February 14, 2012

STATEMENT OF JEFFERY A. JORDAN
TRIAL COUNSEL
MONTGOMERY COUNTY
SENATE ASSESSMENT & TAXATION COMMITTEE
Regarding 2012 SB 317

Mr. Chairman and Members:

My name is Jeffery A. Jordan. I was lead trial counsel for Montgomery County in the tax appeal that is being discussed by the Legislature relating to the Coffeyville Resources Nitrogen Fertilizer (CRNF) plant in Montgomery County. I am not here to address any tax policy issues relating to whether any exemption or change in the classification of property in Kansas should be adopted. I am here to address from Montgomery County's perspective what happened in the tax appeal and how the law was applied by the Kansas Court of Tax Appeals (COTA) to the assets that were at issue with the taxpayer so the legislature can understand the unique nature of this case.

CRNF is asking the Legislature to reverse the impact going forward of a decision made by the COTA finding that CRNF's fertilizer plant in Montgomery County, Kansas is real property and not personal property. CRNF claims the decision was entered contrary to the law. COTA's decision is not contrary to law. As explained below, COTA applied the long established law of fixtures in concluding the CRNF fertilizer plant is real property. The CRNF fertilizer plant is extremely unique and prior to the 2008 tax year at issue, was exempt from property tax altogether. When it came onto the tax rolls in 2008, it was classified by the appraiser's office as real property.

The CRNF property at issue in the COTA case is a massive fertilizer plant which took Farmland Industries (the previous owner) over two years to construct. The property is so unique

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that the COTA heard almost two weeks of testimony concerning the property, how it was constructed, and how it operates. The COTA heard evidence which included design and construction information, along with hundreds of drawings and construction photographs depicting how the property was affixed to the realty and adapted to the use of the land. While there are other fertilizer plants, there are no other fertilizer plants in the United States with the massive gasifier structures used at the CRNF fertilizer plant. This is the only petroleum coke fed fertilizer plant in the United States. The fertilizer plant was constructed in large part to accept as fuel the petroleum coke byproduct of the adjacent refinery, which has been located at its current location since 1906. After hearing all the evidence, the COTA properly applied the well-established law of fixtures to the CRNF property.

CRNF claims Montgomery County reclassified the fertilizer plant assets as real property to circumvent the Legislature's intent in passing the machinery and equipment exemption, which became effective July 1, 2006. There was no such evidence in the record in the COTA. First, the vast majority of the assets in dispute before the COTA had been purchased and installed upon massive foundations YEARS BEFORE July 1, 2006, and would not have qualified for the exemption, which only applies to newly purchased or leased machinery and equipment. Second, the record shows that Robert Kline, the County Appraiser who initiated the process to evaluate the classification and valuation of the fertilizer plant, was actually concerned about the grossly undervalued refinery operated adjacent to the fertilizer plant which was already classified as 90% REAL PROPERTY. The Minutes from the July 6, 2006, Montgomery County Board of County Commissioners meeting reflect that Mr. Kline asked for permission to hire an appraiser to value the oil refinery, not because of a concern about future personal property issues (the refinery was treated as 90% real property), but instead to put an accurate value on the refinery:

> Mr. Bob Kline, Montgomery Country Appraiser, met with the Board to present reappraisal bids for reappraising the Coffeyville Refinery. Bids are as follows:
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> |---|---|
> | American Appraisal, Milwaukee, WI | $84,000 plus expenses |
> | Thomas Pickett & Company, Texas | $48,500 (2007)
$32,500 (2008) |
>
> Mr. Kline recommends Thomas Picket & Company. **He feels he has a duty to put accurate values on for the refinery**. (Emphasis added).

Thomas Pickett & Company was retained by Montgomery County to classify and appraise the refinery and nitrogen fertilizer plant. At that time, the fertilizer plant was still subject to a ten year exemption. The testimony at the trial was that Mr. Kline wanted a baseline appraisal of the nitrogen plant to use when it came off exemption in 2008. As such, the appraiser hired by Montgomery County also classified and appraised the fertilizer plant for 2007 and again for 2008, the first year the plant would be subject to tax after enjoying a ten year exemption from taxation. Montgomery County is not aware of any wholesale changes or changes at all made by any county to avoid the application of the machinery and equipment exemption.

CRNF also advises the Legislature that the COTA and Montgomery County have in some manner changed the law in Kansas and that the Legislature needs to correct that change. That is not the case. In fact, it is CRNF that is trying to effect a change in the law, trying to abrogate the well settled law of fixtures in Kansas by referring to a doctrine that it calls "Trade Fixtures," a term of art that it is now trying to convince the Legislature means something different from what the courts have always held it to mean. The law of "fixtures" has long been well established and was set forth by the Kansas Court of Appeals in *In re Equalization Appeals of Total Petroleum, Inc.*, 28 Kan. App. 2d 295, 299-30, 16 P.3d 981 (2000). In that case, the Kansas Court of Appeals used the following three-part test developed under Kansas common law to determine whether property is to be considered a "fixture" for Kansas *ad valorem* property tax purposes:

"(1) annexation to the realty; (2) adaptation to the use of that part of the realty with which it is attached; and (3) the intention of the party making the annexation." *Id.* (quoting *Stalcup v. Detrich*, 27 Kan. App. 2d 880, 10 P.2d 3 (2000) (internal quotations omitted)); 2008 Personal Property Valuation Guide, Kansas Department of Revenue, Division of Property Valuation, CRNF Ex. 16 ("2008 PVD Guide"), at p. ii; CRNF Ex. 196, Directive #92-011, Kansas Department of Revenue, Division of Property Valuation ("Directive 92-011") at p. 1 (citing *Dodge City Water & Light Co. v. Alfalfa Land & Irrigation Co.*, 64 Kan. 247, 67 P. 462 (1902)). *See also Bd. of Education v. Porter*, 234 Kan. 690, 695, 676 P.2d 84 (1984) (quoting *Dodge City*, 64 Kan. at 252-53); 63C Am. Jur. 2d *Property* § 15 (Westlaw 2010) (setting out the three-part test); 35A Am. Jur. 2d *Fixtures* § 4 (same).

The Court in the *Total Petroleum* case applied this three-part test to hold that the large structures associated with a refinery operation were properly classified as real property. The COTA applied this well settled law to the facts in the CRNF tax appeal and concluded the property in dispute was also real property. There was no change to the law; only its application to a unique and one-of-a-kind facility constructed by CRNF upon millions of pounds of concrete and steel with foundations down to bedrock.

CRNF argued unsuccessfully to the COTA, and now complains to the Legislature, that there is some prolific "trade fixtures rule" that should exempt all of its assets from taxation as real property. However, CRNF fails to explain that as the term is generally used, a "trade fixture" is an item of personal property that is installed by a tenant on leased premises that is used by the tenant to carry on a trade or business. 35A Am. Jur. 2d *Fixtures* § 34 (Westlaw 2010); *Lawson v. Southern Fire Ins. Co.*, 137 Kan. 591, 591-93, 600, 21 P.2d 387 (1933) (airplane hangar erected on leased premises by tenant was trade fixture for purposes of coverage

under tenant's insurance contracts); *Farmer v. Golden Rule Oil Co.*, 130 Kan. 803, 287 P. 706 (1930) (court stating that improvements installed by tenant under a comparatively short-term lease for purposes of trade were in the nature of personal property). At least as between the landlord and tenant, trade fixtures are considered to be the personal property of the tenant so long as they can be removed without material or permanent injury to the land. *Id.*; 82 *Am. Jur. Proof of Facts* 3d 131 § 5 (Westlaw Feb. 2011). Kansas courts have also considered improvements placed on a railroad right-of-way by the railroad to be trade fixtures. *St. Louis K. & S.W.R. Co. v. Nyce*, 61 Kan. 394, syl. ¶ 4, 59 P. 1040 (1900). *But see Union Pac. R.R. Co. v. Bd. of County Comm'rs of Jefferson County*, 114 Kan. 156, 160, 217 P. 315 (1923) (railroad property was statutorily defined as personal property for general taxation purposes, though much of the property would be considered "real property and improvements thereon").

Importantly, for both of these scenarios, an item's classification as a trade fixture is dependent on separate ownership and possessory rights. In a landlord-tenant relationship, the tenant installs personal property on land for which it only has a right of possession. In the railroad cases, the railroad either holds a right-of-way or is a trespasser. When the party installing the personal property is the owner of the real property, the trade fixtures doctrine does not apply. *Union Pac.*, 114 Kan. at 161; *Young Elec. Sign Co. v. Erwin Elec. Co.*, 477 P.2d 864, 867 (Nev.) (citing *Cusack v. Prudential Ins. Co.*, 134 P.2d 984 (Okla. 1943); *Willcox Boiler Co. v. Messier*, 1 N.W.2d 130 (Minn. 1941); *Frost v. Schinkel*, 238 N.W. 659 (Neb. 1931)). As explained by the Kansas Supreme Court:

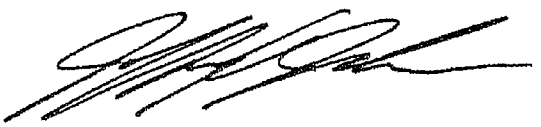
> This "trade fixtures" rule frequently arises over clashing interests of landlord and tenant and situations analogous thereto. It was a convenient, equitable, and highly necessary rule to apply to the unusual situation presented where the title to the realty of the right of way was in one owner and the railway improvements or fixtures belonged to another owner who had no valid claim to the realty. Otherwise an indispensible segment of a railway track would become

> the property of a successful claimant to a strip of real estate occupied by the railway, and the public convenience in railway travel might be interfered with. That was the potential situation in the *Nyce* case. **But where the dominant estate in the land over which the railway is constructed is in the same owner as the railway improvements or fixtures thereon, there is no occasion for the application of the "trade fixtures" rule.** Indeed, for railway purposes, the rails, ties, culverts, signals, etc., are trade fixtures only in the same sense as the land on which they are constructed. Ordinarily the only right in the land which inheres in the owner of the railway is the right to use it for railway purposes. (*Harvey v. Railroad Co.*, 111 Kan. 371, 207 P. 761.) And, with some unimportant exceptions, a railway corporation can hold land in fee or in special ownership for no other purpose.

Union Pac., 114 Kan. at 161 (emphasis added). *See also Farmer*, 130 Kan. at 805 ("As between landlord and tenant, the law is extremely indulgent to the tenant with respect to removal of structures annexed for purposes of the tenancy.").

CRNF and its experts argued to the COTA that anything that in any way serves the manufacturing process is personal property. That included all buildings that cover machinery and equipment, railroad tracks, excavated pits and containment berms, concrete floors that machinery and equipment sits upon, and foundations down to bedrock beneath any structure. Montgomery County and the COTA applied well settled law of fixtures to a very unique and permanent structure built over the course of two years upon millions of pounds of concrete and steel supported down to bedrock to find that these specific assets were properly classified as real property.

Sincerely,



Jeffery A. Jordan