

502.40 CONTRACTS—ISSUE OF BREACH—DEFENSE OF ILLEGALITY OR
UNENFORCEABILITY.

NOTE WELL: Where no genuine dispute exists regarding a contract's substance, whether it is an illegal or unenforceable contract is a question of law for the court. See Fenner v. Tucker, 213 N.C. 419, 423 (1938) (absent conflicting evidence, whether contract is illegal as a gambling contract is a question of law). However, there may be instances where there is a factual dispute as to whether the promise or covenant at issue involves an illegal or unenforceable subject matter. See Collins v. Davis, 68 N.C. App. 588, 592, 315 S.E.2d 759, 762 (1984) (purpose for which money and work were contributed is question of fact; unenforceability of implied contract based upon money paid for illegal purpose is question of law).

The endnotes provide examples of contracts deemed illegal or unenforceable in North Carolina. The body of this instruction provides a model special interrogatory to be used if a predicate fact is genuinely in dispute and must be decided by the jury.

The (state number) issue reads:

"Is the [promise] [covenant] which the plaintiff seeks to enforce against the defendant a (state nature of promise or covenant alleged to be illegal or unenforceable)?"¹

(You will answer this issue only if you have answered the (state number)² issue "Yes" in favor of the plaintiff.)

On this issue the burden of proof is on the defendant.³ This means that the defendant must prove, by the greater weight of the evidence, that the [promise] [covenant] which the plaintiff seeks to enforce against the defendant is a (state factual basis for contention that the promise or covenant at issue is illegal or unenforceable).

Finally, as to the (*state number*) issue on which the defendant has the burden of proof, if you find by the greater weight of the evidence that the [promise] [covenant] which the plaintiff seeks to enforce against the defendant is a (*state nature of promise or covenant alleged to be illegal or unenforceable*), then it would be your duty to answer this issue “Yes” in favor of the defendant.

If, on the other hand, you fail to so find, then it would be your duty to answer this issue “No” in favor of the plaintiff.

1. Certain promises and covenants are deemed illegal or unenforceable at common law or by legislative action. The following list identifies some examples but is by no means exhaustive:

Penalty clauses. “A penalty is a sum which a party similarly agrees to pay or forfeit ... but which is fixed, not as a pre-estimate of probable actual damages, but as a punishment, the threat of which is designed to prevent the breach, or as security ... to ensure that the person injured shall collect his actual damages.” *Kinston v. Suddreth*, 266 N.C. 618, 620, 146 S.E.2d 660, 662 (1966) (quoting *McCormick, Damages*, § 146 (1935)). “The Court will endeavor to ascertain the true intention of the parties and if the sum fixed by the contract is in fact a penalty the measure of damages is the actual loss.” *Wheedon v. American Bonding & Trust Co.*, 128 N.C. 69, 71, 38 S.E. 255, 255 (1901) (quoting *Hennessy v. Metzger*, 152 Ill. 505, 38 N.E. 1058 (1894)).

Personal liability for deficiencies on purchase money obligations secured by real estate. N.C. Gen. Stat. § ~~45-21.38~~.

Contracts to improve real property which adopt the laws of another jurisdiction or which select an exclusive forum in another jurisdiction. N.C. Gen. Stat. § 22B-2. But note that N.C. Gen. Stat. § 1G-3 allows the parties to a business contract to agree that North Carolina law shall govern all rights in connection with the contract, irrespective of whether the parties or contract bear a reasonable relation to this State.

A covenant (other than a non-consumer loan transaction) that requires the prosecution of an action or an arbitration to be instituted in another state. N.C. Gen. Stat. § 22B-3.

BUT NOTE WELL: According to N.C. Gen. Stat. § 1G-4, a forum selection clause in a business contract that selects North Carolina as the forum is enforceable so long as the parties agreed that North Carolina law would govern or otherwise agreed to litigate disputes in the courts of this State.

A covenant (other than an arbitration clause) requiring a party to waive his right to a jury trial. N.C. Gen. Stat. § 22B-10.

“Pay when paid” clauses in non-residential contracts between general contractors and subcontractors. N.C. Gen. Stat. § 22C-2.

Contracts to pay interest in excess of the usury limits established by law. N.C. Gen. Stat. § 24-1.1.

Attorneys fees provisions not expressly authorized by statute. *Lee Cycle Center, Inc. v. Wilson Cycle Center, Inc.*, 143 N.C. App. 1, 11-12, 545 S.E.2d 745, 752, *aff’d per curiam*, 354 N.C. 565, 556 S.E.2d 293 (2001) and *Reavis v. Ecological Dev., Inc.*, 53 N.C. App. 496, 281 S.E.2d 78 (1981).

Contracts in restraint of trade. N.C. Gen. Stat. §§ 75-1, 75-2.

Contracts that are immoral or iniquitous. “Where a contract grows out of and is concerned with an illegal or immoral act, a court of justice will not lend its aid to enforce it.” *Lamm v. Crumpler*, 242 N.C. 438, 442-43, 88 S.E.2d 83, 87 (1955) (quoting *Armstrong v. Toler*, 24 U.S. 258, 268 (1826)). See also *Merrell v. Stuart*, 220 N.C. 326, 331, 17 S.E.2d 458, 461 (1941).

Contracts which attempt to limit the personal liability of certain professional licensees for acts or omissions committed in the rendition of professional services. N.C. Gen. Stat. § 55B-9.

NOTE WELL: N.C. Gen. Stat. § 22B-1 prohibits any agreement indemnifying architects, engineers and construction contractors against the risk of bodily injury or property damage caused by their own negligence. But, except where prohibited by statute, contractual indemnification against one’s own negligence has been expressly recognized as valid and enforceable by North Carolina courts. See CSX Transp., Inc. v. City of Fayetteville, 247 N.C. App. 517, 523, 785 S.E.2d 760, 763-64 (2016) (citing *Gibbs v. Carolina Power & Light Co.*, 265 N.C. 459, 144 S.E.2d 393 (1965)). Legality notwithstanding, contracts which attempt to relieve a party from liability for damages incurred through personal negligence are discouraged and narrowly construed. See *Morrell v. Hardin Creek, Inc.* 371 N.C. 672, 681, 821 S.E.2d 360, 366 (2018).

Covenants not to compete that are (1) not in writing, or (2) not made a part of the original contract of employment or otherwise accompanied by a valuable new consideration from the employer, or (3) not reasonable as to time, or (4) not reasonable as to territory, or (5) contrary to some public policy. *Whittaker General Medical Corp. v. Daniel*, 324 N.C. 523, 525, 379 S.E.2d 824, 826 (1989). See also N.C. Gen. Stat. § 75-4.

Covenants not to compete involving physicians, if enforcement of the covenant would “create a substantial question of potential harm to the public health” by denying the public needed medical care. *Aesthetic Facial & Ocular Plastic Surgery Center, P.A. v. Zaldivar*, ___ N.C. App. ___, ___, 826 S.E.2d 723, 727 (2019) (citing *Iredell Digestive Disease Clinic v.*

Petrozza, 92 N.C. App. 21, 27–28, 373 S.E.2d 449, 453 (1988), *aff'd*, 324 N.C. 327, 377 S.E.2d 750 (1989)).

Contracts barred by applicable statutes of frauds. N.C. Gen. Stat. § 22-1 (oral promise to answer for the debt of another), N.C. Gen. Stat. § 22-2 (oral contract for the sale of land or for a lease of land in excess of three years), N.C. Gen. Stat. § 22-4 (oral promise to revive debt of a discharged bankrupt) and N.C. Gen. Stat. § 22-5 (verbal loan commitment by an institutional lender in excess of \$50,000).

2. See, as appropriate, N.C.P.I.—Civil 502.00 (Contracts-Issue of Breach By Non-Performance) or Civil-502.05 (Contracts-Issue of Breach By Repudiation) or N.C.P.I.—Civil 502.10 (Contracts-Issue of Breach By Prevention).

3. See *Rose v. Vulcan Materials Co.*, 282 N.C. 643, 652, 194 S.E.2d 521, 528 (1973) (“Illegality is an affirmative defense and the burden of proving illegality is on the party who pleads it.”) (citing N.C. R. Civ. P. 8(c)).