FINANCING SALES OF FOOD AND BEVERAGES FOR FUTURE DELIVERY

REPORT OF THE VIRGINIA ADVISORY LEGISLATIVE COUNCIL to THE GOVERNOR and THE GENERAL ASSEMBLY OF VIRGINIA

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REPORT OF THE VIRGINIA ADVISORY LEGISLATIVE COUNCIL

RICHMOND, VIRGINIA, January 9, 1962.

TO:

HONORABLE J. LINDSAY ALMOND, JR., *Governor of Virginia*
and
THE GENERAL ASSEMBLY OF VIRGINIA

In October of 1959 the financial collapse of a frozen food firm in Norfolk brought to the attention of the citizens of Virginia a method of business finance which, when used without responsibility, or for fraudulent purposes can lead to hardship on innocent people.

Briefly, the situation involved selling food on the installment plan. "Warehouse 42", which is the name of the firm which failed, made arrangements to sell and deliver food to householders over a period of months, usually three or four, taking a note from the customer in payment. These notes were usually payable within four months. The concern then discounted the notes immediately. "Warehouse 42" entered into a great many of these arrangements, discounted the notes and delivered only a small part of the food, and in some cases none at all. The holder of the notes which had been discounted was a holder in due course, in this case a Texas corporation. After "Warehouse 42" failed the people who had signed the notes in most cases had to pay the Texas company even though they had not received and would not receive the food for which the note was given.

As a result of this situation, the Governor wrote the following letter to the Chairman of the Virginia Advisory Legislative Council, requesting that the Council study the problem:

February 7, 1961

Honorable Robert Y. Button, Chairman

Virginia Advisory Legislative Council

Culpeper, Virginia

Dear Senator Button:

I take no pleasure in adding to the heavy work load of the V. A. L. C. However, a deplorable situation has been called to my attention which is inimical to the public interest and, in my judgment, warrants remedial legislative consideration.

I enclose herewith copies of editorials and news items recently carried in the Norfolk Ledger-Dispatch, which portray not only an unsavory situation but one, if allowed to go unnoticed by proper authority, may well encourage and permit similar enterprises to wreak untold loss and misery on unfortunate and unsuspecting victims.

I can think of nothing more calculated to bring law and order and the processes of justice into disrepute than to accept the frustrations of a wrong without a remedy. Here is a palpable wrong. There simply must be a remedy to prevent recurrence and afford relief.

I will not here detail the factual situation, as the facts appear from the data herewith submitted or are otherwise readily ascertainable.

I am well aware of the legal sanctity of negotiable paper in the hands of a holder without notice and in due course. I would not advocate legislation that would impinge upon its status as "a courier without luggage, whose countenance is its passport."

It is my view that a business or enterprise similar in nature and modus operandi to that here depicted could and should be lawfully classified and regulated in the public interest. I further feel that the General Assembly possesses the genius and bears the responsibility to do it.

I suggest consideration of the following approach:

That as a condition precedent to the issuance of a license by the Commissioner of the Revenue the applicant (person, firm or corporation) petition the judge of a court of record disclosing such information as may be deemed relevant concerning the enterprise and modus operandi, and in the light of the scope and nature of the operation proposed require the execution of a sufficient bond with surety approved by the court to indemnify and save harmless the customer damaged by default of the licensee.

Instead of interrupting or impeding the flow of commercial paper, this would add to its efficacy. The customer would be fully protected and the negotiable instrument would be more readily marketable.

From the standpoint of classification and regulation in the public interest, the situation under consideration is somewhat analagous to that of pawnbrokers, where the license is issued by the court, and bond required with statutory right of private action on the bond.

I respectfully request that this matter be thoroughly studied by the V. A. L. C. and express the hope that remedial legislation be recommended.

Sincerely yours,

J. Lindsay Almond, Jr.

The Council gathered information concerning the methods whereby some other states guard against the type of happening heretofore described. It conducted a public hearing in order to gather further information on the "Warehouse 42" incident and suggestion as to how its repetition might be averted. It also conferred with representative businessmen operating in this field as to their methods of doing business.

From the evidence gathered it is apparent that while the "Warehouse 42" situation came about at least in part as a result of fraud, the perpetrator of which has been convicted, it is altogether possible that a legitimate business, if it operated in a similar manner, might suffer reverses; if it failed it could produce similar injuries.

In its consideration of this subject, the Council has sought to achieve two ends. The first consideration is to afford protection to the public and to minimize the likelihood that customers dealing with vendors of items such as food and beverages will suffer losses of the kind which

occurred in the "Warehouse 42" case. At the same time, however, the Council has been fully cognizant that the overwhelming majority of the businesses in the field are operated honestly and soundly, that these businesses can perform a useful service to the consuming public and that their operations should not be circumscribed and hampered by unrealistic and unnecessary regulation.

To accomplish these two objectives, we offer the following recommendation:

RECOMMENDATION

It should be made unlawful for any person selling food or beverages to accept any negotiable promissory note or notes in payment therefor in aggregate amount in excess of 150% of the value of such food or beverages delivered to the maker of such note or notes. For the purpose of this recommendation, the term "delivery" means actual physical delivery into the exclusive custody and control of the customer, made within seven days of the receipt of the note by the seller.

REASONS FOR RECOMMENDATION

In essence, and stripped of its fraudulent aspects, the "Warehouse 42" operation was similar to "selling short" in the stock market. The operator sold food he did not have and took negotiable instruments therefor. By discounting these instruments he obtained money with which to purchase the food which he had contracted to deliver in the future. This is obviously an unsound method of doing business; even had the operation been wholly honest, it would have been possible for poor business methods or a rise in prices to cause the business to fail; the result could have been, for some of his unfortunate customers, the same.

Happily this is not the method of operation of other firms dealing in such commodities. In many cases the sale of frozen food is associated with the sale of a home freezer by the dealer. The freezer itself is generally financed by conventional methods and the dealer contracts to supply an amount of food aproximately equal to the capacity of the freezer. In most such cases this will be the equivalent of about a four months' supply of this type of food for the purchaser. The dealer contracts to supply the food, the purchaser signs a note therefor, and the dealer, either at that time or immediately thereafter, makes delivery of the amount purchased. The note is normally discounted by the dealer and paid in two, three or four installments, but meanwhile the customer has and is consuming the food.

In some cases the customer does not have a freezer sufficiently large to accommodate this quantity of food, or it may be partially filled. In such cases the dealer makes delivery of a part of the order contemporaneously with the execution of the note but in order to save the customer additional financing charges, the note is taken for a longer time than it will take to consume the food which can be delivered and delivery of a portion of the order is delayed; however, full delivery is made within the period covered by the note.

Our recommendation, if adopted, will effectively prevent any person who abides by the law from the marginal type of operation which occurred in the "Warehouse 42" incident. It would minimize the losses which could be sustained by any individual and would insure that each purchaser would get at least a part of the value for which he commits himself when he signs a negotiable instrument for these commodities.

At the same time, we believe that it will not prove unduly burdensome to those firms which are now serving an established public demand.

OTHER SUGGESTIONS

Two other approaches to the problem were suggested to us during the course of the study. One was to limit the negotiability of notes given for the purchase of such consumable items as food and beverages. The disadvantages of any change in the negotiable instruments law, which is substantially uniform throughout the country and is one of the fundamental foundations of the law of commerce, would greatly outweigh any advantages which would be produced by this approach.

A suggestion was also made that a bond be required of persons selling food for future delivery. We do not believe that this is a proper solution to the problem for the following reasons:

(1) It would be an unduly burdensome handicap to legitimate businesses. Those which are established and which have operated successfully do so in many cases by means of large volume with small profit margin; the expense of maintaining the bond would jeopardize their success and inevitably mean higher food prices to their customers. The bond requirement, in the case of a person beginning such business with limited capital, might easily prevent his being able to establish his business successfully.

(2) The bond proposal would offer limited protection to consumers. The proposal was for a $10,000 minimum and $20,000 maximum bond. In the Norfolk case the total amount involved was more than five times the maximum bond; thus the maximum suggested would have given less than 20% protection to the customers. In the case of most established such businesses the protection percentage figure would be considerably less.

(3) The bond proposal would involve considerable administrative complications and would be difficult, if not impossible, to police.

CONCLUSION

We wish to express our appreciation to all those who assisted us during the course of the study by giving us factual data and by making suggestions as to how the problem could be met. We believe that the recommendation contained in this report will help to prevent a recurrence of the circumstances which gave rise to this study; it will, at the same time, prove to be a workable solution to the problem.

Respectfully submitted,

CHARLES K. HUTCHENS, Vice-Chairman
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STATEMENT OF J. H. DANIEL

I concur substantially in the report, but am withholding my signature because I believe the matter requires further study. The Council, in my opinion, should have continued its study of this subject.

J. H. Daniel

A BILL to limit acceptance of promissory notes in payment for food sold at retail; and to prescribe penalties.

Be it enacted by the General Assembly of Virginia, as follows:

1. § 1. As used in this act, "food" includes food, groceries and beverages, for human consumption. "Retailer" means a person who sells, at retail, food for consumption and not for resale.

§ 2. It shall be unlawful for any retailer to accept, in payment for any food sold by him to a customer, a promissory note or notes for an amount in excess of one hundred fifty per centum of the value of food delivered by him to the customer. As used in this section the word "delivered" means that actual physical delivery into the exclusive custody and control of the customer is made within seven days of the receipt of the note by the seller.

§ 3. Any person who violates the provisions of this act shall be guilty of a misdemeanor and punished accordingly.