



## Specialist Debt Advice Service Spotlight

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Shelter

### Mental Capacity to Contract

It is common for advisers to query whether a client had the mental capacity to enter a contract and whether they might be able to challenge liability where such capacity was lacking.

There is a presumption in law that everyone has the capacity to contract. Someone wishing to rebut this presumption must show they fall under one of three classes of person:

- a drunken person;
- a person under the age of 18 – a ‘minor’;
- a person who lacked the mental capacity when entering into the contract.

This Spotlight will focus on the last of these exceptions – mental capacity.

The Mental Capacity Act 2005 codified existing case law and set out some principles, which include:

- A person must be assumed to have capacity unless it is established that he/she lacks capacity;
- A person is not to be treated as unable to make a decision unless all practicable steps to help him/her to do so have been taken without success;

- A person is not to be treated as unable to make a decision merely because he/she makes an unwise decision.

Section 2 of the Mental Capacity Act 2005 says:

## ***“2 People who lack capacity***

- (1) *For the purposes of this Act, a person lacks capacity in relation to a matter if at the material time he is unable to make a decision for himself in relation to the matter because of an impairment of, or a disturbance in the functioning of, the mind or brain.*
- (2) *It does not matter whether the impairment or disturbance is permanent or temporary.*
- (3) *A lack of capacity cannot be established merely by reference to—*
  - (a) *a person's age or appearance, or*
  - (b) *a condition of his, or an aspect of his behaviour, which might lead others to make unjustified assumptions about his capacity.*
- (4) *In proceedings under this Act or any other enactment, any question whether a person lacks capacity within the meaning of this Act must be decided on the balance of probabilities.”*

There is a [Code of Practice](#), issued under the Act, which provides further clarification and has the force of the law.

The High Court recently considered the law in [Fehily & Anor v Atkinson & Anor \[2016\] EWHC 3069 \(Ch\)](#) and set out some important principles, raising the bar for challenge in some respects:

- A person needs the mental capacity to recognise the issues that need to be considered, to obtain, receive, understand and retain relevant information, including advice and to weigh the information in the balance in reaching a decision.
- A person may have sufficient capacity for one type of decision but not another.

- A person's capacity to enter into a transaction may vary over time. When determining whether a person has capacity, the court must consider whether the person had capacity at the time of entering into the transaction.
- The key issue is whether the person has the ability to understand the transaction, not whether they actually understood it.
- Individuals may require advice to fully understand a transaction. The fact that they did not receive advice in such a circumstance would not, however, affect capacity. The correct test of capacity is whether a person has the insight and understanding to realise that advice is needed, the ability to find and instruct an appropriate adviser, and the capacity to understand and make decisions based on that advice.
- A person does not need the ability to understand the minute detail of a transaction proposed but if explained in simple language, a person should be able to grasp the key features of the proposed transaction.

### **Voidable not void**

Where it can be proved, on a balance of probabilities, that a party lacked mental capacity, the contract will be voidable. Therefore, the contract will be binding on that party unless they can show that:

- The other party knew of the incapacity at the time of the contract; or
- The facts are so blatant that the other party (as a reasonable person) must have known of the incapacity.

Pursuant to [section 3\(2\)](#) of the Sale of Goods Act 1979, even where the contract may be voidable, the client may still be required to pay reasonable price for the provision of 'necessaries'. The term necessities defined at subsection (3) -

*(3 )In subsection (2) above "necessaries" means goods suitable to the condition in life of the [minor or other] person concerned and to his actual requirements at the time of the sale and delivery.*

### **Ratification**

People with mental health problems will often have fluctuating mental capacity to enter contracts. If a person enters a contract during a period of incapacity, but subsequently ratifies this, either expressly, or through their conduct, the contract will become binding.

So, for example, a person who enters a credit card agreement during a period of incapacity, but subsequently uses it during periods of capacity and makes the monthly payments, would have likely ratified the contract.

### **Practicalities of challenging an agreement on mental incapacity grounds**

Advisers will need to consider what medical evidence might be obtained as to the client's mental incapacity at the point at which the agreement was entered into.

Advisers will also need to consider what evidence there is that the other party knew of, or ought to have known of, the client's mental incapacity. For example, is it possible to obtain a recording or transcript of any telephone or face-to-face discussion? It may be particularly difficult to obtain evidence where an agreement was entered into online.

If a challenge is likely to result in a court claim being issued and defended, are arrangements in place for legal representation? Dealing with what may be complex and time-consuming court litigation would generally be outside the scope of debt advice.

There could also be significant costs-risks for your client depending on whether or not the case is allocated to the small claims track.

Where the client has little by way of disposable income or assets, a creditor is likely to be reluctant to enter litigation if they are aware that they will find it difficult to enforce a judgment if they are successful. In these circumstances, it may be appropriate to inform the creditor of the potential legal defence and client's financial circumstances and invite them to write off the alleged debt.

### **Complaints to the Financial Ombudsman Service (FOS)**

A more practical way forward to resolve liability issues resulting from mental incapacity is likely to involve using the Financial Ombudsman Service. Our [June 2019 Spotlight](#) explains about doing this (in general) in more detail.

FOS are required to determine complaints with reference to what is, in the opinion of the Ombudsman, fair and reasonable in all the circumstances of the case. In doing this, they will consider not just the relevant law but also any relevant FCA rules and

guidance, codes of practice, and what was good industry practice at the time. This will include [CONC 2.10](#) Mental Capacity Guidance.

The [Pre-action Protocol for Debt Claims](#) aims to encourage Alternative Dispute Resolution ('ADR') as an alternative to proceedings being brought to court. Where proceedings have been started, the courts are under a general duty to encourage ADR and it has the power to stay proceedings, pending a determination by FOS, under [CPR 1.4\(2\)\(e\)](#), [CPR 3.1\(2\)\(f\)](#) and [CPR 26](#).

### **Further information**

For a more detailed discussion of the above, and related issues, see Chauntelle Wright's excellent article in Adviser 138, 'Mental Incapacity and Debt in England and Wales'. This article pre-dates the decision in *Fehily* but most of the information remains valid.

LexisNexis Practice Notes 'Mental capacity—an introduction' and 'Forming enforceable contracts—capacity' are acknowledged as sources of reference in producing this Spotlight.