

The Basics of Contracts



A contract is a binding legal agreement that is enforceable by law.

You and the members of your family probably encounter contracts everyday. Contracts can be as simple as a movie rental agreement or as complex as a mortgage loan to buy a home. So, what is a contract? A contract is a binding legal agreement that is enforceable by law.



In order to be enforceable in a court of law, a contract must have several required parts. In the activity shown here, click on each of the purple numbers to explore the five parts of a contract.

Agreement

There must be a real offer and a real acceptance made within the contract.

Consideration

Consideration is anything of value that is exchanged in a contract. The parties in the contract must give up and get something for consideration to be present.

Capacity

Capacity is the legal ability to enter into a contract. The people entering into a contract must be capable of understanding the terms and consequences for the contract to be legal. Minors, people under the age of eighteen, have a limited ability to contract because the law acknowledges that they may not fully understand the agreement. Minors can enter valid contracts if they own their own businesses and need to enter contracts in order to operate the business, are legally married, or if they are emancipated, which is declared to be adults by the courts. Other individuals deemed incompetent by the court may not be held accountable in a contractual situation.

Legality

If any part of a contract involves an illegality that violates the law in any other way, the entire contract is void.

Genuine Assent

The parties in a contract must really mean to enter into the contract. Genuine assent doesn't exist if there is a mistake on the part of both parties of a contract, if there is fraud involved, or if the contract is entered under duress. Since genuine assent must be voluntary, anytime someone is forced to enter a contract, the assent cannot be genuine.

Examples of Contracts

- Movie Rental Memberships
- Property Rentals
- Wireless Phone Agreements
- Online Contracts



Have you ever rented a movie, or bought a ringtone online? As a teenager and as you become an adult, you might encounter some of these different types of contracts.

Movie Rental Memberships

When you rent a movie, whether it's at a store, a mobile provider, or through an online service, you enter into a contract giving the rental company permission to charge your account for any multimedia products that you rent through them. In addition, you assure them that you will return the product in a usable manner, or they have the right to charge you for the full cost of the product.

Property Rentals

Unless you have been saving for years, it's likely that your first home as an adult will be a rental property. When you rent this property, whether it's an apartment or a house, you will sign a lease agreeing to pay the appropriate rent each month and to prevent damage to the property. In exchange, your landlord will maintain the property and allow you to live there. In some cases, your lease will require that you live in that property for a certain amount of time and moving out before that time can cost you extra money or damage your credit.

Wireless Phone Agreements

When you see advertisements for free wireless phones or inexpensive wireless monthly payments, the wireless service provider usually requires that you sign a contract for a one or two year period. They will provide you with a set number of phone minutes, texts, or other data elements for that time period in exchange for your agreement to pay the specified monthly payment. Often, there is a financial penalty for breaking the contract early, so you should be aware of your commitment prior to signing a contract.

Online Contracts

When you purchase an online subscription for services like phone ringtones, networking space, or music membership clubs, the provider may require you to commit to purchasing that service for a set number of months or years in exchange for receiving access to a certain number of ringtones or a certain amount of space for a specific monthly fee. Usually, you are unable to purchase the good or service that you want on its own without subscribing to a service contract.

More Examples of Contracts

- Payday Loans
- Title Loans
- Rent-To-Own Agreements



Some types of loans are examples of contracts that involve income or the ownership of goods.

Payday Loans

A payday loan occurs when a company provides a cash advance loan to a borrower until the borrower receives their next paycheck. The borrower signs a contract agreeing to pay the company back on a certain date, at which time they are responsible for paying the company back the amount on loan plus interest. Payday loans often carry high interest rates and even higher penalties for failure to repay the loan.

Title Loans

A title loan allows a borrower to use their car title as collateral to obtain a short term loan. The borrower signs a contract agreeing to pay the lender back on a certain date, at which time they are responsible for paying the lender back the amount on loan plus interest. Title loans often have high interest rates and should the borrower fail to repay the loan on time, they lose ownership of their car.

Rent-To-Own Agreements

A rent to own agreement allows a consumer to rent furniture, electronics, or appliances in a long term loan that eventually becomes ownership after the consumer pays a certain number of payments over a specified amount of time. Rent-to-own contracts often carry high interest rates and the penalty for a missed payment can be the nullification of the agreement along with repossession of the furniture, electronic, or appliance.



Unless you have built up a significant credit history or have piles of money waiting for you as you enter adulthood, chances are that you will need a co-signer for your first loan or property rental. Co-signing occurs when one individual doesn't have the financial means or credit history to meet the needs of an agreement and a second qualified individual co-signs the contract, too. The second individual is essentially taking responsibility for the terms of the contract if the original applicant is unable to meet them. This can be helpful for a young adult entering the workforce who needs help getting a property rental or buying a car. It also ensures that the terms of the contract will be met.

Should you co-sign for someone else?

Co-signing can be risky if you are faced with carrying the responsibilities of the contract by yourself if that person does not meet the requirements of the contract. Be sure that you have thoroughly explored all of your options and are willing to take on the full responsibility of the contract before you co-sign with another individual.

Sharing Contract Responsibilities



At some point in your life, you may need to share contract responsibilities with one, or more, other adults. One example of this is sharing an apartment. In that instance, both parties should sign the rental property agreement so that both parties are held responsible for the terms within that agreement. By doing so, an individual party cannot be held responsible if the other party does not meet the terms of the agreement. If both roommates are not on the rental agreement, the one roommate on the lease can be held solely responsible for any issues. This means that you could be held responsible for damage to the property, unpaid rent, or any other behavior that violates the agreement, even if you didn't do it! You could be charged fees and lose a security deposit.

When selecting a roommate, be sure that it's someone that you trust to hold up their end of the agreement, and be sure that they enter into the rental agreement with you!

Three-Day Rescission Period



The borrower has three days after signing the contract to cancel the loan. The lender does not process the loan until after the third day.

Have you ever agreed to something and regretted it just a short time later?

Many states have a law requiring a three-day rescission period for some types of loans, like home loans. That means that the borrower has three days after signing the contract to cancel the loan and that the lender does not process the loan until after the third day. Once the three days have passed, the contractual agreement is in place for the term of the contract.

Failure to Comply With a Contract

- Legal

- Lawsuit
- Jail

- Financial

- Accountable for damages
- Cost of legal fees
- Damage to credit



There are possible legal and financial consequences for failure to comply with contract requirements. If you break a contract into which you have entered, you can be held accountable whether legally, like being sued in a course of law, or financially, like having to pay out the remainder of the costs associated with the contract or any legal fees incurred by the opposing party. Any deviation from the terms of a contract, even a missed payment, can have a negative impact on your credit report or your future ability obtain another contract like a lease or a loan. Before you enter into a contract, be sure that you are able to meet the commitments of the contract and that you are aware of the consequences if you are unable to do so.