

Memorandum 73-22

Subject: Study 36.175 - Condemnation (Compensation for Loss of Goodwill)

The staff has compiled all the readily-available statutes providing for business losses generally and goodwill specifically in this memorandum. There are relatively few of them, and the Commission should examine them carefully to determine whether any offers a suitable approach. A few significant points about these statutes are indicated below followed by a brief discussion.

Vermont. Exhibit I (pink). Of the statutes collected, by far the broadest and most widely used at present is the Vermont statute enacted in 1957 and unchanged since. This provision was enacted by the Legislature to cure a perceived defect in the Vermont case law and, since its enactment, it has been fully effectuated by the courts.

The courts have recognized in the cases coming up under this broad provision that the statute is vague as to the precise nature of the losses covered--"No exact formula for measuring the business loss is available and the legislature prescribed none." Fiske v. State Highway Board, 124 Vt. 87, ___, 197 A.2d 790, 793 (1963). As a result, the cases have attempted to put a reasonable gloss on the statute by way of appropriate limitations. This case development is basically codified in the Vermont Legislative Counsel's 1969 draft proposal of a new eminent domain law (not enacted):

[Just compensation shall consist of any] loss of business profits on the part of the condemnee resulting from the taking. In determining loss of business profits under this subdivision, the following limitations and rules shall apply:

(A) The computation of business loss shall be based on loss of net business profits directly resulting from the taking;

(B) A reasonable allowance for any services contributed by the condemnee to the business shall be deducted in arriving at net profits;

(C) A reasonable allowance for the use of any real estate of the condemnee used in the business shall be deducted in arriving at net profits;

(D) The recovery of net business profits shall be limited to the period of time reasonably needed to reestablish the business at a new location.

Subdivision (D) does not codify case law but attempts to deal with a problem that has arisen frequently under the case law--for how long a period should the business loss be allowed. The cases have simply held that the period should be reasonable and should not extend to the life of the property owner (Penna v. State Highway Board, 122 Vt. 290, 170 A.2d 630 (1961)) or for an undue length:

In these circumstances, recent profits have a relevant bearing in determining business loss. It is a factor important to potential buyers, as well as the seller, in arriving at a proper valuation. The evidence in this regard must be received with caution lest resort to capitalization methods project current experience to such an extended period of time that it overreaches any prices that might be set in the present market. [Fiske v. State Highway Board, supra.]

One other problem that has troubled the Vermont courts is the requirement that the jury assess the business losses separately from property damage or value. The courts have pointed out that the two are often closely intertwined, and there are great possibilities of error.

California. Exhibit II (yellow). The California bills were not enacted and were quite limited in application.

New York. Exhibit III (green). The New York water supply provisions date from the turn of the century. Typical of these is the New York City provision in Exhibit III. It requires that the business be "established" before it may receive compensation.

Florida. Exhibit IV (gold). This statute, enacted in 1965, is limited to acquisitions by certain public entities for rights of way and applies only where the business will be relocated on the remainder. It requires that the business be established for at least five years.

Pennsylvania. Exhibit V (blue). The Pennsylvania statute, enacted in 1964, provided an arbitrary measure of compensation and an arbitrary limit on compensation. It did not purport to provide compensation for general losses to going concern value or to goodwill. This section was repealed in 1971.

Ontario, Canada. Exhibit VI (buff). In Canada, provisions for loss of business and goodwill are common. The Ontario statute is provided as a recent example. Notice the delay in compensation designed to make damages less speculative.

Great Britain. Exhibit VII (white). Great Britain, like Canada, provides for business losses. The Housing Act is set out in part as illustrative. Note that payments under it are voluntary rather than mandatory.

Act to Provide Compensation for Loss of Goodwill. Exhibit VIII (pink). This draft act was developed by the Harvard Student Legislative Research Bureau and published in the Harvard Journal on Legislation in 1966. It places a ceiling on the goodwill losses recoverable.

Discussion. It is obvious that most of the statutes provide no limitations or specifications but leave it to the courts to implement. Experience, at least under the Vermont, New York, and Florida provisions, indicates that the implementation has been adequate, and the courts have managed to overcome the difficulties of acting without express statutory directives. The implementation of the Vermont statute is discussed above; a discussion of the

application of the New York statute can be found in Aloï & Goldberg, A Reexamination of Value, Goodwill, and Business Losses in Eminent Domain, 53 Cornell L. Rev. 604 (1968); for the implementation of the Florida statute, see Comment, Eminent Domain: Compensation for Business Losses in Florida, 23 U. Fla. L. Rev. 163 (1969).

Perhaps a general statute is all that is necessary. Aloï and Goldberg comment:

The language of the statute is liberal both in its assumption of liability and in its delineation of the range of compensable damage. Precise refinement is left to case-by-case construction by the courts. Generally, this approach has worked, and perhaps this alone suffices to recommend it. All manners of proof on the direct or indirect decrease in the value of a business are admissible, subject only to the limitation that speculative losses will not be considered. [53 Cornell L. Rev. at 638.]

They also suggest that, if it is politically necessary, limitations on the amount recoverable can be imposed either through (1) mitigation of expenses in case of relocation and renewed profitable operation or (2) a maximum ceiling on the amount of recoverable damages. And, to avoid litigation, some obvious limitations could be codified, such as a requirement that the business be established five years. The Eminent Domain Revision Commission of New Jersey, while it did not recommend a business loss provision ("the views of the respective Commissioners are highly divergent on this phase of the Report and therefore no specific recommendation is made"), did suggest some possible limitations in its 1965 Report:

If [interference with and destruction of a business] is to be compensable, the compensation should be limited to a loss of profits for one year (based upon mathematical average of profits for the three years preceding). Federal tax returns shall be evidential in support and defense of the claim, and failure to exhibit the return shall bar the claim.

Aloi and Goldberg propose as an alternative that the model statute (Exhibit VIII, pink) be taken and expanded to apply to all business losses and not solely to goodwill:

It seems necessary only to make a simple change in terminology to integrate the provisions of this model statute into a general statute compensating for business losses. The model act defines good will as "the expectation of continued patronage by a regular clientele." Business losses could be substituted for good will, with the introductory definition then reading: "Business losses are a decrease in net earnings caused by destruction of or damage to the expectancy of continued patronage by a regular clientele." The elimination of good will from the express terminology of the act would be of no real consequence, because awards based on capitalization of expected future earnings necessarily would include that item. [53 Cornell L. Rev. at 642 (footnotes omitted).]

The staff would add that any provision enacted should make clear that business losses are compensated under the provision only to the extent they are not compensated under the relocation assistance statute. That statute provides expenses of moving a business or, in lieu of moving expenses, a fixed payment not to exceed \$10,000. See Cal. Govt. Code § 7262(c) (Exhibit IX).

At this point, having indicated what there is and some possible directions, the staff believes it will not be fruitful to further pursue any alternative until some direction is indicated by the Commission.

Respectfully submitted,

Nathaniel Sterling
Staff Counsel

Memorandum 73-22

EXHIBIT I

VERMONT STAT. ANN. TIT. 19 § 221(2)

Damages resulting from the taking or use of property under the provisions of this chapter shall be the value for the most reasonable use of the property or right therein, and of the business thereon, and the direct and proximate lessening in the value of the remaining property or right therein and the business thereon.

EXHIBIT II

CALIFORNIA LEGISLATURE—1965 REGULAR (GENERAL) SESSION
ASSEMBLY BILL **No. 3423**

Introduced by Assemblyman Burton

April 26, 1965

REFERRED TO COMMITTEE ON EDUCATION

An act to add Sections 23153 and 23154 to the Education Code, relating to eminent domain, and making an appropriation therefor.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 23153 is added to the Education Code,
2 to read:
3 23153. Whenever the Regents of the University of California
4 acquire property adjacent to the University of California
5 Hospital, either by purchase or eminent domain, the value of
6 any business or revenue-producing facility conducted on such
7 property shall be included in ascertaining the value of the
8 property.
9 Property taken pursuant to this section shall only be for the
10 building, construction or expansion programs of the University
11 of California Hospital.
12 SEC. 2. Section 23154 is added to said code, to read:
13 23154. There is in the State Treasury a fund to be known
14 as the University Hospital Expansion Fund, which fund is
15 continuously appropriated for the purposes of Section 23153.
16 On the effective date of this section the State Treasurer shall
17 transfer the sum of _____ dollars (\$_____) to the University
18 Hospital Expansion Fund from the General Fund.

LEGISLATIVE COUNSEL'S DIGEST

AB 3423, as introduced, Burton (Ed.). Eminent domain.

Adds Secs. 23153, 23154, Ed.C.

Provides that when the regents purchase or take adjacent property for the expansion of the University Hospital, the compensation awarded shall include the value of any business or other revenue-producing facility conducted on the property taken.

Sets up the University Hospital Expansion Fund to help finance such a hospital expansion program, and directs transfer of unspecified amount from the General Fund in the State Treasury to the hospital expansion fund.

AB 3423

-- 2 --

- 1 The amount so made available to the University Hospital at
- 2 any one time shall be equal to the amount of compensation
- 3 paid to a property owner for a business or other revenue-
- 4 producing facility conducted on the property taken or pur-
- 5 chased.

0

CALIFORNIA LEGISLATURE—1965 REGULAR (GENERAL) SESSION
ASSEMBLY BILL No. 3454

Introduced by Assemblyman Allen

April 26, 1965

REFERRED TO COMMITTEE ON EDUCATION

An act to add Section 23153 to the Education Code, relating to the expenditure of funds appropriated for the Regents of the University of California.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 23153 is added to the Education Code,
- 2 to read:
- 3 23153. Existing budgeted funds, and any additional funds
- 4 appropriated to the University of California for the purchase
- 5 of land and the building thereon to expand the physical plant
- 6 and facilities of the University of California Hospital in San
- 7 Francisco, shall be expended only in accordance with a master
- 8 plan adopted, which plan must be adhered to, and in connection
- 9 therewith any business losses experienced by property
- 10 owners whose land is taken by eminent domain proceedings or
- 11 negotiated purchase must be included in the price paid for
- 12 such land and buildings.

LEGISLATIVE COUNSEL'S DIGEST

AB 3454, as introduced, Allen (Ed.). U.C. Hospital expansion.

Adds Sec. 23153, Ed.C.

Specifies that any existing budgeted funds or funds appropriated for the expansion of the physical plant of the U.C. Hospital in San Francisco must be expended in accordance with a master plan, which must be adhered to.

Specifies that any business losses suffered by property owners whose land is taken by eminent domain or by negotiated purchase must be included in the price paid for such property.

CALIFORNIA LEGISLATURE—1967 REGULAR SESSION

ASSEMBLY BILL

No. 1078

Introduced by Assemblyman Quimby

March 15, 1967

REFERRED TO COMMITTEE ON MUNICIPAL AND COUNTY GOVERNMENT

An act to amend Section 1248 of the Code of Civil Procedure, and to add Section 33397 to the Health and Safety Code, relating to community redevelopment.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 1248 of the Code of Civil Procedure is
- 2 amended to read:
- 3 1248. The court, jury, or referee must hear such legal testi-
- 4 mony as may be offered by any of the parties to the proceeding,
- 5 and thereupon must ascertain and assess:
- 6 1. The value of the property sought to be condemned, and
- 7 all improvements thereon pertaining to the realty, and of each
- 8 and every separate estate or interest therein; if it consists of
- 9 different parcels, the value of each parcel and each estate or
- 10 interest therein shall be separately assessed;
- 11 2. If the property sought to be condemned constitutes only
- 12 a part of a larger parcel, the damages which will accrue to the
- 13 portion not sought to be condemned, by reason of its severance

LEGISLATIVE COUNSEL'S DIGEST

AB 1078, as introduced, Quimby (Mun. & C.G.). Community redevelopment.

Amends Sec. 1248, C.C.P., adds Sec. 33397, H. & S.C.

Requires community redevelopment agency acquiring real property and displacing tenant occupying such property to compensate him for injury to good will of his business.

If such property is condemned, requires court, jury, or referee to hear testimony relevant to amount of injury to good will of such business and then ascertain and assess the amount of compensation due displaced tenant.

Vote—Majority; Appropriation—No; State Expense—No.

1 from the portion sought to be condemned, and the construction
2 of the improvement in the manner proposed by the plaintiff;

3 3. Separately, how much the portion not sought to be con-
4 demned, and each estate or interest therein, will be benefited,
5 if at all, by the construction of the improvement proposed by
6 the plaintiffs. If the benefit shall be equal to the damages
7 assessed under subdivision 2, the owner of the parcel shall be
8 allowed no compensation except the value of the portion taken.
9 If the benefit shall be less than the damages so assessed, the
10 former shall be deducted from the latter, and the remainder
11 shall be the only damages allowed in addition to the value.
12 If the benefit shall be greater than the damages so assessed,
13 the owner of the parcel shall be allowed no compensation ex-
14 cept the value of the portion taken, but the benefit shall in no
15 event be deducted from the value of the portion taken;

16 4. *The amount of compensable injury to business as pro-*
17 *vided for by Section 33397 of the Health and Safety Code.*

18 4
19 5. If the property sought to be condemned be water or the
20 use of water, belonging to riparian owners, or appurtenant to
21 any lands, how much the lands of the riparian owner, or the
22 lands to which the property sought to be condemned is ap-
23 purtenant, will be benefited, if at all, by a diversion of water
24 from its natural course, by the construction and maintenance,
25 by the person or corporation in whose favor the right of emi-
26 nent domain is exercised, of works for the distribution and con-
27 venient delivery of water upon said lands; and such benefit, if
28 any, shall be deducted from any damages awarded the owner
29 of such property;

30 5
31 6. If the property sought to be condemned be for a rail-
32 road, the cost of good and sufficient fences, along the line of
33 such railroad, and the cost of cattle guards, where fences may
34 cross the line of such railroad; and such court, jury or referee
35 shall also determine the necessity for and designate the number,
36 place and manner of making such farm or private crossings
37 as are reasonably necessary or proper to connect the parcels of
38 land severed by the easement condemned, or for ingress to or
39 egress from the lands remaining after the taking of the part
40 thereof sought to be condemned, and shall ascertain and assess
41 the cost of the construction and maintenance of such crossings;

42 6
43 7. If the removal, alteration or relocation of structures or
44 improvements is sought, the cost of such removal, alteration or
45 relocation and the damages, if any, which will accrue by reason
46 thereof;

47 7
48 8. As far as practicable, compensation must be assessed
49 for each source of damages separately.

50 8
51 9. When the property sought to be taken is encumbered
52 by a mortgage or other lien, and the indebtedness secured

1 thereby is not due at the time of the entry of the judgment, the
2 amount of such indebtedness may be, at the option of the plain-
3 tiff, deducted from the judgment, and the lien of the mortgage
4 or other lien shall be continued until such indebtedness is paid;
5 except that the amount for which, as between the plaintiff and
6 the defendant, the plaintiff is liable under Section 1252.1 may
7 not be deducted from the judgment.

8 SEC. 2. Section 33397 is added to the Health and Safety
9 Code, to read:

10 33397. Every tenant of real property shall be compensated
11 for any injury to the goodwill of his business caused by dis-
12 placement from such property due to its acquisition pursuant
13 to the provisions of this article.

Memorandum 73-22

EXHIBIT III

NEW YORK CITY ADMINISTRATIVE CODE § K51-44.0(a)

The owner . . . of any established business . . . directly or indirectly decreased in value by reason of the acquiring of land by the city for an additional water supply or by reason of the execution of any plans for such additional water supply by the city . . . shall have a right to damages for such decrease in value.

Memorandum 73-22

EXHIBIT IV

FLORIDA STAT. § 73.071(3)(b)

[Compensation shall be awarded for] any damage to the remainder caused by the taking, including [in a case where] the effect of the taking of the property involved may damage or destroy an established business of more than five years' standing, owned by the party whose lands are being so taken, located upon adjoining lands owned or held by such party, the probable damages to such business which the denial of the use of the property so taken may reasonably cause; any person claiming the right to recover such special damages shall set forth in his written defenses the nature and extent of such damages.

EXHIBIT V

Pennsylvania Stat. Ann. tit. 26, § 1-609

Section 609. Business Dislocation Damages.—The condemnee shall be entitled to damages, as provided in this section, for dislocation of a business located on the condemned property, but only where it is shown that the business cannot be relocated without substantial loss of patronage. Compensation for such dislocation shall be the actual monthly rental paid for the business premises, or if there is no lease, the fair rental value of the business premises, multiplied by the number of months remaining in the lease, not including unexercised options, not to exceed twenty-four months or multiplied by twenty-four if there is no lease. The amount of such compensation paid shall not exceed five thousand dollars (\$5000) and shall not be less than two hundred fifty dollars (\$250). A tenant shall be entitled to recover for such business dislocation even though not entitled to any of the proceeds of the condemnation.

Comment:

This section changes existing law which makes no provision for damages for business dislocation losses. Under it the initial burden is on the claimant to show that the business is of such a local character that it cannot be relocated without substantial loss of patronage. Generally this would be true only of the small neighborhood business. If this burden is sustained then the section provides a mechanical formula for fixing the amount of compensation for this loss. Formulae for business valuation based on earnings or accounting procedures were discarded as too complicated for use in eminent domain cases.

The rent or rental value on which the calculation of compensation is based is the rental of the portion of the property devoted to the business use only, which may be and normally is less than the entire property. This section is intended to compensate in a limited way the small neighborhood merchant substantially put out of business by the condemnation of his business property.

EXHIBIT VI

ONTARIO EXPROPRIATIONS ACT OF 1968-1969

19. (1) Where a business is located on the land expropriated, the expropriating authority shall pay compensation for business loss resulting from the relocation of the business made necessary by the expropriation and, unless the owner and the expropriating authority otherwise agree, the business losses shall not be determined until the business has moved and been in operation for six months or until a three-year period has elapsed, whichever occurs first.

(2) The Board may, in determining compensation on the application of the expropriating authority, or an owner, include an amount not exceeding the value of the good will of a business where the land is valued on the basis of its existing use and, in the opinion of the Board, it is not feasible for the owner to relocate.

EXHIBIT VII

THE BRITISH HOUSING ACT OF 1957

63. (1) A local authority may pay to any person displaced from a house or other building such reasonable allowance as they think fit towards his expenses in removing, and to any person carrying on any trade or business in any such house or other building they may pay also such reasonable allowance as they think fit towards the loss which, in their opinion, he will sustain by reason of the disturbance of his trade or business consequent on his having to quit the house or building, and in estimating that loss they shall have regard to the period for which the premises occupied by him might reasonably have been expected to be available for the purpose of his trade or business and the availability of other premises suitable for that purpose.

(2) Where, as a result of action taken by a local authority under the provisions of this Part of this Act relating to clearance areas, the population of the locality is materially decreased, they may pay to any person carrying on a retail shop in the locality such reasonable allowance as they think fit towards any loss involving personal hardship which in their opinion he will thereby sustain, but in estimating any such loss they shall have regard to the probable future development of the locality.

EXHIBIT VIII

An Act to Provide Compensation for Loss of Goodwill Resulting from Eminent Domain Proceedings

This Act establishes standards by means of which small businessmen, selling directly to the public and heavily dependent upon goodwill for continued earnings, may be compensated for the loss or partial destruction of that goodwill in connection with an exercise of eminent domain. The draftsmen deal both with the case in which a business is physically dislocated and that in which its patrons are dislocated.

PART I. SHORT TITLE AND DEFINITIONS

SECTION 101. Short title.

This Act may be called the "Goodwill Compensation Act of ."

SECTION 102. Definitions.

- (a) "Goodwill" is the expectation of continued patronage by a regular clientele.
- (b) "Injured business" is the business of a seller of goods or services directly to the public whose location has been taken, or whose regular clientele has been displaced by eminent domain.
- (c) "Regular clientele" is a group of people in the vicinity who for a reasonable time have patronized a business as their customary source of goods or services.

SECTION 102. Definitions.

1. "Goodwill." The definition of "goodwill" differs slightly from the only definition which has a statutory basis at the present time. The states of California, Montana, North Dakota, Oklahoma, and South Dakota define "goodwill" as "the expectation of continued public patronage." The definition of goodwill in this act stresses that the expectation of patronage which constitutes goodwill must be not only continued but also regular. The patronage which contributes to the goodwill of a business derives from a basically invariable and identifiable group.

2. "Injured business." The definition of "injured business" outlines both the types of injuries and the types of businesses which are covered by the provisions of this act. This act is not intended to provide compensation for all injuries resulting from a taking by eminent domain nor to all businesses which may be injured by a taking. To come under this act, the injured business must be a retail business, or one which sells directly to the public.

An injury compensable under this act may arise either when the business location is taken or when the regular clientele of a business is displaced. Though the second situation is less familiar

than the first, both constitute direct injuries to the goodwill of the injured business since both situations result in the loss of regular clientele.

3. "Regular clientele." The regular clientele of a business is an identifiable and basically invariable group of people. Its members must reside in reasonable proximity to the business and have patronized it for a reasonable time, as a customary source of goods and services. Unidentified and nonrepetitive customers or customers who use a business only as a secondary and irregular source of goods or services do not qualify as regular clientele.

SECTION 201. *Required conditions.*

Damages are available for loss of goodwill when an injured business can prove:

(a) that prior to the taking a major portion of its income came, and was expected to continue to come, from its regular clientele; and

(b) that the regular clientele will not continue to patronize the injured business as a direct result of

(1) the taking of the business location, or

(2) the taking of property in the vicinity of the business which scatters the regular clientele; and

(c) that the injured business cannot serve the regular clientele from the same or a new location without a decrease in profits.

SECTION 201. *Required conditions.*

The existence of goodwill is inextricably bound to the existence of a regular clientele. Therefore, in order for there to be a loss of goodwill, the regular clientele or a portion thereof must in some way be prevented from maintaining their patronage. The three conditions expressed in this section all assert the requirement that there must be a loss of regular clientele before there can be a loss of goodwill. The injured business must prove the existence of all three of these conditions before there can be a recovery for loss of goodwill under this act.

Subsection (a) requires that the injured business prove that, prior to the taking, a major portion of its income came from its regular clientele. The injured business must further prove that, prior to the taking, the major portion of its income was expected to continue to come from its regular clientele.

Subsection (b) requires that the injured business prove that the regular clientele will not continue their former patronage as a direct result of the taking. The discontinuation of the patronage of the regular clientele may directly result either from the taking of the business location or the taking of property in the vicinity of the business, as the result of which the regular clientele are scattered. If the taking of the property on which the regular clientele reside does not result in the scattering of the regular clientele, the condition stated by this subsection is not satisfied. A taking which would not satisfy the requirements of this subsection would be one which displaces the regular clientele of a business from their former specific residences but which

results in the relocation of the regular clientele in the vicinity of the business.

Damages are not available under subsection (b) when a business's regular clientele will not continue their patronage because a directly competitive business is established on the land taken. This situation arises when land is taken by eminent domain and then sold or leased by the condemning authority to a person or an organization which establishes a business in direct competition with another preexisting business in the vicinity. Although these circumstances may deprive a business of its regular clientele, the business is excluded from recovery under this act because of practical and political considerations. It would be undesirable to discourage the condemning authority from aiding in the creation and development of a new business by requiring it to compensate preexisting businesses for loss of regular clientele when that loss is occasioned not directly by the taking but by the competitive superiority of the new business.

Subsection (c) requires that the injured business prove that the taking of its location or of the residences of its regular clientele has resulted in the inability of the injured business to continue to serve its regular clientele from the same or a new location without a decrease in profits. Ordinarily, proof of such an inability will not be difficult. However, two situations may arise as the result of the taking of the business location or of the regular clientele which will permit the injured business, in spite of the taking, to continue to serve its regular clientele without a decrease in profits. This subsection is intended to prevent recovery when either of these situations arises.

The first situation excluded from recovery under subsection (c) is that which arises when the business location is taken and relocation in the immediate vicinity is possible and would involve no loss of profits. If it is possible for the business to relocate in the vicinity of the location taken so that it is highly unlikely that the business will suffer a decrease in profits due to inaccessibility to its regular clientele, it is not harsh to insist that the business owner either relocate or run the risk of being unable to recover damages. If relocation is not required under the circumstances so described, then the door is opened to full recovery for loss of goodwill by a business which may then relocate and be restored to its regular clientele. To allow such a business to recover for loss of goodwill is to compensate it for an injury which it did not incur.

The second situation excluded from recovery under subsection (c) has already been adverted to in the comment to subsection (b). When the regular clientele are displaced from their residences but relocate in the vicinity of the business, the business will be able to continue at the same location without a decrease in profits due to loss of regular clientele. This situation thus does not involve a loss of goodwill and is not compensable.

SECTION 301. *Damages for permanently discontinued business.*

Subject to the limitations of section 306 of this Act, if the injured business is permanently discontinued, the damages shall equal the expected future earnings of the injured business capitalized at the judgment rate of interest less the actual sale value of the assets of the business.

SECTION 301. *Damages for permanently discontinued business.*

The general purpose of this act and, more particularly, of this and the following section is to place the owner of the injured business in the same position that he would have been in if there had been no taking. Therefore, the first step in compensating the injured business is to calculate the annual earnings which it could have expected if there had been no taking; these earnings can be called the expected future earnings. These expected future earnings are to be capitalized at the judgment rate of interest in order to arrive at an amount which represents the present value of the expected flow of future annual earnings over the years subsequent to the taking.

It should be noted that the judgment rate of interest is selected as the capitalization rate. An alternative would be to capitalize at the "going rate" of interest. Although this latter rate, inasmuch as it is invariably a lower rate of interest than the judgment rate, represents more accurately the return which the injured business owner can actually expect from the award of damages, it is rejected as the capitalization rate because of the difficulties inherent in determining the going rate of interest at any particular time. The going rate of interest is a vague and debatable figure whereas the judgment rate of interest is definite and readily ascertainable.

When the injured business is one that involves the sale of services and when there are no physical assets or the physical assets have no liquidated value, the permanent discontinuance of such a business will entitle the owner to recovery of the full amount of the capitalized expected future earnings. However, in most, if not all, other cases, there will have to be an adjustment of the amount representing capitalized expected future earnings, whether the injured business is permanently discontinued or continues in operation. This section describes the deduction which must be made when the injured business is permanently discontinued and the owner elects to sell his assets. The following section describes the adjustments which must be made when the injured business continues in operation at the same or a new location. These adjustments are necessary in order that the injured business not be overcompensated.

If the business is permanently discontinued and the owner elects to sell his assets, the amount actually received from the sale of the assets must be deducted from the capitalized expected future earnings. Since the deduction required when the assets of

the business are sold is the actual amount received, there is no necessity for a determination of the fair market value of the assets sold if the injured business owner is unable to realize the fair market value of the assets when he sells them. However, under ordinary circumstances, the injured business owner should be able to sell his assets for more than the fair liquidation value since he will have a long period (from the order of taking until the final determination of damages) in which to sell his assets. There need be no fear that the injured business owner will sell his assets at less than their liquidation value in order to minimize the deduction which must be made from the capitalized expected future earnings and burden the condemning authority with an inflated claim. If he elects to sell at less than the liquidation value, he is taking a risk that the assessor of damages will not agree with the owner's evaluation of damages. The injured business owner will thus rarely forsake the opportunity to sell his assets for the highest amount he can get, though this price does not have to be as high as the fair market value. The only situation in which he might sell his assets for less than the liquidation value is one which did not involve an "arm's length" sale. For example, the injured business owner might execute a collusive sale with another with the intention of splitting the profits of the sale. This subsection does not negate the ordinary principles of fraud which would invalidate a claim based upon a collusive sale of the assets.

If the injured business is permanently discontinued and the owner elects to retain his assets, the market value of the assets retained must be deducted from the capitalized expected future earnings. The market value is used in determining the deduction because the owner is benefited by the retention of any assets to the extent that he does not have to purchase similar assets at market prices. The owner of a discontinued business will not often retain his business assets after the discontinuation of the business. However, the owner may retain the business assets if he can transfer them to another business which he owns at another location, or, the owner may retain certain business assets which can be converted to his personal use.

Any damages estimated under this section are limited by the provisions of section 306.

SECTION 302. *Damages if business is continued.*

Subject to the limitations of section 306 of this Act, if the injured business continues operating at the same or a new location, the damages shall equal the expected future earnings of the injured business capitalized at the judgment rate of interest less the actual future earnings of the injured business capitalized at the judgment rate of interest

- (a) plus any increase in the net assets of the injured business, or
- (b) less any decrease in the net assets of the injured business.

SECTION 302. *Damages if business is continued.*

This section describes the adjustments which must be made when the business is continued at the same or a new location. If the net assets of the injured business neither increase nor decrease after the taking, then subsections (a) and (b) of this section are inoperable and the damages will equal the expected future earnings of the injured business capitalized at the judgment rate of interest less the actual future earnings of the injured business capitalized at the judgment rate of interest. However, if the continuation of the injured business results in its operation with an increase in net assets above the net assets prior to the taking, or a decrease in net assets below the net assets prior to the taking, then the actual future earnings (and, consequently, the capitalized actual future earnings) will be partially attributable to any such increase or decrease in net assets.

When net assets are increased or decreased the injured business takes on a new character. If the net assets are increased after the taking, it will almost invariably be the case that average earnings will also increase. Therefore, the average earnings which an injured business loses because of a loss of goodwill may be offset by the average earnings which the injured business gains by an increase in net assets. In fact, if the increase in net assets is significant, it may well be that capitalized actual future earnings will exceed the capitalized expected future earnings so that, if the formula of this section is applied without any adjustment for the increase in assets, it may appear that there has been no loss of goodwill. But such a determination would be patently incorrect because in trying to determine the amount of goodwill which an injured business has lost, one is concerned with the average earnings of a business with a certain amount of net assets (e. g., \$100,000) prior to the taking as contrasted with the average earnings of the same business with the same amount of net assets after the taking. A business with increased net assets (e.g., \$150,000) has a new character; its average earnings, unadjusted to take into consideration the increase in net assets, are irrelevant to a determination of the amount of the goodwill that has been lost by a business with fewer net assets.

Under these circumstances, it would be unfair to the injured business owner to determine the loss of goodwill by subtracting the capitalized earnings of a business with \$150,000 in net assets

from the capitalized earnings of a business with \$100,000 in net assets. Therefore, in order to fairly measure the loss of goodwill suffered by the injured business as a result of the taking, there must be an adjustment to account for the effect which the increase in net assets has upon capitalized actual future earnings. This adjustment consists in adding any increase in the net assets of the injured business to the difference between capitalized expected future earnings and capitalized actual future earnings.

A similar adjustment has to be made if net assets are decreased. If net assets are decreased after the taking, it will almost invariably be the case that average earnings will also decrease. Under such a circumstance, it would be unjust to the condemning authority to determine the loss of goodwill by subtracting the capitalized earnings of a business with \$90,000 in net assets from the capitalized earnings of a business with \$100,000 in net assets. This amount would be particularly unjust to the condemning authority if the decrease in net assets were due to a taking of assets and if the condemning authority had already compensated the injured business owner for such assets as were taken. To award damages based on the capitalized earnings of a business with decreased net assets would be equivalent to allowing the injured business owner double recovery for loss of assets. Therefore, in order to fairly measure the loss of goodwill suffered by the injured business as a result of the taking, there must be an adjustment to account for the effect which the decrease in net assets has upon capitalized actual future earnings. This adjustment consists in subtracting any decrease in the net assets of the injured business from the difference between capitalized expected future earnings and capitalized actual future earnings.

Proper application of the formula stated in this section can best be illustrated by an example of the computations which must be carried out when net assets are increased. For the purposes of this example, assume that prior to the taking an injured business has net assets of \$100,000 and average earnings of \$10,000, that calculations under section 304 indicate that expected future earnings equal average earnings, or \$10,000. Assume further that after the taking the injured business has net assets of \$150,000 and annual earnings of \$12,000 and that calculations under section 305 indicate that actual future earnings equal the annual earnings after the taking, or \$12,000. Assume the judgment rate of interest to be $6\frac{2}{3}\%$. Based on these figures, damages under this section would equal the expected future earnings of the injured business (\$10,000) capitalized at the judgment rate of interest ($6\frac{2}{3}\%$) less the actual future earnings of the injured business (\$12,000) capitalized at the judgment rate of interest ($6\frac{2}{3}\%$) plus any increase in the net assets of the injured business (\$50,000). Damages would thus equal \$20,000.

Arithmetically, the computations would be as follows:

$$\begin{array}{rcl}
 \$10,000 \times 1/.0667 \text{ (or 15)} & = & \$150,000 \text{ — capitalized expected} \\
 & & \text{future earnings} \\
 \$12,000 \times 1/.0667 \text{ (or 15)} & = & \text{—\$180,000 — capitalized actual} \\
 & & \text{future earnings} \\
 & & \text{—\$ 30,000} \\
 \text{plus } (\$150,000 \text{ — } \$100,000) & = & \text{+\$ 50,000 — increase in net assets} \\
 & & \text{—\$ 20,000 — loss of goodwill}
 \end{array}$$

Whichever method is used under this section to estimate the amount of damages, any amount so estimated is limited by the provisions of section 306.

SECTION 303. *Estimation of average earnings.*

"Average earnings" means the average annual net income of a business during the last five years prior to the valuation date. The salary of an owner-manager to the extent that such salary is available to him in the same or similar employment shall be treated as an expense of the business and not as part of net income. If the salary of an owner-manager does not reflect his economic value to the injured business, additional salary, to the extent indicated in the preceding sentence, shall be imputed to him and treated as an expense of the injured business.

SECTION 303. *Estimation of average earnings.*

The annual net income over the last five years prior to the valuation date is chosen as the basis for determining average earnings in order that a clear pattern of business in the recent past may be established. A longer period might introduce figures that are no longer representative and a shorter period might not afford an adequate description of the trend of recent business.

If an owner-manager loses income in the form of salary because of a taking, such salary will be recoverable by him as a part of annual earnings if he is unable to find other employment. However, to the extent that such salary is available to an owner-manager after the taking in the same or similar employment, the salary of the owner-manager prior to the taking will not be recoverable but will be treated as an expense and not as a part of net income.

The salary of an owner-manager prior to the taking may be either real or imputed. The average salary received by others engaged in similar businesses may not accurately represent the economic value of an owner-manager to an injured business. If the salary which an owner-manager receives after the taking is higher than his real salary prior to the taking or a salary imputed from the average salary of those engaged in similar businesses, then it can be presumed that such salaries did not accurately represent the economic value of an owner-manager to an injured business and that, consequently, the owner-manager was underpaid prior to the taking. In such a situation, the salary received by an owner-manager after the taking will be imputed to him as his salary before the taking, whether or not he had a real salary before the taking, and such imputed salary will be treated as an expense of the injured business and not as a part of net income. The salary received by an owner-manager after the taking and used as a basis for imputing his salary prior to the taking may be derived from similar or different employment.

This section is intended to prevent an owner-manager who receives an increase in salary in consequence of the taking from excluding that increase as a deduction from the loss incurred because of the taking. Such an increase in salary is a gain to be set off against any loss incurred because of the taking.

This section is intended to require an owner-manager to mitigate loss of income due to the taking by accepting similar employment which is available to him after the taking. The rule is similar to that which requires an employee to mitigate damages arising from an employer's breach of an employment contract by accepting available similar employment. An owner-manager is not required to accept dissimilar employment which may be available after the taking. Even if an owner-manager does not actually receive the salary which is available to him in a similar employment, the mere fact that such employment is available to him justifies a set-off of the salary available against the loss incurred by the taking.

SECTION 304. *Estimation of expected future earnings.*

The expected future earnings of the injured business shall be estimated from its average earnings, adjusted to take into account extraordinary circumstances which indicate that the level of earnings would have changed in the future if there had been no eminent domain proceedings.

SECTION 304. *Estimation of expected future earnings.*

The expected future earnings represent the average annual net income which was expected in future years from the injured business prior to the taking. The value assigned to expected future earnings is to be derived from an analysis of its average earnings (section 303). The trend of net income over the past five years will be one indication of whether the level of earnings could have been expected to rise or to fall even if there had been no taking. In addition, certain extraordinary circumstances may indicate that the level of earnings would have risen or fallen in the future if there had been no taking.

SECTION 305. *Estimation of actual future earnings.*

The actual future earnings of the injured business shall be estimated from its average earnings and earnings subsequent to the valuation date, so as to fairly reflect the prospects for the business under the changed conditions caused by the eminent domain proceedings.

SECTION 305. *Estimation of actual future earnings.*

The actual future earnings represent the average annual net income which is expected in the future years after the taking from the injured business as continued at the same or a new location under the changed conditions caused by the taking. The value assigned to expected future annual earnings is to be derived from an analysis of its average earnings (section 303) and its annual net income subsequent to the valuation date.

SECTION 306. *Maximum damages payable.*

The amount of damages payable under this act shall not exceed the greater of:

- (a) ten times the average earnings of the injured business; or
- (b) an amount equal to the value of the physical assets of the injured business.

SECTION 306. *Maximum damages payable.*

In order to balance the interests of the injured business against the interests of the condemning authority, it is necessary to set a reasonable maximum upon the damages payable under this act. It would be an unreasonable hindrance to eminent domain proceedings to permit an injured business with negligible physical assets to receive damages under this act in excess of ten times its average earnings prior to the taking. On the other hand, it would be unreasonable to limit an injured business with considerable physical assets and relatively small average earnings to a recovery less than an amount equal to the value of its physical assets. By establishing a maximum this section protects the interests of the condemning authority; by making the maximum the greater of ten times the average earnings of the injured business or an amount equal to the value of the physical assets of the injured business this section protects the interests of the injured business.

EXHIBIT IX

California Government Code Section 7262(c)

* * * * *

(c) Any displaced person who moves or discontinues his business or farm operation who elects to accept the payment authorized by this subdivision in lieu of the payment authorized by subdivision (a), shall receive a fixed relocation payment in an amount equal to the average annual net earnings of the business or farm operation, except that such payment shall not be less than two thousand five hundred dollars (\$2,500) nor more than ten thousand dollars (\$10,000). In the case of a business, no payment shall be made under this subdivision, unless the public entity is satisfied that the business cannot be relocated without a substantial loss of patronage and is not a part of a commercial enterprise having at least one other establishment not being acquired, which is engaged in the same or similar business. For purposes of this subdivision, the term "average annual net earnings" means one-half of any net earnings of the business, or farm operation, before federal, state, and local income taxes, during the two taxable years immediately preceding the taxable year in which such business or farm operation moves from the real property being acquired, or during such other period as the public entity determines to be more equitable for establishing such earnings, and includes any compensation paid by the business or farm operation to the owner, his spouse, or his dependents during such two-year or such other period. To be eligible for the payment authorized by this subdivision, the business or farm operation shall make available its state income tax records, and its financial statements and accounting records, for audit for confidential use to determine the payment authorized by this subdivision. In the case of an outdoor advertising display, the payment shall be limited to the amount necessary to physically move or replace such display.

* * * * *