

# Capacity and Contract: National Law and Proposal for a Common European Sales Law §

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## SUMMARY

INTRODUCTION. – 1. OUTLINE: INVALIDITY OF THE CONTRACT FOR MENTAL INCAPACITY.  
– 2. ITALIAN, FRENCH AND ENGLISH LAW: PERSON'S COMPETENCY NOT LIMITED BY ANY PROTECTIVE MEASURE. – 3. ITALIAN, FRENCH AND ENGLISH LAW: JUDICIAL MEASURE WHICH LIMITS THE PERSON'S CAPACITY. – 4. LIMITS TO THE RULE: LOWER LIMIT.  
– 5. LIMITS TO THE RULE: UPPER LIMITS. – 6. INCAPACITY AND THE CESL: LACK OF ANY SPECIFIC RULE. – 7. CESL AND UNFAIR EXPLOITATION. – 8. FINAL REMARKS.

## ABSTRACT

*The paper concerns the topic of contracts entered into by a person suffering from mental incapacity. The matter is analysed considering the rules of invalidity given in three legal systems (Italy, France and United Kingdom) and their limits as well as the broader framework where incapacity has to be seen (CESL). It is argued that the special rules of invalidity and the traditional distinction between capacity and incapacity will lose their importance in the light of the attention paid by the new instruments to bargaining power abuse.*

## KEYWORDS

MENTAL INCAPACITY - INCOMPETENCY - CONTRACT - INVALIDITY - PROTECTIVE MEASURES - LIMITS TO THE RULE OF INVALIDITY - EVERYDAY LIFE CONTRACTS - GIFTS - CESL - UNFAIR EXPLOITATION

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## INTRODUCTION

This presentation deals with contracts entered into by a person suffering from mental incapacity, in the context of Italian, French and English law as well as the new Proposal for a Common European Sales Law.

We will discuss this through four key points.

First, we will provide an overview of the rules of invalidity linked to mental incapacity of one contracting party in the three legal systems and their general features.

Second, we will consider in greater depth the invalidity conditions under Italian, French and English law.

Third, we analyze the limits of the rule: both the lower limit, given by everyday life contracts, and the upper ones, regarding whether an absolute mental incapacity can lead to a different kind of invalidity and the special rule given under Italian law in the context of gifts.

Finally, the fourth part deals with mental incapacity in the light of the broader framework of 'bargaining power abuse', also considered by the new Proposal for a Common European Sales Law.

### 1. OUTLINE: INVALIDITY OF THE CONTRACT FOR MENTAL INCAPACITY

We are now going to consider the first point, i.e. an overview of the consequences linked to contract entered into by a person who lacks capacity.

Generally speaking, under Italian, English and French law a contract entered into by a person suffering from mental incapacity is invalid, provided that certain conditions are met.

Whilst the examined legal systems refer to such invalidity using different terminology and approaches (with the civil law systems seeing such invalidity as the rule and common law referring to it as an exception), the kinds of invalidity provided share a number of common features.

Specifically, the aim of the invalidity rule is to protect the person of unsound mind. This is why only the person considered incapable is allowed to exercise the rights associated with the status.

Moreover, a distinction can be drawn between a general and a special regime of invalidity of the contract, depending on whether the person is subject to any protective measure (though in the common law such distinction is not expressly drawn by doctrine).

In Italy this issue is regulated by article 428 of the *codice civile* (entitled "Acts made by a mentally disordered person"), the second and third paragraph of article 427, which deal with situations where the person is subject to a protective

measure and someone else should have acted on his behalf or assisted him, and article 412 which addresses the case of ‘amministrazione di sostegno’<sup>1</sup>.

Under French law, the relevant provisions are found in the *code civil* with article 414-1 setting a general regime, and special rules being provided by articles 435, from 464 to 466 and 488<sup>2</sup>.

In contrast to the aforesaid systems, in the United Kingdom the matter is almost entirely regulated by case law. The only relevant statutory provision is section 7 of the Mental Capacity Act 2005. The most relevant precedents are found in: *in re Walker* (1904); *Imperial Loan Company Ltd v Stone* (1892) and *Hart v O'Connor* (1985)<sup>3</sup>.

## 2. ITALIAN, FRENCH AND ENGLISH LAW:

### PERSON'S COMPETENCY NOT LIMITED BY ANY PROTECTIVE MEASURE

If we now turn to the second point and consider the conditions for such invalidity under Italian, French and English law, we firstly have to say that each of the legal systems under consideration provides a different regime regarding the conditions for contractual invalidity depending on whether the person is subject to a protective measure or not. In other words, different provisions apply for legal incompetency (*incapacità legale* in Italy, *incapacité légal* in France) and mental incapacity (*incapacità naturale* in Italy; *insanité d'esprit* in France).

First considering the general case, i.e. the case where the person's competency has not been limited by any protective measure but he was *non compos mentis* at the moment the contract was concluded, we observe two approaches.

On the one hand, Italian and English law establish that the contract is voidable at the insane person's will on the condition that the other party was aware of his mental impairment at the time of the contract.

Conversely, under French law the contract can be declared void at the request of the mentally incapable person without the need of any further requirement but the proof of the mental incapacity. The other party's awareness is therefore irrelevant for the determination of invalidity of the contract.

The Italian courts have interpreted the second paragraph of Article 428 of the Italian *codice civile* as allowing the mentally incapable party to avoid the contract

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1 For an overview, see PESCARA, *Tecniche privatistiche e istituti di salvaguardia dei disabili psichici*, in *Trattato di diritto privato* Rescigno, III, 4, 2<sup>nd</sup> edn, Utet, Torino, 1997, 839 ff.; PIETROBON, *Incapacità naturale*, in *Enciclopedia giuridica*, XVIII, Treccani, Roma, 1989.

2 DUBOIS-PAILLET, «*Incapable Majeurs*», in *Encyclopédie Juridique Dalloz*, *Repostoire de droit civil*, VI, Dalloz, France, mise à jour 2012; STARCK-ROLAND-BOYER, *Droit civil. Les obligations*, 2. *Contrat*, 16<sup>th</sup> edn, Litec, Paris, 1998, 157 ff.

3 *In re Walker* [1905] 1 Ch 160; *Imperial Loan Company Ltd v Stone* [1892] 1 Q.B. 599; *Hart v O'Connor* [1985] 1 A.C. 1000.

on the basis of his mental impairment if the other party was in bad faith, which generally consists in the knowledge of the party's incapacity. However, it has to be said that the interpretation of the article has been a matter of considerable debate. In fact, if we read the first paragraph of article 428 *codice civile*, it refers to the discipline of acts made by a mentally incapable person and provides that the act can be avoided if it causes a prejudice to the mentally impaired party. Now, if we remember that a contract is in the first instance an act, we could argue that a contract can be avoided only if both conditions (bad faith and a prejudice suffered by the incapable person) are met. Such argument is supported by a large part of the doctrine, whilst on the contrary jurisprudence does not require the existence of any prejudice.

Similarly, under English law a contract entered into by a person suffering from mental incapacity is voidable if the other party was aware of his lack of capacity at the moment the contract was concluded. The rule was issued in Imperial Loan Company Ltd v Stone (1892)<sup>4</sup>. Besides, voidability does not depend upon a prejudice suffered by the party, understood as unfairness of the bargain, as shown in Hart v O'Connor (1985). Lastly, at English law a contract is also voidable if any reasonable man would have realized that the person was incapable, which is argued against by Italian authors.

Both Italian and English law try to find a balance between the protection of the person of unsound mind and the protection of the other party's reliance on the contract. In particular, the reason for the bad faith requirement for avoidance is to safeguard the sane party reliance on the contract.

On the other hand, French law does not afford similar protection to the other party's reliance on the contract and is more favorable to the mentally incapable person. In fact, article 414-1 *code civil* does not require that the other party be aware of the incapacity for declaring the contract 'nul' (that means void). Instead, the proof of mental insanity is sufficient. Despite the term used to refer to such invalidity, which is 'nullité' and could be translated with 'voidness', the kind of invalidity provided by French law is similar to Italian voidability.

The same favor to the incapable can be seen as the basis of a further rule. In the French legal system a contract (and, more generally, an act) entered into by a person during the two years preceding the commencement of proceedings for subjecting that person to a protective measure can be declared void just if he proves that he was unable to defend his own interests and he suffered a prejudice from the act (article 462 *code civil*).

This framework raises the question as to how one deals with cases where the mental incapacity is not easily recognizable by the other party.

This could occur in at least two situations.

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<sup>4</sup> For English law, see Treitel's *The Law of Contract*, 13<sup>th</sup> edn, Sweete-Maxwell, London, 2011, 586 ff.; CLARKE, *Vitiating Factors*, in Furmston (ed), *The Law of Contract*, 4<sup>th</sup> edn, Part of Butterworths Common Law Series, United Kingdom, 2010, 857 ff.; HALE, *Mental Health Law*, Sweete-Maxwell, London, 2010.

The first is when no symptom is easily perceptible - we can think about an old person who seems alert at first sight, but who actually suffers from Alzheimer and forgets events after a short time.

A second potential scenario is when the contract is concluded without the physical presence of the parties, for example by means of the internet - for instance a person suffering from a mental incapacity who buys some rare stamps on E-bay -. In such cases, under a domestic point of view, assuming an objective meaning of bad faith might be a helpful approach. The reference to a prejudice ensuing from the act to the incapable contained in the second paragraph of article 428, could be considered sufficient to raise a presumption of bad faith thereby creating the possibility for avoiding the contract. To put it differently, a flexible application of statutory rules could lead to a better protection for the mental incapable. At English law, the courts' concern with not interfering with the freedom of contract means that it is unlikely they would grant voidability of the contract. On the contrary, in France the declaration of voidness simply requires the proof of the mental impairment, meaning that such questions do not arise and the mental insane will always be protected.

### 3. ITALIAN, FRENCH AND ENGLISH LAW: JUDICIAL MEASURE WHICH LIMITS THE PERSON'S CAPACITY

Moving on to the second hypothesis, this is the case the court has found the person permanently insane and has consequently rendered a judicial measure which limits the person's capacity to act for himself (in Italy the relevant legal institutes are *interdizione*, *inabilitazione* and *amministrazione di sostegno*; in France they are *tutelle*, *curatelle* and *sauvegarde de justice*; the United Kingdom does not have the same legal institutes, however section 16 of the Mental Capacity Act 2005 provides that the court could make the decision on his behalf in relation to certain matters or appoint a 'deputy' to make decisions on the person's behalf). In this context, all of the systems under consideration provide for a higher level of protection for the incapable person.

In particular, two issues are worth highlighting.

Firstly, since an evaluation of the person's capacity to understand and act in accordance with his own interests is made *ex ante* by the court, invalidity is not subject to the verification of the lack of mental capacity in the specific case. A non-rebuttable legal presumption of fact applies (that means that the other party is not permitted to prove the contrary).

Turning to the second point, the filing system provided by each legal system enables anyone to be aware of the judicial measure the incapable person is subjected to. Therefore one could argue that the reliance the other party could have had on the contract does not deserve further protection since he has the possibility of taking knowledge of the incapacity.

In fact, the Italian *codice civile* provides that any act the incapable person makes without the necessary assistance or legal representation of the guardian (the so called ‘curatore’ in the first case and ‘tutore’ in the second one) is voidable without any need for effective knowledge of the party’s incapacity (article 427, second and third paragraph).

Similarly, in the United Kingdom if the person’s property is subject to the control of the court, the contract through which he disposes of the property does not bind him, but binds the other party. However, it is unclear whether the rule extends also to contracts unrelated to the disposition of property.

The French system differs from the ones examined and is more complex. If a person is subject to *sauvegarde de justice* or other measure and he personally made an act he should have been legally represented for, the act is voidable (*nullité relative*, provided by articles 435, 465, n. 3 *code civil*). If the person should have been only assisted for acting, the contract can be avoided if a prejudice ensued from it to the incapable (article 465, n. 2 *code civil*).

With regard to those acts for which the person subject to a protective measure retains capacity, the general rules seem to apply in each of the legal systems considered.

However, the French system provides a more flexible regime. Such acts can still be avoided in virtue of the general rule of art. 414-1 *code civil*, but can otherwise be “rescinded for overreaching on the ground of enormous disproportion between the prestations of the parties” or “reduced for excess” (art. 425, 465, n. 1 *code civil*). In such cases the court must consider the usefulness of the act for the person, the other party’s good or bad faith and the importance or consistence of the insane person’s property.

#### 4. LIMITS TO THE RULE: LOWER LIMIT

After analyzing the conditions in which operates the invalidity rule, we have now to examine the third aspect, which concerns the lower and upper limits to the afore examined rules of invalidity.

The lower limit deals with everyday life contracts concluded by the person subject to a protective measure. These are referred to as ‘atti’ or ‘contratti’ ‘minimi’ in Italy, ‘actes de la vie courant’ in France and ‘contracts for necessities’ in the United Kingdom. The question is whether the regime of invalidity we have seen applies to such contracts, or, on the other hand, the need for securing necessary goods and services to the person of unsound mind justifies a different approach.

Although Italian statutory law does not provide any special rule for the case, it is believed that the person subject to a protective measure retains a minimum freedom of contracting in relation to everyday life necessities. Therefore such contracts are to be considered valid, provided that they are not prejudicial (as the general rule provided by article 428 *codice civile* still applies).

Similarly, in France the same approach has been supported by the authors in the absence of any statutory provision. Before 1968, the reason for the rule was found in the existence of an implied mandate in favor of the incapable person. Since then the courts have relied upon the analogic application of the *code civil* rules concerning minors that grant a limited capacity in relation to everyday life acts.

Under English law, the rule applying to this kind of contracts has been set out in Statute. Namely, section 7 of the Mental Capacity Act 2005 provides that if the contract refers to the supply of necessary goods and services, the person who lacks capacity to contract must pay a reasonable price for them. For this purpose, “necessary” means suitable to a person’s condition in life and to his actual requirements at the time when the goods or services are supplied”. In other words, in such cases, even if it is not directly stated that the contract is valid, the law allows the supplier a remedy at common law for recovering a reasonable price.

In brief, the aim of these rules is to find a balance between the interests of the mentally impaired to secure necessary goods and services at fair terms - avoiding the risk of social exclusion and exploitation -, and the interest of the other party to enter into valid contracts, - avoiding the risk of precariousness of the effects -, or at least to obtain payment.

## 5. LIMITS TO THE RULE: UPPER LIMITS

Moving on to the upper limits, two aspects have to be considered.

Firstly, it has to be examined whether an absolute lack of mental capacity excludes the existence of an effective consent and therefore leads to voidness / nullity of the contract (rather than voidability) for lack of one of its essential elements.

The aforesaid argument used to be supported in the past but appears to have lost its persuasiveness as of recent.

In France, until the 1968 reform, authors referred to mental incapacity as an element excluding effective consent, required by article 1108 *code civil* for the validity of the contract.

In Italy the argument had some followers under the previous *codice civile* 1865, whilst since then it has been generally accepted that article 428 *codice civile* has set an organic discipline (only isolated authors still argue that the contract entered into by a person in state of absolute lack of mental capacity is void for defect of consent).

Secondly, special rules are provided by Italian and English law for gifts, therefore the general rule requiring proof of the other party’s awareness for avoiding the contract does not apply to such contracts (anyway, it has to be said, gift is not a contract according to English law). Instead, a gift is voidable to the mentally incapable donor choice if he only gives proof of his mental impairment. The reason for such rule is clear: the reliance of the donee can be sacrificed in favor to the mentally disordered donor interests according to the gratuity of gift.

## 6. INCAPACITY AND THE CESL: LACK OF ANY SPECIFIC RULE

One last point has to be tackled: the one concerning the broader framework where incapacity has to be seen.

A comparative analysis of the subject “mental capacity and contract” is certainly useful in any case that presents elements of extraneousness, which is becoming more and more frequent as a result of increased mobility and of weakening of the connection between trade and national territory.

Where an element of extraneousness exists international private law rules apply: namely, with reference to domestic law, article 13 of Regulation Rome I (n° 593/2008) on the law applicable to contractual obligations, and the second paragraph of article 23 of Italian law n° 218/1995 on the reform of Italian international private law indicates which law to apply in case of one party's incapacity.

However, comparison is not sufficient for an exhaustive analysis of the topic of mental incapacity and contract. In fact, it cannot fail to consider the broader dimension, in which the phenomenon has to be framed namely European law.

In particular, although mental incapacity stands out from its object, it is useful to refer to the new proposal for a regulation on a Common European Sales Law, dated October 2011, which was born from the revision of the Draft Common Frame of Reference and provides an optional regime for sale contracts.

The choice for excluding specific rules about mental incapacity from the proposal (also expressed in recital n° 27 of the proposal) is consistent with the traditional European and international policy as well as with soft law instruments. Namely, an identical exclusion is made, among others, by Convention of 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters and Regulation Bruxelles I (n° 2001/44/EC) on the same matter and by the PECL (Principles of European Contract Law, art. 4:101) and the Unidroit Principles (edition 2010: chapter 3, art. 3.1.1.) as soft law instruments.

Two reasons could explain this exclusion.

The first is the subsidiarity and proportionality principles that guide the European Union's intervention.

The second reason relates to the Regulation's objective matter, the means contracts are more frequently concluded by and the nature of the parties. In fact, the proposed regulation does not only consider natural persons but also small and medium sized enterprises, to which no question of mental incapacity arises. Moreover, the regulation covers cross-border contracts. This implies that the more frequent hypothesis will be the one where the purchase is concluded without the physical presence of the parties, thus it is unlikely that one of them will be aware of the mental incapacity of the other. Finally, as regards contracts whose parties are a trader and a consumer, the lower limit of the invalidity rule could come into consideration; in fact, those contracts would normally provide for everyday life needs.

## 7. CESL AND UNFAIR EXPLOITATION

However, although mental incapacity is not considered by the Proposal for a Common Sales Law, the interests of someone who is mentally impaired could be protected in two different ways.

Firstly, remedies provided for consumer contracts apply if the impaired person acts as a consumer, and not as an entrepreneur. Specifically, in the case where the contract is concluded without the physical presence of the parties provisions for distance contracts could apply. That means that the consumer who is mentally impaired could exercise the right of withdrawal provided by each Member State's statutory law after directive 97/7/EC, which was recently amended by directive 2011/83 on consumer rights (and to which Member States should comply with by December 2013).

Secondly, a wider provision could absorb the importance of mental capacity provisions. Namely Article 51 of the proposal, which regulates unfair exploitation, a legal institute linked to the bargaining power abuse of one party to the detriment of the other.

The rule provides that a party may avoid a contract if two conditions are met at the time of the conclusion of the contract: "(a) that party was dependent on, or had a relationship of trust with, the other party, was in economic distress or had urgent needs, was improvident, ignorant, or inexperienced; and (b) the other party knew or could be expected to have known this and, in the light of the circumstances and purpose of the contract, exploited the first party's situation by taking an excessive benefit or unfair advantage."

Avoidance can be reached extra-judicially, by giving notice of it to the other party (according to Article 52) within one year from when the party becomes aware of the relevant circumstances or becomes capable of acting freely. The mechanism was already provided for by the Unidroit Principles (article 3.2.11), but it remains unknown to domestic law.

From an internal point of view, the rule on unfair exploitation has some features in common with rescission for overreaching on the ground of enormous disproportion between the parties' performances (art. 1448 *codice civile*). However, while the latter requires a certain disproportion between performances, unfair exploitation rescinds from it: the attribution of an unfair advantage is substantially sufficient for presuming the agreement to be harmful for the incapable person or, in any case, for rebalancing contractual positions by providing the mentally impaired the right to avoid the contract.

## 8. FINAL REMARKS

In conclusion, it appears that special rules on mental incapacity could lose a great deal of their importance in the light of the attention paid by the new instruments to bargaining power abuse.

This will be especially true in each case the person of unsound mind would be able to make use of easier accessible remedies provided for situations of contractual power inferiority.

In other terms, the system resulting from the new provisions will be more complex and flexible and will lead to the overcoming of the traditional distinction between capacity and incapacity, this means that protection would be also granted to persons suffering from modest incapacity and undergoing abuse.

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