

# Business Law

## Text & Exercises *6th Ed.*

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## Chapter 12: The Legality of Agreements

# Learning Outcomes

- LO1** • Identify contracts that are contrary to federal or state statutes.
- LO2** • Identify contracts that are contrary to public policy.

# Learning Outcomes

**LO3**

- **State circumstances in which covenants not to compete are enforceable.**

**LO4**

- **Understand the consequences of entering into an illegal agreement.**



# Contracts Contrary to Statute

- **Usury.**
  - Charging an illegal rate of interest.
- **Gambling.**
- **Sabbath Laws.**
  - Blue laws: State or local laws that make the performance of commercial activities on Sunday illegal.
- **Licensing Statutes.**

# Contracts Contrary to Public Policy

- **Even though contracts involve private parties, they may have a negative effect on society:**
  - Contracts in restraint of trade.
  - Unconscionable contracts or clauses.
  - Exculpatory Clauses.

# Contracts in Restraint of Trade

- **Covenants not to compete.**
  - Often contained in contracts concerning the sale of an ongoing business. Terms must be reasonable.
- **Examples:**
  - When a seller agrees not to open a new store in a certain geographical area.
  - Employment contracts (non-compete clauses.)

# Unconscionable Contracts or Clauses

- **Void on the basis of public policy because one party, as a result of his or her inferior bargaining power, is forced to accept terms that are unfairly burdensome and that unfairly benefit the dominating party.**
- **Adhesion Contract:**
  - Standard form contract in which the stronger party dictates terms.

# Exculpatory Clauses

- **Clauses that releases a party to a contract from liability for his or her wrongful acts.**
- **Often held to be enforceable.**



# The Effect of Illegality

- In most illegal contracts, both parties are considered to be equally at fault —*in pari delicto*.
- If a contract is executory (not yet fulfilled), neither party can enforce it.

# The Effect of Illegality

- **Exceptions:**

- Justifiable ignorance of the facts.
- Members of protected classes.
- Withdrawal from an illegal agreement.
- Illegal contract through fraud, duress, or undue influence.
- Reformation of an illegal agreement not to compete.



# **Justifiable Ignorance of the Facts**

- **When one of the parties is relatively innocent, that party can often obtain restitution in a partially executed contract.**

# Members of Protected Classes

- **When a statute protects a certain class of people, a member of that class can enforce an illegal contract even though the other party cannot.**
- **Blue sky law: State law that regulates the offer and sale of securities.**

# **Withdrawal, Fraud, Duress, Undue Influence**

- **Withdrawal:**
  - The party tendering performance can withdraw from the bargain and recover the performance or its value.
- **Fraud, Duress, or Undue Influence:**
  - A plaintiff can either enforce the contract or recover for its value.

# **Reformation of an Illegal Covenant not to Compete**

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