MEDIEVAL JEWISH AND ISLAMIC PAYMENT INSTRUMENTS: THEIR INTERACTION AND LASTING HERITAGE

by

Professor
Benjamin Geva
SJD, Harvard
Osgoode Hall Law School York University
Toronto, Canada

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Based on chapters

4. Deriving History from Law: Are Cheques Traceable to the Talmud?
6. The Medieval *Hawale*: The Legal Nature of the *Suftaj* and Other Islamic Payment Instruments
7. Funds Transfers Under Talmudic Law: Orthodoxy and Adaptation
of
B.Geva

The Payment Order of Antiquity and the Middle Ages: A Legal History

(Oxford and Portland Oregon, Hart Publishing, 2011)

NOTE: Cites and bibliography are available in this book

To be read in conjunction with attached diagrams

I. Introduction

A payment mechanism can be broadly described as any method involving a third party other than the debtor and creditor ('Paymaster'), facilitating the transmission of monetary value in the payment of a debt, which enables the debtor to avoid the transportation of money in specie and its physical delivery to the creditor in the discharge of the debt.

A payment mechanism does not involve the physical delivery of a bag of money from the debtor to the creditor via a third party carrier. Rather, its operation is premised on the discharge of a debt by virtue of an authorized payment made by the paymaster, frequently a debtor's debtor. Besides discharging the original debt (owed by Debtor to Creditor), this payment discharges the debt of the paymaster. Alternatively, where there is no such pre-existing debt owed by the paymaster to the debtor, this payment, besides discharging the original debt, creates a new debt owed by the original debtor to the paymaster.

The operation of payment mechanism is premised on Creditor getting either a substituted debtor [Paymaster] on original Debtor's Debt to Creditor or a substituted debt [of Paymaster to Debtor]- to replace Debtor's original debt to Creditor.

A payment mechanism can also be created by the circulating a 'payment instrument', meaning a document under which a paymaster under a payment mechanism is bound to pay the creditor or the creditor's creditor to whom the original creditor transferred the instrument.

There were primary three hurdles in Antiquity for the emergence of a legal doctrine facilitating the effective operation of a payment mechanism:

- Formal contract requirements;
- Strict privity – even in informal contracts; and
- Debt is not an asset but a personal relationship so as to preclude debtor substitution as well as debt transfer

When these hurdles were overcome, four legal issues arose:

1. Does Paymaster become liable directly to Creditor?
2. On what theory does Debtor discharge, and does Creditor have recourse against Debtor upon the default by Paymaster?

3. What if any defences available to Paymaster against Creditor's claim?

4. Is Creditor's claim against Paymaster transferable – and if so by the mere delivery of the payment instrument? Is it transferable free of defences?

A classic example for a 'perfect' payment mechanism is the post-Medieval English bill of exchange, currently codified worldwide under national bills of exchange statutes. The bill of exchange contains an order by a 'drawer' addressed to a drawee to pay a payee or bearer. In a typical example, the drawer is Debtor (e.g. textile country manufacturer) instructing his debtor (e.g. city retailer of textile products), i.e. Paymaster, to pay to the Debtor's Creditor (e.g. country wool supplier). Drawee-retailer expects to pay out of proceeds of the sale of the textile products to the public. He became liable on the instrument by signing it as an 'acceptor'. As years passed by, it became possible for the payee to effectively have payment to him 'accelerated' by having the instrument discounted with a transferee who then became entitled either to do the same or to recover from the drawee when the instrument fell due. In short, having thus become 'negotiable', the paper could circulate from hand to hand, or from one 'holder' to another. Alternatively, the payee or any subsequent 'holder' could have discharged his own debt owed to his own creditor by properly transferring the instrument to that creditor. Other than when it was payable to the bearer each transfer required also the 'endorsement' of the transferor. Finally, the drwaee could not meet the holder's action by asserting defences to liability.

It is very unusual for commercial instruments and legal principles governing them to come abruptly and from nowhere. Rather, they are typically the result of an evolutionary process having roots in more than one place and in one period of time. The English bill of exchange as a model payment mechanism is no exception. This paper examines the contribution of early Medieval Islamic and Jewish payment instruments and laws, as existed mainly in the Near East, to the development of payment mechanisms and legal doctrine governing them. It endeavours to show the interaction among these two religious laws and practices and point out their everlasting heritage.

II. Islamic Law

Documentation of Islamic payment instruments is quite rich; this is particularly true for the period of the Fatimid Caliphate, which was in power between the 10th and 12th centuries. Approximately from that period, or more specifically, between the 11th and 13th centuries, plenty of documents originate from the Jewish *Geniza* of Cairo. Typical instruments were the *ruq'a* and the *sakk*, both being payment order, as well as the *hawale*, the latter being a withdrawal out of an account with a *sarraf* (private money changer).

Islamic payment instruments have not always acquired distinct names. Thus, the withdrawal out of an account with a *sarraf* in the execution of a non-cash payment made by a small retailer to his wholesaler may be treated simply as a *hawale*. In turn, more specialized terminology, though not necessarily uniform or precise, has also developed. Thus, the *ruq'a* has a few meanings. First, it means an order for the delivery of goods. Second, it is a payment order, issued to the payee,

instructing the paymaster to make payment against its presentment by the person entitled to obtain payment. Third, it denotes the paymaster's own obligation to pay, or in fact, any promissor's debt or acknowledgement of debt instrument. The first sense is outside the scope of the present paper; in both the second and third senses, which are of interest in the context of the present paper, the *ruq'a* overlaps with the *sakk*, from which, linguistically, the modern word 'cheque' may be derived. In fact the second and third meanings may converge; this is so, since the paymaster's obligation to pay on a *ruq'a* or *sakk* is typically in pursuance to the payment order directed to the paymaster which is at least implicit on the instrument. The express terms of the document may however reflect the debtor's order, the paymaster's promise, or both. A payment instrument to be further discussed is the *suftaj*; it contains an obligation of a paymaster or his correspondent to pay at a place other than that of the issue of the document.

This part of the paper focuses on the *hawale* as a legal doctrine facilitating the operation of all these mechanisms. Having recognized informal contracts, to overcome also the other difficulties, Islamic jurisprudence came up with the *hawale*. Its operation relied on a Koranic passage, stating that "Whenever a person transfers his debt upon a rich man and the creditor assents to the same, then let the claim be made upon the rich man." It operated as the transference of an obligation from one person to another, and was constituted by an agreement by which a debtor is freed from a debt by another becoming responsible for it.

Participants in a *hawale* transaction are the original debtor ('transferor'), the paymaster ('transferee'), and the creditor. However, under each of the major Islamic schools the *hawale* agreement is an informal one between two parties which binds the third party. It is universally agreed that the creditor is one of the parties to the agreement. Schools nevertheless vary as to the other contracting party. Thus, under the Hanafi school (ultimately codified in the Mejelle) the parties are the paymaster and the creditor (and not the debtor). Under the Maliki school parties to the *hawale* are the debtor and creditor (and not the paymaster). Hence, in Hanafi legal doctrine, the *hawale* operates to give the creditor a substituted debt (owed by the paymaster to the debtor). At the same time, Maliki doctrine, gives the creditor a new debtor (paymaster) on the original debt owed to the creditor by the original debtor.

The following table summarizes and compares between the features of the hawale under each of the major Islamic schools:

Hanafi v. Maliki *Hawale*
D=Debtor
C=Creditor
PM=Paymaster

Hanafi *Hawale* [substituted debt by new debtor]	Maliki *Hawale* [substituted debtor on D's debt]
• **PM must consent.**	• **PM need not consent.**
• **PM need not have owed D.**	• **PM is to have owed D.**
• Usually D gets absolute discharge: no recourse to C.	• Usually D gets absolute discharge: no recourse to C.

- C's claim against PM is subject to D's defences.
- C's claim against PM is subject to PM's defences.

Under each school C gets a new debtor, except that under the Hanafi school it is on a new debt and under the Maliki school it is on the original D's debt to C.

A mechanism facilitating payment between distant parties premised on the Islamic *hawale is* the *suftaj*. The latter could be used e.g. by Debtor in point of origin who wishes to pay to Creditor in point of destination without risking the physical delivery of the money. In such a case the underlying operation of the *suftaj* is as follows: Debtor 'lends' money to Paymaster at point of origin. Document issued by Paymaster may include Paymaster's obligation to pay Creditor at the point of destination as well as Debtor's instruction to do so. Debtor sends the document to Creditor who then presents it for payment to Paymaster's Correspondent at the point of destination. Correspondent may effectively be same as Paymaster or someone in an ongoing relationship with Paymaster who will settle with Paymaster periodically on a balance resulting from payment activities in both directions.

Being a loan of money to avoid the risk of transport the *suftaj* has been suspected as conferring a gain on the Debtor-'lender' in violation of prohibitions against interest. Overall, it was nevertheless tolerated. Its operation can be explained as two *hawales*. Participants in the first hawale are Debtor, Creditor, and Paymaster. In the second *hawale* Debtor drops out. Instead, Paymaster acts ad debtor while Correspondent acts as the paymaster.

Under the Hanafi school, the agreement between PM and C discharges D. This agreement is created by the acceptance of the *suftaj* document by C. Correspondent becomes indebted to C (so as to discharge PM) under the second hawale only upon Correspondent's agreement to honour D's order when the *suftaj* is presented by C to Correspondent.

Under the Maliki school, the agreement between D and C, created by the acceptance of C of the *suftaj* document, constitutes the first *hawale*, so as to replace D by PM as the one indebted to C. However, acceptance of the *suftaj* document by C, also constitutes an agreement between C and PM (C's new debtor under the first *hawale*) so as create a second *hawale*, under which Correspondent (as the new paymaster) becomes directly liable to C. Stated otherwise, under the Maliki school, paymaster's agreement is dispensed with so that Correspondent, as the paymaster under the second *hawale*, becomes automatically liable to C upon C's acceptance of the *suftaj* document. Hence, in dispensing with Correspondent's agreement, the Maliki school conferred on C a right against Correspondent by the mere receipt of the *suftaj* document from D. This is a substantial improvement compared to the Hanafi school which still required Correspondent's agreement in order to entitle C.

III. Jewish Law

The Jewish Talmud, of which substantial part was written in what is now modern Iraq contains substantial discussions on variety of topics relevant to payments, including:

- Monetary legal theory ('metalism');
- Doctrinal issues relating to cheques;
- No debt transfer (presence of all three is required)– *except for*:
- **Transfer of debt instruments by delivery;** and
- Particular payment mechanisms: *oditta*; *zechi; urcheta*; and the *dyokani*.

Discussion as to the monetary legal theory is included in the book but is not part of the present paper.

The modern cheque is a species of a bill of exchange. Normally, it is drawn against funds available to the drawer with the drawee. It is an order by a drawer to a drawee bank to pay the payee or bearer. It is transferable by delivery (plus endorsement where applicable). Its issue to the payee constitutes a conditional discharge to the drawer. Stated otherwise, a payee who takes a cheque is taken to implicitly renounce his rights against Creditor, on the condition that payment will be received from the drawee. On his part, the drawee does not incur liability on a cheque so that the debt owed by the payee to the drawer is absolutely discharged only upon payment by the drawee.

A similar mechanism under the Talmud did not require a written instrument. Nor was the order to pay out of funds available to the drawer with the drawee -- but rather against credit extended by the drawee to the drawer. Payee was not allowed to transfer his claim and presumably all three, drawer, payee and drawee were required to be present at the same time at the same place to give any efficacy to the arrangement. As well, Talmudic law looked for an obligation of the drawee towards the payee and was reluctant to confer upon the drawer conditional discharge. It was agreed that drawer/Debtor was fully discharged if payee/Creditor expressly and unconditionally renounced his rights against drawer/Debtor. At the same time it was thought that without drawee/Paymaster's guarantee there cannot be an implied renunciation by payee/Creditor against drawer/Debtor. In turn, express renunciation by payee/Creditor, conditional upon drawee/Paymaster, was considered ineffective since under such circumstances drawee/Paymaster's obligation was revocable.

Hence, this mechanism is not a cheque; and yet, the discussion around it, as to the nature of the discharge, heralded a discussion on the nature of payment by bill of exchange or cheque, that surfaced in England around 12 centuries later.

An important doctrine under the Talmud is that a monetary debt is not transferable. However, an instruction by Debtor to Paymaster to pay Creditor money owed by Paymaster to Debtor binds Paymaster and inures to the benefit of Creditor when given by means of a declaration made by Debtor in the presence of all three. As under the *hawale,* it is disputed whether Paymaster becomes liable to Creditor on Paymaster's debt to Debtor or on Debtor's Debt to Creditor.

And yet, the Talmud pioneered the concept of a transferable debt document. Under the Talmud, to be transferable, a documentary note of indebtedness must be a *shetar*; it thus has to comply with formality requirements, even if only as to adequate witnessing. Furthermore, there may be formalities to be observed as for the transfer itself. However, it was agreed that Debtor

may pay Creditor, or borrows money from him so as to become obligated to him, by physically transferring to Creditor a debt instrument reflecting Paymaster's obligation to pay debtor. Two disputations nevertheless existed:

- Does transfer occur by the mere delivery (by Debtor to Creditor) of debt document (relating to debt owed by Paymaster to Debtor) or does transfer require also the execution of an accompanying formal bill of sale?
- Does the transfer forfeit altogether the power of Debtor to release Paymaster?

The Talmud further allowed payment from Debtor to Creditor by the unilateral transfer of Debtor's claim to deposited money with Paymaster. These two methods were the *Oditta* and *Zechi*. The former is a formal 'acknowledgement' by Debtor that the deposit actually belongs to the Creditor. The latter is a proprietary act by Paymaster, as instructed by Debtor, that he, i.e. Paymaster, holds the money on deposit for Creditor.

Another Talmudic payment mechanism is that of the *Urcheta*. Thereunder, Debtor, being Creditor's debtor and Paymaster creditor, issues to Creditor the *Urcheta* document. This document gives Creditor the power to collect from Paymaster the debt owed by Paymaster to Debtor, with the view of applying the proceeds to Debtor's debt to Creditor.

The last Talmudic payment mechanism to be discussed here is that of the *Dyokani*. Thereunder, Debtor delivers money to Paymaster with the view of paying Debtor's debt to Creditor. Paymaster is however Creditor's emissary. The circumstances under which payment by Debtor to Paymaster is considered as payment to Creditor's agent, so as to discharge Debtor's debt to Creditor, are disputed. In effect, the issue is who bears the risk of embezzlement or loss on the way between Paymaster and Creditor.

IV. Convergence

Unsurprisingly, the convergences between the Talmudic *Dyokani* and the Islamic *Suftaj*, as mechanisms for payment between distant parties, did not go unnoticed. The following is the question addressed to post-Talmudic Rabbis in what is now Iraq in Gaonic Resposne No. 423:

> Reuven wrote to Shimon a *suftaj from one place to another and Shimon delivered it to* Levy who received from him and after that denied. And the one who delivered and he [the second receiver] admits that he did not give. May Shimon go back to Reuven and claim the *suftaj money since he got nothing from Levy?.*

[Emphasis added].

Effectively then, the question concerns Debtor (let assume it is Reuven) who owes money to Creditor (Shimon). They are located in two different places. The Paymaster is Levy, who operates in both Reuven's and Shimon's places. Levy issued a *suftaj* to Rueven who sent it to Shimon. Shimon presented the suftaj document to Levy who ultimately declined to pay. The

question addressed to the Rabbis was whether upon Paymaster Levy's default Creditor Shimon has recourse against Debtor Reuven .

Adhering to the view that Paymaster Levy did not become Creditor-Shimon's agent under the Talmudic *Dyokani* (which would have allowed Shimon to recover from Reuven) the Gaonite Rabbis nevertheless answered in the negative:

> *We have seen that there is* nothing in the roots of our laws to permit [to send] the ***suftaj***. *This is so since our* Rabbis said that you may not remit coins by means of a **dyokani** *even when signed by* witnesses. Nevertheless, having seen that people actually use the *suftaj we recognized* it so as not to hinder commerce. And we accepted upon ourselves to admit the *suftaj* under the law of the merchants and neither add nor subtract. And so is the law and it ought not to be changed.

[Emphasis added].

Stated otherwise, fully submitting themselves to commercial usage that prevailed in the market, the Rabbis departed from the law and applied rules that governed the Islamic *suftaj*. They did not even attempt to 'bend' Talmudic legal principles with the view of adapting them so as to reach the 'desired' result in their framework.

Amazing as it is, this Response remained limited to the circumstances that existed in what is now Iraq at the end of the first millennium. It did not affect subsequent developments in Jewish law.

V. Conclusion

In his monumental work on the history of English law, Holdsworth is skeptical as to whether the modern bill of exchange is a true derivation from the business practices of the Arabs. He nevertheless speaks (vol. VIII, 2nd ed. at 133) of the Arabs using "something very much like the modern bill of exchange" that as early as the 8th century CE:

> [C]ould pass from hand to hand by something very much like an indorsement; and, to use modern terms, the payee [thereof] had a right of recourse against the drawer in the event of non-payment by the acceptor.

My research does not support this specific observation. First, 8th century may be too early a milestone, at least for a solid record of Medieval Islamic payment instruments. Second, there is no indication that at any time Medieval Islamic payment instruments were endorsable, that is, that their transfer was accomplished by the delivery plus the endorsement signature by the transferor of the instrument. Third, in the case of default by the drawee (being either the correspondent or paymaster), both Hanafi and Maliki rules permit recourse by Creditor-payee against Debtor-drawer only under narrow circumstances. Rather, in principle, debtor-drawer's discharge is absolute.

Holdsworth's observation appears to be exaggerated also in another respect. Transferability of a debt in association with the physical transfer of the debt instrument is not an Islamic innovation. Thus, as was already indicated, the transferability by delivery of a loan document payable by the borrower to his lender, almost as if it were an ordinary chattel, goes back to the Jewish Talmud and thus preceded Islam.

At the same time, unlike any earlier legal doctrine or institution, Maliki principles governing the *hawale* provided for solid rules to govern a simplified procedure for the transfer by delivery of informal debt instruments by the simple delivery of an informal debt instrument.

While the transferability by delivery feature is the forerunner of circulation by negotiation, the creditor's direct entitlement from the paymaster and correspondent is the precursor of the acceptor's liability to the payee on a bill of exchange. Indeed, Islamic practice did not encourage the circulation of the *suftaj*, and Islamic doctrine was hostile to the paymaster's obligation on the *suftaj*. In the final analysis, however, fundamental elements of the bill of exchange, both as a negotiable instrument and machinery for the transfer of funds, are traceable to Islamic instruments and legal doctrine.

Besides introducing the circulation of debt instruments, Jewish law provided for important discussion on the effect of the use of a payment mechanism on the debt which is paid with it. As Islamic law, it struggled with applying relatively rigid legal rules to new circumstances evolving in commerce. In some way it introduced the otherwise controversial 'law merchant' as permitting mercantile custom to supersede rules of law.

Neither Islamic nor Jewish law facilitates the accrual in the hands of a creditor of an 'abstract' right, namely an entitlement by the credtior from the paymaster (or his correspondent) to the sum of the money to which the obligation relates, free of defences available to the parties in their bilateral relationships. This aspect is the contribution of Roman law and is outside the present discussion.