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Payments and the concept of legal tender

Nick McBride

The Reserve Bank occasionally fields queries from the public about the rules of legal tender. Typically, we find, these people have had a dispute with a seller over payment methods, for instance, a seller may insist on EFTPOS while the customer wants to use cash.

Other disputes, we find, also occur when two types of currency are circulating. This last happened in 2007 when there was a brief period during which the old-style cupro-nickel 10, 20 and 50 cent pieces were co-circulating with the new plated steel coins. At that time, there was some public discussion about consumers' rights when sellers refused to accept the old coins in payment.

From late 2015, new Series Seven banknotes will be co-circulating for a while with the older Series Six notes. The old notes will remain legal tender, and it seems timely to publish a brief description of what 'legal tender' actually is, and how it works.

1 Legal tender in theory[1]

Legal tender underpins the vast number of ordinary payment transactions made every day, supporting the functioning of the economy at its most basic level – the exchange of goods and services for money. However, the concept of 'legal tender' is often taken for granted and frequently misunderstood.

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.

1 This section draws on the following sources: Charles Proctor Mann on the Legal Aspect of Money (6th Ed) (Oxford University Press, 2005) Chapter 7 in particular; and Michael Brindle and Raymond Cox (eds) Law of Bank Payments (3rd Ed) (Sweet & Maxwell, 2004) Chapter 1.

(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 change over from cupro-nickel to steel plated coins, two sets of same-denomination coins were in circulation for three months. Some consumers and sellers wondered whether a seller had to accept payment for goods in the 'old' cupro-nickel coins. A number of sellers were reluctant to do so and put up signs in their shops to tell consumers that they would accept only the 'new' coins.

At the time, this displeased some consumers who disputed the validity of the signs. Their argument was that they had the right to pay in the old

Figure 1
Series 7 notes, $5 and $10 denominations

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'. It is possible that similar disputes may arise while the Series Seven notes circulate alongside the Series Six notes, although in practice we expect it to be more unlikely than at the time of the coin changeover.

The actual legal situation is more complex than an assertion that legal tender means payment has been made legally. It hinges on the legal distinction between tender and payment, and depends on whether it can be determined that the consumer and seller have concluded a sales contract before or after the notes are 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 coins or notes 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 notes or coins tendered by the consumer and its acceptance by the seller, thus fulfilling that particular term of the sales contract.

These concepts have relevance only 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 either Series Six or Series Seven notes. However, as explained above, offering legal tender does not mean that payment has technically been made – only tendered.

The technical 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. In practical terms, also, it seems unlikely a creditor would refuse to accept the tendered notes after concluding a sales contract that allows the consumer to retain his or her purchase and leave the seller without a remedy to recover the price.

Certainly, the legal principles relating to legal tender did not play an important role during the coin changeover. This is because consumers and sellers dealt with the issues in a practical way based on their common desire to complete the transaction.[2] 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 their mind and

2 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.

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 was too trivial for any party to consider resolving the issues by resorting to the legal position. Legal tender concepts were therefore only of theoretical relevance during the coin changeover.

We expect the concepts to be of even less relevance while Series Seven and Series Six notes co-circulate. This is because we do not believe the seller has any incentive to prefer one version of a note over another. Rather, their incentive is to secure the payment that has been tendered to fulfil a sales contract.

Most payments do not take place with notes or coins. How does section 27 of the Reserve Bank of New Zealand Act and the principles of legal tender apply to a payments made by other means, such as electronically?

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'.[3] This is because the courts will take into account the commercial context of the transaction and the practical difficulties faced by the creditor who must count out very large sums of cash. Professor Roy Goode makes a similar remark:

'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]

Goode's remark relates to the entitlement of the creditor to be paid in legal tender. He acknowledges the entitlement of the debtor to pay in legal tender is less clear, but his general proposition as to the presumed intention of the parties in the absence of a clear contractual provision otherwise would seem to apply. For very large sums, therefore, the courts would most likely conclude that payment in legal tender has been implicitly excluded unless specifically agreed to. This is on the basis that payment by bank transfer is the almost universal method of settlement and parties would be assumed to have agreed to it, without necessarily stating it, and at the same time excluded other methods such as payment in banknotes.

3 Proctor, pp 162-163.

4 Roy Goode *Commercial Law* (4th Ed) (Penguin, 2010), p 487.

2 Conclusion

The Bank commonly receives queries about legal tender and members of the public often ask for advice on how to resolve payment disputes, where they have tendered cash in some form and it has not been accepted by a seller.

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 currency issue 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 will likely presume that the parties do not contemplate legal tender. And where disputes arise over payment, members of the public will rely on pragmatic solutions while the formal rules underlying legal tender will rarely have any bearing on the outcome.