International Municipal Lawyers Association
2014 Annual Conference
Baltimore, Maryland

Condemnation Update
Wednesday, September 10, 2014 – 11:00 a.m.

Compensation for Businesses Destroyed by Urban Renewal or Economic Development Projects: Is There a Need for Reform?

Kurt J. Fischer
Partner
Venable LLP
750 East Pratt Street, Suite 900
Baltimore, Maryland 21202

©2014 International Municipal Lawyers Association. This is an informational and educational report distributed by the International Municipal Lawyers Association during its 2014 Annual Conference, held September 10-14, 2014 in Baltimore, MD. IMLA assumes no responsibility for the policies or positions presented in the report or for the presentation of its contents.

COMPENSATION FOR BUSINESSES DESTROYED BY URBAN RENEWAL OR ECONOMIC DEVELOPMENT PROJECTS: IS THERE A NEED FOR REFORM?

The Fifth Amendment to the United States Constitution states in pertinent part: "nor shall private property be taken for public use without just compensation." The Supreme Court has interpreted the Fifth Amendment to mandate that property can only be taken by eminent domain for a "public use." 2A-7 Nichols on Eminent Domain, §§ 7.01[1], 7.02[2] & [3].[1] The Court has not interpreted the public use requirement, however, to limit the power of eminent domain to the taking of property for actual use by the government or public. Id. Rather, in the latter half of the 20th Century, the Supreme Court adopted a much broader view. The Court ruled that property may be acquired by the government through eminent domain even if it is to be used by another private person or entity and not by the government or the public, "so long as its acquisition furthers the public good or general welfare, or secures some public benefit." Id. at § 7.01[1]. In short, the Court ruled that the scope of the power of eminent domain is "'coterminous with the scope of a sovereign's police powers.'" Id. quoting Haw. Hous. Auth. v. Miclkiff, 467 U.S. 229 (1984). The Supreme Court has emphasized that the determination as to whether there is a valid "public use" for the property must be made in the first instance by the governmental agency exercising eminent domain. In reviewing this determination, the courts will inquire only as to whether there is a reasonable and rational basis to support the agency's determination. The Supreme Court has articulated its broad interpretation of the public use doctrine in two leading cases: Kelo v. City of New London, 545 U.S. 469 (2005) and Berman v. Parker, 348 U.S. 26 (1954).

In Berman v. Parker, 348 U.S. 26 (1954), Congress had authorized the District of Columbia Redevelopment Land Agency (the "Agency") to acquire and assemble by eminent domain real property for the redevelopment of blighted areas within the District. In the exercise of this authority, the Agency sought to condemn a parcel on which the owners operated a department store. The department store was not a blighted property. It was a successful business. The Agency intended to demolish the department store and sell the land to a private developer who would build residential units, including low rent units. The Supreme Court ruled that, because Congress had authority to take actions to eliminate blight and protect the public health, safety, and welfare by providing safe and adequate housing, Congress could authorize the exercise of eminent domain for this purpose, even if the property was not blighted and it was being acquired from one private person for the purpose of conveying it to another private person (348 U.S. at 33-34, citations omitted):

---

[1] The author of this paper was the Chair of the Maryland State Task Force on Business Owner Compensation in Condemnation Proceedings created by Chapter 446 of the Laws of 2004 and was the principal author of the Task Force's Report to the Governor and General Assembly. Much of the legal background set forth in this paper was taken from that report.

> Once the object is within the authority of Congress, the right to realize it through the exercise of eminent domain is clear. For the power of eminent domain is merely the means to the end. ... Once the object is within the authority of Congress, the means by which it will be attained is also for Congress to determine. Here one of the means chosen is the use of private enterprise for redevelopment of the area. Appellants argue that this makes the project a taking from one businessman for the benefit of another businessman. But the means of executing the project are for Congress and Congress alone to determine, once the public purpose has been established. ... The public end may be as well or better served through an agency of private enterprise than through a department of government – or so the Congress might conclude. We cannot say that public ownership is the sole method of promoting the public purposes of community redevelopment projects. What we have said also disposes of any contention concerning the fact that certain property owners in the area may be permitted to repurchase their properties for redevelopment in harmony with the overall plan. That, too, is a legitimate means which Congress and its agencies may adopt, if they choose.

In Kelo v. City of New London, 545 U.S. 469 (2005), the Supreme Court reaffirmed the Berman rule in the context of an economic development project under which the City of New London condemned a group of properties through a non-profit development corporation to further an economic development plan for an area in the City adjacent to a research facility operated by Pfizer, Inc. The City of New London had undergone decades of economic decline and the United States Naval Underwater Warfare Center, which had been located in the City, had shut down its operations. These events resulted in widespread unemployment and a decreasing tax base in the City, particularly on a peninsula known as the Fort Trumbull area of the City. The non-profit corporation developed, and the State approved, a comprehensive redevelopment plan in which the following uses would be established: a hotel, an urban village with restaurants and retail shops, 80 residences, research and development space, office space and parking and other amenities to support a nearby State park and marina. This comprehensive plan, however, required the acquisition of numerous properties that were not blighted.

The Supreme Court reaffirmed its broad view of the public use doctrine, ruling that the power to exercise eminent domain is coterminous with the police power. The Court held that the City could exercise eminent domain to acquire property from one private person to give it to another private person even if neither the property acquired nor the area in which it is located is blighted. The Court held that a government's exercise of eminent domain in this circumstance will pass muster under the public use doctrine as long as it were rationally related to a public purpose (545 U.S. at 483-84):

> Those who govern the City were not confronted with the need to remove blight in the Fort Trumbull area, but their determination that the area was sufficiently distressed to justify a program of economic rejuvenation is entitled to our deference. The City has carefully formulated an economic development plan that it believes will provide appreciable benefits to the community, including – but by no means limited to – new jobs and increased tax revenue. As with other exercises in urban planning and development, the City is endeavoring to coordinate a variety of commercial, residential, and recreational uses of land, with the hope that they will form a whole greater than the sum of its parts. To effectuate this plan, the City has invoked a state statute that specifically authorizes the use of eminent domain to promote economic development. Given the comprehensive character of the plan, the thorough deliberation that preceded its adoption, and the limited scope of our review, it is appropriate for us, as it was in Berman, to resolve the challenges of the individual owners, not on a piecemeal basis, but rather in light of the entire plan. Because that plan unquestionably serves a public purpose, the takings challenged here satisfy the public use requirement of the Fifth Amendment.

An unfortunate, but inescapable, consequence of the rule established in the Berman and Kelo cases is that viable businesses that cannot be relocated, particularly many small and family-owned businesses, are destroyed because they find themselves in the path of a comprehensive plan for the redevelopment of a large area to further an urban renewal or economic development project. As will be explained below, the Supreme Court has ruled that, if the government condemns only real property, the Fifth Amendment ordinarily requires compensation only for the property and does not require compensation for the value of the business operated on the property – even if the business is destroyed. This rule is based on the irrebuttable assumption that business or intangible interests can always be relocated.

Another factor that compounds the impact on the owner of a business caught in the path of an urban renewal or economic development project is that, if the business owner is a tenant, the owner will only be entitled to the value of its leasehold interest in the condemnation proceeding. As will be explained below, if the business owner does not have a "lease advantage" (that is, the fair rental value of the property on which the business is operated does not exceed the contract rent) the tenant will not be entitled to any compensation in the condemnation action and must look solely to statutory relocation assistance which is available only as a matter of "legislative grace." These factors and the resultant plight of many small business owners in the State led the Maryland General Assembly to enact Chapter 446 of the Laws of 2004 creating the State Task Force on Business Owner Compensation in Condemnation Proceedings. In creating the Task Force, the Legislature indicated concern about the plight of small and family business owners who are forced to interrupt or shut down their businesses to make room for large redevelopment projects. The Task Force was directed to study, and to

report on or before December 31, 2005, on the following primary issues: (1) the concept of business goodwill and whether a business owner should be entitled to compensation for loss of goodwill, (2) the feasibility of requiring a condemning authority to study the impact of condemnation on businesses in the proposed area where condemnation will occur, and (3) the feasibility of a shorter condemnation process to lessen the uncertainty that the process creates for businesses.

The recommendations of the Task Force and their disposition in the Maryland General Assembly will be reviewed below. In short, Maryland, like most states pursuing large-scale urban renewal or economic development projects, refused to address the impact of condemnation on small business owners, particularly minority business owners, who find their businesses and livelihood destroyed with little hope of compensation.

I. JUST COMPENSATION UNDER CURRENT LAW

A. Compensation For Real Property Interests: Fair Market Value

The power of eminent domain is an essential attribute of sovereignty and any limitation on that power, including any requirement of compensation, must emanate directly from the Federal and State Constitutions or statutes. The Fifth Amendment to the United States Constitution (applicable to the States through the Fourteenth Amendment, Chicago, B. & O. R.R. v. Chicago, 166 U.S. 226 (1897)) prohibits the taking of private property without payment of "just compensation." The Supreme has defined "'just compensation' to be the 'full and perfect equivalent in money of the property taken' from the landowner." United States v. Miller, 317 U.S. 369, 373, reh'g denied, 318 U.S. 798 (1943). The Supreme Court has explained, however, that this "full and perfect equivalent" is an amount equal to the fair market value of the property at the time of the taking. 317 U.S. at 374. Fair market value means:

> Fair market value … denotes what "it fairly may be believed that a purchaser in fair market conditions would have given," or, more concisely, "market value fairly determined."

317 U.S. at 374.

The constitutional requirement for just compensation applies to leasehold interests. A leasehold interest constitutes an interest in real property for which just compensation must be paid if the whole or part of the leased property is taken by eminent domain. 4-12D Nichols on Eminent Domain § 12D.01[3][a] (3rd ed.); A.W. Duckett and Co. v. United States, 266 U.S. 149, 151 (1924). The lessee is entitled to be compensated for the taking of a leasehold interest, as is any sublessee or assignee of the lessee under the lease from the fee owner of the leased property. 2 Nichols on Eminent Domain § 5.02[6][a] (3rd ed.).

> Just compensation for the taking of a leasehold interest is generally measured by the fair market value of the balance of the demised lease term. 4-12D Nichols on Eminent Domain § 12D.01[3][j] (3rd ed.), citing Baltimore v. Gamse Bros., 132 Md. 290, 294 (1918).

The fair market value of a leasehold interest is the amount of any positive difference between (1) the present market value of the use and occupancy of the property under the terms of the lease for the remainder of the lease term, plus the value of any right to renew, and (2) the agreed rent which the tenant would pay for such use and occupancy. United States v. Petty Motor Co., 327 U.S. 372, 381 (1946). The leasehold interest has a compensable value only if "the capitalized then fair rental value for the remaining term of the lease, plus the value of any renewal right, exceeds the capitalized value of the rental the lease specifies." Alamo Land & Cattle Co. v. Arizona, 424 U.S. 295, 304 (1976). The excess of the fair rental value over the rental specified in the lease is referred to as the "lease advantage."

"If there is no lease advantage, the expropriator owes the lessee nothing." Central La. Electric Co. v. Gamburg, 200 So.2d 733, 740 (La. App. 1967). Accord, In re Urban Redevelopment Auth. of Pittsburgh, 272 A.2d 163, 165 (Pa. 1970) ("[Because] the leases had no 'bonus value' ... the lessee was not damaged by their condemnation."). As the court explained in NJ Highway Auth. v. J. & F Holding Co., 123 A.2d 25, 29 (N.J. Sup. 1956) (citations omitted):

> The tenant's recoverable damage, if any, is ascertained and determined fundamentally by a comparison of the fair value of his leasehold interest and the rent reserved. The burden descends upon the tenant to disclose by a fair preponderance of the evidence that the fair market value of his lease was greater than the rent reserved. The mere proof that one holds a tenancy in the condemned premises is not sufficient ipso facto to prove that the tenant has suffered a compensable loss in consequence of his deprivation of possession.

Accord, John Hancock Mutual Life Ins. Co. v. United States, 155 F.2d 977, 978 (1st Cir. 1946) (upholding instruction to jury that it could award damages to the lessee only if the fair market rental of the premises exceeded the rent specified in the lease); Commercial Delivery Service v. Medema, 129 N.E.2d 579, 581 (Ill. App. 1955) (holding that the tenant was entitled to no compensation because the market rental value of the property was equal to or less than the rent stated in the lease); State v. Platte Valley Public Power & Irrigation Dist., 23 N.W.2d 300, 308 (Neb. 1946) ("Where the rent reserved equals or exceeds the rental value, the lessee had suffered no loss and cannot recover.").

The fair market value of a leasehold interest must reflect the terms and conditions of the lease under which the interest is held. Smith v. Potomac Electric Power Co., 236 Md. 51 (1964); Veirs v. State Roads Commn., supra, 217 Md. at 551-52 (The fair market value of a tenant's leasehold interest may be affected by any of the terms of the lease ...); 29A C.J.S. Eminent Domain § 151 (2014) (Any restrictive clause in the lease must be considered in determining the ... value of the tenant's interest.). Thus, it is settled that when the lease limits the character of the business that can be carried on upon the premises, the value of the term for any other purpose is not material. 4-12D Nichols on Eminent Domain § 12D.01[3][j] (3rd ed.).

As the Supreme Court of Missouri explained in Redevelopment Corp. v. Doernhoefer, 389 S.W.2d 780, 784 (1965):

> the value of the leasehold should be determined from the testimony of qualified expert witnesses as that value which a buyer under no compulsion to purchase the tenancy would pay to a seller under no compulsion to sell, taking into consideration the period of the lease yet to run, including the unexercised right of renewal, the favorable and unfavorable factors of the leasehold estate, the location, type and construction of the building, the business of the tenant, comparable properties in similar neighborhoods, present market conditions and future market trends, and all other material factors that would enter into the determination of the reasonable market value of the property.

Accord, State v. Samborski, 463 S.W.2d 896, 902 (Mo. 1971); Minneapolis-St. Paul A.C. v. Hedberg-Freidmein Co., 32 N.W.2d 569, 572 (Minn. 1948) (The fair market value of a leasehold interest is "the price a buyer would be willing to pay for the leasehold with the [improvement], subject to the terms and conditions of the lease."); Application of Bronx River Expressway, 104 N.Y.S.2d 554, 556 (N.Y. App. Div. 1951) ("All the provisions of the lease, including those governing the right of cancellation, must be given consideration in determining the rental value of the leasehold.").

If the tenant has installed or erected structures or other permanent improvements on the leased property, and the lease provides that the tenant is entitled to remove them during or at the end of the lease term, the right to remove the structures must be considered in valuing the leasehold interest. 4-13 Nichols on Eminent Domain § 13.07[2]. The tenant, however, is not entitled to recover the value of the improvements as a separate item in addition to the value of the leasehold interest. Rather, the measure of damages is the increased market value of the leasehold interest by reason of the buildings and fixtures. Id.; accord, Minneapolis – St. Paul A.C. v. Hedberg Friedmein Co., supra, 32 N.W.2d at 572; State v. Samborski, supra, 463 S.W.2d at 902; Bd. of Regents v. Fischer, 498 S.W.2d 230, 233 (Tex. Civ. App. 1973).

The structural value of the buildings and fixtures – that is, the cost of their replacement or reproduction less depreciation – "may be a fair test of what they add to the market value of the leasehold if they are well adapted to the best use of the property ... [and the lease is] of such duration that it will outlast the fixtures, or ... contain[s] a covenant of perpetual renewal at the option of the tenant." 4 J. Sackman, Nichols' The Law of Eminent Domain, § 13.121[1], at 13-63 (Cum. Supp. 2005). Additionally, "[e]vidence of the cost of removing the fixtures, the damage to them by removal, and the value of fixtures lost because incapable of removal has been admitted, not as proving specific items of damage, but as a means of showing the value of the unexpired term." 4 J. Sackman, Nichols' The Law of Eminent Domain, § 13.12[1], at 13-61 (Cum. Supp. 2005).

B. Real Estate Valuation Techniques

Economists and real estate appraisers recognize three approaches to determining the market value of property: the cost approach, the sales comparison approach, and the income capitalization approach ("Income Approach"). The Appraisal of Real Estate (12th ed.) at 417 describes the sales comparison approach as follows:

> In the sales comparison approach, the appraiser develops an opinion of value by analyzing similar properties and comparing these properties with the subject property. The comparative techniques of analysis applied in the sales comparison approach are fundamental to the valuation process. Estimates of market rent, expenses, land value, cost, depreciation, and other value parameters may be derived in the other approaches to value using similar comparative techniques. Similarly, conclusions derived in the other approaches are often analyzed in the sales comparison approach to estimate the adjustments to be made to the sale prices of comparable properties.
>
> In the sales comparison approach, an opinion of market value is developed by comparing properties similar to the subject property that have recently sold, are listed for sale, or are under contract (i.e., for which purchase offers and a deposit have been recently submitted). A major premise of the sales comparison approach is that the market value of a property is related to the prices of comparable, competitive properties.
>
> Comparative analysis of properties and transactions focuses on similarities and differences that affect value, which may include variations in the following:
>
> (1) Property rights appraised
>
> (2) The motivations of buyers and sellers
>
> (3) Financing terms
>
> (4) Market conditions at the time of sale
>
> (5) Size
>
> (6) Location
>
> (7) Physical features
>
> (8) Economic characteristics, if the properties produce income

In the cost approach, value is estimated as the value of the land as vacant, plus the current replacement cost new (or reproduction cost of) the improvements, less accrued depreciation to the improvements. The Appraisal of Real Estate (12th ed., The Appraisal Institute, 2001) at 50. (Ex. 7). There are three elements of accrued depreciation: physical deterioration, functional obsolescence, and external obsolescence or externalities. An externality is a loss or gain in improvement value based on factors that are external to the property

itself. Id. at 352-53. "If properties of a certain type are scarce or it is difficult to construct new, competitive properties, the value of a newly constructed building may be higher than its cost." Id. at 353. On the other hand, a lack of demand for the property may "cause the value of the property to be less than its cost." Id.

Income producing properties or business properties are ordinarily valued using the income approach. "Income-producing real estate is typically purchased as an investment, and from an investor's point of view earning power is the critical element affecting property value." Id. at 471. Further, it is settled that "[a]ny property that generates income can be valued using the income capitalization approach," and "when more than one approach to value is used to develop an opinion of value for an income-producing property, the value indication produced by the income capitalization approach might be given greater weight...." Id. at 472. In the Income Approach, the appraiser analyzes a property's capacity to generate the benefits of cash flow and a reversion and converts those benefits to a present value. Id. at 471. In a direct capitalization, the appraiser determines the present value of a future income stream by applying an overall capitalization rate to the net operating income of the property. Id. The authors of The Appraisal of Real Estate provide the following example of the determination of net operating income for an apartment complex (id. at 525):

Southside Apartments: Reconstructed Operating Statement

Income		
Potential gross annual income		
Rents:		
11 units @ $500/mo.	$66,000	
12 units @ $525/mo.	75,600	
16 units @ $575/mo.	110,400	
16 units @ $600/mo.	115,200	
	$367,200	
Other income	1,380	
Total potential gross income @ 100% occupancy	$368,580	
Less vacancy and collection loss @ 4%	-14,743	
Effective gross income		$353,837
Operating expenses		
Fixed		
Real estate taxes	$18,700	
Insurance		
Fire and extended coverage	1,880	
Other	770	
Subtotal	$21,350	
Variable		
Management ($352,512x0.05)	$17,625	
Superintendent	16,800	
Site maintenance and snow removal	5,900	

Electricity	2,200
Other utilities	1,000
Repair and maintenance	12,500
Trash removal ($45x12)	540
Pest control ($65x12)	780
Supplies	325
Other	325
Subtotal	$57,995
Replacement allowance	
Interior decorating	$3,750
Exterior paint ($4,650/3)	1,550
Kitchen and bath equipment ($1,300x55)/10	7,150
Carpeting ($900x55)/6	8,250
Roof ($18,000/20 years)	900
Subtotal (6.1% of EGI)	$21,600

Total operating expenses

Operating expense ratio ($100,945/$353,837) = 28.53% -$100,945
Total expenses per unit ($100,945/55) = $1,835 per unit

Net operating income $252,892

C. Relocation Assistance

Relocation assistance laws enacted by the federal government and in many states guarantee reimbursement to a displaced person whose home or business is displaced as a result of condemnation by a public agency of the person's costs and expenses incurred in relocating the home or business. Relocation assistance is provided in a separate administrative proceeding and is not part of the condemnation proceeding in which the condemning authority acquires real property interests for their fair market value. Generally, if the acquisition of land for a project undertaken by a public agency will result in the displacement of any person, the agency is required to make a payment to the displaced person, upon proper application, of (1) the actual reasonable expenses in moving himself, his family, business, farm operation or other personal property, and (2) the amount of actual direct loss of tangible personal property as a result of moving or discontinuing a business or farm operation, but not exceeding an amount equal to the reasonable expenses that would have been required to relocate the personal property, as determined by the agency, (3) actual reasonable expenses in searching for a replacement business or farm, and (4) actual reasonable expenses necessary to reestablish a displaced farm, nonprofit organization, or small business at its new site as determined by the displacing agency. Typically, a cap is imposed on reestablishment expenses. 49 CFR § 301.

Federal law requires for federal acquisitions and acquisitions undertaken with federal funding that any eligible person, family, business, farm or non-profit organization displaced by any public agency be offered relocation assistance

advisory services. Md. Code Ann., Real Prop. § 12-206; 49 CFR § 24.205. Section 4622(a)(1) of the Relocation Assistance Act provides that a person or business displaced by a federally funded project is entitled to the payment of "actual reasonable expenses in moving" to a new location. Pursuant to § 4633(b) of the Relocation Assistance Act, the Department of Transportation ("DOT"), the lead agency for administering the Relocation Assistance Act, adopted §§ 24.301 et seq. of Title 49 of the Code of Federal Regulations ("CFR") which sets forth the specific moving and related expenses that are eligible for relocation assistance under the Relocation Assistance Act. Specifically, 49 CFR § 24.301 identifies the following eligible actual moving expenses for which the displacing agency is responsible under the Relocation Assistance Act for non-residential moves:

(1) Transportation costs for a distance of up to 50 miles;

(2) Packing, crating, unpacking and uncrating of the personal property;

(3) Disconnecting, dismantling, removing, reassembling, and reinstalling relocated household appliances, personal property, machinery, equipment, and connections to utilities and includes modifications to the personal property, machinery, and equipment necessary to adapt it to the replacement structure, site, or utilities at the replacement site;

(4) Storage of the personal property for a period of up to 12 months;

(5) Insurance for the replacement value of the property in connection with the move and necessary storage;

(6) Replacement value of property lost, stolen, or damaged in the process of moving provided that the loss is not through the fault or negligence of the displaced person, his agent or employee and where insurance covering such loss, theft or damage is not reasonably available;

(7) Any license, permit, fees or certification required of the displaced person at the replacement location based on the remaining useful life of the existing license, permit, fees or certification;

(8) Professional services as the displacing agency determines to be actual, reasonable, and necessary for planning the move, moving, and installing the personal property at the replacement location;

(9) Relettering signs and replacing stationary on hand at the time of displacement that are made obsolete as a result of the move;

(10) Actual direct loss of tangible personal property incurred as a result of moving or discontinuing the business or farm operation including the lesser of (a) the fair market value of the item as is for continued use, less the proceeds from its sale, or (b) the estimated cost of moving the item as is but not including any allowance for storage or for reconnection if the item is in storage or not being used at the replacement location. If the business or farm operation is discontinued, the estimated cost of moving the item shall be based on a moving distance of 50 miles;

(11) If an item of personal property which is used as part of a business or farm operation is not moved but is promptly replaced with a substitute item, the displaced person is entitled to payment of the lesser of (a) the cost of the substitute item, including installation costs at the substituted site minus the proceeds from the sale or trade-in of the replaced item, or (b) the estimated cost of moving and reinstalling the replaced item but with no allowance for storage;

(12) Costs, not to exceed $2,500, incurred in searching for a replacement location, including transportation, meals and lodging, time spent searching based on reasonable salary or earnings, fees paid to a real estate broker or agent to locate a replacement site, time spent in obtaining permits and attending zoning hearings, and time spent negotiating the purchase of a replacement site based on a reasonable salary or earnings; and

(13) Other necessary and related incidental expenses.

The displacing agency, however, is not responsible for the reimbursement of the property owner for the following ineligible moving and related expenses for non-residential moves (49 CFR § 24.301(h)): (1) the cost of moving any structure or other real property improvement in which the displaced person reserved ownership, (2) interest on a loan to cover moving expenses, (3) loss of goodwill, (4) loss of profits, (5) loss of trained employees, (6) personal injury, (7) any legal fee or other cost for preparing a claim for a relocation payment or representing a claimant before the displacing agency, (8) expenses for searching for a replacement dwelling, (9) costs for storage of personal property on real property already owned or leased by the displaced person, or (10) refundable security and utility deposits.

D. Damages to Business Goodwill And Loss Of Business Value Are Typically Not Compensated Under Federal or State Law

1. Valuation Of The Total Assets of A Business And Business Intangibles

It appears to be universally accepted by economists and real estate appraisers that an operating business can have a market value that exceeds the real property and tangible personal property that are utilized in the operation of the business. The Appraisal of Real Estate (12th ed. The Appraisal Institute, 2001) at 641-44; 4-13 Nichols on Eminent Domain § 13.18 (3rd ed.). The increment of value in excess of the value of real and personal property interests has been given numerous labels. The additional increment has been referred to as "business goodwill," "going concern value" or "business enterprise." The Appraisal of Real Estate (12th ed. The Appraisal Institute, 2001) at 642. In The Appraisal of Real Estate (11th ed., Appraisal Institute, 1996) at 578-79, the Appraisal Institute defined "business enterprise value" ("BEV") as:

> Business enterprise value is a value enhancement that results from items of intangible personal property such as marketing and management skill, an assembled work force, working capital, trade names, franchises, patents, trademarks, non-realty related contracts/leases, and some operating agreements.

One commentator, M. Kenney, Business Enterprise Value: The Debate Continues, The Appraisal Journal, Vol. 63, No. 1, 1995 WL 12072365 (1995), quoting William N. Kinnard, Jr., "Standards for Measuring Business Enterprise Value in Regional and Super-regional Shopping Centers: Operating Entrepreneurship, Economic Rent and Profit Residuals," 57th Annual International Association of Assessing Officers (IAAO) Conference (Phoenix, Arizona, October 1991) explains (at 3):

> The creation of BEV may have several sources; the "ultimate reason for its existence, however, is superior management or operating entrepreneurship. ... Operating entrepreneurship is resource management of an operating business that results in supramarket rentals and [net operating income] NOI."

In the Twelfth Edition of The Appraisal of Real Estate, the Appraisal Institute abandoned the term "business enterprise value" in favor of the term "total assets of the business" which includes the following component parts (at 642):

- Real property
- Tangible personal property
- Intangible personal property

The personal property is broken down into:

- Furniture, fixtures, and equipment (FF&E)
- Inventory

The intangibles are made up of:

- Contracts
- Name
- Patents
- Copyrights
- An assembled work force
- Cash
- Other residual intangibles

The "residual intangible" category includes a component called "capitalized economic profit" or "CEP" which the Appraisal Institute defines as the present worth of an entrepreneur's economic profit expectation. In other words, the CEP is the residual value that is left after all agents of production employed in a business (e.g., land, labor, capital, tangible personal property) are identified and stripped away.

Businesses are bought and sold in the same manner as other property interests. When an entire business is sold, it is sold with all its component property interests, real, tangible and intangible, including the CEP. The total assets of a business can, therefore, have a fair market value that is distinct for the fair market value of any of its component property interests. Many Federal and State statutes and regulations require that the fair market value of a business be determined for estate taxation, excise taxation income taxation and a myriad of other purposes. The "fair market value" of intangible property, such as businesses, must be determined under: (1) 26 U.S.C. § 170, income tax charitable contributions, (2) 26 U.S.C. § 642, special rules for charitable deductions, (3) 26 U.S.C. § 664, charitable remainder trusts, (4) 26 U.S.C. § 2055, estate tax charitable contributions, (5) 26 U.S.C. § 2512, gift tax, and (6) 26 U.S.C. § 2624, generation skipping transfer tax. In Hood, Tax Management Portfolio, Estates, Gifts and Trusts: Valuation General and Real Estate (2003), the commentator listed numerous authorities (court decisions, revenue rulings, Treasury regulations) describing the determination of the "fair market value" for intangible interests in closely held corporations, partnerships, limited liability companies and joint ventures. These authorities include Treasury Reg. §§ 20.2031-3 and 25.2512-3 which govern the determination of fair market value of a sole proprietor business.

The Twelfth Edition of The Appraisal of Real Estate states (at 643) that the income approach to value is generally the most effective way to determine the

fair market value of the total assets of a business if the business has an operating history. The cost approach offers little or no insight into the value of the operating business, and the sales comparison approach, while reasonably straightforward and sometimes effective, involves difficult adjustments in many situations.

Accordingly, the most effective manner of determining the fair market value of the total assets of the business is the income approach. The application of the income approach to determine the value of the total assets of the business is very similar analytically to that employed to value income producing real property. First, the future net income from the business is projected based on sales and revenue forecasts and cost models. The net income is the net cash flow from the business, after accounting for all expenses, investments, and other capital cost. In other words, the net income is the actual cash flow to the owner, plus retained earnings. Projections of revenues and expenses are based on historic experience and reasonably anticipated changes. In the income capitalization approach, the projected net income for a stabilized year is reduced to a present value using an appropriate capitalization rate to give the present value of future income. In a discounted cash flow approach the projected net income for a holding period, plus a terminable capitalization value, is reduced to present value by use of a discount rate. A business is viable when the present value of future cash flow is greater than the sum of the values of all real property, tangible personal property and identifiable and separable intangible assets such as patents, copyrights and contracts.

2. General Rule: No Compensation In Condemnation Proceedings For Loss Of, Or Damage To, Business Intangibles

In Kimball Laundry Co. v. United States, 338 U.S. 1 (1949), the Supreme Court analyzed whether, in an action to condemn real estate on which a business is operated, the owner of the business is entitled to compensation for the loss of, or damages, to business intangibles or "goodwill." The Court ruled that, as a general matter, a business owner is not entitled to compensation for business intangibles, but the Court identified two limited exceptions. The United States had condemned the right to temporary use and occupancy of Kimball's laundry during World War II to provide laundry and dry cleaning services for members of the armed services. The property owner argued that it was entitled to compensation for the going concern value of the business. The Supreme Court initially explained that such a value is ordinarily not compensable in a condemnation case (338 U.S. at 11-13):

> 'In determining the value of a business as between buyer and seller, the good will and earning power due to effective organization are often more important elements than tangible property. Where the public acquires the business, compensation must be made for these, at least under some circumstances.' See also Des Moines Gas Co. v. Des Moines, 238 U.S. 153, 165, 35

S.Ct. 811, 814, 59 L.Ed. 1244; McCardle v. Indianapolis Water Co., 272 U.S. 400, 414, 47 S.Ct. 144, 149, 71 L.Ed. 316.

What, then, are the circumstances under which the Fifth Amendment requires compensation for such an intangible? Not, indeed, those of the usual taking of fee title to business property, but the denial of compensation in such circumstances rests on a very concrete justification: the going-concern value has not been taken. Such are all the cases, most of them decided by State courts under constitutions with provisions comparable to the Fifth Amendment, in which only the physical property has been condemned, leaving the owner free to move his business to a new location. E.G. Bothwell v. United States, 254 U.S. 231, 41 S.Ct. 74, 65 L.Ed. 238; Banner Milling Co. v. State of New York, 240 N.Y. 533, 148 N.E. 668, 41 A.L.R. 1019. In such a situation there is no more reason for a taker to pay for the business' going-concern value than there would be for a purchaser to pay for it who had not secured from his vendor a covenant to refrain from entering into competition with him. It is true that there may be loss to the owner because of the difficulty of finding other premises suitably situated for the transfer of his good will, and that such loss, like the cost of moving, is denied compensation as consequential. See Joslin Mfg. Co. v. Providence, 262 U.S. 668, 676, 43 S.Ct. 684, 688, 67 L.Ed. 1167. But such value as the good will retains, the owner keeps, and the remainder dissipated by removal would not contribute to the value paid for by a transferee of the vacated premises, except perhaps to the extent that the prospect of its loss would induce the owner to hold out for a higher price for his land and building. Cf. United States v. General Motors Corp., 323 U.S. 373, 383, 65 S.Ct. 357, 361, 89 L.Ed. 311, 156 A.L.R. 390. When a condemnor has taken fee title to business property, there is reason for saying that the compensation due should not vary with the owner's good fortune or lack of it in finding premises suitable for the transference of going-concern value. In the usual case most of it can be transferred; in the remainder the amount of loss is so speculative that proof of it may justifiably be excluded. See Sawyer v. Commonwealth, 182 Mass. 245, 65 N.E. 52, 59 L.R.A. 726, per Holmes, C.J. By an extension of that reasoning the same result has been reached even upon the assumption that no other premises whatever were available. Mitchell v. United States, 267 U.S. 341, 45 S.Ct. 293, 69 L.Ed. 644.

The situation is otherwise, however, when the Government has condemned business property with the intention of carrying on the business, as where public-utility property has been taken over for continued operation by a governmental authority.

The Supreme Court then explained that the property owner was entitled to compensation for the going concern value in the case before it because the government's exercise of eminent domain had the inevitable effect of depriving the owner of the going concern value of its business (338 U.S. at 14):

> The Government's temporary taking of the Laundry's premises could no more completely have appropriated the Laundry's opportunity to profit from its trade routes than if it had secured a promise from the Laundry that it would not for the duration of the Government's occupancy of the premises undertake to operate a laundry business anywhere else in the City of Omaha. The taking was from year to year; in the meantime the Laundry's investment remained bound up in the reversion of the property. Even if funds for the inauguration of a new business were obtainable otherwise than by the sale or liquidation of the old one, the Laundry would have been faced with the imminent prospect of finding itself with two laundry plants on its hands, both of which could hardly have been operated at a profit. There was nothing it could do, therefore, but wait. Besides, though trade routes may be capable of transfer independently of the physical property with which they have been associated, it is wholly beyond the realm of conjecture that they could have been sold from year to year or that the Laundry would have bound itself to give them up for a longer period when at any time its plant might be returned. It is equally farfetched, moreover, to suppose that they could have been transferred for a limited period and then recaptured.

Accordingly, under the Federal Constitution, a property owner is ordinarily not entitled to compensation for business "goodwill" or intangibles. The two narrow exceptions to this rule are that the property is entitled to compensation for business intangibles if: (1) the condemning authority is acquiring the business to continue operating it; or (2) the condemning authority is acquiring the property only temporarily and will return it after a period of time. It is important to note that, under the Kimball Laundry rule, the Court established an irrebuttable presumption that business intangibles can be transferred to a new location in all situations, even if this may not be true as a practical matter in a specific situation. Further, the Court's analysis indicated that just compensation does not include compensation for the disruption of a business. See Newark v. Cook, 133 A. 875, 879 (N.J. Eq. 1926) ("Loss of business, profits, goodwill, ... and cost of removal and the like suffered ... are obviously not lands or real estate or rights or interest therein in the legal sense and not within the criterion fixed by the statute.").

Like the Supreme Court in Kimball Laundry, courts in other jurisdictions have consistently held that, in the absence of a statute that authorizes compensation for the loss of business intangibles or "goodwill," a business owner is not entitled to compensation for such damages. A leading commentator, 4-13

Nichols on Eminent Domain § 13-18 (3rd ed.) states, quoting State v. Davis Concrete of Delaware, Inc., 355 A.2d 883, 886 (1976):

> Businesses are bought and sold like any other property. A perusal of any major newspaper will disclose classified advertisements for the sale of going businesses. The numerous franchises a prospective entrepreneur can purchase are another aspect of the business market. Clearly, businesses do not need to be started from scratch; many operating businesses are available for purchase on the open market.
>
> Despite the marketplace's widespread acceptance of businesses as valuable and saleable assets, it has generally been held that a business is not property covered by the constitutional prohibition against the taking of private property for public use without payment of just compensation. One court stated:
>
> "It is settled here and elsewhere that, in determining constitutional 'just compensation,' the owner is not entitled to recover compensation for the destruction of a business conducted on the land taken. A business is not "property" in the constitutional sense; and the value of a business is not material to the issue of just compensation, except insofar as it may tend to establish the market value of the real property."
>
> This statement summarizes the past consensus of many courts addressing the condemnation of a business. Under this reasoning, an owner whose business was destroyed or interrupted was out of luck when it came to receiving compensation from the condemnor.

This commentator then explained the various rationales offered by the courts for the rule that the loss of business goodwill is not compensable (4-13 Nichols on Eminent Domain § 13-18[2] (3rd ed.)):

> Past judicial justification for denying compensation for goodwill has been based upon various theories:
>
> (1) Under one theory, damage to a business was not considered compensable by virtue of the fact that neither the business nor its goodwill were taken. Since title to property is held subject to the implied condition that it must be surrendered whenever the public interest requires it, the inconvenience and expense of surrendering possession are not compensable.
>
> (2) The second theory is merely a restatement of the rule in different terms. The denial of compensation is based upon the doctrine that damages to a business or goodwill are damnum absque injuria (Loss without injury in the legal sense).

(3) The third theory is based upon the argument that business is less tangible in nature and more uncertain in its vicissitudes than the rights which the constitution undertakes to protect.

(4) Still another view embodies the concept that such losses were not within the contemplation of the eminent domain clause of the constitution.

Another commentator, 1 L. Orgel, Orgel On Valuation Under Eminent Domain, § 77, pp. 333-34 (1953) agrees, stating:

> With respect to the allowance of incidental damages, the courts appear to adhere rather strictly to the market value standard. Thus, they exclude from consideration certain types of losses which can be regarded as having little, if any, bearing on the sale value of the premises. These losses are generally expressed in terms of the financial outlays which the condemnation imposes on the owner or in terms of lost opportunity to secure an income.... [I]t seems plausible that the underlying basis of this argument is the feeling that to permit recovery for these losses would make it impossible to estimate in advance the probable cost of the property appropriated and would thus deter or discourage public improvements. The denial of compensation and the strict adherence to the market value standard in these cases is thus seen to be a mode of compromising or adjusting the conflict between the community'[s] interest in public improvements and the principle of complete indemnity to the owner.

3. The Uniform Eminent Domain Code And Statutes And Constitutions From Other States Providing For Compensation For Loss Of Business Intangibles

The Uniform Eminent Domain ("UED") Code is a model condemnation statute first promulgated by the Real Property, Probate, and Trust Section of the American Bar Association during the late 1960s and later redrafted by the National Conference of Commissioners on Uniform State Laws in 1974. Section 1016 of the UED Code was intended to reverse the general, but widely criticized, rule under which compensation for loss of business goodwill is not allowed in eminent domain. See Auraria Businessmen Against Confiscation, Inc. v. Denver Urban Renewal Auth., 517 P.2d 845 (Colo. 1974). Section 1016 of the UED Code provides:

> (a) In addition to fair market value determined under Section 1004, the owner of a business conducted on the property taken, or on the remainder if there is a partial taking, shall be compensated for loss of goodwill only if the owner proves that the loss is (1) caused by the taking of the property or the injury to the remainder, (2) cannot reasonably be prevented by a relocation of the business or by taking steps and adopting procedures that a reasonably prudent person would

take and adopt in preserving the goodwill, (3) will not be included in relocation payments under Article XIV, and (4) will not be duplicated in the compensation awarded to the owner.

(b) Within the meaning of this section, "goodwill" consists of the benefits that accrue to a business as a result of its location, reputation for dependability, skill, or quality, and any other circumstances resulting in probable retention of old or acquisition of new patronage.

Several jurisdictions have created statutory or constitutional entitlements to compensation for the loss of business intangibles in condemnation proceedings. For example, California and Wyoming have amended their eminent domain laws to conform with § 1016 of the UED Code. Section 1263.510 of the California Code of Civil Procedure and § 1-26-713 of the Wyoming Statute each adopt the definition of "goodwill" provided in § 1016(b) of the UED Code. The California and Wyoming statutes further provide that the owner of a business conducted on the property taken by the condemning authority shall be compensated for loss of goodwill if the owner proves all of the following:

(1) the loss is caused by the taking of the property or injury to the remainder;

(2) the loss cannot reasonably be prevented by a relocation of the business or by taking steps and adopting procedures that a reasonably prudent person would take and adopt in preserving the goodwill;

(3) compensation for the loss will not be included in payment under the provision of the State Code which provides for relocation assistance; and

(4) compensation for the loss will not be duplicated in the compensation otherwise awarded to the owner.

Cal. Civ. Proc. Code § 1263.510; Wyo. Stat. Ann. § 1-26-713.

Vermont also recognizes business loss as an item of damage in a condemnation proceeding. 19 Vt. Stat. Ann. § 501(2). To be compensable, the business loss must be one "'which has not necessarily been compensated for in the allowance made for [the] land.'" In re Condemnation Award to 89-2 Realty, 566 A.2d 979, 981 (Vt. 1989), quoting Sharp v. Transp. Bd., 451 A.2d 1074, 1076 (Vt. 1982). Business loss, however, is allowed only with respect to a "fixed and established business." Sharp, 451 A.2d at 1076.

Florida provides that in limited circumstances, a property owner may recover the lost profits or goodwill of the business located on a property taken by the condemning authority. Fla. Stat. Ann. § 73.071(3). If the following conditions are met, an award can be made for going concern value:

(1) The business must be more than five years old. This does not mean that the present owner must have been the owner for five years, but the courts draw a distinction between the sale of a business versus the sale of a place of business. Tampa-Hillsborough County v. K.E. Morris Allign., 444 So.2d 926, 929 (Fla. 1983); Division of Admin. v. Lake of the Woods, Inc., 404 So.2d 186, 187-88 (Fla. Dist. Ct. App. 1981); Hodges v. Division of Admin., 323 So.2d 275, 276-77 (Fla. Dist. Ct. App. 1975).

(2) The taking must be for right-of-way purposes by one of the condemning authorities named in the statute, i.e., the state road department, a county, a municipality, board, district or other public body. Fla. Stat. Ann. § 73.071(3)(b).

(3) The business must have been located upon the land taken and adjoining land for five years. Tampa-Hillsborough, 444 So.2d at 929.

The Florida statute is strictly construed in favor of the State and business damages will be awarded only when it is clearly consistent with the legislative intent. Tampa-Hillsborough, 444 So.2d at 929. If a business is completely destroyed, the proper total measure of damages is the market value of the business on the date of the loss. Polyglycoat Corp. v. Hirsch Distribs., Inc., 442 So.2d 958, 960 (Fla. Dist. Ct. App. 1983). If the business is not completely destroyed, then the business owner may recover lost profits. Aetna Life & Cas. Co. v. Little, 384 So.2d 213, 216 (Fla. Dist. Ct. App. 1980). A business, however, may not recover both lost profits and the market value of the business. Sostchin v. Doll Enters., Inc., 847 So.2d 1123, 1128 n.6 (Fla. Dist. Ct. App.), review denied, 860 So.2d 977 (Fla. 2003); Trailer Ranch, Inc. v. Levine, 523 So.2d 629, 631 (Fla. Dist. Ct. App. 1988).

Finally, Louisiana took a constitutional approach to resolving the question of business losses when it redrafted its constitution in 1974. In Article I, § 4 of the Louisiana Constitution, the provision of "just and adequate compensation" was replaced with one requiring that the condemnee "be compensated to the full extent of his loss." Louisiana Courts interpret this provision to include business losses. Layne v. City of Mandeville, 633 So.2d 608, 611 (La. Ct. App. 1993).

4. Judicially Established Exceptions To The General Rule Denying Compensation For Loss Of Business Intangibles

Courts in some jurisdictions have carved out further exceptions to the general rule and allowed the recovery of damages to business intangibles where the business and the land are so intertwined that the property constitutes a "special purpose" or "unique" property, or if the business is otherwise incapable of being moved from the land.

One of these exceptions exists where (1) the property owner holds a franchise or license that enables him or her to conduct a regulated business, and the franchise or license relates specifically to the property being condemned, (2) the franchise or license can be transferred to a subsequent purchaser of the property, and (3) the franchise cannot, as a legal or practical matter, be transferred to a new location. If these elements exist, the franchise is found to be an integral and concrete component of the real estate, and the condemnor must pay for the value of the franchise as an element of just compensation. As the authorities described below establish, if these elements exist, the franchise is an integral component of the real estate, and the condemnor must pay for the value of the franchise as an element of just compensation.

"A franchise is a contract creating property rights." 4 J. Sackman, Nichols' The Law of Eminent Domain, § 13.15[2] (3d. ed. 1982, Supp. 1998). Nichols' has defined a franchise as follows (id.):

> In the typical franchise agreement, a company (the "franchisor") owns a trade mark or trade name which it licenses to another (the "franchisee") to use upon the condition that the uses conform to the franchisor's business standards insofar as the franchisee's business is associated with the trade mark or trade name. Franchise agreements, therefore, require a cooperative effort. McDonald's and other fast food restaurants are well known franchise businesses.

Further, "it is generally held that a franchise is property for which compensation must be paid when it is taken for a public use," and "[t]his is true whether a business franchise is involved between private parties or the franchise exists between a government and a private party." Id.

These courts have held just compensation must be paid for a franchise when the three requisite elements listed above exist. The leading case is Michigan State Highway Commn. v. L&L Concession Co., 187 N.W.2d 465 (Mich. App. 1971). There, the State Highway Commission condemned real property improved by an automobile racetrack and grandstands. L&L Concession Company ("L&L") held a leasehold interest in a portion of the property which included a franchise which gave it the exclusive right to concessions in the grandstand for a specified period of time. At trial, L&L was denied the opportunity to present evidence regarding the value of its leasehold interest and concessions franchise, and the Highway Commissioners returned a verdict only in favor of the fee owner of the track and grandstand for the value of the real estate. No award was made to L&L.

The Michigan Court of Appeals reversed and ordered a trial on the issue of the value of the leasehold interest and franchise. Initially, the Court stated the general rule that the goodwill or going concern value of a business is not compensable in a condemnation case (187 N.W.2d at 468-69, footnotes omitted):

> Ordinarily no compensation is allowed for goodwill or going-concern value of a business operated on the real estate being

> condemned. This view has been strongly criticized by commentators who argue that 'the owner has no assurance after the taking that he can again combine (at a new location) all the factors of production into his previously efficient and profitable operation.' However, since the State but rarely intends to operate the business, the courts have been unwilling to award compensation unless the destruction of the business was a necessary consequence of the condemnation.

The Court then held that the value of L&L's franchise to sell concessions at the racetrack was a compensable interest if L&L could prove at trial that the franchise could not practically be transferred to a new location (187 N.W.2d at 470-71):

> The going-concern value of L&L's business is not related to customers L&L cultivated but to the patronage of the race track; the concession gives L&L a monopoly on food and souvenir sales at the Speedrome. The value of the concession flows from location advantage and L&L's monopoly position at that location, not conventional customer goodwill. The value flows from an 'adaptation' of the grandstand to a use for which it is suited. Viewed from that perspective, allowing compensation for the value of the concession is consistent with the case law which recognizes that in valuing real estate for condemnation purposes it is proper to include value attributable to a use for which the real estate is adapted.
>
> The efforts to limit Kimball [Laundry Co. v. United States, 338 U.S. 1 (1949)] to temporary takings eludes the central meaning of that case. The Federal government was not required to pay for the route lists because the plant was only temporarily taken or because they represented customer goodwill but because their value was destroyed by the taking. The circumstances which caused the destruction of the value of the route lists was the temporariness of the taking which precluded construction and outfitting of a replacement plant. L&L claims that, given the opportunity to prove its case, it can provide comparable assurances that the value for which it seeks compensation has been destroyed, not saved to its advantage elsewhere.

Likewise, in City of Detroit v. Michael's Prescriptions, 373 N.W.2d 219 (Mich. App. 1985), the City condemned Michael's Prescriptions, a pharmacy, as part of an urban renewal project known. Michael's Prescriptions was located directly across the street from the entrance into St. Joseph Mercy Hospital, and the pharmacy held the exclusive right to fill prescriptions for the emergency room at the hospital. The trial court permitted Michael's Prescriptions to recover the going-concern value of its business because the monopoly franchise with St. Joseph Mercy Hospital would not be transferred elsewhere (373 N.W.2d at 225-26):

> Respondent's accountant testified that due to the unique location of the pharmacy and monopolization of the prescription business of St. Joseph Mercy Hospital's emergency room, Michael's Prescriptions generated phenomenal gross sales of pharmaceuticals. Testimony established that when Michael's Prescriptions and St. Joseph Mercy Hospital were the only businesses operating in the condemned area, Michael's Prescriptions still generated its highest sales and most profitable year.
>
> * * *
>
> We conclude that the trial court did not err in allowing the introduction of evidence as the going concern value of Michael's Prescriptions. Since the verdict was within the range of the valuation testimony offered at trial, we decline to disturb it on appeal. Moreover, we find that the method of valuation used in determining the going concern value of Michael's Prescriptions was proper under In re Park Site on Private Claim 16, 247 Mich. 1, 225 N.W. 498 (1929), and that the jury's award reflects the value of the leasehold interest. [City of Lansing v.] Wery, 68 Mich. App. 163, 242 N.W. 2d 51 [(1976)].

In State v. Saugen, 169 N.W. 2d 37 (Minn. 1969), for another example, the State of Minnesota condemned an improved property on which Saugen operated a liquor lounge. Saugen had a license from the City of Minneapolis to operate the liquor lounge on the property, and the license related specifically to the property designated in the license, that is, to the property being condemned. The license was transferable to purchasers of the property. Saugen tried three times to transfer the license to a new location, but was unsuccessful. The property was subsequently demolished and the liquor license expired. The Commissioners appointed by the trial court to determine just compensation determined that the fair market value of the land, building and fixtures was $39,500. The Commissioners, however, refused to award the value of the liquor lounge business as an element of just compensation. The parties had stipulated that, if the value of the business were compensable, that value was $17,500.

Saugen appealed, contending that, under the circumstances presented, he was entitled to receive the value of the liquor lounge business as a going concern as an element of just compensation. The Supreme Court of Minnesota recognized the general rule that the loss of the going concern value of a business is not recoverable as an element of just compensation in a condemnation of real estate, but the Court held that there is an exception to this rule, and a property owner is entitled to the going concern value of a business if three elements are satisfied: (1) the business is one which cannot be pursued without a license, (2) the license is transferable to subsequent purchasers of the property, and (3) the license relates specifically to particular premises which are designated in the license itself. The Court stated (169 N.W. 2d at 42-43, citations omitted):

> In our opinion, an exception to the general rule applies in the situation where, as here, the condemnee's business is one which cannot be pursued without a license, and where that license, while transferable between persons, must relate specifically to particular premises which are designated in the license itself.

Further, the Court held that the three elements were satisfied in the case before it (id. at 46):

> The present case is one where the way is open to award appellant compensation for the going-concern value of the business. Here the condemnee was deprived of far more than the value of cold assets. The exercise of the right of eminent domain effectively destroyed appellant's valid and unrevoked ability to continue to engage in the liquor business. The parties stipulated that absent the taking by the state, there was no evidence that appellant could not have continued to operate its lounge at the premises in question and that the appellant has gone out of the liquor business because it was unsuccessful in transferring its license to another location. It was unable to relocate because of the restricted liquor patrol limits and other peculiarities of the Minneapolis licensing situation. There is no problem here with a speculated loss because the going-concern value has been stipulated to be $17,500. Although a liquor license is a privilege vis-à-vis the licensing authorities, it has qualities of a property right as to third parties, and in eminent domain proceedings we consider the condemnee to have a property right in his liquor license vis-à-vis the condemnor. The going-concern value of appellant's liquor lounge operating under a valid and unrevoked liquor license was a property right which was taken by the condemnor. As such, we hold that the facts of this particular case fall within an exception to the general rule of no compensation for incidental damages and that appellant is entitled to recover for the loss of the going business (stipulated as $17,500) as well as the usual award for the value of the real property taken (stipulated as $39,500).

The Minnesota Supreme Court relied on the Supreme Court's decision in Kimball Laundry Co. v. United States, 338 U.S. 1 (1949), holding that Kimball Laundry was entitled to compensation for the value of the trade because the government's exercise of eminent domain had the inevitable effect of depriving the owner of the going concern value of its business.

The Minnesota Supreme Court also relied on Jackson v. United States, 103 F. Supp. 1019 (Ct. Cl. 1952). In that case, the property owner, Jackson, held a license from the State of Maryland to conduct commercial fishing operations in certain areas of the Chesapeake Bay. Under Maryland law, the license was effective for one year, but could be renewed. In 1943, the United States expanded restricted proving grounds for the Aberdeen Proving Ground to include Jackson's fishing ground. Jackson was, therefore, prohibited from conducting his fishing

operations, and he could not establish his business elsewhere because all other fishing grounds had been appropriated by other fishermen. The Court of Claims ruled that Jackson was entitled to a compensation for the value of his fishing business (103 F.Supp. at 1020-21):

> We think, therefore, that the plaintiff had a sort of property right in his fishing ground, and that the Government took that property from him. But the valuation of what was taken, for the purposes of just compensation, is difficult, for at least two reasons. The first is that he fished only by license from and at the sufferance of the State of Maryland, which could have changed its law at any time and refused him a further license. The second is the considerable fluctuation of the plaintiff's net income from his fishing, during the years before he was forbidden, and upon the basis of which his loss must be estimated. The best that can be done, in our opinion, is to make an estimate, in the nature of a jury verdict, of approximately what the plaintiff' rights and prospects would have sold for in 1943. We fix that sum at $10,000. In addition, the plaintiff's nets were reduced to a secondhand value, by his being forbidden to use them. The fact that they were later destroyed by fire, without the fault of anyone, did not increase the Government's liability. But the taking of his fishing ground reduced their value by $1,500, for which he should be compensated.

Similarly, in United States v. Smoot Sand & Gravel Corp., 248 F.2d 822 (4th Cir. 1957), the United States Army acquired a 250-acre farm in Virginia from the Smoot Corp. to construct a radio transmitter station. Virginia, by law, granted a revocable right to property owners to dredge sand and gravel in adjacent tidal waters owned by the state. The jury included in its award of just compensation the value of the right to dredge the gravel and sand. The Fourth Circuit upheld the award stating (248 F.2d at 827):

> Even a narrow construction of the statute cannot overlook what seems to us obvious, namely, that the riparian owner is awarded the exclusive right to dredge, and in case of its infringement by anyone, he is entitled to be reimbursed for the loss which he thus sustains. It cannot be disputed that when one is assigned the right, pending its revocation, to use or consume something to the exclusion of all others, and to receive compensation from anyone who ventures to exercise the privilege without his authority, he has a species of property, regardless of what theory of property we may adopt.

In a similar line of analysis, the courts in Georgia have ruled that a property owner is entitled to recover the value of a business located on a property that is condemned, in whole or in part, if two elements exist: (1) the property on which its business is located constitutes a unique location allowing operation of the business, and (2) the determination of the value of the business is not remote or speculative. Dept. of Transp. v. Dixie Highway Bottle Shop, 265 S.E. 2d 10,

10-11 (Ga. 1980); Dept. of Transp. v. Fitzpatrick, 361 S.E. 2d 241, 242-44 (Ga. App. 1987); Simms v. Foss, 411 S.E. 2d 59, 59-60 (Ga. App. 1991). In Dept. of Transp. v. Arnold, 530 S.E. 2d 767, 770 (Ga. App. 2000), for example, the Court of Appeals of Georgia upheld a jury verdict based on the destruction of a business that was uniquely situated on land condemned for a highway (530 S.E. 2d at 770):

> Therefore, when land qualified as peculiar because of the peculiar relationship to the owner and when any business operated on such location has a particular "good will," an intangible property interest peculiar to the land, identified only with that location in the minds of clients. Business losses reflect the value of such intangible property interest that is taken or destroyed in the condemnation and cannot be relocated, because such value is peculiar to that land and the owner's relationship to the business conducted on that location.

See also, Carlson v. Union City, 601 F. Supp. 801, 813 (W.D. Mich. 1985) (a franchise granted by the Village to a cable television company granting the company the right to build, operate and maintain a cable television system within the Village is a compensable property interest).

II. THE INVESTIGATION, FINDINGS AND ILL-FATED RECOMMENDATIONS OF THE MARYLAND TASK FORCE

The Task Force published its Report to the Governor and the General Assembly on December 19, 2005. The Task Force heard from condemning authority representatives, as well as numerous small and family business owners. A majority of the Task Force was particularly concerned with the impact of large-scale urban renewal or economic development projects on family businesses, frequently minority businesses, that leased their facilities at market and were unable to relocate to a new location. These business owners effectively lost their livelihood and received compensation only for the depreciated value in place of personal property as relocation assistance. The large developers who took control of the assemblages created by the urban renewal or economic development generally were unable or unwilling to find a place for the small business in the new development being created. The Task Force cited a series of examples:

> (1) People's Liquors was located on the corner of Howard and Fayette Streets in Baltimore. The store had substantial goodwill, a stable customer base, and is said to have been in continuous operation at this location since the end of Prohibition. Baltimore City decided to condemn property on which the business was operated as part of an urban renewal project. The City unsuccessfully attempted to relocate the liquor store business. Within months, the business failed, and the owner's $400,000 investment, constituting his life savings, was lost.
>
> (2) Beauty Plus, a minority, family-owned retail business, was located at the corner of Baltimore and Eutaw Streets. This

property was condemned by the Maryland Stadium Authority and is now the site of the lobby of the Hippodrome Theatre. The business was relocated, over the objection of the owners. The business has never recovered its customers and the family is hanging on, day to day.

(3) The Lambert Insurance Agency is located on Edmondson Avenue in Baltimore. It is owned by Arthur Lambert, a minority businessman. After more than 30 years he has accumulated a solid, consistent customer base who live in the surrounding community and walked to see him. In December 2004, Baltimore City targeted numerous properties in the Edmondson – Old Frederick – Uplands area for acquisition for a redevelopment project. Mr. Lambert was frightened that he would lose his livelihood to redevelopment.

A majority of the Task Force found that governments carrying out urban renewal or economic development projects should at least have authority and discretion under the State relocation law to provide compensation where a business is significantly disrupted or destroyed as a result of the project. The Task Force made the following specific recommendations:

(1) it is the policy of the State that a viable existing business should be preserved where reasonably practicable and should not be acquired for urban renewal or economic development purposes unless other alternatives are shown not to be reasonably practicable, and when it is necessary to acquire an existing business, the condemning authority should make every reasonable effort to ensure that the business is incorporated in the project at its existing location or a nearby location.

(2) prior to exercising the power of eminent domain for urban renewal or economic development purposes, the condemning authority must enter specific findings as to whether (a) an existing business will be affected, (b) the public project can be restructured to avoid the acquisition of the business, (c) the business can be incorporated into the redevelopment project and continue at its existing, or a nearby, location, (d) the exercise of eminent domain is necessary to perform the project, and (e) the government will maintain significant control over the redevelopment project.

(3) if the business cannot be continued on property as a result of a taking but the business can be relocated, the business owner is entitled to compensation for the present value of reasonably anticipated reductions in net operating income, for a period not to exceed three years following the date of taking, that are caused by the taking and the relocation of the business. The

basis for the recommendation was to ensure that the business owner would be placed in the same position that he or she would have been had the taking not occurred.

(4) if a business cannot be continued on the property as a result of the taking and the business cannot be relocated, the owner of the business is entitled to recover the fair market value of the total assets of the business. The Task Force thus recommended that Maryland adopt a provision similar to § 1016 of the Uniform Eminent Domain Code. The compensation based on the income approach for the total assets of the business must include, and cannot be duplication of, any compensation that the business owner is entitled to for real estate interests also owned by the business owner.

(5) upon written request of either party after the case is at issue in circuit court, a condemnation case be set for trial within 90 days, and to require that a relocation counselor of a condemning authority be assigned to every business affected by a public project and that the counselor must contact the business owner within 30 days prior to the filing of a condemnation action and negotiate with the business owner on a consistent basis to provide an effective plan for relocation for a business that will be relocated.

(6) if a business moves from its existing location as a result of condemnation, but an item of intangible personal property cannot be moved, the owner is entitled to recover the reasonable cost of a substitute item, even if the cost of that item exceeds the cost of moving or the fair market value in place for continued use. The purpose of the change is to prevent businesses from being destroyed by a condemnation where they cannot move their equipment to a new location and cannot afford substitute items because the appraised, depreciated value of the equipment is substantially less than the cost of substitute equipment.

(7) where it is reasonably required to continue a business as a viable business, the displacing agency is required to conduct a "turn-key" relocation under which the business owner is entitled to close operations at an existing location one day and begin operations the next day at the new location without interruption. In the case of a required "turn-key" relocation the displaced person would be entitled to reimbursement for a substitute item within the meaning of 49 C.F.R. § 24.301(g)(16), even if the cost of the substitute item exceeds the cost of moving the original item or its fair market value in place for continued use. This recommendation was made in response to the comments of business owners that their businesses could not survive if they were forced to endure an extended period of interruption.

The Task Force's recommendations were introduced in the 2006 Session of the Maryland General Assembly as House of Delegates Bill 1137 and Senate Bill 3. Although business groups, the State Departments of Business and Economic Development and Transportation supported the legislation, local government groups argued vehemently that it would increase the cost of urban renewal and economic development projects and inhibit the government's ability to address chronic problems in blighted areas. The legislation did not advance, receiving an unfavorable report from the House Environmental Matters Committee. Although the legislation received a favorable report from the Senate Judicial Proceedings Committee, it was later returned to committee and did not receive a vote.

In Armstrong v. United States, 364 U.S. 40, 49 (1960), the Supreme Court observed that the ultimate goal of just compensation is to "bar Government from forcing some people alone to bear public burdens which in all fairness and justice should be borne by the public as a whole." Serious questions remain as to whether our country is living up to this goal when a small, family business operated on leased property is condemned and unable to relocate. These families are bearing the burden alone.