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PRESENT PROBLEMS OF ARTICLE XIII

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ARTICLE XIII of the Illinois Constitution deals with a single problem, warehouses where grain or other property is stored for compensation. One, upon inspection, is immediately impressed with the great detail which the problem of grain warehousing received in the constitution of 1870. Obviously, the delegates who drafted the constitution of 1870 were greatly concerned about this subject.¹ One concludes immediately, as did the court in *Munn v. People*, that "The article itself seems out of place in an organic law . . ."² The convention, however, had lost its faith in the legislature. As one delegate said during debate on Article XIII, "the legislature has power to regulate these things. I grant it, but it is a power that they have refused to exercise . . . and it is not unreasonable to say that in the future, unless there is some provision in the organic law, they will still refuse this relief."³ This statement seems strange in view of the adoption of legislation in 1867 regulating grain warehouses and grain hauling by railroads intended to remedy the abuses at which Article XIII is directed.⁴

During debate on Article XIII, the delegates described the grain trade in Chicago as being controlled by "a few warehouse men and the officers of railways." They complained of improper weighing and grading of grain, manipulation of prices and monopolistic practices by the warehouses and railroads. One delegate referred to the boards of trade as "leeches upon commerce and the community, that suck the life blood out of the farmers and dealers in grain. . ."⁵ Chicago eleva-

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¹ 2 DEBATES AND PROCEEDINGS OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF ILLINOIS pp. 1622-36, 1693-1700 (1869).

² *Munn v. People*, 69 Ill. 80, 93 (1873), *aff'd*, 94 U.S. 113 (1876).

³ *Supra* note 1, at 1624.

⁴ Ill. Public Laws, 25th Gen. Ass., at 177 (1867).

⁵ *Supra* note 1, at 1623.

tor operators were accused of selling five to ten thousand more bushels of grain each year than was received during the year and selling grain at a higher grade than the grades delivered to them. Delegates complained that every car of grain shipped to Chicago was short in weight. On the other hand, there were objections raised that provisions such as Article XIII were legislative in character and warnings of the dangers of writing inflexible legislative provisions into the organic law, but these arguments failed to sway those determined to use the opportunity to correct the existing evils in the grain market.⁶

The delegates wanted to impose the following five rules in the conduct of those engaged in the grain business.

The first is, that the grain of the farmers and shippers shall be delivered where consigned, and to the elevator to which it is sent.

The second is, that the weight or quantity of grain delivered shall be equal to that received by the railway companies from the owners.

The third thing is, that the quantity of the grain in store shall be known to the owners of the grain and to the public.

The fourth proposition is, that a reasonable degree of honesty must be secured in grading the grain into and out of the warehouse.

The fifth proposition is, that railroads shall be compelled to permit connections with their tracks to competing warehouses in the vicinity of the track.⁷

To accomplish these objectives, Article XIII provides: (a) all storehouses where grain or other property is stored for a compensation are public warehouses;⁸ (b) elevators in towns of over 100,000 people must make sworn weekly statements and daily records of grain in store and warehouse receipts outstanding;⁹ (c) holders of warehouse receipts may examine the grain and records of the warehouse;¹⁰ (d) railroads are required to weigh grain and are liable for shortages in shipment;¹¹ (e) railroads are required to deliver grain in accordance with instructions and permit connections to be made to their tracks from warehouses or coal yards;¹² (f) the General Assembly is directed to pass laws to prevent fraudulent warehouse receipts and implement

⁶ *Supra* note 1, at 1628.

⁷ *Supra* note 1, at 1629.

⁸ ILL. CONST. art. XIII, § 1.

⁹ ILL. CONST. art. XIII, § 2.

¹⁰ ILL. CONST. art. XIII, § 3.

¹¹ ILL. CONST. art. XIII, § 4.

¹² ILL. CONST. art. XIII, § 5.

Article XIII;¹³ and (g) the General Assembly is directed to "pass laws for the inspection of grain, for the protection of producers, shippers and receivers of grain and produce."¹⁴

It is my purpose in this paper to outline the legal problems presented by Article XIII. The scope of this paper will not include the problems of federal regulatory law nor the problems under the Uniform Commercial Code. Also excluded from the scope of this paper are the problems of warehouses storing personal property which is not fungible for the reason that the legal problems of Article XIII are confined to goods, primarily grain, which are commingled in storage becoming a fungible mass. In outlining the legal problems, I shall attempt to describe the function of the country elevator in present day grain marketing, processing and storage.

Grain warehouses in Illinois which are not licensed by the United States Department of Agriculture¹⁵ are licensed by the Illinois Department of Agriculture under "The Public Grain Warehouse and Warehouse Receipts Act."¹⁶ Warehouse receipts representing grain in store may be issued under federal law if the warehouse is licensed by the United States Department of Agriculture or under Illinois law if licensed by the Illinois Department of Agriculture.

Warehouse receipts are intended to be partly based upon the credit of the warehouseman, but the acceptance of federal warehouse receipts is better than acceptance of Illinois warehouse receipts, regardless of the credit of the warehouse. Because warehouse receipts issued by warehouses licensed by the United States Department of Agriculture receive better acceptance by those in the grain trade than warehouse receipts issued by warehouses licensed by the Illinois Department of Agriculture, terminal and sub-terminal elevators usually have applied for and received licenses by the United States Department of Agriculture. Many country elevators are also licensed by the United States Department of Agriculture. It has been the personal observation of the author that federal warehouse receipts are accepted because the grain trade believes administration by the United States Department of Agriculture has been excellent and there have been no

¹³ ILL. CONST. art. XIII, § 6.

¹⁴ ILL. CONST. art. XIII, § 7.

¹⁵ United States Warehouse Act, 7 U.S.C. §§ 241-73 (1965).

¹⁶ ILL. REV. STAT. ch. 114, § 214.1-214.28 (1967).

legal obstacles to good warehouse operation. The Illinois warehouse receipt is in disrepute because the grain trade believes that past administration of the law has been inadequate and because of certain legal problems caused by Article XIII.

Illinois has become a leading producer of both corn and soybeans and a major producer of wheat.¹⁷ Virtually all of the soybeans and approximately sixty-six percent of the corn grown in Illinois is sold from the farm where produced, into commercial channels.¹⁸ In some counties as high as ninety percent of the corn grown is sold into commercial channels.¹⁹ Since in a normal year the harvest season extends over only a few weeks, while the feeding, exporting or processing of grain is relatively evenly spread throughout the year, a major part of the crop must be placed into storage, either on the farm where produced or in commercial storage.²⁰ Grain of all kinds, and especially corn, is a perishable commodity requiring efficient equipment and proper handling for successful storage. Generally, elevators have found that grain handling problems have multiplied because of the trend toward field shelling of corn at high moisture levels. In recent years the amount of grain stored on farms and elevators has increased as the amount held by the Commodity Credit Corporation has declined.²¹

Many elevators have found it profitable to offer the service of drying and storing grain in their elevators, and many farmers seem to prefer this service to drying and storing the grain on their own farms. The farmer may also wish to take advantage of commercial facilities to dry and store his grain while at the same time retaining ownership so he can market the grain most advantageously.

Because of the farmer's desire to retain ownership but take advantage of commercial facilities, and because of the desire of country elevators to fully utilize their total storage capacity and to accept delivery of the maximum amount of grain in the short harvest season, country elevators have faced a problem of changing marketing methods. Under present marketing conditions the country elevator functions as a collection point for locally grown grain and as a grain merchandiser accumulating a large inventory during harvest and then

¹⁷ ILL. COOPERATIVE REP. SERV., 67-3 BULL. 16-17 (1967).

¹⁸ *Id.* at 6.

¹⁹ *Id.* at 16-17.

²⁰ 202 FDS (Feb. 1964), *United States Department of Agriculture*, Table 26; 222 FDS (Feb. 1968), *United States Department of Agriculture*, Table 31.

²¹ *Id.*

gradually reducing the inventory during the months after harvest. Accumulation of such large inventories requires a large amount of borrowed capital in relation to total net worth of the enterprise. In some cases adequate capital can be borrowed on the general credit of the enterprise, but many country elevators can borrow the necessary capital only by use of some type of secured credit.

The security device normally used by banks and others extending credit to carry inventories of grain beyond what can prudently be extended on an unsecured basis is the warehouse receipt pledged to secure the debt. The elevator will either issue a warehouse receipt to himself for grain he owns and endorse it to the lending institution or he will issue a warehouse receipt for grain he owns in the name of the lending institution. Lending institutions often require that the elevator "hedge" its grain in inventory, thus largely eliminating risk of market fluctuations. Using this device, some lending institutions will lend certain elevators up to ninety percent of the value of the grain represented by the warehouse receipt. This device has worked well and does provide the lending institution easily liquidated collateral. However, if the lender has doubt of its secured position in the event of insolvency, it must evaluate the borrowing limit of the elevator on the basis of its general credit and not on the collateral. Because of the high credit requirements of many country elevators, their general borrowing capacity does not provide adequate credit.

Court decisions based upon Article XIII have cast considerable doubt upon the status in insolvency of a lending institution holding a warehouse receipt as collateral. As a part of the Illinois regulatory scheme, all grain warehouses are required to obtain a surety bond based upon the total capacity of the warehouse.²² In case of insolvency the holder of a warehouse receipt is entitled to share rateably with all other holders in the grain in store²³ and if such grain is insufficient to cover all outstanding receipts, to recover from the surety up to the amount of the bond.²⁴

In *Central National Bank of Mattoon v. Fidelity and Deposit Co. of Maryland*,²⁵ the court distinguished the position of the lending insti-

²² ILL. REV. STAT. ch. 114, § 214.8 (1967).

²³ ILL. REV. STAT. ch. 26, § 7.207 (1967).

²⁴ ILL. REV. STAT. ch. 114, § 214.8 (1967).

²⁵ Cent. Nat'l. Bank of Mattoon v. Fidelity & Deposit Co. of Md., 324 F.2d 830 (7th Cir. 1963).

tution holding a warehouse receipt as collateral from holders who actually deposited grain, and held that the lending institution was not entitled to recover from the surety because its warehouse receipt was void, thus reducing the status of the bank from a secured to a general creditor. The receipt in this case was issued by the warehouseman to himself and then endorsed to the Central National Bank of Mattoon and was void because this showed that the grain pledged was owned by the warehouseman and was commingled with grain owned by depositors in violation of Article XIII as construed by the Illinois Supreme Court. Elevators have followed a practice of commingling grain deposited for many years and the validity of warehouse receipts for a part of the fungible mass is well established.²⁶ Thus, the defect of the warehouse receipt in the *Central National Bank of Mattoon*²⁷ case was not that the grain was commingled but that the warehouseman commingled grain that he owned with grain owned by other depositors.

The first case construing Article XIII was *Central Elevator Company v. People*²⁸ decided in 1898. This case was an action to enjoin a number of grain warehouses in Chicago from storing their own grain or grain owned by their shareholders. The court held that Article XIII created a fiduciary duty which a warehouseman could not be permitted to break by commingling his own grain with depositors' grain. The warehouses presented evidence that it was customary to mix such grain but the Court dismissed the argument saying "there was a benefit to sellers, but there was an entire failure to show that in the general average there was any public good to the producers or shippers"²⁹ as required by Article XIII. The reasoning of the court was that if a warehouseman could commingle his grain with depositors' grain he could blend lower quality grain which he owned with higher quality grain owned by depositors. Also, by charging full storage on deposited grain but exacting less than full storage on grain he owned, the warehouseman could always outbid his depositors, thus fostering monopoly.

Following the *Central Elevator Case*,³⁰ the legislature amended the

²⁶ *Snydacker v. Stubblefield*, 177 Ill. 506, 52 N.E. 742 (1898); *Yockey v. Smith*, 181 Ill. 564, 54 N.E. 1048 (1899).

²⁷ *Supra* note 25.

²⁸ *Cent. Elevator Co. v. People*, 174 Ill. 203, 51 N.E. 254 (1898).

²⁹ *Id.* at 209, 51 N.E. at 256.

³⁰ *Supra* note 28.

warehouse law then in effect to specifically authorize warehouses to mix their grain with deposited grain.³¹ After enactment of this amendment one of the defendants in the *Central Elevator Case*³² commenced mixing its own grain with depositors' grain. After the change in the law, the case of *Hannah v. People*³³ arose to enforce the injunction ordered in the case of *Central Elevator Company*.³⁴ The court in the *Hannah* case³⁵ held that the prohibition against a warehouseman mixing his own grain with depositors' grain was based upon the policy established by Article XIII and a statute authorizing such a practice was void. Authorizing commingling would encourage a warehouseman to breach his fiduciary duty to depositors.

In 1965 the General Assembly amended the Illinois Warehouse Act³⁶ in an effort to provide protection to holders of warehouse receipts including lending institutions holding warehouse receipts as collateral. As a result of these amendments, the Illinois Department of Agriculture is now authorized to license grain elevators to mix their own grain with their depositors' grain,³⁷ and the law provides that even if the elevator does mix its grain with depositors' grain, that the warehouse receipts are valid.³⁸ Warehouse receipts are also required to state that grain may be commingled and that a surety may not use violations of law by the warehouseman as a defense in an action on the surety bond.³⁹ These changes have not been tested and so doubt still remains as to the rights of a lender holding a warehouse receipt.

A recent case, *People v. Farmers Elevator Mutual Insurance Company*⁴⁰ held that a warehouse receipt issued by an elevator to a grain dealer for grain purchased but not delivered was valid even if the holder had not deposited the grain physically. In this case, Loda Farmers Grain Company purchased corn stored in its warehouse by Commodity Credit Corporation and immediately sold it to Tabor and

³¹ Ill. Laws, 40th Gen. Ass. at 302 (1897).

³² *Supra* note 28.

³³ *Hannah v. People*, 198 Ill. 77, 64 N.E. 776 (1902).

³⁴ *Supra* note 28.

³⁵ *Supra* note 33.

³⁶ Ill. Laws, 74th Gen. Ass. at 862 (1965).

³⁷ ILL. REV. STAT. ch. 114, § 214.3 (1967).

³⁸ ILL. REV. STAT. ch. 114, § 214.7a (1967).

³⁹ ILL. REV. STAT. ch. 114, § 214.8 (1967).

⁴⁰ *People v. Farmers Elevator Mutual Ins. Co.*, 74 Ill. App. 2d 1, 220 N.E.2d 585 (1966).

Company by issue of a warehouse receipt. However, there is a distinction between the facts in the *Farmers Elevator Mutual Insurance Company*⁴¹ case and the facts in the *Central National Bank of Mattoon*⁴² case. Until doubt is resolved, those lending to grain warehouses must exercise caution. So long as the position of a lender holding a warehouse receipt as collateral may be distinguished from the holder who physically deposits grain or purchases grain in store, the policy established by the court in the *Central Elevator Company*⁴³ case in 1898 will continue to be a problem.

Whatever the validity of the reasoning of the court in *Central Elevator Company*,⁴⁴ the Congress, in adopting the "United States Warehouse Act,"⁴⁵ resolved the policy choice in favor of permitting federally licensed grain warehouses to commingle owned grain with deposited grain. At the present time, Illinois terminal, sub-terminal and many country elevators are licensed under federal law and thus are permitted to commingle their own grain with depositors' grain.⁴⁶ It is submitted that the practice of mixing the grain owned by the warehouseman with depositors' grain has not caused injury to depositors. When grain is received at an elevator, it must be graded⁴⁷ in accordance with the standards promulgated pursuant to the "United States Grain Standards Act."⁴⁸ The grain is either sold at a price based upon the grade and the market price at that time, or is delivered into storage and a warehouse receipt issued for the grade delivered. If the owner has high moisture corn, rather than sell and accept the discount for moisture, the owner may request the elevator to dry the corn. In this situation, the elevator will issue a warehouse receipt representing dry corn, making appropriate adjustments for the loss in weight due to drying. At the country elevator all corn delivered, whether into storage or purchased by the elevator, is placed into the same bin. Grain of wide variation in quality may be placed into sepa-

⁴¹ *Id.*

⁴² *Supra* note 25.

⁴³ *Supra* note 28.

⁴⁴ *Supra* note 28.

⁴⁵ 7 U.S.C. § 258 (1965); 7 C.F.R. § 102.48.

⁴⁶ *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

⁴⁷ ILL. REV. STAT. ch. 114, § 214.9 (1967).

⁴⁸ 7 U.S.C. §§ 71-87 (1965).

rate bins but few elevators are capable of complete separation of grades. Generally, the grain owner depositing in a country elevator does not demand physical delivery but will sell in storage at a price based upon the market and the grade for which the warehouse receipt was issued. The obligation of the warehouseman is to keep sufficient grain on hand properly balanced by grades to cover all warehouse receipts outstanding.⁴⁹

In conclusion, Article XIII has caused serious problems making it more difficult for a large industry to function as it should. Experience under the "United States Warehouse Act"⁵⁰ which does authorize grain warehouses to mix their own grain with depositors' grain should alleviate concern over authorizing elevators licensed by the State of Illinois to engage in the same practice. Article XIII is an excellent example of detailed constitutional provisions which have outlived conditions which existed at the time they were written. If the provisions of Article XIII had been written into statutory law, the legislature could have corrected the problem. As a part of our Constitution, even if obsolete, the legislature and the grain industry are without power to correct the problem.

⁴⁹ ILL. REV. STAT. ch. 114, § 214.9 (1967).

⁵⁰ 7 U.S.C. § 71 (1965).

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