Capacity: The legal ability to enter into a contract.
Two groups of people usually lack capacity:
1. Minors
2. Those with a mental impairment

A Voidable Contract
✓ Is valid and enforceable unless and until the one party with the right to avoid the contract chooses to exercise that right.
✓ A minor has the right to disaffirm a contract until they reach the age of majority, and for a short time thereafter.
Star Chevrolet Co. v. Green
✓ Chapter opener on pages 309 and 311
✓ What did the Supreme Court of Mississippi decide?
✓ Is this another situation where the law lets someone lie?
✓ Do you now see why businesses require minors to get an adult co-signer on their contracts?

How to Disaffirm a Contract
1. Tell the other party, orally or in writing, that you want to return the property for a refund.
2. Refuse to perform your obligations under the contract (e.g. monthly payments on the car.)
3. File suit to rescind the contract.

Timing of Disaffirmance
✓ A minor may disaffirm a contract any time before she reaches 18.
✓ She may also disaffirm within a reasonable time after turning 18.
Ratification
✓ Any words or action indicating an intention to be bound by the contract.
✓ Not effective if the person attempting to ratify the contract is still a minor.
✓ Continuing to make payments, or exercising dominion over the property will usually ratify the contract.

Minors: Restitution
✓ A minor who disaffirms a contract must return the consideration he has received, to the extent he is able.
✓ But if the minor cannot make restitution, most states rule the way Mississippi did, which is that they still get a full refund.

Exception: Necessaries
✓ Something essential to the minor’s life and welfare
✓ Examples: emergency medical care, food, basic clothing, and housing
✓ On a contract for necessaries, a minor may still disaffirm, but must pay the reasonable value of the benefits he obtained under the contract.
Exception:
Misrepresentation of Age
If the minor shows a fake i.d. or otherwise lies about his age…
✓ A few states will still permit the minor to disaffirm, but
✓ Most states will not

Mentally Impaired Persons
Persons who by reason of mental illness or defect are unable to understand the nature and consequences of a contract.
Two types:
✓ Those previously adjudicated to be incompetent, and
✓ Those not so adjudicated

But be careful! A person not previously so adjudicated will be considered mentally impaired only if

They have a mental illness or defect

and

Because of that mental illness or defect they were unable to (in the opinion of the jury) understand the nature and consequences of this contract.

Note that neither one is enough by itself!
Mentally Impaired Persons not previously so adjudicated
True or False?

If a person is too drunk to legally drive (for example more than 0.08% blood alcohol content in California,) they will be presumed too drunk to understand the nature and consequences of their contracts and any contracts they make while in that mental state will definitely be voidable.

Mentally Impaired Persons: Restitution
✓ A person who lacks mental capacity must make restitution to avoid the contract.
✓ If restitution is impossible, the court will not rescind the agreement unless the infirm party can show bad faith by the other.

Misrepresentation and Fraud
Contracts induced by any of the following are voidable:
✓ Misrepresentation
✓ Fraud
✓ Mistake (in certain circumstances)
✓ Duress
✓ Undue influence
Misrepresentation and Fraud

- The protected party has the power to **rescind** the contract.
- Unless and until the protected party rescinds the contract, the contract will continue to be valid and enforceable by **either party**.

Misrepresentation and Fraud

To rescind a contract based on misrepresentation or fraud, a party must show three things:
1. There was a false statement of fact.
2. The statement was fraudulent or material, and
3. The injured person justifiably relied on the statement.

False Statement of Fact

- A statement that an event took place when it did not, or
- A statement that a thing exists when it does not, or
- A statement that a product or property has a particular characteristic, when it does not, and
- Not an opinion or prediction, and
- Not sales puffery
Exception: When will a statement of opinion form a basis to rescind?

Answer: When the speaker actually has or plausibly represents themselves to have expert knowledge on the subject.

Examples:
✓ Vokes v. Arthur Murray, Inc.
✓ Sunderhaus v. Perel & Lowenstein

Vokes v. Arthur Murray, Inc.
Florida Court of Appeals, 1968

Mrs. Audrey Vokes, a widow of fifty-one years and without family, purchased fourteen separate dance courses from J.P. Davenport’s Arthur Murray School of Dance. The fourteen courses totaled 2,302 hours of dancing lessons at a cost of $31,090. Mrs. Vokes was induced continually to reapply for new courses by representations made by Mr. Davenport that her dancing ability was improving, that she was responding to instruction, that she had excellent potential, and that they were developing her into an accomplished dancer. In fact, she had no dancing ability or aptitude and had trouble “hearing the musical beat.” Mrs. Vokes brought action to have the contracts set aside. The plaintiff’s complaint was dismissed for failure to state a cause of action, and she appealed.

Sunderhaus v. Perel & Lowenstein
Tennessee Supreme Court, 1965

On Feb. 10, Mrs. Sunderhaus purchased a diamond ring from Perel & Lowenstein for $699. She was told by the company’s salesman that the ring was worth its purchase price, and she also received at that time a written guarantee from the company attesting to the diamond’s value, style, and trade-in value. When Mrs. Sunderhaus went to trade the ring for another however, she was told by two jewelers that the ring was valued at $300 to $350. Mrs. Sunderhaus seeks rescission of the contract or damages in the amount of the difference between the price she paid and the ring’s current appraised value per the independent jewelers. Will she win?
Is a Lie the same thing as a False Statement of Fact?

True or False?

1. All lies are false statements of fact.
2. All false statements of fact are lies.

Sales Puffery

A statement is sales puffery when a reasonable person would realize that it is a sales pitch, representing the exaggerated opinion of the seller.

- This is the best computer chip on the market.
- This computer chip is better than any other.
- This is a high-quality piece of furniture.
- This piece of furniture has expert workmanship.

Because they are not subject to precise measurement, these statements are mere puffery and not actionable.

Fraud or Materiality

- A statement is fraudulent if it was made for the purpose of inducing the other party to enter the contract, and either with knowledge of its falsity or no reasonable basis to believe it is true.
- A statement is material if it would be likely to induce the other party into entering the contract.
**Justifiable Reliance**
The injured party must show that:
1. She *actually relied* on the false statement, and
2. Her reliance was *reasonable*
The injured party has:
- No duty to undertake an active investigation into claims, but
- Must keep her eyes open

**Plaintiff’s Remedies for Misrepresentation or Fraud**
✓ A defendant who commits fraud may also be liable for the tort of *deceit*.
  - Plaintiff may be able to rescind and sue for economic losses and punitive damages.
✓ Most states do *not* allow plaintiffs to **both** rescind the contract **and** sue for damages for deceit *at common law* – they must **choose** one or the other.

**If Plaintiff Elects *Not to Rescind***
✓ An innocent misrepresentation, even if material, will not allow the plaintiff to recover any damages under common law.
✓ But under the UCC, they can sue for damages if they can prove materiality.
✓ At common law, a fraudulent misrepresentation will permit the plaintiff to sue for damages (based on the tort of deceit) provided they do not also request rescission.
Silence

Amounts to misrepresentation only where disclosure:

1. Is necessary to correct a previous assertion
2. Would correct a basic mistaken assumption that the other party is relying on
3. Would correct the other party’s mistaken understanding about a writing, or
4. Is reasonably expected based on a relationship of trust between the parties

Stambovsky v. Ackley

✓ The seller of the house, Ackley, was merely silent with regard to the house’s reputation as being haunted.
✓ Therefore, the trial court dismissed Stambovsky’s action for rescission.
✓ However, the New York Court of Appeals disagreed.
Stambovsky v. Ackley

“Where a condition...materially impairs the value of the contract and is peculiarly within the knowledge of the seller or unlikely to be discovered by a prudent purchaser exercising due care, nondisclosure constitutes a basis for rescission as a matter of equity.”
- New York Court of Appeals, 1991

Other Situations in Which There is a Duty of Disclosure

3. Mistaken understanding about a writing
4. A relationship of trust and confidence between the parties:
   - A mother and her children
   - A businessman and his partners
   - These are not arm’s length relationships.

Active Concealment and Half-Truths

Active concealment is fraud. The use of half-truths can also be fraud if they would predictably lead a reasonable person to an incorrect conclusion about an important fact.

Examples:
- Exam strategy question, page 321
- Fimbel v. DeClark (next slide)
Under certain circumstances, parties may avoid their contracts because of bilateral or unilateral mistake.

The doctrine of mistake prevents unexpected and unbargained for losses.

Mistake: A belief about a past or present fact that is not in accord with the truth.

**Bilateral Mistake**

If the parties contract based on an important mutual factual error, the contract is voidable by the injured party.

**Example 1:** Rose 2d of Aberlone

**Example 2:** End-of-chapter additional question #8 (Morell bought a security guard business…)
Mistake vs. False Expectation

✓ The fact must be a past or present fact.
✓ A false belief or expectation about something that may occur in the future will not qualify as a mistake under contract law.
✓ Also, you will not be granted relief for a mistake if you enter a contract with conscious awareness that your knowledge is imperfect in some area.

Conscious Uncertainty

✓ Some contracts are deliberately made with incomplete knowledge. This is called conscious uncertainty.
Examples:
1. The farmer and the town jeweler.
2. Garage sale paintings collector.
3. Home safe auctioned with locked interior compartment.

Requirements for Unilateral Mistake

It is more difficult for the mistaken party to avoid the contract, but they can still do it if they can prove:
1. That they were mistaken regarding an essential or important factual matter, and that either
2. a. That the nonmistaken party was aware of the mistaken party’s mistake, or should have been, or
   b. That it would be unconscionable to enforce the contract.
Donovan v. RRL Corporation
✓ CA Vehicle Code section 11713.1, subdivision (e) makes it unlawful for an automobile dealer not to sell a motor vehicle at the advertised price while the vehicle remains unsold and before the advertisement expires.
✓ The local newspaper had made a mistake and printed a lower price than the dealership requested.

Donovan v. RRL Corporation
✓ Brian Donovan came to the dealership and accepted the offer to sell for $25,995 which was printed in the ad.
✓ The dealership refused to sell it at that price.
✓ Donovan sued to enforce the contract.
✓ The trial court entered judgment for the dealership.

Donovan v. RRL Corporation
✓ The court of appeals reversed.
✓ The state supreme court reversed the appeals court decision and reinstated the trial court’s ruling.
✓ “There is no evidence that the Lexus dealership knew of the misprint or intended to mislead customers.”
Donovan v. RRL Corporation

✓ “Nothing indicated that the dealer routinely permitted such errors to appear in the press.”
✓ A contract was formed when the customer tendered the asking price, but RRL Corporation may rescind that contract based on unilateral mistake.

Donovan v. RRL Corporation

What the defendant must prove in California (to rescind based on unilateral mistake):
1. The defendant made a mistake regarding a basic assumption about the contract.
2. The mistake produces material, unbargained-for gains for the plaintiff and losses for the defendant.
3. The defendant does not bear the risk of the mistake (due to conscious uncertainty.)
4. Enforcement of the contract would be unconscionable.
Duress

✓ If one party makes an improper threat that causes the victim to enter into a contract, and the victim had no reasonable alternative, the contract is voidable.

✓ The duress can be from a physical threat or it can be economic duress.

Economic Duress

✓ Driving a hard bargain when someone is in economic difficulty AND

✓ When YOU ARE THE CAUSE (at least in part) of the economic difficulty

International Underwater Contractors, Inc. v. New England Telephone and Telegraph Company

FACTS

International Underwater Contractors, Inc. (IUC) entered into a written contract with New England Telephone and Telegraph Company (NET) to assemble and construct an undersea telephone cable from Boston, Massachusetts to New York City. The contract price of $810,000 (Delays caused by NET turned IUC’s work to be performed in the winter months instead of during the summer as originally stipulated) and as a result, a major change had to be made in the contract that specified in the contract, NET repeatedly assured IUC that they would pay the cost if IUC would complete the work. The change order to NET was issued to IUC for $300,000. However, when IUC attempted to recover the balance due, NET informed IUC that the contract was ended because it was signed under economic duress. Summary judgment was denied by NET.

DECISION

Summary judgment reversed.

OPINION

A release signed under economic pressure illegally or intentionally applied is not binding. To prove that the release was signed under economic duress, IUC must show (1) the plaintiff was under economic pressure, (2) the circumstances prevented any other alternatives, and (3) the circumstances were the result of the active acts of the other party. Merely taking advantage of another’s financial difficulty is not duress; rather, the party claiming duress must show that the financial difficulty was caused by the active acts of the other party. These facts are not duress, so the release is admissible. The case is remanded to the trial court for further proceedings.

INTERROGATION

Economic coercion that compels a person to enter into a contract renders the contract voidable.

ETHICAL QUESTIONS

1. Did the IUC act on an immoral trans- form? Explain.

2. CRITICAL THINKING QUESTION: Should abuses include improperly applied economic pressure, or should it be limited to the use of, or threats to use, physical force? Explain.
In Re: RLS Legal Solutions, L.L.C.

YOU BE THE JUDGE

✓ What were the facts that led to this case?
✓ What did the trial court decide?
✓ How many think Maida won?
✓ How many think RLS Legal Solutions won?

Undue Influence

A situation where one party so dominates the other’s thinking that consent is lacking. The influenced party lacked free will.

Requirements for undue influence:
1. There existed a relationship of trust or domination between the two parties, and
2. The stronger party engaged in improper persuasion.

Improper Persuasion

✓ Repeating the same arguments (over and over)
✓ Using unusually strong rhetoric, such as
  • You have no moral right to keep this child
  • You should be ashamed of yourself for wanting to
  • You have no legal right to keep this child (false!)
  • If you don’t sign this, it proves you don’t love me
  • You always liked Walter better than me and this proves it
When does the law let you lie*?

1. When you’re a minor.
2. When you are induced to agree (to a contract) by an improper threat, and had no reasonable alternative.

*Additional situations we have learned in chapter 13.