

Memorandum 98-85

Issues Relating to Compensation for Loss of Goodwill in Eminent Domain

COMPENSATION FOR LOSS OF GOODWILL

Under the Eminent Domain Law, in addition to compensation for the value of property taken and damage to the remainder, the property owner is entitled to compensation for loss of business goodwill resulting from the taking. Code Civ. Proc. §§ 1263.510-1263.530. Several issues have arisen concerning application of provisions of the Eminent Domain Law to this element of compensation. Specifically, (1) is data relating to compensation for loss of goodwill included in an exchange of valuation data, and (2) does the parties' final offer and demand include compensation for loss of business goodwill?

EXCHANGE OF VALUATION DATA

The Eminent Domain Law provides for a pretrial exchange of valuation data on demand of a party. Code Civ. Proc. §§ 1258.210-1258.300. The parties must provide a statement of valuation data for each witness who will testify on (1) the value of the property taken, (2) any damage or benefit to the remainder, or (3) the amount of "any other compensation required to be paid" by specified statutes, including Chapter 9 (commencing with Section 1263.010). Code Civ. Proc. § 1258.250(d). Chapter 9 includes provisions that require compensation to be paid for loss of business goodwill. Code Civ. Proc. §§ 1263.510-1263.530.

It is thus apparent that the statutes require goodwill valuation data to be included in the data exchanged. However, a Court of Appeal opinion suggests that the statute might be made more clear on this point. In *City of Fresno v. Harrison*, 154 Cal. App. 3d 296, 201 Cal. Rptr. 219 (1984), the city argued that its failure to provide goodwill valuation data did not violate the statute, "since it is ambiguous whether the special eminent domain discovery statutes applied to cases for recovery of goodwill under section 1263.510". 154 Cal. App. 3d at 302. This interpretation derives from the city's observation that the specific types of

information required to be exchanged (which are listed in Code of Civil Procedure Section 1258.260) include factors more relevant to valuing tangible than intangible property and damage.

Code of Civil Procedure Section 1258.260 provides:

1258.260. (a) The statement of valuation data shall give the name and business or residence address of the witness and shall include a statement whether the witness will testify to an opinion as to any of the matters listed in Section 1258.250 and, as to each such matter upon which he will give an opinion, what that opinion is and the following items to the extent that the opinion on such matter is based thereon:

- (1) The interest being valued.
- (2) The date of valuation used by the witness.
- (3) The highest and best use of the property.
- (4) The applicable zoning and the opinion of the witness as to the probability of any change in such zoning.
- (5) The sales, contracts to sell and purchase, and leases supporting the opinion.
- (6) The cost of reproduction or replacement of the existing improvements on the property, the depreciation or obsolescence the improvements have suffered, and the method of calculation used to determine depreciation.
- (7) The gross income from the property, the deductions from gross income, and the resulting net income; the reasonable net rental value attributable to the land and existing improvements thereon, and the estimated gross rental income and deductions therefrom upon which such reasonable net rental value is computed; the rate of capitalization used; and the value indicated by such capitalization.
- (8) If the property is a portion of a larger parcel, a description of the larger parcel and its value.

(b) With respect to each sale, contract, or lease listed under paragraph (5) of subdivision (a), the statement of valuation data shall give:

- (1) The names and business or residence addresses, if known, of the parties to the transaction.
- (2) The location of the property subject to the transaction.
- (3) The date of the transaction.
- (4) If recorded, the date of recording and the volume and page or other identification of the record of the transaction.
- (5) The price and other terms and circumstances of the transaction. In lieu of stating the terms contained in any contract, lease, or other document, the statement may, if the document is

available for inspection by the adverse party, state the place where and the times when it is available for inspection.

(6) The total area and shape of the property subject to the transaction.

(c) If any opinion referred to in Section 1258.250 is based in whole or in substantial part upon the opinion of another person, the statement of valuation data shall include the name and business or residence address of such other person, his business, occupation, or profession, and a statement as to the subject matter to which his opinion relates.

(d) Except when an appraisal report is used as a statement of valuation data as permitted by subdivision (e), the statement of valuation data shall include a statement, signed by the witness, that the witness has read the statement of valuation data and that it fairly and correctly states his opinions and knowledge as to the matters therein stated.

(e) An appraisal report that has been prepared by the witness which includes the information required to be included in a statement of valuation data may be used as a statement of valuation data under this article.

The Court of Appeal notes that, of the factors listed in this section, those which may apply to goodwill are (1) the interest being valued, (2) the date of valuation, (3) the gross income, deductions and net income, and (4) the rate of capitalization and resulting value. The court states, "It is likely that section 1258.260 was written without contemplation of business goodwill valuation problems. If it is not explicit on the subject, as the trial court thought, it should be amended. However ill-fitting the words may be, the intent is clearly to expose fully the expert's opinion on the subject concerned." 154 Cal. App. 3d at 302-303.

It would be a simple matter to remove any uncertainty. And in fact, it could be helpful to expressly require that a goodwill valuation expert identify the method used to determine goodwill. There is no fixed method for valuing goodwill. The cases have held that all of the following techniques, among others, may be used:

- Capitalized value of net income or profits of business, or some similar method of calculating present value of anticipated profits. *People ex rel. Dept. of Transportation v. Leslie*, 55 Cal. App. 4th 918, 64 Cal. Rptr. 2d 252 (1997).
- Market analysis. *Community Development Comm'n v. Asaro*, 212 Cal. App. 3d 1297, 261 Cal. Rptr. 231 (1989).

• “Excess income” method. *People ex rel. Dept. of Transportation v. Muller*, 36 Cal. 3d 263, 203 Cal. Rptr. 772 (1984).

An amendment along the following lines could be beneficial. Technical revisions are included for consistency with current statutory drafting technique.

Code Civ. Proc. § 1258.260 (amended). Contents of statement of valuation data

1258.260. (a) The statement of valuation data shall give the name and business or residence address of the witness and shall include a statement whether the witness will testify to an opinion as to any of the matters listed in Section 1258.250 and, as to each such matter upon which ~~he~~ the witness will give an opinion, what that opinion is and the following items to the extent that the opinion ~~on such matter~~ is based ~~thereon~~ on them:

- (1) The interest being valued.
- (2) The date of valuation used by the witness.
- (3) The highest and best use of the property.
- (4) The applicable zoning and the opinion of the witness as to the probability of any change in such zoning.
- (5) The sales, contracts to sell and purchase, and leases supporting the opinion.
- (6) The cost of reproduction or replacement of the existing improvements on the property, the depreciation or obsolescence the improvements have suffered, and the method of calculation used to determine depreciation.
- (7) The gross income from the property, the deductions from gross income, and the resulting net income; the reasonable net rental value attributable to the land and existing improvements ~~thereon~~, and the estimated gross rental income and deductions ~~therefrom~~ upon which ~~such~~ the reasonable net rental value is computed; the rate of capitalization used; and the value indicated by ~~such~~ the capitalization.
- (8) If the property is a portion of a larger parcel, a description of the larger parcel and its value.
- (9) If the opinion concerns loss of goodwill, the method used to determine the loss and the data supporting the opinion.

(b) With respect to each sale, contract, or lease listed under paragraph (5) of subdivision (a), the statement of valuation data shall give:

- (1) The names and business or residence addresses, if known, of the parties to the transaction.
- (2) The location of the property subject to the transaction.
- (3) The date of the transaction.
- (4) If recorded, the date of recording and the volume and page or other identification of the record of the transaction.

(5) The price and other terms and circumstances of the transaction. In lieu of stating the terms contained in any contract, lease, or other document, the statement may, if the document is available for inspection by the adverse party, state the place where and the times when it is available for inspection.

(6) The total area and shape of the property subject to the transaction.

(c) If any opinion referred to in Section 1258.250 is based in whole or in substantial part upon the opinion of another person, the statement of valuation data shall include the name and business or residence address of such other person, his and the business, occupation, or profession of the other person, and a statement as to the subject matter to which ~~his opinion~~ the opinion of the other person relates.

(d) Except when an appraisal report is used as a statement of valuation data as permitted by subdivision (e), the statement of valuation data shall include a statement, signed by the witness, that the witness has read the statement of valuation data and that it fairly and correctly states his the opinions and knowledge of the witness as to the matters therein stated in it.

(e) An appraisal report that has been prepared by the witness which includes the information required to be included in a statement of valuation data may be used as a statement of valuation data under this article.

Comment. Paragraph (9) is added to Section 1258.260(a) to make clear that the basis for an opinion as to loss of goodwill is to be included in the exchange of valuation data. This codifies the rule in *City of Fresno v. Harrison*, 154 Cal. App. 3d 296, 201 Cal. Rptr. 219 (1984).

If the Commission approves, the staff will convert this material into a tentative recommendation and circulate it for comment.

OFFER AND DEMAND

The Eminent Domain Law requires that at least 30 days before trial, the parties file and serve on each other their final offers and demands of compensation in the proceeding. Code Civ. Proc. § 1250.410(a). The statute does not define what is included in the meaning of the term “compensation”. If the plaintiff’s offer is unreasonable and the defendant’s demand reasonable in light of the evidence admitted and the compensation awarded in the proceeding, the defendant is entitled to litigation expenses. Code Civ. Proc. § 1250.410(b).

At least two appellate cases have indicated that the compensation referred to in this section does not include prejudgment interest (or ordinary costs). *Coachella Valley County Water Dist. v. Dreyfuss*, 91 Cal. App. 3d 949, 154 Cal. Rptr. 467 (1979); *People ex rel. Dept. of Transportation v. Gardella Square*, 200 Cal. App. 3d 559, 246 Cal. Rptr. 139 (1988). Unfortunately, these cases also include loose language (dictum) to the effect that the provision is not intended “to require the offer and demand to cover items other than the value of the part taken and damage, if any, to the remainder.” 91 Cal. App. 3d at 954; 200 Cal. App. 3d at 568. This interpretation would seem to exclude from coverage of the section compensation for loss of goodwill.

Notwithstanding the language in the cases, the law intends that the offer and demand include compensation for loss of goodwill. But it may not make sense to start tinkering with the statutory language. The impression of the staff is that the problem, if any, is inchoate. The terms of the offer and demand will ordinarily spell out what is included in them. This is a sensitive area in which statutory elaboration could easily result in a provision that is either over- or under-inclusive. It is better left to case law development.

A preferable resolution, from the staff’s perspective, would be to expand the Comment to make clear that “compensation” in this section may include compensation for loss of goodwill. It is likely we will want to refine this section in other respects as part of the Eminent Domain Law update project, and that would be an occasion to expand the Comment to it.

Respectfully submitted,

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Executive Secretary