

CALIFORNIA LAW REVISION COMMISSION

TENTATIVE RECOMMENDATION

Compensation for Loss of Business Goodwill in Eminent Domain: Selected Issues

February 1999

This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN May 30, 1999.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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SUMMARY OF TENTATIVE RECOMMENDATION

This recommendation would clear up a number of technical questions that have arisen in connection with compensation for loss of business goodwill in eminent domain proceedings. It would make clear that the exchange of valuation data is to include compensation for loss of goodwill, and require an expert to identify the method of valuation and summarize the supporting data. And it would make clear that the claimed compensation for loss of goodwill is to be included in the final offer and demand of the parties.

The recommendation also solicits input on proper accounting techniques involving loss of business goodwill.

This recommendation was prepared pursuant to Resolution Chapter 91 of the Statutes of 1998.

1 **COMPENSATION FOR LOSS OF BUSINESS**
2 **GOODWILL IN EMINENT DOMAIN:**
3 **SELECTED ISSUES**

4 Under the Eminent Domain Law, in addition to compensation for the value of
5 property taken and damage to the remainder, the property owner is entitled to
6 compensation for loss of business goodwill resulting from the taking.¹ This
7 recommendation addresses several issues have arisen concerning application of
8 provisions of the Eminent Domain Law to this element of compensation:

- 9 • Is data relating to compensation for loss of business goodwill required to
10 be included in an exchange of valuation data?
- 11 • What are the proper techniques for calculation of loss of business
12 goodwill?
- 13 • Is the parties' final offer and demand required to include compensation
14 for loss of business goodwill?

15 **Exchange of Valuation Data**

16 The Eminent Domain Law provides for a pretrial exchange of valuation data on
17 demand of a party.² The parties must provide a statement of valuation data for
18 each witness who will testify on (1) the value of the property taken, (2) any
19 damage or benefit to the remainder, or (3) the amount of "any other compensation
20 required to be paid" by specified statutes, including Chapter 9 (commencing with
21 Section 1263.010).³ Chapter 9 includes provisions that require compensation to be
22 paid for loss of business goodwill.⁴

23 Thus the statutes on their face require goodwill valuation data to be included in
24 the data exchanged. However, a Court of Appeal opinion suggests that the statutes
25 might be made more clear on this point. In *City of Fresno v. Harrison*,⁵ the city
26 argued that its failure to provide goodwill valuation data did not violate the statute,
27 "since it is ambiguous whether the special eminent domain discovery statutes
28 applied to cases for recovery of goodwill under section 1263.510."⁶ This
29 interpretation derives from the city's observation that the specific types of
30 information required to be exchanged (which are listed in Code of Civil Procedure
31 Section 1258.260) include factors more relevant to valuing tangible than intangible
32 property and damage.

33 Code of Civil Procedure Section 1258.260 provides:

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1. Code Civ. Proc. §§ 1263.510-1263.530.
 2. Code Civ. Proc. §§ 1258.210-1258.300.
 3. Code Civ. Proc. § 1258.250(d).
 4. Code Civ. Proc. §§ 1263.510-1263.530.
 5. 154 Cal. App. 3d 296, 201 Cal. Rptr. 219 (1984).
 6. 154 Cal. App. 3d at 302.

1 1258.260. (a) The statement of valuation data shall give the name and
2 business or residence address of the witness and shall include a statement whether
3 the witness will testify to an opinion as to any of the matters listed in Section
4 1258.250 and, as to each such matter upon which he will give an opinion, what
5 that opinion is and the following items to the extent that the opinion on such
6 matter is based thereon:

7 (1) The interest being valued.

8 (2) The date of valuation used by the witness.

9 (3) The highest and best use of the property.

10 (4) The applicable zoning and the opinion of the witness as to the probability
11 of any change in such zoning.

12 (5) The sales, contracts to sell and purchase, and leases supporting the
13 opinion.

14 (6) The cost of reproduction or replacement of the existing improvements on
15 the property, the depreciation or obsolescence the improvements have suffered,
16 and the method of calculation used to determine depreciation.

17 (7) The gross income from the property, the deductions from gross income,
18 and the resulting net income; the reasonable net rental value attributable to the
19 land and existing improvements thereon, and the estimated gross rental income
20 and deductions therefrom upon which such reasonable net rental value is
21 computed; the rate of capitalization used; and the value indicated by such
22 capitalization.

23 (8) If the property is a portion of a larger parcel, a description of the larger
24 parcel and its value.

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

27 (1) The names and business or residence addresses, if known, of the parties to
28 the transaction.

29 (2) The location of the property subject to the transaction.

30 (3) The date of the transaction.

31 (4) If recorded, the date of recording and the volume and page or other
32 identification of the record of the transaction.

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

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

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

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

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

51 The Court of Appeal notes that, of the factors listed in this section, those which
52 may apply to goodwill are (1) the interest being valued, (2) the date of valuation,

1 (3) the gross income, deductions and net income, and (4) the rate of capitalization
2 and resulting value. The court states, “It is likely that section 1258.260 was written
3 without contemplation of business goodwill valuation problems. If it is not explicit
4 on the subject, as the trial court thought, it should be amended. However ill-fitting
5 the words may be, the intent is clearly to expose fully the expert’s opinion on the
6 subject concerned.”⁷

7 It is a straightforward matter to remove any uncertainty, and the Law Revision
8 Commission recommends that this be done.

9 **Calculation of Loss of Goodwill**

10 There is no fixed method for valuing goodwill. The cases have held that the
11 following techniques, among others, may be used:

- 12 • Market analysis.⁸
- 13 • “Excess income” method.⁹

14 There is a question whether capitalized value of net income or profits of
15 business, or a similar method of calculating present value of anticipated profits,¹⁰
16 is distinct from the excess income method, if properly applied excluding the value
17 of tangible assets or the normal return on those assets.¹¹ **The Law Revision
18 Commission solicits comment on whether, under accounting practice,
19 goodwill is considered to be an asset for purposes of calculating the return on
20 the assets of a business.**

21 In any event, it would be helpful to require that, in the exchange of valuation
22 data, a goodwill valuation expert identify the method used to determine goodwill
23 and summarize the data supporting the opinion.

24 **Offer and Demand**

25 The Eminent Domain Law requires that at least 30 days before trial, the parties
26 file and serve on each other their final offers and demands of compensation in the
27 proceeding.¹² The statute does not define what is included in the meaning of the
28 term “compensation.” If the plaintiff’s offer is unreasonable and the defendant’s
29 demand reasonable in light of the evidence admitted and the compensation
30 awarded in the proceeding, the defendant is entitled to litigation expenses.¹³

7. 154 Cal. App. 3d at 302-03.

8. *Community Dev. Comm’n v. Asaro*, 212 Cal. App. 3d 1297, 261 Cal. Rptr. 231 (1989).

9. *People ex rel. Dep’t of Transp. v. Muller*, 36 Cal. 3d 263, 203 Cal. Rptr. 772 (1984).

10. *People ex rel. Dep’t of Transp. v. Leslie*, 55 Cal. App. 4th 918, 64 Cal. Rptr. 2d 252 (1997).

11. *People ex rel. Dep’t of Transp. v. Muller*, 36 Cal. 3d 263, 271 n.7, 203 Cal. Rptr. 772 (1984).

12. Code Civ. Proc. § 1250.410(a).

13. Code Civ. Proc. § 1250.410(b).

1 At least two appellate cases have indicated that the compensation referred to in
2 this section does not include prejudgment interest (or ordinary costs).¹⁴
3 Unfortunately, these cases also include loose language (dictum) to the effect that
4 the provision is not intended “to require the offer and demand to cover items other
5 than the value of the part taken and damage, if any, to the remainder.”¹⁵ This
6 interpretation would seem to exclude from coverage of the section compensation
7 for loss of goodwill.

8 Notwithstanding the language in the cases, the law intends that the offer and
9 demand include compensation for loss of goodwill. The statute should be revised
10 to make clear that the final offer and demand should include all statutorily or
11 constitutionally required compensation, including compensation for loss of
12 goodwill. For purposes of clarity, each offer and demand should also indicate
13 whether or not interest and costs are included.

14 **Proposed Legislation**

15 The Commission’s recommendations would be effectuated by enactment of the
16 following measure.

14. Coachella Valley County Water Dist. v. Dreyfuss, 91 Cal. App. 3d 949, 154 Cal. Rptr. 467 (1979);
People ex rel. Dep’t of Transp. v. Gardella Square, 200 Cal. App. 3d 559, 246 Cal. Rptr. 139 (1988).

15. 91 Cal. App. 3d at 954; 200 Cal. App. 3d at 568.

PROPOSED LEGISLATION

1 **Code Civ. Proc. § 1250.410 (amended). Pretrial settlement offers**

2 SECTION 1. Section 1250.410 of the Code of Civil Procedure is amended to
3 read:

4 1250.410. (a) At least 30 days prior to the date of the trial on issues relating to
5 compensation, the plaintiff shall file with the court and serve on the defendant its
6 final offer of compensation in the proceeding and the defendant shall file and serve
7 on the plaintiff its final demand for compensation in the proceeding. The offer and
8 the demand shall include all statutorily and constitutionally required
9 compensation, including compensation for loss of goodwill if any, and shall state
10 whether interest and costs are included. Such offers and demands shall be the only
11 offers and demands considered by the court in determining the entitlement, if any,
12 to litigation expenses. Service shall be in the manner prescribed by Chapter 5
13 (commencing with Section 1010) of Title 14 of Part 2.

14 (b) If the court, on motion of the defendant made within 30 days after entry of
15 judgment, finds that the offer of the plaintiff was unreasonable and that the
16 demand of the defendant was reasonable viewed in the light of the evidence
17 admitted and the compensation awarded in the proceeding, the costs allowed
18 pursuant to Section 1268.710 shall include the defendant's litigation expenses. In
19 determining the amount of such litigation expenses, the court shall consider the
20 offer required to be made by the plaintiff pursuant to Section 7267.2 of the
21 Government Code and any other written offers and demands filed and served prior
22 to or during the trial.

23 (c) If timely made, the offers and demands as provided in subdivision (a) shall
24 be considered by the court on the issue of determining an entitlement to litigation
25 expenses.

26 **Comment.** Subdivision (a) of Section 1250.410 is amended to counteract dictum in cases to the
27 effect that the provision is not intended to require the offer and demand to cover items other than
28 the value of the part taken and damage, if any, to the remainder. See, e.g., *Coachella Valley*
29 *County Water Dist. v. Dreyfuss*, 91 Cal. App. 3d 949, 154 Cal. Rptr. 467 (1979); *People ex rel.*
30 *Dep't of Transp. v. Gardella Square*, 200 Cal. App. 3d 559, 246 Cal. Rptr. 139 (1988).

31 The amendment makes clear that the final offer and demand should include all statutorily or
32 constitutionally required compensation, including compensation for loss of goodwill. Although
33 interest and costs are not covered by this provision, the amendment also requires, for purposes of
34 clarity, that each offer and demand also indicate whether or not interest and costs are included.

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

36 SEC. 2. Section 1258.260 of the Code of Civil Procedure is amended to read:

37 1258.260. (a) The statement of valuation data shall give the name and business
38 or residence address of the witness and shall include a statement whether the
39 witness will testify to an opinion as to any of the matters listed in Section
40 1258.250 and, as to each such matter upon which he the witness will give an

1 opinion, what that opinion is and the following items to the extent that the opinion
2 ~~on such matter~~ is based ~~thereon~~ on them:

3 (1) The interest being valued.

4 (2) The date of valuation used by the witness.

5 (3) The highest and best use of the property.

6 (4) The applicable zoning and the opinion of the witness as to the probability of
7 any change in such zoning.

8 (5) The sales, contracts to sell and purchase, and leases supporting the opinion.

9 (6) The cost of reproduction or replacement of the existing improvements on the
10 property, the depreciation or obsolescence the improvements have suffered, and
11 the method of calculation used to determine depreciation.

12 (7) The gross income from the property, the deductions from gross income, and
13 the resulting net income; the reasonable net rental value attributable to the land
14 and existing improvements ~~thereon~~, and the estimated gross rental income and
15 deductions ~~therefrom~~ upon which ~~such~~ the reasonable net rental value is
16 computed; the rate of capitalization used; and the value indicated by ~~such~~ the
17 capitalization.

18 (8) If the property is a portion of a larger parcel, a description of the larger parcel
19 and its value.

20 (9) If the opinion concerns loss of goodwill, the method used to determine the
21 loss and a summary of the data supporting the opinion.

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

24 (1) The names and business or residence addresses, if known, of the parties to
25 the transaction.

26 (2) The location of the property subject to the transaction.

27 (3) The date of the transaction.

28 (4) If recorded, the date of recording and the volume and page or other
29 identification of the record of the transaction.

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

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

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

40 (d) Except when an appraisal report is used as a statement of valuation data as
41 permitted by subdivision (e), the statement of valuation data shall include a
42 statement, signed by the witness, that the witness has read the statement of

1 valuation data and that it fairly and correctly states ~~his~~ the opinions and knowledge
2 of the witness as to the matters ~~therein~~ stated in it.

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

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

9 Technical revisions are also made to the statute for consistency with contemporary statutory
10 drafting techniques.