such as marriage contracts and contracts to enlist in the armed services, cannot be avoided.
        2. A minor who enters into a contract for necessaries may disaffirm the contract, but remains liable for the reasonable value of the goods.
           + **Necessaries** include whatever is reasonably needed to maintain the minor’s standard of living.
     4. **Ratification –** In contract law, **ratification** is the act of accepting and giving legal force to an obligation that previously was not enforceable. A minor who has reached the age of majority can ratify a contract expressly or impliedly.
        1. *Express* ratification occurs when the individual, on reaching the age of majority, states orally (or in writing) an intention to be bound by the contract.
        2. *Implied* ratification takes place when the minor, on reaching the age of majority, behaves in a manner inconsistent with disaffirmance.
           + ***See* Example 13.2**
     5. **Parent’s Liability –** As a general rule, parents are not liable for the contracts made by minor children acting on their own, except contracts for necessaries, which the parents are legally required to provide.
  2. **Intoxicated Persons**
     1. A contract entered into by an intoxicated person can be either voidable or valid.
        1. If the person was sufficiently intoxicated to lack mental capacity and the other party had reason to know it, then the transaction may be *voidable* at the option of the intoxicated person, even if the intoxication was purely voluntary.
        2. Courts look at objective indications of intoxication to determine if a person possessed or lacked the required capacity.
  3. **Mentally Incompetent Persons**
     1. Contracts made by mentally incompetent persons can be void, voidable, or valid.
        1. If a court has previously determined that a person is mentally incompetent and has appointed a guardian to represent the person, any contract made by that person is *void* and no contract exists.
           + Only the guardian can enter into a binding contract on behalf of the mentally incompetent person.
        2. If a court has not previously judged a person to be mentally incompetent but the person was incompetent at the time the contract was formed, the contract is *voidable* in most states.
           + A contract is voidable if the person was unaware of entering into the contract or lacked the mental capacity to comprehend its nature, purpose, and consequences.
           + ***See* Case Example 13.3: *Black v. Duffie***
     2. A contract entered into by a mentally ill person who has not been declared legally incompetent may also be *valid* if the person had capacity *at the time the contract was formed*.
  4. ***Knowledge Check Activity (1) PPT Slide: 1 minute(s) total (5 minutes with discussion and review of answer).*** *Tests students’ knowledge of intoxication as it applies to contracts. After answer is provided, review with students when a court may apply intoxication to avoid a contract.*

1. **13-2 Legality** (PPT Slides 11-20)

Legality is the fourth requirement for a valid contract to exist. For a contract to be valid and enforceable, it must be formed for a legal purpose. A contract to do something that is prohibited by federal or state statutory law is illegal, as such, it is void from the outset and thus unenforceable.

* 1. **Contracts Contrary to Statute**
     1. **Contracts to Commit a Crime –** A contract to sell illegal drugs in violation of criminal laws is unenforceable, as is a contract to hide a corporation’s violation of securities laws or environmental regulations.
        1. Sometimes, the object or performance of a contract is rendered illegal by statute *after* the contract has been formed. In that situation, the contract is considered discharged (i.e., terminated) by law.
     2. **Usury –** Almost every state has a statute that sets the maximum rate of interest that can be charged for different types of transactions, including ordinary loans.
        1. A lender who makes a loan at an interest rate above the lawful maximum commits **usury**.
        2. Although usurious contracts are illegal, most states simply limit the interest that the lender may collect on the contract to the lawful maximum interest rate in that state.
     3. **Gambling –** Traditionally, the states have deemed gambling contracts illegal and thus void. Today, many states allow and regulate certain forms of gambling (e.g., horse racing, video poker machines, etc.).
     4. **Licensing Statutes –** All states require members of certain professions to have licenses.
        1. Whether a contract with an unlicensed person is legal and enforceable depends on the purpose of the licensing statute.
           + ***See Business Law Analysis – Determining If a Contract with an Unlicensed Party Is Enforceable***
  2. **Contracts Contrary to Public Policy**
     1. **Contracts in Restraint of Trade –** The United States has a strong public policy favoring competition in the economy. Thus, contracts in restraint of trade generally are unenforceable because they are contrary to public policy.
        1. ***Covenants Not to Compete and the Sale of an Ongoing Business.*** Many contracts involve a type of restraint called a **covenant not to compete**, or a restrictive covenant (i.e., promise).
           + Provided the restrictive covenant is reasonable and is an ancillary part of the sale of an ongoing business, it is enforceable.
        2. ***Covenants Not to Compete in Employment Contracts.*** Some **employment contracts** include an agreement not to compete provision.
           + Noncompete agreements are generally legal in most states so long as the specified period of time is not excessive in duration and the geographic restriction is reasonable.
           + Companies sometimes use covenants not to compete as the starting point for lawsuits against competitors.

***See* Case Example 13.4: *Crossroads Hospice, Inc. v. FC Compassus, LLC***

* + - 1. ***Enforcement Problems.*** *The laws governing the enforceability of covenants not to compete vary significantly from state to state.*
      2. ***Reformation.*** Depending on the jurisdiction, courts will reform covenants not to compete.
         * If a covenant is found to be unreasonable in time or geographic area, the court may convert the terms into reasonable ones and then enforce the reformed covenant.
         * Courts usually resort to contract **reformation** only when necessary to prevent undue burdens or hardships.
         * ***See* Case 13.2: *Kennedy v. Shave Barber Co.***
    1. **Unconscionable Contracts or Clauses –** In certain circumstances, bargains are so oppressive that the courts relieve innocent parties of part or all of their duties.
       1. Such bargains are deemed **unconscionable** because they are so unscrupulous or grossly unfair as to be “void of conscience.”
          - A contract can be unconscionable on either procedural or substantive grounds.
          - ***See* Exhibit 13-1 – Unconscionability**
       2. ***Procedural Unconscionability.*** Procedural unconscionability often involves inconspicuous print, unintelligible language or the lack of an opportunity to read the contract or ask questions about its meaning.
          - This type of unconscionability typically arises when a party’s lack of knowledge or understanding of the contract terms deprives the party of any meaningful choice.
          - An example of such a contract is an **adhesion contract**, which is a standard-form contract written exclusively by one party.

***See* Case Example 13.5: *Saribekyan v. Bank of America, NA***

* + - 1. ***Substantive Unconscionability.*** Substantive unconscionability occurs when contracts, or portions of contracts, are oppressive or overly harsh.
         * Courts generally focus on provisions that deprive one party of the benefits of the agreement or leave that party without remedy for nonperformance by the other.
    1. **Exculpatory Clauses –** Closely related to the concept of unconscionability is the **exculpatory clause**, which releases a party from liability in the event of monetary or physical injury, no matter who is at fault.
       1. ***Violation of Public Policy.*** Most courts view exculpatory clauses with disfavor. Exculpatory clauses found in rental agreements for commercial property are frequently held to be contrary to public policy.
          - Courts also usually hold that exculpatory clauses are against public policy in the employment context.
       2. ***Enforcement of Exculpatory Clauses.*** Courts do enforce exculpatory clauses if they are reasonable, do not violate public policy, and do not protect parties from liability for intentional misconduct.
          - The language used must not be ambiguous, and the parties must have been in relatively equal bargaining positions.
          - ***See Managerial Strategy – Creating Liability Waivers That Are Not Unconscionable***
          - ***See* Spotlight Case Example 13.3: *Holmes v. Multimedia KSDK, Inc.***

1. **13-3 The Effect of Illegality** (PPT Slides 21-24)
   1. **Justifiable Ignorance of the Facts**
      1. In situations where one of the parties to a contract has no reason to know that the contract is illegal and thus is relatively innocent.
      2. That party can often recover any benefits conferred in a partially executed contract.
      3. The courts will not enforce the contract, but will allow the parties to return to their original positions.
         1. ***See* Example 13.6**
   2. **Members of Protected Classes**
      1. When a statute is clearly designed to protect a certain class of people, a member of that class can enforce a contract in violation of the statute even though the other party cannot.
         1. ***See* Example 13.7**
   3. ***Knowledge Check Activity (2) PPT Slide: 1 minute(s) total (5 minutes with discussion and review of answer).*** *Tests students’ knowledge of in pari delicto as it relates to a contract. After answer is provided, review with students the concept of in pari delicto and how both parties being at fault affects a contract.*
   4. **Withdrawal from an Illegal Agreement** 
      1. If the illegal part of a bargain has not yet been performed, the party rendering performance can withdraw from the contract and recover the performance or its value.
         1. ***See* Example 13.8**
   5. **Severable or Divisible Contracts**
      1. A contract that is severable, or divisible, consists of distinct parts that can be performed separately, with separate consideration provided for each part.
         1. With an indivisible contract, in contrast, complete performance by each party is essential, even if the contract contains a number of seemingly separate provisions.
      2. If a contract is divisible into legal and illegal portions, a court may enforce the legal portion but not the illegal one to the extent that the illegal portion does not affect the essence of the bargain.
         1. ***See* Example 13.9**
   6. **Fraud, Duress, or Undue Influence**
      1. When one party uses fraud, duress, or undue influence to induce the other party to enter into an agreement, the second party will be allowed to recover for the performance or its value.
   7. ***Knowledge Check Activity (3) PPT Slide: 1 minute(s) total (5 minutes with discussion and review of answer).*** *Tests students’ knowledge of discharge by full performance for a contract. After answer is provided, review with students the concept of full performance and when it discharges obligations of a contract.*

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# Discussion Questions

You can assign these questions several ways: in a discussion forum in your LMS; as whole-class discussions in person; or as a partner or group activity in class.

1. **Discussion – Contracting with Minors, Disaffirmance, and the Effect of a Minor’s Misrepresentations ([13-1 Contractual Capacity], PPT Slides 5-10). Duration 15 minutes.**
   1. **What is a minor’s obligation on disaffirmance?** 
      1. A duty of restitution arises when a contract has been executed—a minor can disaffirm but must return whatever he or she received, or pay for its reasonable value.
      2. Generally, a minor need only return whatever he or she received, if it is still in his or her possession or control. If it has been damaged, a minor’s right to disaffirm is not affected.
      3. In a few states, minors have a duty of restitution to return the other party to the position he or she was in before the contract was made. Some states do not require full restitution but only that it be reasonable.
      4. The minor may recover whatever he or she transferred as consideration, even if it is in the possession of a third party. If the consideration cannot be returned, the minor is entitled to its value.
      5. However, under the UCC, a minor cannot recover goods transferred to a third party who is a “good faith purchaser for value.”
   2. **What effect does a minor’s misrepresentation of age have on his or her right to disaffirm?** 
      1. In most states, a minor can disaffirm even if he or she misrepresented his or her age. Also, in some states, a minor will not be liable in tort for misrepresenting his or her age, because, indirectly, the judgment might force the minor to perform the contract.
      2. In many states, under certain circumstances a minor will be bound to a contract despite the misrepresentation:
         1. In some states, misrepresentation of age is enough to prohibit disaffirmance; in others, a minor who engaged in business as an adult is prohibited from disaffirming contracts negotiated in carrying on the business.
         2. Some courts refuse to allow minors who misrepresented their age to disaffirm executed contracts unless they can return whatever consideration they received, on grounds that the combination of misrepresentation and unjust enrichment estops minors from asserting contractual incapacity.
         3. Some courts allow a minor who misrepresents his or her age to disaffirm a contract but hold the minor liable for damages in tort, and the defrauded party may sue the minor for the misrepresentation.
2. **Discussion – Enforceability of Contracts Involving Members of a Protected Class and Agreements Against Public Policy ([13-2 Legality], PPT Slides 11-20). Duration 20 minutes.**
   1. **Identify and discuss some exceptions to the rule that a court will not enforce an illegal agreement.** 
      1. *Members of protected classes.* If a statute is clearly designed to protect a certain class, a member of the class can enforce a contract that violates the statute. (For example, statutes proscribe excessive working hours, but an employee who works those hours can recover the pay for them.)
      2. *Withdrawal from an illegal agreement.* If the illegal part of a bargain has not been performed, a party can withdraw from the bargain and recover whatever he or she rendered in performance or its value.
      3. *Fraud, duress, or undue influence.* A party induced to make an illegal bargain through fraud, duress, or undue influence can recover for his or her performance, even if that party was also partly at fault (e.g., transferring assets to defraud creditors, under an agreement to transfer them back, may not prevent a recovery of those assets).
3. **Discussion – Mistakes, Fraudulent Misrepresentation, and Undue Influence ([13-3 The Effect of Illegality], PPT Slides 21-24). Duration 20 minutes.**
   1. **What is the legal significance of the difference between a mistake in judgment as to market conditions and a mistake of fact?** 
      1. Mistakes in judgment as to market conditions involve believing something is worth more than it ultimately proves to be.
      2. Mistakes of fact involve believing something is other than what it is. The legal significance of the difference between a mistake in judgment as to market conditions and mistakes of fact is that only under a mistake of fact can a contract be avoided.
   2. **Does a unilaterally mistaken party have any right to relief?** 
      1. Generally, no, but there are exceptions. Relief may be granted if the other party knew or should have known that a mistake was made (e.g., a bid well below other bidders’ figures).
      2. Some states will not enforce a contract against a mistaken party if an error was due to a mathematical mistake, and it was done inadvertently and without gross negligence (e.g., a typographical error).
   3. **The elements of fraudulent misrepresentation include misrepresentation of a material fact. Discuss this element.**
      1. Misrepresentation can be in words (“this is a Warhol,” if the work is by another artist). Misrepresentation can occur through conduct (e.g., concealment by showing samples that differ markedly from actual goods).
         1. All of us are expected to use care and judgment when entering into contracts, however—predictions (“this land will be worth twice as much next year”) or statements of opinion (“this car will last for years”) are ordinarily not subject to claims of fraud.
      2. A seller can use puffery without liability for fraud, but an expert’s statement of opinion to a layperson is treated as fact. As regards the law, at common law people are assumed to know the law where they live.
         1. A layperson should not rely on a statement made by a nonlawyer about a point of law. A misrepresentation of law (“you can build anything you want here”) does not normally entitle a party to relief from a contract.
      3. There is an exception if the person who makes the misrepresentation is a member of a profession that is known to require greater knowledge of the law than a layperson possesses (e.g., realtors are expected to know the law governing land sales and use).
         1. Disclosing some, but not all, of the facts can be deceitful. Nevertheless, normally, a contract cannot be set aside because certain pertinent information (e.g., a used car was in an accident) is not volunteered. That is, under normal circumstances, no party to a contract has a duty to disclose.
         2. If a serious potential problem or latent defect (e.g., a crack in a building’s foundation) is known to the seller but cannot reasonably be suspected by the buyer, the seller may have a duty to speak.
         3. Also, in a fiduciary relationship, one party’s failure to disclose facts that materially affect the other’s interests may constitute fraud. There are other exceptions. If circumstances change so that what once was true is now false, the party aware of the change has a duty to inform the other.
         4. Other exceptions are provided by statutes (e.g., the Truth-in-Lending Act).
   4. **In what circumstance does undue influence occur?**
      1. Undue influence occurs in relationships in which one party can greatly influence another, thus overcoming the other’s free will (e.g., an attorney’s inducing a client to enter into a contract that benefits the attorney may indicate undue influence).
      2. When a contract enriches one party at the expense of another who is in a fiduciary relationship with or who is dominated by the enriched party, it may be presumed that the contract was made under undue influence.
      3. To rebut the presumption, the enriched party must show that there was full disclosure, that consideration was adequate, and that the other party received independent and competent advice before completing the transaction. A contract entered into under undue influence is voidable.

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# Additional Activities and Assignments

1. **MindTap** – Why Does Capacity Matter to Me?
   1. Online auto-graded activities connect the upcoming chapter to a real-world scenario designed to pick engagement and emphasize relevance. Consists of 1 multiple choice question in each.
2. **Mind Tap** – Learn It: Capacity; Disaffirmance, Emancipation, and Ratification
   1. Get familiar with one of the key concepts from the chapter.
3. **MindTap** – Check Your Understanding: Capacity and Legality
   1. Online auto-graded activity that assesses students’ foundational knowledge of the concepts presented in this chapter. Consists of 10 multiple choice questions.
4. **MindTap** – Case Problem Analysis: Age of Majority
   1. Online auto-graded activity that first walks students through a fact pattern, and then asks them to answer similar questions with slight variations in the fact pattern. Consists of approximately 5 fill-in-the-blank questions.
5. **MindTap** – Brief Hypotheticals: Capacity and Legality
   1. Online auto-graded activity that presents 5 fact patterns in which students are asked to apply the concepts of the chapter, and to come up with a legal conclusion. Consists of 5 multiple choice questions.

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# Additional Resources

## Cengage Video Resources

* MindTap Quick Lesson Videos:
  + Contract Capacity. Duration 2:21 minutes.
  + Discharge of a Contractual Obligation. Duration 2:28 minutes.
  + Promissory Estoppel. Duration 3:05 minutes.
  + Quasi-Contracts. Duration 2:59 minutes.