

Fixtures

What Kind of Property Are They?

By Sharon L. Morris

Sharon L. Morris is special counsel to Lemle & Kelleher, LLP, Baton Rouge, Louisiana.

The law distinguishes between real property and personal property. Most lawyers learn early in their careers that the characteristics of each are vital to their practices. A property's classification affects the property's transfer of title, insurance, estate matters, taxes, family law treatment, and more. But property does not always fit so neatly into the categories of real and personal (or immovable and movable, the corresponding terms used in Louisiana). The law recognizes a third category, commonly referred to as fixtures, that fits somewhere in between. Often it is hard enough to determine what should be considered real or personal property in one jurisdiction, but it becomes even more complicated when a lawyer represents parties with property in multiple locations.

In this down economy, when time is of the essence and every dollar counts, lawyers need to have a general understanding of how these terms are used across the country. The many foreclosures in 2009 have made it even more important to understand how to properly classify property to protect both ownership rights and the rights of lenders. This article will discuss how fixtures are generally defined and, because parties are permitted to agree to the terms of their obligations, proper drafting of such definitions in sales contracts, leases, wills, and loan documents.

Real Property and Personal Property

To understand the definition of fixtures, it is first important to comprehend the basics of classification. Almost every "thing" fits into one of two categories of property: real and personal. Real property includes land and, typically, items that are affixed to land, such as buildings and other improvements. In some jurisdictions the nature of the attachment is specifically described. For example, Cal. Civ. Code § 660 provides:

A thing is deemed to be affixed to land when it is attached to it by roots, as in the case of trees, vines, or shrubs; or imbedded in it, as in the case of walls; or permanently resting upon it, as in the case of buildings; or permanently attached to what is thus permanent, as by means of cement, plaster, nails, bolts, or screws; except that for the purposes of sale, emblements, industrial growing crops and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale, shall be treated as goods and be governed by the provisions of the title of this code regulating the sales of goods.

In California personal property is defined as anything that is not "real." Id. § 663. Personal property includes movable things, that is, items that are not affixed to the land, such as furniture, cash, and vehicles. The problem arises when personal property becomes attached to real property. Then the question becomes whether the personal property has lost its movable nature so as to become a part of the real property. The answer typically depends on the facts of each case.

Fixtures

Fixtures fall somewhere between personal property and real property, but, generally, once a fixture is attached to real estate it is considered real property. Article 9 of the Uniform Commercial Code (Article 9) defines fixtures as goods that have become so related to particular real property that an interest in them arises under real property law. U.C.C. § 9-102(a)(41). *Black's Law Dictionary* 713 (9th ed. 2009) defines a fixture as "personal property that is attached to land or a building and that is regarded as an irremovable part of the real property, such as a fireplace built into a home." The significant part of both definitions is the relation to real property. A fixture starts out as personal property, that is, goods, that typically become so attached to the real estate as to become a part of it while retaining a theoretically separate identity. For example, a brick, although deemed personal property, is essentially a building material that becomes such a part of the real estate that it cannot be separated without causing damage to the real estate. (Bear in mind that the level of damage is not dispositive.) But a chandelier, water heater, or the like, once incorporated into the real estate, can still be considered something separate from the real estate. It is this separate identity that often leads to confusion.

The typical scenario in which the fixture definition becomes important looks like this: Debtor owns a bakery that operates in a two-story building encumbered by a mortgage in favor of Lender A. All of Debtor's baking takes place on the bottom floor in a room with large pieces of equipment bolted to the floor and, in some cases, to the wall. Lender B finances the purchase of a new oven for the bakery and Debtor grants Lender B a security interest in the oven. The oven, while sitting on the showroom floor, is clearly personal property. It can easily be picked up and

hauled away. Debtor installs the oven in the bakery by attaching it to the wall with heavy bolts and to additional bakery equipment with conveyor belts. If Debtor defaults in its payments to Lender B, who holds a security interest in the oven, or defaults in its payments to Lender A, who holds a mortgage on the real estate, then the classification of the oven becomes vitally important in determining who holds the superior interest.

Lender A's mortgage indicates that it covers the "real estate." If the oven is considered a part of the real property, then it is covered under Lender A's mortgage. Note, however, that under Article 9 Lender B can preserve its priority interest by filing its fixture filing before the oven becomes a fixture or within 20 days thereafter. U.C.C. § 9-334(d)(3). Every state, except Louisiana, has adopted this "20-day rule." In Louisiana, to perfect its security interest a lender must file a fixture filing before goods become fixtures; otherwise the lender's interest is not protected. La. Rev. Stat. § 10:9-334(d)(3).

If Lender B has not perfected its fixture filing under section 9-334(d)(3) of Article 9, resolution of the scenario above depends on the law of the jurisdiction in which the property is located. A general review of the law of most states reveals that the majority follow the same rule. For a fixture to be considered a part of the real property, the following elements must exist: "(1) annexation of the article to the land, (2) adaptation of the article to the use of the land, and (3) an intention that the article become a permanent part of the freehold." *Green Tree Servicing, LLC v. Random Antics, LLC*, 869 N.E.2d 464, 469 (Ind. Ct. App. 2007). This three-part test is very fact specific.

Although annexation was historically the most significant part of the test, most states now appear to focus more on intent. In a case with facts similar to the bakery scenario above, the Supreme Court of Virginia stated that the "method of the annexation to the realty receives slight consideration and then only as a circumstance from which the intention of the annexor may be deduced." *Danville Holding Corp. v. Clement*, 16 S.E.2d 345, 349 (Va. 1941). The court held that certain machinery and equipment installed in the bakery after execution of a deed of trust encumbering the real property were a part of the real estate, thus covered under the deed of trust.

In a case out of Texas, the court indicated that the third criterion—the intent criterion—is preeminent, "whereas the first and second criteria constitute evidence of intention." *Trenolone v. Cook Exploration Co.*, 166 S.W.3d 495, 499 (Tex. App. 2005).

Intent is made apparent by objective manifestations. As a general rule, intent is a question of fact to be decided by the jury. However, even testimony of intention that the chattel was not meant to become a fixture will not prevail in the face of undisputed evidence to the contrary. Where reasonable minds cannot differ, the issue is one of law rather than one of fact.

Id. Similarly, in a New York case the court stated: "The intent which is regarded as controlling is not the initial intention at the time the [item] is acquired, nor the secret or subjective intention of the party making the attachment, but rather the intention which the law will deduce from all the circumstances." *Mastrangelo v. Manning*, 793 N.Y.S.2d 94, 95 (N.Y. App. Div. 2005) (quoting *Midland Tr. Co. of Binghamton v. Ahern*, 168 N.Y.S.2d 656, 659 (N.Y. Sup. Ct. 1939)).

Intent

Because the intent of the party annexing the property appears to be the most important test in most jurisdictions for classifying a fixture as either real or personal, it is worth considering whether or not changed intentions would lead to a different result. For instance, if a person purchases real property at a sheriff's sale with the intent to redevelop the property for another use, does that change the nature of things attached to the real property? The Supreme Court of Connecticut considered this issue in *ATC Partnership v. Town of Windham*, 845 A.2d 389 (Conn. 2004). This case involved a replevin claim in which the threshold issue was whether or not certain factory machinery and equipment could properly be classified as personal property because only personal property is covered under Connecticut's replevin statute. In a nutshell, the plaintiff purchased property once used as a textile mill with the intent to redevelop the site for another use. Most of the machinery and equipment remaining in the mill was bolted to the building and had been used to operate the property as a textile mill. The plaintiff sought to recover the property when the building was seized by the town of Windham through a condemnation proceeding. The plaintiff argued that the machinery and equipment were personal property not subject to the condemnation proceeding. The trial court placed particular emphasis on the facts and circumstances present when the property was first annexed and determined that the property was not the type covered under the replevin statute. Id. On appeal the partnership claimed that because the parties intended to redevelop the property in a manner that called for treating the items as personal property, they could no longer be considered to have retained the status of fixtures. Id. The court disagreed. The parties agreed that the items were fixtures at the time the property was used as a textile mill, so the court considered whether or not events after the cessation of the mill operations "had the effect of severing the fixtures from the realty such that the fixtures reverted to the status of personalty." Id. at 401. Although the evidence showed

that the partnership had tried to enter into an economic redevelopment agreement with the town concerning the property, these discussions failed to lead to a final agreement. For that reason, the Supreme Court in Connecticut agreed with the trial court that the owner's mere expectation of a future use for the property was insufficient to effect a constructive severance of the property. Consequently, the court found that the machinery and equipment at issue were fixtures and, therefore, not personal property that could be recovered under the state's replevin statute.

Careful Drafting Is Key

Once an item is deemed to be a fixture, then it is usually considered a part of the real property. That characterization means that the property at issue, depending on the jurisdiction, can be taxed, transferred, or leased as a part of the real estate. A careful drafter that understands the subtle distinctions that may lead to property being classified as a fixture, and thus part of the real estate, can then address that fact in the drafting process. For instance, in the bakery scenario, if the new oven is considered a part of the real estate, then any transfer of the building housing the bakery would automatically include the oven. If Debtor did not want that to be the case, Debtor's lawyer could draft the sale documents to specifically exclude the transfer of the oven and any other items of personal property. Moreover, if Debtor plans to purchase additional items that should be encumbered by Lender A's mortgage, this fact should be taken into account before executing the mortgage. Assuming Lender A agrees, the loan documents could be prepared with a description of Lender A's collateral that excludes goods to be purchased and installed on the property after the date of the mortgage. Therefore, these goods would retain their identity as personal property. It is for this reason that a property owner's lawyer should not use the term "fixture" in any agreement without further specifying the items that are or are not included in that term.

Transfers of Real Property

Although classification is important to lenders desiring to protect their security interests, it may be even more important to the average property owner or purchaser. Imagine first-time homebuyers that find the house of their dreams, replete with custom drapes, surround sound speakers, high-end appliances, and a six-foot security fence wrapped around the whole lot. They are so excited that they sign a purchase agreement, provided by their real estate agent, the first time they see it. Then imagine their shock when, after the closing, they drive up to their new home and the fence is gone, the drapes are removed, and the speakers have been ripped from the walls. This is not an unrealistic scenario. Few purchase agreements mention items like these, but so often they are exactly the kind of home improvements that become the subject of post-closing arguments.

Classification of the fence is not the simple proposition it may seem to be. The facts are always key. In an Alabama case, *Groves v. Segars*, 261 So. 2d 389 (Ala. 1972), the court was asked to determine ownership of a chain link fence removed from the property just before the sale. The fence stood on property that plaintiffs possessed under a lease/sale contract. They agreed to transfer the contract and the property to the defendant but would continue to live on the property until their new residence was constructed. While occupying the property, but before the sale, the plaintiffs dismantled and removed the fence. At the outset the court indicated that ordinarily "a fence composes part of the land on which it is located and passes to the vendee of the land." *Id.* at 391. Based on the facts of the case, however, the court determined that the plaintiffs had orally indicated their intent to reserve the fence to themselves. Therefore, the trial court correctly found that a fixture could be reserved "or the right to remove it may be obtained, by an oral agreement between the owner of the equitable title and his vendee." *Id.* at 393. The case emphasizes the point that the status of property should never be presumed and that parties can, in most cases, change that status by agreement. The general rule is that fixtures follow the real property, but it is always better to be specific.

A more recent case from New York highlights how the scenario mentioned above typically plays out between seller and purchaser and the importance of that relationship to the outcome. In *Fisher v. Baronti*, 761 N.Y.S.2d 820 (N.Y. City Ct. 2003), the plaintiffs purchased a single-family residence from the defendants. On moving in, plaintiffs discovered that defendants had taken the hose and attachments for the central vacuum system. The question was whether "the hose and attachment were a fixture, in which case they became a part of the property and should have been left, or whether they were chattel, in which case defendants may have been free to remove it from the premises." *Id.* The court first discussed the nature of the attachments. The parties did not contest the fact that the hose and attachments were removed without damage to the property, but clearly the hose and attachments were essential to support the system to which they were attached, a strong indication to the court that they were fixtures.

More interesting was the court's discussion of the relationship between the parties. According to the court,

[w]hile an intention to make a permanent accession to the property may be presumed where the annexer is the owner, no such presumption necessarily arises where the annexer is a lessee. So, a given object may be a fixture as between vendor and vendee, but a chattel as between lessor and lessee In the instant matter, the parties

were contract vendee and vendor which would suggest that the items in question are fixtures rather than personalty.

Id. at 821.

Finally, the court looked directly to the agreement between the parties, which specifically stated that the sale would include “all fixtures and articles of personal property now attached or appurtenant to the Premises, unless specifically excluded below.” Id. There was no exclusion for the hose and attachments. Therefore, the court held that the central vacuum hose and attachments were a fixture that should have been left with the property.

Fisher reaffirms many of the points already made in this article: (1) the intent of the annexer is essential when determining whether or not an item annexed to realty should be considered a part of the realty; (2) the role of the parties involved can affect ownership of items considered fixtures; and (3) any agreement between the parties controls.

As noted, the agreement in *Fisher* was important to the court’s decision. When dealing with improved real estate, it is best to use more than just the property’s legal description to describe the property to be transferred. For example, it would be better to add “this sale includes all fixtures, equipment, furniture, furnishings, supplies, and personal property owned by seller and used in connection with the operation of the property” and then reference any specific exclusions.

The fixture issues that can arise in sales become even more complicated when dealing with commercial property. If the property to be sold is leased to a third party, then the third party needs to protect its interest in items that might be considered fixtures. For example, if a tenant is operating a restaurant in which the tenant purchased and installed the equipment, then the tenant should make sure that the purchase agreement and transfer documents do not include the tenant’s equipment. Alternatively, if the equipment was owned and installed by the landlord, then the purchaser should make sure the equipment is specifically included in the purchase agreement’s description of the property to be purchased. If the equipment has significant value, then a bill of sale in addition to the deed would be the best way to transfer the equipment to reduce potential claims from tenants, or any other parties, later. Again, it is important to recognize the issues and document the transaction so that any items of questionable classification are considered.

Conclusion

No bright-line rule defines fixtures. Most states generally consider fixtures to be things capable of existing separate and apart from the realty but that are annexed to the realty for a specific use related to the realty and that are intended to be a part of the realty. The facts of each case make a big difference. For that reason, a good understanding of the basic rules is imperative when drafting documents dealing with both real and personal property. Recognizing the facts that will make the difference in each situation aids the practitioner immensely when trying to protect the client’s interests.