

**IN THE SUPREME COURT
OF THE STATE OF NORTH DAKOTA**

American Crystal Sugar Company,)	
)	Supreme Court No.: 20050343
Applicant, Appellee and Cross-Appellant,)	Dist. Ct. No.:49-05-C-00030
)	
v.)	
)	
Trail County Board of Commissioners,)	
)	
Appellant and Cross Appellee.)	

**BRIEF OF APPELLEE/CROSS-APPELLANT
AMERICAN CRYSTAL SUGAR COMPANY**

**APPEAL FROM THE
TRAILL COUNTY BOARD OF COMMISSIONERS' DECISION
TO DENY ABATEMENT OF TAXES**

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STATEMENT OF ISSUES

1. The Board rejected consistent and compelling market evidence in favor of a fixed formula that bears no relation to reality. Was this decision arbitrary, capricious or unreasonable?

2. Should a strained interpretation be allowed to defeat tax legislation designed to exempt equipment that is a necessary and integral part of the manufacturing process?

3. The abatement process has been characterized as a legislative function. Does this deprive the taxpayer of any semblance of due process, including the right to a fair and impartial hearing?

STATEMENT OF THE CASE

The subject property is a sugar factory located seven miles north of the City of Hillsboro, North Dakota. It is used to process sugar beets into refined sugar. The original factory was built in 1973, and acquired by American Crystal Sugar Company (“ACSC”) two years later. Most of the improvements consist of the machinery and equipment used in the manufacturing process. The scale is enormous. Furthermore, much of the equipment is freestanding and does not need to be protected by buildings. Appr. Rpt., p. 15.

All of the machinery, equipment and other personal property at the site is exempt from property taxation. N.D.C.C. § 57-02-04(2). Only the real property is subject to taxation in proportion to its “full and true value”, or fair market value. N.D.C.C. § 57-02-27.1.

Other commercial property in Traill County is assessed in accordance with the accepted approaches to the appraisal of real estate. County assessors first use a cost approach. Assuming it is appropriate and data is available, an income approach is also used. Tr., pp. 423-24. The results obtained using those methods are then validated or verified by comparison to “whatever is happening in the market”. Id. at 424, ln. 8. The goal is to value property “at the market level”. Id. at 424, ln. 13.

Traill County has always used a very different approach, however, when valuing the subject property. Instead of a dynamic and analytical approach that reflects actual market conditions, the county uses a fixed and arbitrary formula to determine the market value of the taxable improvements. This formula largely dates back to the construction of the original factory. Id. at 399, 408, 422-23. Although there were some minor revisions

in early years, since 1987 all aspects of the formula have been “set and stabilized”. Id. at 409, ln. 3.

Annual assessments are conducted by simply performing the calculations required by this formula. No attempt is made to perform any type of market analysis, or to review comparable sales. Similarly, nothing is done to adjust the formula to reflect changes in the condition of the property, its degree of functional obsolescence, or the economic environment in which it operates. Id. at 389-92. It is this lack of meaningful analysis that serves as the focus of this appeal.

The underlying land at the Hillsboro factory is valued based on classification. The acreage classified as agricultural is valued based on productivity, in accordance with the controlling statute. Id. at 387-88. Most of the land is classified as commercial, however, resulting in an almost seven fold increase in the assessed value. Id. at 388-89.

Without considering the impact of any temporary exemptions then in effect, during the years in question the assessed value of the subject property ranged from \$38,821,479 in 2001 to \$37,562,701 in 2003. Supp. App., pp. 1 - 27. ¹

Although the assessment formula has not changed significantly in the three decades since ACSC acquired the Hillsboro factory, much that affects the value of that property has. This is compellingly demonstrated by an analysis of comparable sales. During the period in question, 14 of the 26 sugar beet factories still operating in the United States were sold. Without exception, those sales establish that the assessed value

¹ As a means of promoting business development, taxing jurisdictions typically grant property tax exemptions for a specified period after new improvements are constructed. During the years in question, portions of the Hillsboro factory still qualified for such exemptions and were only taxed at 50% of their assessed value. The “assessed values” in the county’s brief are actually the net values after these exemptions are factored in.

of the Hillsboro factory is assessed many times higher than its actual market value. Tr., p. 65.

In June of 2003, representatives of ACSC first met with the Traill County Board of Commissioners (“Board”) to discuss the valuation of the Hillsboro factory. The presentation made by ACSC at that time focused on deferred maintenance, and did not have the benefit of a completed market analysis. Those discussions were unproductive, and the Board refused to modify the valuation formula. Supp. App., p. 31. On October 30, 2003, ACSC filed formal applications for abatement of the property taxes paid or payable in 2001 through 2003. App., pp. 3-17.

Thereafter, the independent appraiser hired by ACSC continued to refine and supplement his analysis. That effort culminated in the issuance of a detailed appraisal report on December 21, 2004. That report concluded the disparity between the assessed value and the actual market value was even greater than initially thought. This was mostly due to the results of the exhaustive market survey conducted after the abatement applications were submitted. An additional factor was the realization that eight large items of processing equipment were incorrectly included on the listing of taxable improvements. In bottom line terms, the final appraisal concluded the market value of the taxable portions of the Hillsboro factory, during the time period in question, was \$5,700,000. Appr. Rpt., pp. 35 - 36.

A formal hearing was conducted by the Board on January 6 and 7, 2005. The statutes governing abatement proceedings provide almost no procedural guidance. There are no provisions for pre-hearing discovery or its equivalent. As a result, it is true that the county did not learn of ACSC’s final positions until the time of the hearing. The reverse

was also true. Furthermore, ACSC was forced to complete its presentation before it saw or heard any part of the county's. Tr., pp. 198-99, 348-50. As a result, ACSC was denied an opportunity to either confront or rebut anything said by the county in support of the assessment formula.

All told, the abatement hearing was a very contentious affair. There was no semblance of objective or impartial fact finding. Thereafter, the Board proceeded to summarily deny any form or measure of relief. Tr. (1/25/05), pp. 7-10.

ACSC appealed to the district court, which issued its decision on August 29, 2005. App., pp. 18-41. As the issues before the district court must be reviewed de novo by this court, that decision has limited bearing on this appeal. Briefly stated, the district court proceeded as if both parties had presented competent valuation evidence, leaving it powerless to reverse the Board's conclusions as to the weight and credibility of that evidence. Id. at 28-31. The Board's decisions as to classification, however, were properly regarded as fully reviewable. In this regard, the district court agreed with some, but not all, of the positions taken by ACSC. Id. at 31-39.

The Board filed the first appeal to this court. App., p. 44. ACSC followed with its cross appeal. App., p. 45. This requires that all aspects of the case be addressed in this brief.

STATEMENT OF FACTS

The significant facts will be outlined as part of the discussion of each issue. To avoid unnecessary repetition, a separate statement of those facts is omitted.

ARGUMENT

I. The Board arbitrarily rejected a wealth of available market evidence, and based its decision on an arbitrary and unsupported formula.

a. Standard of review.

The applicable standard of review is well established. Tax assessment determinations made by a local governing body must be reversed when “there is such an absence of evidence or reason that the Board’s decision is arbitrary, capricious or unreasonable.” Dakota Northwestern Assoc. Ltd. P’ship v. Burleigh County, 2000 N.D. 164, ¶ 8, 616 N.W.2d 349. A decision is arbitrary, capricious or unreasonable “if it is not the product of a rational mental process, by which the facts and law are considered together for the purpose of achieving a reasoned and reasonable interpretation.” Id. Furthermore, if the assessment is based on an approach to valuation that is “arbitrary and unsupported”, any decision endorsing that approach is likewise flawed. Nat’l Sun Indus., Inc. v. Ransom County, 474 N.W.2d 502, 506 (N.D. 1991).

In multiple respects, the Board’s conclusions regarding value were both arbitrary and unreasonable. The Board gave no consideration to the comprehensive and compelling market evidence. App., p. 43. Its stated justification for the rejection of this best evidence is patently without merit. The Board also rejected a sound and thoroughly researched cost approach analysis, and instead concluded the rigid and unsupported assessment formula was the only “fair” method of assessing the subject property. Id. at 42.

b. The appraisal process - an overview and introduction.

The appraisal of property for tax purposes is not “an exact science but the method of appraisal should bear some relationship to the realities of the situation.” Midwest Processing Co. v. McHenry County, 467 N.W.2d 895, 901-02 (N.D. 1991) (VandeWalle, J., concurring). A valid assessment cannot be conducted in a vacuum, or be based on static formulas that bear no relation to current realities, particularly the dynamics of the marketplace. Instead, the appraiser must thoroughly “understand the interrelationships among the principles, forces, and factors that affect real property value in the specific market area.” Appraisal Institute, The Appraisal of Real Property, 49 (12th ed. 2001) hereafter [“Appraisal Textbook”] (Supp. App., p. 39).

A comprehensive market analysis is the keystone of any reliable appraisal. The more complex the appraisal assignment, the more detailed this analysis must be. Id. at 60 (Supp. App., p. 43). By way of elaboration:

The data and conclusions generated through market analysis are essential components in other portions of the valuation process. Market analysis yields information needed for each of the three traditional approaches to value. In the cost approach, market analysis provides the basis for adjusting the cost of the subject property for depreciation, i.e., physical deterioration and functional and external obsolescence. In the income capitalization approach, all the necessary income, expense, and rate data is evaluated in light of the market forces of supply and demand. In the sales comparison approach, the conclusions of market analysis are used to delineate the market and thereby identify comparable properties.

Id. at 59-60 (Supp. App., p. 42-43).

The county’s assessment is not based on, or supported by, even the most rudimentary market analysis. Tr., p. 240. It is like working in the dark. It is simply not possible to achieve any reasoned, rational or credible result in this manner. Id. at 242. By contrast, the market analysis conducted by John Coates (“Coates”), ACSC’s independent

appraiser, started in 2003 and was not completed until the last days of 2004. In total, Coates devoted approximately 500 hours to this assignment and the companion task of appraising ACSC's Drayton factory. Id. at 90. As part of that work he:

- Analyzed data from various public and private sources. Id. at 91.
- Inspected the Hillsboro factory on three separate occasions. Id. at 90.
- Personally inspected twelve other factories used to derive comparable sales data. Id. at 92.
- Interviewed approximately forty people involved with the comparable sales transactions or properties. Id.
- Reviewed comparable sales data provided by ACSC, trade and industry sources, and offering memoranda. Id. at 95.
- Analyzed a replacement cost summary prepared for the United States Beet Sugar Association. Id. at 92-93.
- Analyzed detailed construction cost data from the most recent sugar beet factory built in the United States. Id. at 93.
- Reviewed extensive background documents and data supplied by ACSC, including specially compiled income and expense statements. Id. at 90-91.
- Stabilized net operating income using data from seven different sugar beet factories. Id. at 100.

As an integral part of this process, the available data was reconciled and compared for internal consistency. When appropriate, it was also discounted or rejected. Id. at 101.

Once the market analysis is completed, the next step in any valid appraisal process is to apply the data found to be reliable to the traditional approaches to valuation. They are referred to generally as the sales approach, the cost approach, and the income approach. See, e.g., Mike Golden, Inc. v. Tenneco Oil Co., 450 N.W.2d 716, 719 (N.D. 1990).

c. The sales approach.

Although the property tax statutes speak in terms of “true and full value”, it is undisputed that this is synonymous with actual market value. The Tax Commissioner’s guidelines define “true and full value” as:

[T]he price a property would bring if it were offered for sale in the open market for a reasonable length of time and purchased by a willing buyer from a willing seller, both parties being prudent and having reasonable knowledge of the property and neither being under undue pressure to complete the transaction.

N.D. Tax Comm., Guidelines for Property Tax Valuation, G-24 (2003) hereafter [“Valuation Guidelines”] (Supp. App., p. 33).

Because the appraisal process is designed to estimate the price a property would bring if sold in the open market, it follows that actual sales are usually the best evidence. Correspondingly, “[t]he sales comparison method is one of the more accurate methods of estimating market value.” Valuation Guidelines, supra, at G-26b. (Supp. App., p. 37). This court has likewise acknowledged the dominant role played by comparable sales data in the valuation process. Mike Golden, Inc., 450 N.W.2d at 719-20. The valuation treatise published by the International Association of Assessing Officers says it this way:

The fundamental strength of the sales comparison approach to value is that it reflects the actions of the marketplace and what buyers and sellers are actually doing and paying. This approach places less reliance on subjective judgments and the opinion of the assessor because the data are taken directly from the market and related directly to the subject. The comparison of actual sales is generally recognized as good appraisal practice by courts and other review authorities.

Int'l Ass'n of Assessing Officers, Property Assessment Valuation, 124 (2d ed. 1996) hereafter ["Assessment Textbook"] (Supp. App., p. 48).

During the relevant time period, there were 26 sugar beet factories operating in the United States. From a design standpoint, all of these factories are very similar. As they are so few in number, recent sales data would ordinarily be scarce. In this case, however, the opposite is true. Spurred by consolidation and a trend towards cooperative ownership, in 2002 fourteen of these factories were sold. Tr., p. 145.² Collectively, these transactions provide an "enormous amount of data relative to the universe of potential properties." Id. at 281, lns. 13-15. Clearly this data is the best and most reliable indication of both market value and total accrued depreciation. Nonetheless, it is not reflected in any manner in the county's assessment. Id. at 282.

The first of the transactions deemed by Coates to be reliable involved the sale of six factories from Western Sugar to Rocky Mountain Sugar Growers Cooperative. This transaction closed in early 2002. The factories are located in Montana, Wyoming, Nebraska and Colorado. Appr. Rpt., p. 29. The second significant transaction also closed in early 2002. It involved the sale of four operating factories from Michigan Sugar (a subsidiary of Imperial Sugar) to Michigan Sugar Beet Growers. All of those factories are located in Michigan. Id. at 30. The last significant transaction closed in late 2002. It involved the sale of a factory located in Sidney, Montana, from Imperial Sugar ("Imperial") to Sidney Sugars, a wholly owned subsidiary of ACSC. Id.

Coates personally inspected each of these comparable sale properties in order to assess their design and relative condition. As a result, he was able to make appropriate

² The available market data is summarized in sections VI-A through VI-D of the addenda to the Coates' appraisal report.

adjustments. He made further adjustments for variables such as length of campaign and transportation costs. Tr., pp. 147-49. He concluded that the prices paid for the four Michigan factories “set the upper limit of value.” Id. at 148, Ins. 5-6. This conclusion was based on location, the factor that inevitably seems to have the most affect on the value of real estate. More specifically, the Michigan factories are much closer to major markets, and therefore enjoy a tremendous transportation cost advantage over the other factories. Id. at 147-48.

Coates adopted price per ton of daily slice capacity as the appropriate unit of comparison. This is the approach used by the industry, and also by several assessing jurisdictions, to make comparisons. Furthermore, the necessary data was readily available. Appr. Rpt., p. 32. The price received by Western Sugar for its six factories was the equivalent of \$1,490 per ton of daily slice capacity. Michigan Sugar was paid \$3,599 per ton of capacity for the four factories it sold. Finally, the factory in Sydney, Montana, sold for \$2,195 per ton. Appr. Rpt., *addenda* VI - B. To put these unit prices in perspective, in 2002 the application of the assessment formula used by the county suggests the Hillsboro factory has a value in excess of \$23,000 per ton of daily slice capacity. (All of these unit prices reflect the total value of all improvements (real and personal), exclusive of the land.)³

In relative terms, the assessed value of the Hillsboro factory in 2002 was more than six to fifteen times higher than the prices paid for the eleven factories that were

³ In 2002, the assessed value of the taxable portions of the Hillsboro factory was \$38,017,238. Supp. App., pp. 10-18. As part of his analysis, Coates concluded the ratio between assessable (real) and non-assessable (personal) components was 20%/80%. App. Rpt., p. 18. Therefore, the total value of all improvements becomes approximately \$190,000,000. The factory has a daily slice capacity of 8,200 tons. Id. at 15. ($\$190,000,000 \div 8,200 = \$23,170.73$).

actually sold that year. Differences of this magnitude can not reasonably be ignored, but that is just what the Board did. Traill County did nothing to analyze the actual sales transactions, or to rebut the wealth of comparable sales evidence submitted by ACSC. Nonetheless, the Board categorically rejected this best and most compelling evidence.

In the written decision ultimately adopted by the Board, the only justification offered for rejecting the comparable sales evidence was the conclusion some of the sales were “compelled”. App., p. 43. There is simply no credible support for this conclusion. Furthermore, even if some of the sales were compelled, this would do nothing to impair evidence obtained from the sales that were not.

Jodi Buzick (“Buzick”), the county’s Director of Tax Equalization, did suggest the sale of the factory in Sidney, Montana was not a true sale because “there was never a sign on the front yard of that plant saying for sale.” Tr., p. 401, lns. 17-18. She went on to suggest that because ACSC also purchased market allotments as a different part of the same transaction, it was a compelled buyer. Id. at 402. To support her final conclusion that Imperial was a compelled seller, Buzick cited the facts that it had recently emerged from bankruptcy, and had indicated on its website the sale was motivated by a desire to reduce debt and strategically reorganize. Id. at 403.

Although ACSC was not afforded any opportunity to respond to these comments at the hearing, it has since supplemented the record with a copy of Imperial’s plan of reorganization, which was approved before any of the sales at issue occurred. Supp. App., p. 52-54. This plan did not require the sale of any of Imperial’s sugar beet processing plants, and certainly did not compel sales at less than market prices. Instead, it

provided that Imperial could “acquire or dispose of property ... free of any restrictions of the Bankruptcy Code or Bankruptcy Rules.” Id. at 53.

The conclusion that Imperial was a compelled seller is also logically inconsistent with the terms of the various transactions. There has been no suggestion that the sale by Western Sugar to Rocky Mountain Sugar Growers was in any manner compelled. Nonetheless, in relative terms Imperial was paid more than twice as much for the factories its subsidiary sold in Michigan.

Finally, the conclusion that some of the sales were compelled stands in stark contrast to the only direct evidence in the record. One of the witnesses who testified on behalf of ACSC was its treasurer, Samuel Wai. Wai has personal knowledge of the negotiations between Imperial and ACSC. He testified that, like any seller, Imperial wanted to be paid as much as possible. Conversely, like any buyer, ACSC wanted to negotiate the lowest possible price. Id. at 69. Wai described the sale as a “typical arms-length kind of a transaction” that involved “long nights in the conference rooms.” Id. at 69, *Ins.* 8-10.

For his part, Coates did not simply accept as valid all of the sales data. Indeed, he placed little, if any, reliance on the three transactions that yielded the lowest prices on a per unit basis. Each of those sales involved a single factory. Two of those factories were not operating at the time of sale. The third sale was discounted because the low price suggested it may have been made on a distressed basis. Tr., p. 146.

After making the appropriate comparisons and adjustments, Coates concluded that the improvements at the Hillsboro factory have a unit value of \$2,800 per ton of daily slice capacity. Appr. Rpt., p. 34. As this represents the total value of all improvements,

the next step was to eliminate the value contributed by non-taxable machinery and equipment. The taxable unit value was then multiplied by the capacity of the Hillsboro factory to establish the market value of the taxable improvements. Finally, the land value was added.⁴ The net result was a valuation based on the sales approach of approximately \$6,000,000. Tr., pp. 149-50.

d. The cost approach.

Regardless of the variation used, the cost approach to value involves well established steps. In the guidelines for assessors promulgated by the Tax Commissioner, these steps are described as follows:

(1) estimate the value of the site or land as if vacant; (2) estimate current replacement cost new of the structures; (3) estimate the amount of accrued depreciation on the structures; (4) deduct the estimated accrued depreciation from the replacement cost new of the structures; and (5) add the estimated site value to the total depreciated replacement cost of all the improvements to provide an indicated value of the appraised property.

Valuation Guidelines, supra, at G-25 (Supp. App., p. 34).

The last two steps only involve simple math, but the first three require much more - current and reliable information must be analyzed to derive a meaningful estimate. The assessed value of the subject property is calculated without the benefit of this critical analysis. This makes the assessment formula “unsupported and insubstantial”. Nat’l Sun Indus. Inc., 474 N.W.2d at 508. It also renders any decision based on that formula “arbitrary and unreasonable”. Id.

⁴ As will be explained in the following section, Coates erroneously valued the land based on its market value rather than its production capacity. By statute, the latter approach is mandatory when assessing agricultural land in North Dakota. N.D.C.C. § 57-02-27.2.

Both the Board and the district court focused their analysis on whether the “trended cost” approach is a valid means of estimating market value. Cost trending involves the upward adjustment of historical acquisition costs utilizing factors supplied by a valuation service. In theory, these trending factors adjust for inflation and other changes that tend to increase the cost of construction over time. As will be explained below, cost trending is a particularly inappropriate means of estimating the replacement cost new of the subject property. However, the biggest flaws in the assessment formula do not result from the fact that it is patterned after an inherently unreliable theoretical approach. Rather, it is the inescapable fact that the depreciation allowances used by the county are completely arbitrary and bear no relation to any reality, something the Board and district court have failed to address.

The following sections discuss the first three steps of the cost approach. In each instance, the assessment formula will be compared to the analysis performed by Coates as part of his appraisal. This comparison establishes the Board had things backwards when it concluded Coates’ estimates were not based on valid information, but the assessed value was. App., p. 42.

i. Step one.

The first step in the cost approach requires that any land be valued based on the assumption that it is vacant and unimproved. Because improvements are separately valued, the result is inflated if the land valuation is influenced by those improvements.

The subject property is surrounded by farmland. It is miles from any commercial development. If the land were vacant and unimproved, its highest and best use would

clearly be agricultural, not commercial. The Coates' appraisal proceeds on this basis, but the county has classified most of the land as commercial and values it accordingly.

The district court held the land must be reclassified as agricultural, but went on to conclude the valuation of that land is a "legislative decision" delegated to the Board's sole discretion. App., pp. 37-39. The first part of this decision was clearly correct, but it is submitted the second part fails to consider the impact and effect of a special statute governing the assessment of agricultural land.

The Legislature has decreed that agricultural land in North Dakota must be assessed based on its productivity, not its market value. N.D.C.C. § 57-02-27.2. The county currently follows this statute when valuing the parcels at the factory site classified as agricultural. Like all other farmland in the county, that acreage is given a value based on productivity statistics. Tr., pp. 387-88. Coates was not aware of this statutory mandate when performing his appraisal. Accordingly, he valued the land based on the results of a specially commissioned market value appraisal. This mistake had a significant impact on the result. At least in this instance, a valuation based on productivity is much lower than the estimated market value of the land.⁵

After the district court's decision was received, the Board reconvened to discuss its potential implementation. It was plainly indicated that the land will be valued based on its market value if the reclassification order is affirmed, but no further direction is provided. Tr. (9/20/05), pp. 30-34. Therefore, if this court agrees with ACSC on this issue, it is urged to include appropriate instructions as part of its remand.

⁵ During the years in question, the county valued the parcels classified as agricultural at \$550 to \$557.50 per acre. Tr., p. 388. The market value appraisal commissioned by ACSC suggests a value of \$1,200 to \$1,560 per acre. Appr. Rpt., addenda IV-E.

ii. Step two.

The second step in the cost approach requires an estimation of the current replacement cost new of any taxable improvements on the land. In the county's assessment formula, indicated acquisition costs are "trended" in order to calculate the replacement cost new. There are inherent limitations in this procedure. In particular, "as the time span increases, the reliability of the current cost indication tends to decrease." Appraisal Textbook, *supra* at 369 (Supp. App., p. 46). In the language of the International Association of Assessing Officers, costs "trended over a long time lose accuracy, consistency, and credibility." Assessment Textbook, *supra*, at 148 (Supp. App., p. 49).

There are many reasons why cost trending over time is inherently unreliable. As a starting proposition, it becomes increasingly difficult to verify the accuracy of the indicated acquisition costs. Tr., p. 229. That is particularly true here. During her presentation Buzick indicated that it is hard to know exactly where the original cost numbers came from, and the historic records reflect significant discrepancies in this regard. Id. at 394. Furthermore, all acquisition costs generated since the original construction of the factory have resulted from renovation or expansion projects. It is common knowledge that additions and improvements to existing facilities are much more expensive than original construction. Duplication also becomes increasingly problematic. Of necessity, original components are replaced during the course of any renovation or expansion project. Unless meticulous care is taken to eliminate the original costs, this results in duplication. Id. at 123-24. Finally, the trending of historical acquisition costs does not reflect changes in technology, design, construction techniques, materials, and

many other things. Instead, this methodology proceeds on the assumption that the property would be rebuilt the same way, which is almost never an accurate assumption over time. Id. at 229. See also, Appraisal Textbook, supra, at 369 (Supp. App., p. 46).

There are many alternative methods available to establish replacement cost. Particularly when the subject property is older, cost data from more recent but similar construction projects provides “a primary source of comparable cost data.” Appraisal Textbook, supra, at 367 (Supp. App., p. 45).

Recognizing the unreliability inherent in this approach, Coates did not derive his replacement cost estimates by trending acquisition costs. Tr., p. 107. Instead, he based his replacement cost new estimate on data from two alternative sources. First he used cost data from the construction of the Moses Lake factory. Completed in 1998, this is the only sugar beet factory that has been built in the United States in the last 30 years.⁶ The second source of cost data utilized by Coates was an industry study designed specifically to analyze the cost of constructing a sugar beet factory. Id. at 106.

iii. Step three.

The third step in the cost approach requires an analysis of accrued depreciation. Before proceeding, a brief explanation of the relevant terminology is warranted.

The generally recognized forms of depreciation are physical, functional and economic. The terms depreciation and obsolescence are interchangeable. Similarly, economic obsolescence is frequently referred to as external depreciation. Each form of depreciation can be analyzed separately, or the appraiser can make a combined estimate of total depreciation from all causes.

⁶ This factory operated for only three years before it failed. Tr., p. 61.

In National Sun, the county based its assessment on a recent appraisal prepared by the State Supervisor of Assessments. That appraisal incorporated an economic obsolescence allowance of 35%, based on data obtained from one other sunflower plant operated in North Dakota. National Sun argued that its comprehensive market analysis justified an allowance of 70%. Nat'l Sun Indus., Inc., 474 N.W.2d at 505. This court ultimately concluded that the allowance in the county's appraisal lacked both substance and support. Id. at 508. Accordingly, the case was remanded with instructions that the county reassess the degree of economic obsolescence based on the evidence submitted by National Sun, the only valid and competent evidence in the record. Id. at 508-09.

The depreciation allowance invalidated in National Sun was at least based on a limited and current market analysis. By contrast, the functional and economic obsolescence rates used by Traill County were derived from thin air, at a very different and distant time. Furthermore, although the physical depreciation rates are increased each year until the cap is reached, nothing is done to determine if the resulting calculation bears any rational relationship to reality. These fundamental flaws become self-evident when the assessment formula and its origins are explained.

During her testimony at the abatement hearing, Buzick described the depreciation allowances contained in the assessment formula.⁷ For each line item or improvement, the physical depreciation allowance is automatically increased at the rate of 3% per year until a cap of 75% is reached. Tr., p. 390. Buzick assumes these physical depreciation rates and cap were modeled after a similar approach developed to assess the Minn-Dak

⁷ Buzick is not a licensed appraiser, and she lacks the training and experience to qualify for such a license. She did not even complete the training necessary to be certified as a county tax director until after the assessments at issue were prepared. Tr., pp. 385-86.

sugar beet factory near Wahpeton. Id. at 389-90. After all of the physical depreciation allowances are subtracted from the trended acquisition costs, functional obsolescence is next calculated by multiplying the net number by 12.5%. The formula's stated economic obsolescence allowance is 10%. Id. at 391-92. In this regard, however, a computational aberration has also crept into the process. At least in recent years, the economic obsolescence allowance is calculated by subtracting the functional economic allowance from the physical depreciation allowance, and then by multiplying the remainder by 10%. Supp. App., p. 51. With newer improvements, this approach has a nominal impact on the assessed value. For example, according to the 2003 assessment work papers the desugarization expansion had a replacement cost new of \$22,646,675, but the amount subtracted for economic obsolescence was only \$22,647. Supp. App., p. 25. Expressed as a percentage of replacement cost new, this is an actual allowance of only 0.1%.

There are many valid methods that can be used to estimate accrued depreciation. As the Tax Commissioner's guidelines emphasize, however, an analysis of the sales of comparable property is usually "the most reliable method for determining accrued depreciation." Valuation Guidelines, supra, at G-26 (Supp. App., p.35). Very similar language appears in the valuation text published by the International Association of Assessing Officers. That text indicates the sales comparison method "is probably the most reliable" means of calculating total accrued depreciation "because it has market justification." Assessment Textbook, supra, at 158. (Supp. App., p. 50). This is particularly true as the property ages, and it becomes very difficult to establish separate rates for each form of depreciation. Tr., p. 233.

In his appraisal, Coates relied on the sales comparison approach as the primary means for estimating total accrued depreciation.⁸ More specifically, an analysis of the extensive sales data he had accumulated indicated that the appropriate level of total accrued depreciation (physical depreciation, functional obsolescence and economic obsolescence) was 94% of replacement cost new. However, because the alternative methodology Coates also employed suggested a lower percentage, the results were reconciled to an overall depreciation rate of 90%. Id. at 126-29. Although this overall depreciation rate is certainly high, it has very rational explanations. These explanations were ignored by the Board, but they are critical to any fair resolution.

Part of the explanation involves the concept of deferred maintenance. At the Hillsboro factory, buildings have been erected only where necessary to house equipment or personnel. Id. at 42-43. Maintenance priorities focus on the machinery and equipment. Id. at 43. There is also a very limited time window to perform maintenance and repairs. Most of that work must be crammed into the off-season when the factory is not in operation, approximately a thirty-day period. Id. at 28, 42-43. Because of these simple realities, an extensive list of deferred maintenance items had accumulated by the time period in question. Id. at 44-51. The total estimated cost to correct these items was set at \$4,115,865. Id. at 51.

Conceptually, deferred maintenance is “the extraordinary wear and tear of a facility that hasn’t been maintained or replaced or fixed as often as it should have been.” Id. at 250, lns. 20-23. It goes beyond the physical deterioration that would be expected

⁸ This is a perfect example of the importance of market data to all aspects of the appraisal process. Tr., p. 235.

for a property with the same age and use. Id. at 250. Deferred maintenance affects market value as buyers typically insist that the price be discounted by the estimated cost of necessary repairs. Similarly, it is a common appraisal and assessment practice to subtract from the final valuation the estimated cost of correcting any deferred maintenance items. See, e.g., Dakota Northwestern Assoc. Ltd. P'ship, 2000 N.D. 164, ¶¶ 2-3, 616 N.W.2d 349. However, the approach used by Coates incorporated deferred maintenance into the methodologies used to derive the overall depreciation rate, so such an adjustment is not necessary in this case. Tr., p. 127.

Trail County has consistently argued that deferred maintenance is addressed by the physical depreciation allowance in the assessment formula. This position incorrectly assumes that physical depreciation and deferred maintenance are the same thing. Tr., pp. 250-52. Furthermore, a fixed and inflexible rate of physical depreciation fails to account for extraordinary wear and deterioration, or circumstances that compel the deferral of appropriate maintenance.

The next part of the explanation is functional obsolescence, or “loss in value as a result of defects in design or of changes which have taken place over the years which have made some aspects of the structure, materials or design obsolete by current standards.” Valuation Guidelines, supra, at G-26 (Supp. App., p.35). Over time, the Hillsboro factory has become obsolete in multiple respects. Its energy consumption per unit of production is approximately twice what a modern plant would achieve. The factory lacks automation and similar refinements. In turn, this increases labor costs. The factory is also too small to achieve maximum economies of scale. A modern factory would have two or three times its production capacity. Tr., pp. 67-68.

Finally, there are all of the considerations that must be weighed when assessing the impact of economic obsolescence. “Market value is generally seen as a reflection of market participants’ perceptions of future economic conditions.” Appraisal Textbook, *supra*, at 53 (Supp. App., p. 40). Economic obsolescence “is the loss in value resulting from adverse influences outside the property itself. These include . . . adverse economic conditions.” Valuation Guidelines, *supra*, at G-26 (Supp. App., p. 35).

Although the rate of economic depreciation allowed by the assessment formula has not changed since 1980, the economic environment in which ACSC operates most definitely has. At the hearing, this was underscored by the testimony of Samuel Wai, who has been employed by ACSC throughout most of this period, and who currently serves as its treasurer. Tr., p. 63.

As Wai explained, the prices for domestically produced sugar are heavily influenced by federal farm bill provisions. In recent decades this has kept the price structure essentially flat. Id. at 54-55. When adjustments for inflation are made, the real prices received by sugar processors today are approximately 40% lower than the prices received in the early 1980s. Id. at 60. During the same period, however, production costs have consistently gone up. Id. at 62. Demand has also been relatively flat. This is because sugar is a “mature” industry, which has no means of creating increased demand or growth. At best growth rates have been slow, basically in sync with population growth. Furthermore, since 2001 there have been significant declines in domestic sugar sales. Id. at pp. 59-60.

Growth is further restrained by provisions in the 2002 Farm Bill establishing market allotments. These are the equivalent of quotas given to each domestic sugar

processor, which limit the amount of sugar they can sell in a given year. In effect, this also places caps on production. Id. at 55-56.

These constraints on growth adversely affect processors in a variety of ways. The highest rates of return are generated by the extra volume produced after fixed costs have been recovered. When production costs increase but prices do not, a processor is caught in a cost/price squeeze. The typical model for overcoming this dynamic is growth, but that is something the sugar market and allotment system will not permit. Id. at 56.

Compounding these problems, the market share of domestic processors is increasingly threatened by imports. Until recently, WTO treaties limited sugar imports to about 15% of the current domestic market. That is no longer true. NAFTA and CAFTA already open the door for Mexico and Central America, major producers of cane sugar. Other pending trade agreements threaten to confer the same status on many other countries that also produce sugar, and do so very cheaply. Id. at 56-57. Independent studies conducted by NDSU and LSU both conclude there is a direct correlation between import levels and prices paid to domestic sugar processors. Ominously, these studies indicate that if imports simply double from current levels, prices will fall below domestic costs of production. Id. at 58-59.

Domestic factory construction and ownership reflects these economic trends. The newest sugar beet plant still in operation in the United States was constructed in 1975. The only factory built recently operated for three years and then failed. In 1980 there were forty sugar beet processing facilities operating in the United States. Fourteen have since closed. Nine of those closures occurred within the last ten years. Id. at 61.

Indeed, there are strong indications that the operation of a sugar processing facility is no longer viable as a stand-alone business. All of the sugar beet processing factories still operating in the United States are now owned by grower cooperatives.⁹ The simple explanation is that growers have a unique incentive to keep these factories in operation. By doing so they maintain a “value added” market for the beets they grow. *Id.* at 61-62.

In summary, the overall depreciation rate of 90% estimated by Coates has ample market justification and is consistent with the realities outlined above. By comparison, during the relevant period the effective overall rate of depreciation allowed by the county’s assessment formula ranged from 52% in 2001 to 55.2% in 2003. *Id.* at 274-75. This disparity alone accounts for much of the difference between the appraised and assessed values.

Although none of the depreciation allowances contained in the assessment formula are tied to anything real, the district court held that the Board could have properly determined these allowances were the most credible and least conjectural. This holding was supported by the observation that the formula’s overall depreciation range is not far below the result that would be obtained by using a straight line approach and assuming the factory had a useful life of fifty years. *App.*, p. 29. During the hearing, a Board member made a similar argument. *Tr.*, pp. 307-10. It is a badly flawed analysis.

Accountants often do use straight line approaches to calculate physical depreciation for income tax purposes. Such approaches, however, are inherently arbitrary

⁹ At the time of the hearing three factories were still owned by corporations not also involved with growing sugar beets. All of those factories have since been sold to grower owned cooperatives. In relative terms the prices were similar to the sales that occurred in 2002, only a small fraction of the assessed value of the Hillsboro factory.

and have no place in the appraisal of real property. In particular, they do not account for unusual wear and deterioration, or usages that accelerate rates of physical depreciation. The original portions of the Hillsboro factory were built in 1973. Even at the time, an anticipated useful life of fifty years would have been optimistic. In fact, the use made of this facility has been so intense and unrelenting that ACSC has already been forced to replace major portions of the original facility. Many of the remaining portions (including cement floors, structural beams, walls and roofs) are badly in need of replacement. Furthermore, any straight line analysis only addresses physical depreciation, and fails to account for the additive impact of functional and economic obsolescence.

e. The final reconciliation.

The three basic approaches to valuation are inter-related, and “more than one approach to value is usually appropriate and necessary to arrive at a value indication.” Appr. Textbook, supra, at 58 (Supp. App., p. 41). “Appraisers should apply all of the approaches that are applicable and for which there is data. The alternative value indications derived can either support or refute one another.” Id. at 62 (Supp. App., p. 44).

The approach used by the county is actually a static and arbitrary formula, masquerading as a “trended cost” approach to valuation. It is also the only approach that Traill County has ever used. In contrast, Coates utilized appropriate variations of all three of the traditional approaches to valuation. He then reconciled the results to obtain a final opinion as to value.

Coates concluded that in this case the income approach was the least reliable, so those results were given little weight. Appr. Rpt., p. 35. Due to the quality and quantity

of the sales and cost data that he was able to generate through his market analysis, Coates concluded that the sales and cost approaches were both reliable.¹⁰ Moreover, they yielded very similar results. The value established utilizing the sales comparison approach was \$6,000,000. Utilizing the cost approach, Coates calculated a value of \$5,300,000. Id. These relatively close results add further credibility to the overall result. Tr., pp. 292-93. They also explain the reconciled final valuation of \$5,700,000. Appr. Rpt., p.36.

In summary, this unique property is not assessed in accordance with good or credible appraisal procedures. Instead, for tax purposes it is arbitrarily assigned a value based on a fixed formula that was last adjusted in 1987. Over time, the result has become increasingly inequitable, and out of step with market realities. The current disparity is inordinate. When a unit value comparison is made, the assessed value is approximately six to fifteen times higher than the actual prices paid for comparable factories during the relevant time period.

As the following section will address, these inequities are compounded by the fact that much of the property the county has been taxing should never have been placed on the tax roles. As a matter of law, eight very large components should be recognized, in whole or in part, as exempt processing equipment.

Finally, the manner in which this matter was heard and decided by the Board raises fundamental due process concerns. These concerns, and their implications, are addressed in the final section of this brief.

¹⁰ On page 20, the appellant's brief indicates the district court referenced a statement by Coates that the sales approach is not appropriate in this case. This is a gross mischaracterization of both the record and the lower court's opinion. Coates certainly made no such admission, and the district court's opinion does not suggest otherwise.

II. As a matter of law, three significant components of the Hillsboro factory should be recognized as non-taxable processing equipment.

a. Standard of review and controlling law.

The items in dispute from a classification standpoint are: two beet freezers; three extract tanks; and three conditioning bins. The district court agreed the conditioning bins are processing equipment, but concluded the balance of the disputed items were taxable. App., pp. 33-37. As this court must now make the final determination, it is necessary to review the relevant and undisputed evidence in light of the controlling legal principles.

It should first be explained that Coates did not include any of the disputed items in his appraisal. He was directed to take this approach as a result of the legal analysis conducted on behalf of ACSC. Tr., p. 271. Therefore, to this extent the issues of valuation and classification are intertwined.

The North Dakota statutes and case law relevant to the classification issues are extensively discussed in the county's brief. Only the two most significant points will be repeated here.

First, classification determinations require the correct interpretation and application of legal principles. As a result, there is no dispute regarding the standard of review. All of the classification issues are fully reviewable by this court. Ladish Malting Co. v. Stutsman County, 416 N.W.2d 31, 33-34 (N.D. 1987) ("Ladish II").

Second, the legal analysis involves a three-pronged test. The core holding in Ladish Malting Co. v. Stutsman County, 351 N.W.2d 712 (N.D. 1984) ("Ladish I") is that the statutory definition of real property is intended to exclude those items:

- (1) which pertain to the use of structures and buildings (such as machinery or equipment used for trade or

manufacture), and (2) which are not constructed as an integral part of and are not essential for the support of such structures or buildings, and (3) which are removable without materially limiting or restricting the use of such structures or buildings.

Id. at 721.

There is a third significant point which the county overlooks. The relevant statutory language was intended to remove from the tax rolls those items “which fall into that questionable area between real and personal property, such as industrial machinery and equipment.” Id. at 720. This requires that the statutory definition be “given a liberal and not a harsh or strained construction to obtain a reasonable result effectuating the legislative intent in providing a tax exemption.” Id. at 718. Accordingly, “doubt must be resolved in favor of the taxpayer.” Id.

There appears to be little dispute regarding the ability of the disputed items to meet the second and third prongs of the Ladish I test. All are free standing, so they obviously were not constructed as an integral part of, or essential for the support of, any buildings. Furthermore, at least the conditioning bins and extract tanks are removable from both a practical and economic standpoint. These devices were fabricated off-site, and delivered in pieces or sections. The exterior shells consist of panels, which were welded together at site. They can be disassembled through a reverse process, and removed from the site by either truck or rail. Tr., at 38. It is estimated that these items contain approximately 5,400 tons of reclaimable steel. In today’s economy, scrap steel has a low-end value of approximately \$200 per ton. Id. Therefore, at minimum, these

components would have more than a million dollars in salvage value should they ever be removed.¹¹

The first prong of the Ladish I test is the major bone of contention. It boils down to whether the items “are used directly in and solely for effectuating that particular purpose to which the taxpayer has employed its structures and buildings.” Ladish I, 351 N.W.2d at 722. In the case of a malting plant, any items “which are used directly in and solely for effectuating the transformation of barley into malt” meet this test. Id.

Therefore, in this case any items which are used directly in and solely for effectuating the transformation of beets into sugar likewise meet the first prong of the test. Simply ignoring all of the evidence to the contrary, the Board argues the disputed items are storage structures and play no role in the transformation of beets into sugar. Before the relevant facts are addressed, further analysis of the controlling law is helpful.

The first prong of the Ladish I test is largely based on Pennsylvania law. The interim committee that drafted the relevant statute and this court both placed particular emphasis on the following language from In re Borough of Aliquippa, 175 A.2d 856 (Pa. 1961):

[U]nder the statute involved, improvements, whether fast or loose, which are used *directly* in manufacturing the products that the establishment is intended to produce and are necessary and integral parts of the manufacturing process and are used *solely* for effectuating that purpose, are excluded from real estate assessment and taxation. On the other hand, improvements which benefit the land generally and which may serve various users of the land, are not in this category. Neither are structures, which are not necessary and integral parts of the manufacturing process

¹¹ By way of confirmation and illustration, in 2004 ACSC sold an incomplete and inoperable sugar beet refinery in Texas to a salvage company for \$1.5 million. Tr., pp. 69-70.

and which are separate and apart therefrom within the exclusion. A structure used for storage, for example, is part of the realty and subject to real estate taxation.

Id. at 861-62 (emphasis in original).

Subsequent Pennsylvania decisions provide further insight. Unlike this state, Pennsylvania has an abundance of industrial facilities. Therefore, it has had much need to consider issues of this nature. In U.S. Steel Corp. v. Bd. of Assessment, 223 A.2d 92 (Pa. 1966) the Pennsylvania Supreme Court faced the same argument Trill County now makes. It concluded that processing equipment does not become assessable simply because it simultaneously serves as a temporary storage area. As long as the equipment is a “necessary and integral” part of the overall process, any storage function should be deemed incidental and inconsequential. Id. at 96.

This only makes sense. Most processing equipment must simultaneously store or contain the material being processed. If the storage function was the only criteria, much equipment that falls into “that questionable area between real and personal property” would become taxable, thereby defeating the Legislature’s intent in creating the personal property exemption. Ladish I, 351 NW.2d at 720. It is submitted that the appropriate test can be found in the above quoted language from Aliquippa. Only storage structures that are “not necessary and integral parts of the manufacturing process”; that are “separate and apart” from the processing equipment; and “which benefit the land generally and which may serve various users of the land” can properly be regarded as taxable. In re Borough of Aliquippa, 175 A.2d at 861-62. See also, Alleghany Energy Supply Co., LLC v. Green County, 837 A.2d 665, 668 (Pa. 2004).

By way of example, Pennsylvania courts have recognized that ore yards, blast furnace stock bins, and slag pits are all essential to the process of manufacturing steel, and do not become taxable simply because their functions include the storage of materials. U.S. Steel Corp., 223 A.2d at 95-97. Oil refining tanks are likewise classified as machinery and equipment. Gulf Oil Corp. v. City of Philadelphia, 53 A.2d 250, 255-58 (Pa. 1947). As a final example, dams, dikes and canals are machinery and equipment when they are necessary and integral parts of the process of manufacturing electricity, are used solely for this purpose, and are of no benefit to the land generally. Commonwealth v. Philadelphia Electric Co., 372 A.2d 815, 820-21 (Pa. 1977).

b. The extract tanks.

Applying these principles to the facts of this case, the extract tanks are certainly necessary and integral parts of the manufacturing process. The extract they contain is an intermediate stage in the transformation of beets into sugar. Tr., p. 33. The tanks are essential to the overall process because, until the primary slicing campaign has ended, the factory lacks sufficient capacity to refine all of the extract as it is made. They are essentially a wide point in the pipeline that delivers extract from the molasses desugarization addition (MDS) to the sugar end of the factory. During the primary slicing campaign, extract accumulates in these tanks as it is fed in faster than it is drawn out. Id. at 33-34.

The extract tanks are directly connected to other equipment, have no alternative use, and do not benefit the land generally. Id. at 37-38. Furthermore, they do not simply contain the extract. They prevent that extract from spoiling by using a combination of sophisticated heat exchangers and air handling equipment to keep it at a controlled

temperature and pH. Id. at 33-34. The fact physical and chemical processes occur in these tanks is a further indication that they are properly classified as processing equipment. Gulf Oil Corp., 53 A.2d at 255-58.

The Tax Commissioner's classification guidelines also support the conclusion the extract tanks are not taxable. Those guidelines indicate, in mandatory terms, that "vats" installed as part of an "industrial plant" are classified as personal property. Ladish I, 351 N.W.2d at 721. In turn, a vat is commonly defined as a large vessel used to store liquid, usually in an intermediate stage or state. Merriam-Webster Online Dictionary at <http://www.m-w.com/dictionary/vat>.

c. Conditioning bins.

The same analysis applies to the conditioning bins. They too are critical to the overall process of making sugar. The only difference is that their role is played at the end of that process, rather than the middle. The refined sugar that enters these bins is still relatively warm and moist. Without further processing or curing, the crystals would stick together. Tr., p. 27.

The conditioning bins are patented devices, commonly referred to as "Weibul bins" after their inventor, Nils Weibul. They were fabricated and installed by contractors working under licenses granted by Weibul. Id. at 31. Uncured sugar emerging from the crystallization process is moved by conveyors to the top of these bins. Internal leveling equipment then evenly distributes this sugar over the top of the pile so it can be cured. The curing process requires a minimum of 72 hours. It is accomplished by mechanically maintaining the air above the uncured sugar at appropriate levels of temperature and low humidity. Id. at 32-34. Only after it is cured is the finished sugar drawn from the bottom

of these bins, and either loaded on rail cars for bulk transport, or packaged into the four pound bags seen on grocery shelves. Id. at 27-28. Like the extract tanks, the conditioning bins are directly connected to other processing equipment. They also have no feasible alternative use, and therefore do not benefit the land generally. Id. at 37-38.

In many respects, the conditioning bins are like the oil tanks analyzed in Gulf Oil Corp. v. Delaware County, 849 A.2d 321 (Pa. Commw. Ct. 1985). Those tanks also used a combination of heating and mechanical devices to remove excess water, and to keep the contents from solidifying. This process, which occurs over a three to five day period, is essential to refining the crude oil. Therefore, the tanks are an integral and direct part of the refining process, and not subject to taxation. Id. at 325.

The district court recognized these undisputed facts, and ordered that the bins be reclassified as personal property. App., p. 41. On appeal, however, the Board attempts to refute otherwise undisputed testimony by focusing on a generic illustration included as part of the ACSC's presentation. That schematic refers to the sugar entering the bins as "dried". Id. at 46-47. Without question, much drying does occur as part of the crystallization and extraction process. Tr., pp. 26-27. Unless it is further cured in the conditioning bins, however, the sugar would still lump together to form an unsaleable mass.¹² The explanation is that only final curing removes enough of the residual moisture trapped inside the crystals. Id. at 31.

d. Beet freezers.

Admittedly, the beet freezers do not as readily fit all aspects of the Ladish I test.

¹² At the district court hearing, ACSC displayed a sample of uncured sugar. All crystals in that sample were fused together, forming a single lump.

On one hand, they are necessary and integral parts of the factory. Simply stated, they allow that factory to continue to operate until all of the beets harvested in a typical year can be utilized. Beets are perishable. Freezing is the basic method used to prevent spoilage, but naturally frozen beet piles usually spoil by mid to late April. The capacity of the Hillsboro factory is not sufficient to process a typical harvest that quickly. Instead, the slicing campaign usually extends through May. Id. at 34-35. The beet freezers solve this problem. These specially designed facilities use a combination of insulation, air plenums or ducts, and computer controlled fans to first solidly freeze the beets stored within, and to then keep those beets frozen until they can be processed. The freezing of the beets is a physical transformation or process. Furthermore, as the beets contained in these facilities are the last to be further processed, this keeps the factory running longer. Id. at 35-36.

On the other hand, although the beet freezers are in close proximity, they are not directly connected to other processing equipment. Employees are not permitted to use the freezers in any alternative manner. Id. at 67. However, they do confer some general benefit on the land as they could be used as general storage structures.¹³ Id. at 38. Furthermore, the floors, walls and roofs are probably not removable from a practical or economic standpoint.

In BFC Hardwoods, Inc. v. Bd. of Assessment, 771 A.2d 759 (Pa. 2001), the court was required to rule on the appropriate classification of a wood-drying kiln. It was a very analogous issue. Like the beet freezers, a kiln has all the outward appearances of a

¹³ The feasibility of any alternative use is a different matter. The freezers are enormous. Even the smaller of the two contains over 3 million cubic feet of useable space, much more storage than any alternative user would need.

building. However, it is used solely and directly in the process of manufacturing lumber. The only difference is that the specialized features which transform a building into a kiln are used to heat and dry, rather than to freeze and keep frozen. The court's ultimate holding was that "the entirety of the kilns, including the specialized physical structure, the chamber, and the associated components, are necessary and integral, functional parts of the industrial process." Id. at 767. Accordingly, they were not subject to property taxation. Id.

ACSC could make the same argument in this case. Indeed, for income tax purposes all portions of the beet freezers are classified as equipment.¹⁴ Accordingly, they are depreciated at a faster rate than buildings and real property. ACSC has been using this approach since it was formed. During this period it has frequently been audited by the IRS. Those auditors have never challenged the equipment classifications. Tr., pp. 66-67. Nonetheless, for property tax purposes, ACSC has consistently suggested a compromise approach to the classification of the beet freezers.

Should these structures be put to some alternative storage use, no utility would be provided by the special features which convert them to specialized beet freezers. The unique components which make this conversion account for approximately 45% of the total acquisition costs. Id. at 38-39. ACSC maintains that this undisputed fact should be reflected in the assessment process. Costs associated with the construction of the roofs, walls and floors typical of a building should stay on the tax rolls. However, the total acquisition costs should be reduced by 45% to account for the special equipment and

¹⁴ The same is true for the extract tanks and conditioning bins. Tr., p. 66.

design features that convert these structures into specialized frozen storage containers. Id. at 39-40.

The approach suggested by ACSC is consistent with the tax commissioner's classification guidelines. Those guidelines mandate that "refrigeration equipment (not for air conditioning the building)" be classified as processing equipment if it is part of an industrial facility. Ladish I, 351 N.W.2d at 721. It is also consistent with holdings in other jurisdictions that refrigeration equipment needed to convert a building into a cold storage warehouse should not be taxed. See, e.g., FACs of New Ulm, LLC v. County of Brown, 2001 WL 579058 (Minn. Tax Ct.).

e. Related issues.

There are two remaining issues that should be addressed as part of this discussion.

In its decision, the district court added a temporal requirement to the first prong of the Ladish I test. In effect, it concluded that an item is not equipment if its essential purpose takes a long time to accomplish. App., p. 34. There is no good or logical basis for this distinction. In any manufacturing process, the various steps take varying amounts of time. From a tax classification standpoint, however, why should equipment that does its job quickly be different from equipment that takes time to perform its essential role? Moreover, the temporal test added by the district court is at odds with the requirement that the definition of machinery and equipment be "given a liberal and not a harsh or strained construction". Ladish I, 351 N.W.2d at 718.

The last issue involves the appropriateness of a remand in connection with any favorable rulings for ACSC. In short, the existing record provides a more than adequate basis for the necessary legal determinations. Nothing the county could have done in the

past, or might attempt to do in the future, will change the necessary and integral use of the equipment at issue. Likewise, nothing will move the factory, or suddenly surround it with commercial development. Instead, a remand would only give the Board one more opportunity to simply reject those facts which stand in the way of the results it wants.

III. Although tax abatement may be a legislative function, the fundamental requirements of due process must still be met.

A board of county commissioners is expected to abate any assessment that is “invalid, inequitable, or unjust.” N.D.C.C. § 57-23-04. It is a curious process. It involves the application, not the making of laws. It is also an evidentiary and fact finding process. However, in In re Johnson, 173 N.W.2d 475 (N.D. 1970) the court concluded it involves “a legislative rather than a judicial function.” Id. at 481-82. This language has since become firmly embedded in the case law. See, e.g., Ulvedal v. Grand Forks County, 434 N.W.2d 707, 709 (N.D. 1989); Shaw v. Burleigh County, 286 N.W.2d 792, 795 (N.D. 1979).

Unfortunately, these holdings provide no guidance regarding the interface between due process and such “legislative” functions. They left the district court free to conclude that abatement hearings are essentially a political process, which operate without regard for any of the protections or restraints applicable to judicial or quasi-judicial proceedings. App., pp. 40. The existing decisions also do nothing to address the fundamental distinctions between rulemaking hearings and adjudicative hearings. Rulemaking is political in nature. It involves policy decisions, and results in the establishment of procedures that have general application. Adjudication occurs when the rights or liabilities of a specific party are involved, and the outcome depends

predominantly on the application of the facts established at the hearing to existing laws or rules. See, e.g., Assoc. of Nat'l Advertisers, Inc. v. FTC, 627 F.2d 1151, 1160 (D.C. Cir. 1979).

Clearly abatement hearings are adjudicative rather than rulemaking in nature. Parties to adjudicative hearings should have the right to present evidence, to conduct cross-examination, and to otherwise meet or confront the evidence offered against them. Id. at 1160, 1162. They are also entitled to have their cases decided by a neutral body. Id. at 1168. In this case, however, the Board obviously concluded it was free to conduct the hearing as it saw fit, unconstrained by any regard for due process or materiality.

It first required that ACSC present its evidence before the opposing case was made. Tr., pp. 198-99. Combined with the ruling that witnesses would not be subject to cross-examination, this deprived ACSC of any opportunity to confront or rebut the county's presentation in support of the assessment formula. Tr., pp. 348-49. Indeed, ACSC was even required to present its final summation before it had heard the opposing presentation. Id. at 349-50. Certainly this is not the way such a hearing should be conducted. A much bigger concern, however, is the lack of any semblance of fairness and impartiality.

It is often said that hard cases make bad law. This must be particularly true when political bodies act as the judge and jury, and when harsh political realities stand in the way of relief. ACSC is by far the largest property taxpayer in Traill County. Public schools, in particular, are dependant upon property tax revenue for their operation. Although the tax laws are designed to require that each taxpayer contribute equitably, in proportion to the fair market value of their property, for years ACSC has been

shouldering a very disproportionate share of the burden. To now afford tax relief to ACSC will require either budgetary reductions or an overall increase in property taxes. Tr., pp. 417-20. These are facts, but they should not frustrate the demands of fairness and justice. Nonetheless, it is clear the elected officials who constitute the Board had both their priorities reversed, and their minds shut.

It is often hard to assess an individual's state of mind or decision making process. In this instance, however, there are multiple indications that Traill County and the Board placed the emphasis on political considerations and expediencies, rather than on any notion of justice or fair play. In large part this is due to the fact that the local press has had free access to the Board and other county representatives. Based on the press accounts, it is obvious that the county's position was firmly entrenched long before ACSC was given any opportunity to present its side of the case.

Before the hearing various county officials, but particularly Buzick, repeatedly took advantage of the press to argue the assessment formula was fair, and adequately addressed all of the concerns expressed by ACSC. Supp. App., pp. 55-59. The implications to the Hillsboro school and the county's tax base were likewise stressed. Id. at 60-62. Another recurrent theme in the local press was the need for public opposition to the requested tax relief. Id. at 63-68. This dovetailed with attempts on the part of the Board to lobby the local directors of ACSC. Id. at 32.

When the Board was advised that ACSC would need two days to present its evidence, its reaction was publicly stated annoyance. Commissioner Larson was quoted as saying that he could not understand why two days should be required "to discuss information that could be faxed to us on one sheet." Id. at 69 At a later meeting, the

Board debated whether public comment should be received at the hearing. Commissioner Knudsvig spoke in favor of this approach, arguing that “emotions count, too.” Id. at 71.

When the hearing date finally arrived, the commissioners’ comments, both on and off the record, displayed a remarkable lack of impartiality. Any questions asked by the Board were clearly not intended to objectively explore the evidence or search for the truth. Instead, they were consistently adversarial and confrontational, both in tone and content.

At the hearing much attention was also paid to irrelevant considerations, including some that are inherently prejudicial. For example, during Traill County’s presentation it was emphasized that ACSC has received temporary exemptions in connection with recent expansion projects, and has also received assistance with bond financing. Tr., pp. 413, 416-17. This was stressed as part of the theme that Traill County has always been fair in its treatment of ACSC. However, these are common forms of assistance provided under the rubric of economic development. Such assistance is given in equal measure to any business in the county making real estate improvements. Of course, it also has nothing to do with market value.

The greatest emphasis, however, was on the “very, very detrimental” impact to the tax base generally, and to the Hillsboro school specifically, that would be felt if any form of relief was granted. Id. at 417, lns. 17-21. Traill County’s presentation attempted to quantify the budgetary impact on the school. Dire predictions were made regarding the potential consequences. An attempt was also made to quantify the increase in mill levies that would be required to compensate for the relief sought by ACSC. Id. at 417-419. The county concluded its remarks by recommending that the pending abatement applications

be denied “as the impact to each taxing district and to the county as a whole is just too great to rationally approve” them. Id. at 423, lns. 2-4. Such comments were calculated to strike a cord with the Board. However, they have absolutely no bearing on the merits, and are inherently prejudicial and inflammatory.

Perhaps the most telling indication of the Board’s predisposition was the dispatch with which it handled the ultimate decision making process. At the conclusion of the hearing, Chairman Eblen announced that the commissioners would individually review the extensive written submittals, and then reconvene as a body to publicly deliberate. Id. at 430-31. He later explained to the press that it would take considerable time for the Board members to review the “unbelievabl[y]” comprehensive record. Supp. App., p. 72. The very next week, however, the Board decided it should act as soon as possible, without even waiting for the hearing transcript. Comments from Commissioners Knudsvig and Peterson suggest they were responding to pressure from their constituents. Knudsvig was quoted as saying that voters in his district “are pretty much against giving [ACSC] anything.” Id. at 75. Accordingly, the date for the Board’s “deliberations” was advanced to January 25. Id. at 74.

On that date, any pretense of a rational or reasoned decision making process was completely overlooked in the Board’s rush to judgment. When the chair opened the 2001 abatement application for discussion the response was an immediate motion, unsupported by any explanation or rationale, that the application be denied. Tr. (1/25/05), p. 7. That motion proceeded immediately to a vote and was passed unanimously. The only discussion occurred when one of the commissioners initially voted against the motion, which was recognized by the chair for the mistake it was. Id. at 7-8. The Board then

proceeded to also deny the 2002 and 2003 applications, again without saying one word about the evidence or record. Id. 8-10.¹⁵ After the vote, Commissioner Peterson publicly berated ACSC board members for allowing the abatement applications to proceed. Id. at 11. He then made a statement to the press, describing the request for tax relief as “the ultimate in boorishness and gall I have seen.” Supp. App., p. 76.

This is not the first time county boards have shown more concern for the preservation of their tax base than for their statutory obligation to correct assessments that are “invalid, inequitable, or unjust.” N.D.C.C. § 57-23-04. Indeed, as the National Sun and Ladish cases illustrate, this appears to be a common tendency when dealing with large corporate taxpayers, upon whom the county is very dependant for its fiscal support.¹⁶

Although there is no North Dakota case law on this subject, other jurisdictions have concluded that political bodies conducting legislative functions are bound by at least minimal due process constraints. Most fundamentally, this includes the requirement for “fair and impartial consideration by a local governing board.” Hanig v. City of Winner, 692 N.W.2d 202, 205-06 (S.D. 2005). “A fair trial in a fair tribunal is a basic requirement of due process. ... Not only is a biased decision maker constitutionally

¹⁵ At some point after the vote it occurred to someone that an attempt should be made to justify this action. Accordingly, the Board met again on February 1 to adopt a written decision, presumably drafted by the county attorney. App., pp. 42-43. No record was made of those proceedings.

¹⁶ It is not, however, a universal tendency. ACSC also requested tax abatements in connection with the factory it owns and operates in Pembina county. The Pembina County Board of Commissioners heard an almost identical presentation. Thereafter, it issued a joint press release acknowledging that tax relief was clearly appropriate. Supp. App., pp. 78-79.

unacceptable, but our system of law has always endeavored to prevent even the probability of unfairness.” Id. Even when the hearing is characterized as rulemaking in nature, the interested parties still “have a right to a fair and open proceeding” including “access to an impartial decision maker.” Assoc. of Nat’l Advertisers, 627 F.2d at 1174.

Although the Board’s decision in this case would be flawed regardless of how it was reached, clarification as to the extent to which due process considerations govern will certainly benefit future proceedings. Furthermore, an understanding of the Board’s approach in this case serves to underscore the arbitrary and unreasonable nature of its ultimate decision. It also suggests that any instructions on remand will need to be clear, and the appropriate action following remand will need to be carefully spelled out. Otherwise, the Board is likely to persist in placing political expediency ahead of the paramount demands of justice.

CONCLUSION

It is respectfully submitted that the Board’s decision must be reversed, and the matter be remanded for further proceedings consistent with this court’s instructions. Typically, on remand the county commissioner’s would still be required to make a revised valuation based “on the substantial evidence in this record.” Nat’l Sun Indus., 474 N.W.2d at 508-09. In this case, however, the only substantial evidence in the record is the Coates appraisal report. By choosing to place total reliance on the validity of its assessment formula, Traill County effectively removed any middle ground. Therefore, it is submitted that the remand should direct the Board to reduce the value of the taxable improvements to the amount established by the Coates appraisal. As that appraisal incorporates ACSC’s position regarding the proper classification of the disputed items, no

further adjustments should be required in this regard. However, Coates valued the land based on its market value, when by statute it should have been valued based on productivity. To correct this misapplication of statute, the remand instructions should direct the Board to reclassify all parcels of land as agricultural, and to then value the land based on the same productivity analysis used generally in Traill County.

Of course, Traill County must also be compelled to refund the excess taxes paid in tax years 2001 through 2003. Furthermore, the 2003 payment was made under protest and has been placed in an interest bearing escrow account. ACSC is entitled to any interest earned on the refunded portion of this payment. Ladish II, 416 N.W.2d at 37.

Dated this 29th day of December, 2005.

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CERTIFICATION OF COMPLIANCE

The Appellee American Crystal Sugar Company hereby certifies, by and through its undersigned counsel, that the Brief of Appellee contains 12,985 words (including footnotes) and is therefore within the 13,000 word count expansion granted by the court. This brief is done in WordPerfect 11, Times New Roman 12 format.

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