**W1**

**Incapacity**

**SUMMARY**

This chapter considers how the law deals with contracting parties who lack capacity, or full capacity, to contract: minors, those who lack mental capacity, companies and public authorities.

**W1.1** This chapter concerns the law’s approach to parties who do not have full capacity to contract. An adult of sound mind is free to make any contract permitted by law and, more to the point, to bind himself by incurring enforceable contractual obligations, but others have more limited capacity. There are different reasons for limiting contractual capacity. Infants and people with mental infirmity lack the capacity to contract in certain circumstances, because the law recognises them as particularly vulnerable and deserving of protection. Non-natural persons, such as companies and public authorities, are legal fictions and only have ‘capacity’ to contract (or indeed to do anything) insofar as the law chooses to recognise it. But whatever its rationale, the law’s response to incapacity always involves a delicate balance between the interests of those of limited capacity and of those who contract with them in good faith.

**Minors**

**W1.2** The rules about the contractual capacity of minors are of less practical significance since the reduction in the age of majority from 21 to 18, but nonetheless raise some very interesting theoretical issues about the extent to which a minor can escape what appear to be ‘contractual’ obligations (there is, of course, no need to protect minors from acquiring contractual rights). Contracts made by minors fall into one of three categories.

**W1.3** In the first category, certain contracts are enforceable against the minor, principally contracts for the ‘necessaries of life’ and, where beneficial to the minor, contracts of employment, apprenticeship, and education. ‘Necessaries’ are defined in s 3 of the Sale of Goods Act as ‘goods suitable to the condition in life of the minor ... and to his actual requirements at the time of the sale and delivery’. So the court takes into account the type of goods and the minor’s circumstances. In *Nash v Inman* (1908) an under-graduate ordered 11 expensive waistcoats from a tailor, but did not pay for them. The tailor failed to convince the court that the waistcoats were necessary for the under-graduate’s status in life. (It is interesting to speculate whether a court would regard a mobile phone as one of life’s ‘necessaries’ in the twenty-first century!) In addition to contracts for the sale of goods, other contracts may also count as contracts for necessaries, provided they are beneficial and reasonably necessary, such as essential legal advice or medical care.

**W1.4** The meaning and scope of ‘contracts of employment, apprenticeship and education’ was considered by the court in *Proform Sports Management Ltd v Proactive Sports Management Ltd* (2006). Wayne Rooney, the prodigious and world-famous footballer, entered into a representation agreement with the claimant company when he was only 15 years old and an apprentice at Everton FC. Rooney later met the defendant management company, pulled out of the agreement with the claimant and contracted with the defendant instead. The claimant sued the defendant for damages in tort, alleging that it was liable for inducing Rooney to breach his contract with the claimant. This action had no prospect of success, unless that contract had been enforceable against Rooney (because it is not tortious to procure the ‘breach’ of an unenforceable contract). The judge held that the representation agreement was *not* analogous to a contract of employment, apprenticeship, or education (unlike Rooney’s contract with Everton FC), concluding, ‘It seems to me that this case falls within the general principle that merely because a contract is beneficial to a minor, if such is the case, it is not binding on him unless it falls within a particular category.’ Consequently, the claimant’s action had no reasonable prospect of success and the judge gave summary judgment to the defendant.

**W1.5** The second category is that of contracts involving permanent rights and obligations, such as contracts to acquire an interest in property. These are binding on the minor, *unless* he expressly disclaims the contract while still a minor or within a reasonable time after reaching majority (sometimes called ‘positive voidable contracts’). Although such contracts are binding and may give rise to an equitable interest in land, notice that under s 1(6) of the Law of Property Act 1925 a minor cannot hold a legal estate in land, an issue that the Court of Appeal had to consider in *Alexander-David v Hammersmith and Fulham LBC* (2009) in the context of local authority tenancies granted to homeless teenagers. The third category is the default category: all other contracts do not bind the minor (although he may enforce them against the other party) *unless* the minor ratifies them once he reaches majority. Although these are sometimes called ‘negative voidable contracts’ this is misleading, because the label ‘voidable’ suggests a contract which is enforceable unless avoided, whereas contracts in this third category are the opposite, unenforceable unless ratified.

**W1.6** The various categories of minor contracts were in issue in *Take-Two Interactive Software Inc v James* (2020). The claimants were the developers and publishers of the leading video game ‘Grand Theft Auto V’, and were suing various defendants in respect of the use of cheating software, which was a breach of the licence agreement to play the game. One of the defendants was a minor. The judge declined to grant summary judgment for the claimants in the contractual claim against the minor defendant. This was first because it was arguable that the licence agreement did not confer the sort of permanent interest in property required for the second category. Similarly it was arguable that the agreement was not one for necessaries. As Falk J observed, ‘In one sense computer games might be regarded as necessary for a certain age group. However, that does not mean that they are “necessary” as a matter of law’.

**W1.7** The nature of the minor’s liability under contracts in the first category and (until disclaimed) the second category is disputed. On one view, although the minor has limited contractual capacity, when acting within the limits of his capacity, he is liable on the contract in the normal way. This means that he could be sued for damages for breach of contract if he did not perform his part of the bargain, even where the contract was purely executory. The alternative view is that the minor is only liable to pay on a restitutionary basis for the benefit of what he actually receives under the contract (after all, the Sale of Goods Act obliges the minor to pay a reasonable sum for necessaries, not the contract price).

**W1.8** Further remedial difficulties arise in situations where the minor definitely lacks contractual capacity: for example, a contract to purchase luxury goods. The law does not allow the other party to *enforce* the contract against the minor and does not permit other relief that would amount to indirect enforcement, but that does not mean that the other party is left with no remedy at all. Equity traditionally assisted a claimant who was induced to contract with a minor because the minor fraudulently misrepresented his age, by ordering restitution of benefits transferred under the contract. In *Stocks v Wilson* (1913) a minor induced the claimant to sell him some furniture for £300, by misrepresenting his age. The minor did not pay (having disposed of the furniture already for £130) and was held liable to account to the claimant for the £130 proceeds. However, the claimant was not fully protected, as he was not entitled to sue for the £300 price, since this would have involved enforcing the contract against the minor (see also *R Leslie Ltd v Sheill* (1914)).

**W1.9** Today, this equitable jurisdiction is less significant, because statute provides for an equivalent remedy without being confined to cases of fraudulent misrepresentation. The Minors’ Contracts Act 1987 provides that where a contract is unenforceable against a minor:

the court may, if it is just and equitable to do so, require the defendant [minor] to transfer to the plaintiff any property acquired by the defendant under the contract or any property representing it.

This provision gives the court a *discretion* to order the minor to return property acquired under the contract. The phrase ‘any property representing it’ probably includes the proceeds of sale if the minor has disposed of the property: after all, it makes no sense for the court to have the power to order the minor to hand over something he *swapped* for the property, but not money he received from selling it. The court’s discretion would certainly extend to ordering the minor to repay any money received from the other party under the contract; moreover a restitutionary action for the recovery of money paid on a total failure of consideration would probably be available, regardless of the statute, since it is not a claim for damages and thus does not represent indirect enforcement of the contract. There is no statutory discretion to order the minor to pay for property received under the contract that has been consumed or destroyed. For a compelling discussion of the remedial treatment of minors’ contracts, see Hedley (2004).

**Mental incapacity**

**W1.10** At common law, a contract made by a mentally incapacitated person is binding and enforceable *unless* the other party *knew* or, as Baroness Hale suggested (obiter) in the Supreme Court in *Dunhill v Burgin* (2014), *ought to have known* of his lack of capacity (on which see also *Josife v Summertrot Holdings Ltd* (2014)), in which case the contract can be avoided. This principle was made clear by the House of Lords in *Imperial Loan Co v Stone* (1892) and was reaffirmed by the Privy Council in *Hart v O’Connor* (1985), in which an elderly man was suffering from dementia but his condition was unknown to the defendant, who purchased land from him (see also Chapter 12). The Privy Council disapproved of the proposition in a New Zealand authority, *Archer v Cutler* (1980), that a contract made by a mentally incapacitated person could be avoided solely on the ground that it was ‘unfair’, even if the other party knew nothing of the mental incapacity.

**W1.11** In other words, unless the other party knew (or possibly, if they ought to know) they were contracting with someone of unsound mind, the transaction can only be set aside if the normal test of unconscionability is satisfied (discussed in Chapter 12) and this test requires more than just unfair or unbalanced contractual terms. This means that people who contract with the mentally incapacitated, without realising they are incapacitated, are better protected than people who contract with minors without realising they are minors. It is the actual age of the minor that is relevant, not the age the other party reasonably believed them to be.

**W1.12** Three other issues are relevant to contracts made by the mentally incapacitated. First, provisions in the Sale of Goods Act concerning contracts for the sale of necessaries (see para **W1.3**) used to apply equally to adults who lack capacity to contract, but this regime has been replaced by new statutory rules contained in s 7 of the Mental Capacity Act 2005, which apply both to necessary goods and necessary services and which require that a reasonable price must be paid for them. The explanatory notes accompanying the Act provide a useful example of how ‘necessaries’ are defined:

... if the milkman carries on delivering milk to the house of someone who has progressive dementia, he can expect to be paid. If, however, a roofer puts a completely unnecessary new roof on to that person’s house, when all that was required was a minor repair, then the rule will operate to prevent the roofer from being able to recover his charges.

Second, the Mental Capacity Act 2005 is relevant in other aspects, such as where someone with capacity executes a ‘lasting power of attorney’ which later becomes effective once the donor has lost contractual capacity, or where a ‘deputy’ has been appointed under the jurisdiction of the Court of Protection to deal with the property and affairs of an incapacitated person. Third, the regime relating to contracts made by the mentally incapacitated reveals how out of step the ‘*non est factum*’ principle is in the twenty-first century (discussed further in Chapter 3).

**Companies**

**W1.13** When a company is formed today, it is almost invariably given the status of a legal person (‘incorporated’) under the provisions of the Companies Act. Until 2006, the relevant legislation provided that a company could only do that which it was empowered to do by its constitutional documents, so if it purported to make a contract that was not authorised by its constitution, the contract was *ultra vires* and utterly void. This principle was modified to protect those who dealt in good faith with a company, but nonetheless represented a significant limitation on corporate capacity. Under the Companies Act 2006, the capacity of companies is now much closer to that of natural persons. Section 31(1) provides that a company has unrestricted objects and so unrestricted capacity, unless its constitution contains a specific restriction. Even where an act is done contrary to such a specific restriction, thanks to s 39 its validity can nonetheless not be questioned on the ground of lack of capacity. Finally, where a director purports to act beyond his powers, s 40 provides that the transaction will be valid in favour of a person who deals with the company in good faith.

**Public authorities**

**W1.14** Like companies, a public authority is a legal person whose capacity to contract derives from, and is restricted by, its statutory constitution. Where a public authority purports to make a contract that is outside its statutory powers, such a contract will be *ultra vires* and void. A notorious modern example is seen in the House of Lords case of *Hazell v Hammersmith and Fulham London Borough Council* (1992), which decided that ‘interest rate swap transactions’ entered into by many local authorities with merchant banks in the 1980s were *ultra vires* and void. The *ultra vires* rule is meant to protect ratepayers, but the practical effect of the decision in *Hazell* was a spate of complex and expensive litigation, in which the courts attempted to resolve the remedial implications of unravelling and reversing payments made under the void swap transactions.

**OVERVIEW**

**1** Minors (those under the age of 18) have the capacity to make valid contracts for ‘necessaries’ (though not everyone agrees that the theoretical basis of the minor’s liability here is contractual). Certain other contracts made by minors, such as contracts to acquire an interest in property, are valid unless the minor disclaims them. All other contracts are invalid unless ratified once the minor reaches 18. Although such contracts cannot be enforced against the minor, directly or indirectly, some remedial assistance is given to those who contract with minors. This is now supplemented by a statutory discretion given to the court to order the minor to return property acquired under a contract or any property representing it.

**2** A contract made with a person who lacks mental capacity to contract is valid and enforceable against them unless the other party knew or ought to have known of the mental incapacity. There is also an important statutory regime under the Mental Capacity Act 2005 of Lasting Powers of Attorney and Deputies appointed under the jurisdiction of the Court of Protection.

**3** Finally the doctrine of *non est factum* remains in existence, which seems out of line with the basic approach to contractors who lack mental capacity.

**4** A company’s capacity may be restricted by its constitutional documents and, strictly, any contract which the company does not have capacity to make is, in theory, *ultra vires* and void. However a third party who contracts with a company is generally protected by statute from needing to worry about the company’s capacity. Similarly, the capacity of a public authority to make contracts derives from and is limited by its constitution, but there is no equivalent statutory protection for those who unwittingly make contracts with public authorities which turn out to be *ultra vires.*

**SELF-TEST QUESTIONS**

**1** What remedies are available to a person who contracts with a minor?

**2** Why is a contract made by a mentally incapacitated person valid unless the other party knows of the incapacity?

**3** What is the relationship between the rules on mental incapacity and unconscionability?

**4** Two years ago Daniel Tuncliffe, a child actor then aged 15 and famous for his role in a series of successful films, signed a contract with Crumb, a property developer. In the contract Daniel agreed to purchase for £1.5 million a penthouse flat in a luxury apartment block, which Crumb was in the process of building. Daniel, who was advised by leading city real-estate solicitors, paid a deposit of £250,000, with the balance of £1,250,000 due on completion. Two years later, Crumb has completed the flat, but the property market has crashed and it is worth less than half the contract price. Daniel wishes to recover his deposit and walk away, while Crumb wishes to hold Daniel to his obligation to pay the balance and buy the flat. Discuss.

For hints on how to answer question 4, please see the guidance on answering the questions on the relevant section of the website.