Payments and the concept of legal tender

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This article briefly looks at the concept of legal tender, drawing on the experience of New Zealand's recent change-over to new, lighter coins. Legal tender is a tender of payment that, by law, cannot effectively be refused in settlement of a debt denominated in the same currency. Although the basis for most cash transactions is generally taken for granted, the article notes that without the concept of legal tender, cash transactions could not always take place with sufficient certainty to satisfy the needs of consumers and sellers.

1 Introduction

On 31 July 2006, the Reserve Bank issued smaller, lighter 50, 20 and 10 cent coins and announced that on 1 November 2006 the existing 50, 20, 10 and 5 cent coins of cupro-nickel composition would no longer be legal tender.[1] For three months, the two alternative sets of coins were in circulation and could be used to pay for goods and services.

This unique situation brought into rare focus the arcane but important concept of legal tender. While legal tender underpins literally millions of ordinary payment transactions that take place daily and therefore supports the functioning of the economy at its most basic level – the exchange of goods and services for money – it is a concept that is taken for granted and frequently misunderstood. This article uses the coin change-over as an opportunity to briefly explore the legal theory that underpins legal tender and the continuing relevance of the concept.

2 Legal tender in theory[2]

The concept of legal tender in New Zealand is enacted by section 27 of the Reserve Bank of New Zealand Act 1989. This section gives an exclusive benefit to the currency issued by the Reserve Bank, as follows:

Legal tender

(1) Every bank note issued, or deemed to be issued, under this Act shall be a legal tender for the amount expressed in the note.

(2) A tender of payment of money, to the extent that it is made in coins issued, or deemed to be issued, under this Act, shall be a legal tender,-

(a) In the case of coins of a denomination of $10 or more, for the payment of any amount:

(b) In the case of coins of a denomination of $1 or more but less than $10, for the payment of any amount not exceeding $100:

(c) In the case of coins of the denomination of 5 cents or more, but less than $1, for the payment of an amount not exceeding $5:

(d) In the case of any coins of the denomination of less than 5 cents, for the payment of an amount not exceeding 20 cents.

(3) The references to coins and bank notes in subsections (1) and (2) of this section do not include references to coins and bank notes that have been called in.

However, the Act does not say what 'legal tender' actually means and 'legal tender' is commonly confused with the related concept of 'payment'. In fact, to offer to pay for goods with legal tender is not the same as actually paying for them, and an offer of legal tender does not always conclude a payment obligation.

During the coin change-over, when two sets of same-denomination coins were in circulation for three months, a situation that faced many consumers and sellers was whether a seller had to accept payment for goods in the 'old' cupronickel coins. A number of sellers were reluctant to do so and put up signs in their shops to inform consumers that they would only accept the 'new' coins.

[1] However, the Bank noted that it would always redeem the coins in the future, as it is required to do under section 26(5) of the Reserve Bank of New Zealand Act 1989.

[2] This section draws on the following sources: Mann (2005), Chapter 7 in particular; and Brindle and Cox (eds) (2004), Chapter 1.

Some consumers were displeased by that and disputed the validity of the signs. Their argument was that they had the right to pay in the old coins on the basis that the old coins were legal tender. It was typically asserted that 'legal tender means that payment has been made legally'.

The actual legal situation was more complex and hinged on the legal distinction between tender and payment, and was fact-dependent to the extent that it could be determined whether the consumer and seller had concluded a sales contract before or after the old coins were tendered in payment.

The distinctions are as follows: 'tender' refers to an act of the consumer to take steps to complete the payment required to conclude a contract, such as to offer old coins as means of paying the agreed price for goods in order to complete their side of a sales contract. It is a unilateral act of the debtor.

'Payment' is a bilateral act requiring the consent of both the consumer and the seller, ie, it is the offer of old coins tendered by the consumer and its acceptance by the seller, thus fulfilling that particular term of the sales contract.

These concepts only have relevance in the context of a contract, in which payment by the consumer is one of the terms. In this article we are referring to sales contracts (but the principles obviously apply more widely to other types of contracts). The conclusion of a sales contract creates a debt on the part of a consumer which is fulfilled by payment of the agreed price.

The consumer (or 'debtor' at this point) having incurred the debt may tender payment for it. For example, they may offer 'legal tender' in notes or coins under current issue by the Reserve Bank.[3] Between 31 July and 1 November 2006 they had a choice of offering old or new coins. However, as explained above, offering legal tender does not mean that payment has technically been made – only tendered.

The important point here is that the seller is under no positive legal duty to accept the payment that is tendered by the debtor. The statement that 'legal tender means that payment has been made' is, in technical terms, incorrect. So what is the relevance of legal tender? Most consumers would naturally assume that having offered valid notes and coins they have done all that could reasonably be expected of them to meet their side of the bargain.

The answer has greater theoretical than practical relevance. While the seller ('creditor' at this point) is not required to accept the payment, the fact that a valid tender has been made means that in refusing to accept it, the seller is barred from recovering the debt in court. Therefore, in practical terms, the creditor has little choice but to accept the legal tender payment.

3 The relevance of legal tender in practice

The principles above can now be applied to retrospectively resolve the dilemma that faced consumers and sellers during the coin change-over between 31 July and 1 November 2006. The situation typically brought to the Bank's attention was a sale of goods taking place in a shop.

If a consumer offered to pay for the goods with 'old coins', which were still valid legal tender, the seller did not have to accept the tender. As long as there was no concluded sales contract at that point and therefore no debt owed by the consumer, the consumer would have had no legal or practical means of unilaterally settling the transaction.

However, if a sales contract had been concluded – for example, the consumer had been allowed possession of the goods and owed the price, or had consumed the goods before paying (eg a restaurant meal) – then a debt would be owed by the consumer to the seller. The consumer may settle the obligation with legal tender: old or new coins. If they offered old coins the seller could refuse to accept them, but as discussed earlier, they would then be left with no legal remedy to enforce payment.

While these situations are interesting in order to illustrate the concepts of legal tender and payment, and to apply them in a unique situation, in reality the legal issues

[3] **Bear in mind the limitations on legal tender imposed by s 27(2): eg by virtue of s 27(2)(c) offering to pay a price of $20 in 20 cent pieces would not be a valid tender of the price; the debtor would not have performed their contractual commitment to pay the contract price in this case.**

were not important during the coin change-over. This is because consumers and sellers dealt with the issues in a practical way based on their common desire to complete the transaction.[4] Fine legal distinctions were not pertinent to those motivations, and with little detriment the buyer could easily walk away from the transaction if their payment in old coins was unacceptable. Alternatively, the seller could change its mind and accept the new coins in the knowledge that the coins could be re-used for value.

In addition, the sums involved where payment is made in legal tender of coins were far too trivial for any party to consider resolving the issues by resorting to the legal position. The issues in this context are really only of theoretical, and now historical, interest.

However, it is interesting to apply the principles discussed here to a far more substantial transaction - for example, the settlement of a large commercial deal, perhaps running into millions of dollars. Do section 27 of the Reserve Bank of New Zealand Act and the principles discussed above allow such a deal to be settled in cash?

To assume on the basis of section 27 (2)(a) that the answer is 'yes' would be to misread the section. While section 27 provides what is legal tender, it does not say that payment must be in legal tender or that any payment in legal tender is sufficient for the debtor to meet their payment obligations.

The actual form of payment – whether it is by legal tender or some other method – is determined by the contractual context. A contractual provision may specify the form of payment as something other than legal tender. For example, it may specify that payment be made electronically or by cheque, in which case the debtor has no right to insist on payment in legal tender. With small sums and routine transactions, contracts are frequently silent on this matter and payment in cash is not considered unreasonable.

With large sums, where the contract is unspecific as to the form of payment the courts are likely to conclude that payment by legal tender is, in the words of one author "unthinkable and cannot possibly be within the contemplation of the parties".[5] This is because the courts will take into account the commercial context in which the transaction takes place and the practical difficulties faced by the creditor who must count out very large sums of cash. Professor Roy Goode makes a similar remark.[6]

'In describing the legal characteristics of physical money we have made reference to one that is generally considered to be of fundamental importance, namely the right of the creditor to be paid in legal tender, that is, bank notes and coins which meet the statutory requirements for legal tender. This is no doubt true in the case of small transactions where payment of legal tender would be a reasonable method of payment; it is undeniably false in the case of transactions of any size, where in the absence of a clear agreement for payment in legal tender it would be absurd to suppose that this was the method of payment intended by the parties.'

4 Conclusion

This article has drawn upon practical, but unusual, scenarios to illustrate the concept of legal tender. Legal tender is a tender of payment that, by law, cannot effectively be refused in settlement of a debt denominated in the same currency. Without the concept of legal tender cash transactions could not always take place with sufficient certainty to satisfy the needs of consumers and sellers. The enactment into law of the concept also supports and reinforces the issue of currency by the state by guaranteeing its currency has an exclusive legal status that is good to settle debts. These benefits are largely taken for granted.

On the other hand, the practical limitations of legal tender should be acknowledged. It is always subject to the intention of the parties, who may contract to receive payment in other than legal tender. For larger transactions, the courts would be likely to presume that the parties did not contemplate legal tender. And where disputes arise over payment, members of

4 For instance although a retailer's sign warning that 'old coins' would not be accepted might have had dubious legal validity when it came to disputed payments for a debt already incurred, it had the practical advantage of persuading consumers carrying old coins to take their business elsewhere thus preventing such disputes arising in the first place.

5 Proctor, pp 162-163.

6 Goode (2004), p 451.

the public are likely to rely on pragmatic solutions, while the formal rules underlying legal tender would rarely have any bearing on the outcome.

References

Brindle, M and R Cox (eds), (2004), *Law of Bank Payments*, 3rd Edition, Sweet & Maxwell.

Goode, R, (2004), *Commercial Law,* 3rd Edition, Penguin.

Mann, C P, (2005), *On the Legal Aspect of Money*, 6th Edition, Oxford University Press.

[**Erratum**: Footnote 2, p. 31 first sentence should read:

"This section draws on the following sources: Proctor (2005), Chapter 7 in particular..."

Final reference should read: Proctor, C. (2005), *Mann on the Legal Aspect of Money*, 6th Edition, Oxford University Press.]