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NOTES

THE UNSOUNDNESS OF CALIFORNIA’S NONCOMPENSABILITY RULE AS APPLIED TO BUSINESS LOSSES IN CONDEMNATION CASES

The elements that constitute “business damage,” as used in this note, are lost profits and goodwill. Profits, generally, are the amount of the sales revenue of the business minus all costs of doing business. Goodwill is the general reputation of a business as measured by “the expectation of continued patronage by a regular clientele.” The distinction between these two elements was perhaps best expressed by the Iowa Supreme Court:

Profits are the gains realized from trade; good-will is that which brings trade. A favorable location of a mercantile establishment, or the habit of customers to resort to a particular locality, will bring trade. This advantage may be designated by the term “good-will.”

What the trader gains from the trade so acquired are profits.2

General Rule: Noncompensability

The eminent domain clause in the California Constitution provides: “Private property shall not be taken or damaged for public use without just compensation . . . .”3 A property owner has a remedy under this clause against any public entity for “private property” that is “taken or damaged for public use.” That remedy is inverse condemnation,4 which is an eminent domain suit initiated by the property owner instead of the condemnor.5 Unfortunately, property owners that have initiated inverse condemnation suits have been denied compensation for lost profits and goodwill through judicial misinterpretation of this clause.6 As a result, California businessmen often

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1 AN ACT TO PROVIDE COMPENSATION FOR LOSS OF GOODWILL RESULTING FROM EMINENT DOMAIN PROCEEDINGS § 102(a), printed in 3 HARV. J. LEGIS. 445 (1968).
2 Carey v. Gunnison, 17 N.W. 881, 885 (Iowa 1885).
3 CAL. CONST. art. I, § 14 (emphasis added).
4 See Reardon v. San Francisco, 66 Cal. 492, 6 P. 317 (1885).
suffer noncompensable damage to their businesses caused by a public entity's construction of a public improvement. In some cases the entity purchases the real property (or a part of it) upon which the business is conducted; in other cases, the public entity interferes with customer access through construction activity without purchasing any of the real property. California, with only one exception, has followed for more than half a century the general rule that, in the absence of a statute, injury claimed by a real property owner for lost profits or goodwill of his business is noncompensable under the eminent domain clause of the constitution. In view of the forceful language employed by the California Supreme Court in enunciating this rule, the evolution of any new approach through decisional law is doubtful.

Underlying all the decisions that deny compensation for lost profits and goodwill is an explicit or implicit balancing of "the magnitude of the damage to the owner of the land [against] the desirability and necessity for the particular type of improvement and the danger that the granting of compensation will tend to retard or prevent it." Unfortunately, the balance has always been weighed in favor of the condemnor. The one exception was in Natural Soda Products Co. v. Los Angeles, where the California Supreme Court awarded damages for lost profits caused by a direct physical intrusion of flood waters into the company's two manufacturing plants. This decision, however, has not been followed and is inconsistent when


10 See Natural Soda Products Co. v. Los Angeles, 23 Cal. 2d 193, 143 P.2d 12 (1943).


13 "A particular business might be entirely destroyed and yet not diminish the actual value of the property . . . ." People v. Ricciardi, 23 Cal. 2d 390, 396, 144 P.2d 799, 802 (1943).

14 See, e.g., Bacich v. Board of Control, 23 Cal. 2d 343, 359, 144 P.2d 818, 823 (1943).


16 Bacich v. Board of Control, 23 Cal. 2d 343, 359, 144 P.2d 818, 823 (1943).


18 23 Cal. 2d 193, 143 P.2d 12 (1943).
compared to prior and subsequent cases in which a plaintiff has claimed compensation for lost profits. In other cases the courts repeatedly have found the state's interest compelling, as evidenced by their reluctance to hold that there has been any actual damage sustained by the property owner that is compensable under constitutional mandates.

The purpose of this note, therefore, is to examine critically the anachronistic and unjust rule that denies property owners compensation from a public entity for lost profits and goodwill, and to impel the abrogation of such rule by either the courts or the legislature. Integrated into the analysis of judicial arguments supporting this rule will be two hypothetical situations illustrating the property owner's claim for lost profits and goodwill.

Recovery for Business Losses When Real Estate Is Taken

Typical Fact Situation

A owns and operates a retail store and has developed a steady clientele. The business has been making a profit of $10,000 per year for 10 years. A public entity has condemned his property for a public use and has offered A the fair market value of his real property ($50,000); however, no consideration was given to the element of goodwill in valuing the property. A will not be able to relocate. A argues that he is entitled to compensation for the value of his goodwill, i.e., $40,000.

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19 See People v. Dunn, 46 Cal. 2d 639, 297 P.2d 964 (1956); Stockton & Copperopolis R.R. v. Galgiani, 49 Cal. 139 (1874).
20 See cases cited in note 6 supra.
21 See text accompanying notes 24 & 74 infra.
22 "Public use" within the meaning of section 14 [CAL. CONST. art. I, § 14] is defined as a use which concerns the whole community or promotes the general interest in its relation to any legitimate object of government." Bauer v. Ventura County, 45 Cal. 2d 276, 284, 289 P.2d 1, 6 (1955).
23 The problems involved if relocation were possible are outside the scope of this note. For a discussion of the subject, see generally Note, Compensation for Moving Expenses of Personal Property in Eminent Domain Proceedings, 20 HASTINGS L.J. 749 (1969).
24 The value of the goodwill was determined by assuming certain variables and applying them to a standard formula. The formula is \( V \times R = I \). \( V \) = Value of the goodwill; \( R \) = the capitalization rate measuring the rate of expected return or profit based on the value of the asset (in this case the asset is goodwill); \( I \) = income attributable to the employment of an asset (in this case goodwill). In the hypothetical above A has earned an income of $10,000 each year. The real property is worth $50,000. A buyer will attribute some part of the $10,000 income to employment of the real property in operating the business. That portion is determined by the return realized by owners of similar property in the area of the same character as A's. The average return on similar property is 8%. It follows that A is entitled to an 8% return on his investment of $50,000 in the real estate, or $4,000. Subtract-
The "Not Property" Argument

The first argument for denying compensation for lost profits and goodwill when real property is taken was applied in Oakland v. Pacific Coast Lumber Co., a leading California case. The city brought suit to condemn a leasehold interest of the lumber company. The lumber company claimed that it sustained damage to its business by reason of the taking. The leased property had been used as a lumberyard in connection with the company's mill business that was located on separate property some distance away, no part of which had been itself condemned. In holding the business losses damnum absque injuria, Justice Henshaw said that business is not "private property" within the eminent domain clause:

It is quite within the power of the legislature to declare that a damage to that form of property known as business or the goodwill of a business shall be compensated for, but unless the constitution or the legislature has so declared, it is the universal rule of construction that an injury or inconvenience to a business is damnum absque injuria, and does not form an element of the compensating damages to be awarded.

The reasonableness of this figure becomes apparent when one considers that A can only be "made whole" by compensation which includes the value of his goodwill. For example, if A were paid only $50,000 (the value of his real estate) and invested the money in similar property, which returns 8%, A would have an annual income of only $4,000; whereas, before his property was taken by the public entity, he had had an income of $10,000. On the other hand, if A is paid an additional $40,000 for the value of his goodwill, he can invest it in another business similar to the one which was taken with a return of 15% on his investment. Adding the 8% return on the new land—$4,000—and the 15% return on the new business—$6,000—A now has an income of $10,000 annually; he is "made whole." "The guiding principal of just compensation is reimbursement to the owner for the property . . . taken; he must be made whole. . . ." Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App. 2d 4, 10, 62 Cal. Rptr. 113, 117 (1967) (emphasis added). For a discussion of the formula $V \times R = I$, see American Institute of Real Estate Appraisers, The Appraisal of Real Estate 266 (3d ed. 1960).

26 Id. "[T]hat doctrine [damnum absque injuria] means merely that a person may suffer damages and be without remedy because no legal right or right established by law and possessed by him, has been invaded, or the person causing the damage owes no duty known to the law to refrain from doing the act causing the damage." Rose v. State, 19 Cal. 2d 713, 729, 123 P.2d 505, 514 (1942).
27 171 Cal. 392, 398, 153 P. 705, 707 (1915).
This language of the court clearly distinguishes between tangible and intangible property for purposes of compensation under the eminent domain clause, the result being that compensation for goodwill was denied. However, neither the United States Constitution nor the California Constitution makes an express distinction between property which is compensable and property which is not. Furthermore, the United States Supreme Court has required compensation for intangible property under the fifth amendment. And finally, even Justice Henshaw in the Oakland case admitted that business losses should be compensable, but felt constrained by then existing law:

[B]usiness is property, and when the taking by the state or its agencies interferes with, impairs, damages, or destroys a business, compensation may be recovered therefor. We are not to be understood as saying that this should not be the law when we do say that it is not our law.

The courts' rationale for ignoring business damage was predicated on the belief that recognition of goodwill as compensable “private property” would deter public improvements because of the added cost. However, when the question of business damage arises between private litigants in tort and contract actions, the courts do not hesitate in recognizing business damage as compensable property.

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29 “[J] ust compensation requires payment for the franchise to take tolls as well as for the value of the tangible property . . . .” Monongahela Navigation Co. v. United States, 148 U.S. 312, 345 (1892). Monongahela quoted with approval language from Montgomery County v. Bridge Co., 110 Pa. 54 (1885): “[T]o measure the damages by the mere cost of building the bridge would be to deprive the company of any compensation for the destruction of its franchises. The latter can no more be taken without compensation than its tangible corporeal property. Their value necessarily depends upon their productiveness. If they yield no money in return over expenditures, they would possess little if any present value. If, however, they yield a revenue over and above expenses, they possess a present value, the amount of which depends in a measure, upon the excess of revenue. Hence it is manifest that the income from the bridge was a necessary and proper subject of inquiry before the jury.” Montgomery County v. Bridge Co., 110 Pa. 54, 59 (1885). But see United States v. Rands, 399 U.S. 121, 126 (1967) (restricting Monongahela to its facts).
30 171 Cal. 392, 398, 153 P. 705, 707 (1915) (emphasis added).
Justice Henshaw's admission that business, i.e., goodwill, is property, coupled with the general judicial recognition in other contexts that profits and goodwill are property, suggests that a restrictive interpretation of "private property" is in conflict with awarding "just compensation" to the property owner. To say that the expansion of "private property" to include profits and goodwill would stop public improvements because of the prohibitive cost to the public entity is begging the question. Decisions applying this restriction offer no statistical proof of that prediction. On the contrary, experience in those jurisdictions that allow compensation for lost profits and goodwill in condemnation proceedings demonstrates that, in fact, stoppage of public improvements does not result.

The "Benefit to the Condemnor" Argument

The second major argument for denying compensation for business losses is that the condemnor will receive no benefit from the business alleged to have been taken. As stated in Oakland, damages are limited to the property taken and there can be no "taking" of any "business . . . which may have been conducted upon the property." Conversely, in Southern California Edison v. Railroad Commission, compensation for business losses was awarded when the condemnor intended to continue operation of the business conducted upon the land. The condemnor condemned the plaintiff's utility company, intending to continue to operate the utility business itself. The utility company was awarded compensation based on the reasonable return of its plant investment. Edison distinguished Oakland on the ground that in the latter case the lumber company's business was not taken to be run as such by the condemnor.

To a condemnor the distinction made between Oakland and Edison is a practical one. If the property condemned will produce an income that will eventually repay the condemnor for his initial acquisition cost, then the property is of greater benefit to him, and its owner is entitled to greater compensation. This distinction, however, is unsound because the property owner is entitled to just compensation measured by the fair market value of his property in any situation where his real property is taken. All factors that a private buyer

33 See cases cited note 6 supra where all lacked this statistical proof.
36 6 Cal. 2d 737, 59 P.2d 808 (1936).
37 Id.
38 See Rose v. State, 19 Cal. 2d 713, 737, 123 P.2d 505, 519 (1942).
would consider in arriving at fair market value must be weighed in determining just compensation. A buyer of a business places heavy emphasis upon the profits and goodwill in appraising its value. It follows, therefore, that the public entity should also include the value of the business when appraising the fair market value of the property. Realistically, the property owner would not sell to a private buyer unless he did in fact receive a fair price; he should not have to lose his property to the state at a lower price based upon the distinction made in the Edison case that it is worth more only if there is a greater benefit to the condemnor.

Moreover, in 1953, the California Supreme Court stated, contrary to the assumption made in the Edison case, that "[c]ompensation is based on loss imposed on the owner, rather than on benefit received by the taker." This principle was first applied in 1890 in Muller v. Southern Pacific Railway Company, where just compensation was measured by what the condemnee was to lose, including the value of the business that may have been conducted on the land. From the language the court employs, it is not clear whether it intended to imply that future profits, as the only possible measurement of a prospective "business," were recoverable, or whether the court was merely guilty of imprecise terminology. However, although Muller has never been overruled, the decision has consistently been disregarded and is, therefore, questionable authority. At best, it is an anomaly in the California law.

The statement in Oakland that a business is not "property" and, therefore, is not capable of being "taken" leads to a denial of just compensation for an actual loss suffered by the condemnee. The California Supreme Court should return to the principle first enunciated in Muller; or the California Legislature should heed Justice Henshaw's admission in the Oakland case that goodwill of a business is "property" and enact remedial legislation.

The "Speculation" Argument

The third major argument used to deny compensation for lost profits and goodwill when real property is taken can be briefly stated as follows: Lost profits and goodwill are too "speculative" to ascertain with any degree of certainty, and they are not compensable, therefore, under the eminent domain clause.

In Stockton & Copperopolis Railroad Company v. Galgiani,
a strip of farmland was “taken” by the condemnor, and the condemnee introduced evidence of the net profits derived from the crops grown on the strip as an element to be considered in determining “just compensation.” The court held this evidence inadmissible on the ground that any attempted proof of annual profits would depend upon too many uncertain variables, such as the price of labor, the nature of the season, and the market factor of supply and demand. “A valuation from such evidence would be conjectural and speculative, and would not form a basis for an estimate of damages.”

This decision was handed down in 1874. At that time the California Constitution did not include the “or damaged” section, which was added in 1879. By implication the court was saying that if such evidence had not been “speculative” it would have been an element to consider in determining just compensation under the constitutional provisions for “taking” property. Subsequent decisions, however, have avoided discussing this implication where there has been a “taking” by resort to the court-created “not property” argument.

The Michigan court squarely faced the issue of speculation in the case of *In re Grand Haven Highway,* justly resolving it in favor of the condemnee. In *Grand Haven* a condemnation action was brought by the highway department to take a part of the land and buildings of a manufacturer. The latter was forced to move to a new location and sought compensation for profits lost during the period his business was interrupted. The accounting firm of Ernst & Ernst prepared the following evidence, which was admitted:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional direct labor costs</td>
<td>$20,633.32</td>
</tr>
<tr>
<td>Additional indirect labor costs</td>
<td>7,091.67</td>
</tr>
<tr>
<td>Efficiency loss of direct productive labor</td>
<td>7,970.10</td>
</tr>
<tr>
<td>Estimated additional cost of operating dual facilities during the relocation period</td>
<td>17,371.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$53,066.09</strong></td>
</tr>
</tbody>
</table>

Since this additional cost was absorbed into general production costs, it necessarily reduced net profits by the same amount.

The court said:

To eliminate any doubt of this Court’s position, we hold that the evidence introduced in this condemnation proceeding showing expense occasioned by business interruption was properly introduced for consideration . . . .

To recover damages from business interruptions the proof must not be speculative and must possess a reasonable degree of certainty.

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47 Id. at 140.
48 See Reardon v. San Francisco, 66 Cal. 492, 500-01, 6 P. 317, 322 (1885).
50 357 Mich. 20, 97 N.W.2d 748 (1959).
51 Id. at 33, 97 N.W.2d at 754.
52 Id. at 31-32, 97 N.W.2d at 754.
The court in *Grand Haven* gave substance to "just compensation" by implying that its holding would be applicable to any entire "taking," and would not be limited to the facts in *Grand Haven*. The court said that although the property owner must yield to public necessity, *in no instance is he to make any sacrifice in doing so. This is the essence of "just compensation."

The words "just compensation" as interpreted by the California courts also imply that no sacrifice is to be made by the condemnee; the property owner should be made whole, or put in as good a pecuniary position after the taking as he would have been in had there been no taking. However, this language is only lip service to the principle of just compensation. Compare the following results to A in the hypothetical situation discussed above, under the principle of just compensation as applied in Michigan and then as applied in California:

**MICHIGAN**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount paid for real property</td>
<td>$50,000</td>
</tr>
<tr>
<td>Value of goodwill</td>
<td>$40,000</td>
</tr>
<tr>
<td><strong>Total Recovery</strong></td>
<td><strong>$90,000</strong></td>
</tr>
</tbody>
</table>

**CALIFORNIA**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount paid for real property</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Total Recovery</strong></td>
<td><strong>$50,000</strong></td>
</tr>
</tbody>
</table>

Certainly this $40,000 "sacrifice" made by A to the State of California could be absorbed better by the taxpayers as a whole, rather than by any one individual.

There are situations in California where even the taxpayers would be relieved of this burden, e.g., where the condemnor is a revenue-producing public entity such as a rapid transit district, a bridge authority, or a municipal transportation system. When such a public entity constructs a public improvement the initial construction cost is financed by the sale of revenue bonds to the public.

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54 357 Mich. 20, 28, 97 N.W.2d 748, 752 (1959).
56 See note 24 supra for a discussion of the measure of goodwill.
57 "The decisive consideration is whether the owner of the damaged property if uncompensated would contribute more than his proper share to the public undertaking." Clement v. State Reclamation Bd., 35 Cal. 2d 628, 642, 220 P.2d 897, 905 (1950); see Colberg, Inc. v. State, 67 Cal. 2d 408, 428, 432 P.2d 3, 15, 62 Cal. Rptr. 401, 413 (1967) (dissenting opinion), cert. denied, 390 U.S. 949 (1968).
59 See, e.g., *San Francisco Bay Area Rapid Transit District, Official Statement Relating to $70,000,000 General Obligation Bonds, Series J.* (Copy on file in Hastings Law Library).
After the completion of the public improvement, the operating revenue generated pays off the bonded indebtedness with interest; thus, the taxpayer does not contribute his tax dollar to the cost of construction.\(^{60}\) In either case—whether the condemnor is a revenue-producing public entity or not—A, or property owners in his situation, should not have to make this sacrifice.

In the above comparison of Michigan and California law, goodwill was measured according to the formula set out above;\(^{61}\) however, several state courts have successfully measured goodwill in condemnation actions in compliance with state statutes.\(^{62}\) The Vermont court in applying its statute\(^{63}\) recognized the uncertainty in measuring damage to a business, but pointed out that:

Notwithstanding uncertainty, the legislature has ordained that the owner shall be entitled to a recovery of his consequential loss in this respect [damage to business] [citations omitted]. The practical difficulty in ascertaining the exact amount does not stand in the way of carrying out the statute.\(^{64}\)

Furthermore, California agencies have, in fact, measured goodwill when purchasing property by using the appraisal technique\(^{65}\) of capitalizing income.\(^{66}\) This suggests, therefore, that not only is goodwill

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\(^{60}\) See Van Alstyne, Modernizing Inverse Condemnation: A Legislative Prospectus, 8 SANTA CLARA LAW. 1, 34 (1967).

\(^{61}\) See note 24 supra.


\(^{63}\) VT. STAT. ANN. tit. 19, ch. 5, § 221(2) (1959).


\(^{65}\) For example, when purchasing a filling station for the San Francisco Bay Area Rapid Transit District, an independent appraiser will employ the capitalization of income approach (see note 66 infra), as well as other standard methods of appraisal, in determining the fair market value of the real property. Elements included in arriving at a proper capitalization rate are: location, gross sales, and rate of return on investment. The maximum rate set by the District is 7½ per cent. Interview with Edward E. Jaynes, Senior Right-of-Way Agent for the Bay Area Rapid Transit District, in San Francisco, Sept. 6, 1968. It is interesting to note that the capitalization of income method of appraisal necessarily includes a measure of goodwill and profit. See Aloi & Goldberg, A Reexamination of Value, Good Will, and Business Losses in Eminent Domain, 53 CORNELL L. REV. 604, 615 (1968).

\(^{66}\) “The capitalized income method is best described as an attempt to measure the present value of the future income potential of a property. This present value is determined by dividing a capitalization rate (an estimate of the security and length of the income flow) into the yearly projected income.” Aloi & Goldberg, A Reexamination of Value, Good Will, and Business Losses in Eminent Domain, 53 CORNELL L. REV. 604, 615 (1968). For a complete discussion of appraisal techniques in valuing real property, including capitalization of income, see AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE, 226-82 (3d ed. 1960).
measurable with a degree of certainty, but that consideration of the value of goodwill is required in order to reach "just" compensation within the eminent domain clause of the California Constitution.67

The *Grand Haven* decision, discussed above, is also noteworthy for its modern approach to the principle of "just compensation." The Michigan court did not reject the speculation argument for denying compensation, but merely said that damage to business was compensable when ascertainable, and to deny compensation when adequate proof was presented was "sacrificing" the property of the individual to the state.68 Modern statutes in several states embody this approach and provide standards to measure damage, minimizing speculation and uncertainty.69 This result could also be realized in California if the legislature were to enact a similar statute requiring compensation for lost profits and goodwill and providing a means of measurement thereof.70 In the absence of such legislative action, the California Supreme Court should overrule or modify its decision in *Stockton & Copperopolis Railroad Company v. Galgiani*,71 to provide, at least, that when adequate proof is supplied to minimize speculation, lost profits and goodwill are elements to be considered in determining just compensation when business property is taken.

**Recovery for Business Losses When No Real Estate Is Taken**

A different, albeit related, set of arguments is used to deny compensation for lost profits and goodwill where no tangible real estate is taken. The damage to profits and goodwill is usually caused by a public entity's construction activities that interfere with customer access, thus temporarily reducing or eliminating profits and damaging the value of the business's goodwill.72

**Typical Fact Situation**

*B* owns and operates a retail store. The business has been making an annual profit of $10,000 for 10 years. A public entity has

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68 *In re Grand Haven H'way, 357 Mich. 20, 28, 97 N.W.2d 748, 752 (1959).*
69 See, e.g., Pa. Stat. Ann. tit. 26, § 1-609 (Supp. 1967), where it is stated that "[t]he condemnee shall be entitled to damages . . . for dislocation of a business located on the condemned property. . . . Compensation for such dislocation shall be the actual monthly rental paid for the business premises, or if there is no lease, the fair rental value of the business premises . . . ."
70 One measure of compensation could be to set the maximum award at ten times the average earnings of the damaged business, which is not to exceed the physical assets of the business. This measure is contained in *AN ACT TO PROVIDE COMPENSATION FOR LOSS OF GOODWILL RESULTING FROM EMINENT DOMAIN PROCEEDINGS* § 306, printed in 3 HARV. J. LEGIS. 445, 446 (1966).
71 49 Cal. 139 (1874).
started construction of a public improvement on the street abutting B's property. As a result of the construction, B's customers are denied access to the property, causing B to lose the profits of $15,000 he would have made during the 18-month period of construction interference. B anticipates that his business will return to normal at the end of the construction period.79

B argues that he is entitled to compensation for his lost profits of $15,000 under the "or damaged" clause of the eminent domain section of the California Constitution.

The "or damaged" Clause: Physical Intrusion Is Not Requisite

The leading California case interpreting the "or damaged" clause is Reardon v. San Francisco.74 In this case the plaintiff sued in inverse condemnation to recover costs incurred in repairing his building's foundation, which had been damaged when the city's construction activity caused subsidence of the plaintiff's land. In affirming the judgment for compensation, the court said:

To what kind of damage does this word "damage" refer? We think it refers to something more than a direct or immediate damage to private property, such as its invasion or spoilation. There is no reason why this word should be construed in any other than its ordinary and popular sense.75

The ordinary popular sense of the word "damage" supplied by a dictionary is "loss due to injury; injury to person, property, or reputation; hurt; harm."76 Damage to business in the form of lost profits easily conforms to this definition, leading one to believe that, under the language of Reardon, B might recover his lost profits of $15,000.

The "Not Property" Argument

Despite express approval of Reardon's interpretation of "damage," however, the California Supreme Court in Albers v. Los Angeles County77 said that "cases . . . involving loss of business . . . do not involve direct physical damage to real property, but only diminution in

The assumption that business will return to normal limits the scope of the damage to the profits lost during the period of interference. A situation where business would be permanently impaired, for example, a freeway diverts all traffic away from a business establishment, would be tantamount to a "taking" under the eminent domain clause, and the arguments set forth in the first section of this note would be applicable. Fairness would demand that the public entity compensate the owner for the diminution in the value of his real property including the value of the goodwill of the business. The measure of compensation should be the difference between what a willing buyer would pay before the diminution in value and after the diminution in value. See Rose v. State, 19 Cal. 2d 713, 738, 123 P.2d 505, 519-20 (1942).78 66 Cal. 492, 6 P. 317 (1885).
75 Id. at 501, 6 P. at 322 (emphasis added).
76 WEBSTER'S NEW INTERNATIONAL DICTIONARY 664 (2d ed. 1956).
its enjoyment,78 so that such losses are not compensable. Such language, however, is misleading. There are at least two situations in which the supreme court will allow compensation even in the absence of direct physical damage: (1) where the owner's personal right of ingress and egress is impaired;79 and (2) where the owner's personal right of light and air is obstructed.80 These rights are characterized as property rights by the courts,81 and unless an abutting property owner claims a loss based upon one of these “property” rights, no compensation will be allowed in the absence of physical damage.82 Since a businessman must depend on customer access in order to operate his business profitably, it is the infringement of this right of customer access that should be recognized as compensable. But as the California Supreme Court has said, “[a] landowner has no property right in the continuation or maintenance of the flow of traffic past his property.”83

Why the concept of property rights has not been expanded to include a right of customer access was discussed in Bacich v. Board of Control.84 In that case, the court explained at length its policy concerning property rights. If the court “decides” that the diminution in the value of the property involved is of sufficient magnitude to warrant compensation under the eminent domain clause, then it is not necessary to consider the presence of the public improvement as a “damaging” of the land; the interest involved necessarily is entitled to protection of the law and becomes a “property right” within the meaning of the eminent domain clause. However, when the court “decides” that an interest, e.g., the right of customer access, “is . . . of insufficient magnitude to warrant the payment of compensation . . . it obviously is not ‘private property’ within the scope of that clause . . . .”85 Under this self-determining approach, therefore, it is

78 Id. at 262, 398 P.2d at 136, 42 Cal. Rptr. at 96.
84 23 Cal. 2d 343, 144 P.2d 818 (1943).
85 Id. at 359-60, 144 P.2d at 823 (concurring opinion) (emphasis added).
apparent that a court could arbitrarily "decide" for itself what is and what is not protected by the constitution.

An extreme example of the injustice suffered when the court refused to "decide" that a particular right was a compensable property right is Colberg, Inc. v. State. The plaintiff shipbuilders claimed damages for permanent interference with their right of riparian access to the ocean, basing their cause of action on inverse condemnation. The state contemplated construction of two low-level bridges that would prohibit the launching of the plaintiffs' ships. The court refused to award damages; thus 81% of one shipbuilder's business and 35% of the other's business were destroyed without any compensation. Although one ground of the decision was that the state's police power over navigable waterways was superior to any right that the plaintiffs' might have had, it is suggested that the true reason behind the decision was to prevent the assertion of claims against the state treasury for business damage, which the court feared might impede the construction of public improvements.

The dissenting opinion of Justice Peters repudiated the harsh position taken by the majority of the court:

I cannot agree that because the state wants to build two low level highway bridges across the mouth of an inlet where plaintiffs' shipyards are located, plaintiffs must suffer the complete loss caused by the impairment of their right of one-way access to deep water. Principles of fairness, logic and public policy suggest this loss is a part of the freeway that should not be borne by plaintiffs but should be borne by the public...

Such access is indispensable to the operation of plaintiffs' businesses...

How can there be a public policy to put... well established businesses out of operation without compensation? The answer is obvious. There can be and is no such public policy.

Plaintiffs' personal right of one-way access to deep water was not the property right denied compensation; it was the right of customer access that was, in fact, unjustly denied compensation. A customer would not contract for the building of a ship if there were no

87 Id. It seems the court went to extreme lengths in determining that it was the power over navigable waterways that deprived the plaintiffs of any compensation. The construction of the bridges was actually part of the highway program and it seems remote from construction of a water project, e.g., a dam, spillway, or dock facility. Also, the whole problem could have been obviated by construction of draw bridges. The cost of such bridges could have been compared to the cost of compensating plaintiffs for damage to their businesses, and the lesser of the two amounts could have been included as a cost of construction.
88 The unsoundness of this fear is discussed in the text accompanying notes 33-34 supra.
deepwater access after launching. Justice Peters said that there is no public policy that permits the destruction of well established businesses without compensation; he was suggesting, therefore, that a property owner with an established business has a right of customer access, the denial of which by the state ought to be compensable in inverse condemnation as a recognized "property right.'

To avoid the unjust result of Colberg the courts must recognize the businessman's right of customer access. To deny this right protection is to put the burden of constructing public improvements on the shoulders of a few private citizens, rather than on the taxpayers as a whole where it properly belongs. Non-recognition by the courts should inspire some action by the California Legislature. Recently, the legislature has moved to nullify an unjust judicial rule that relocation expenses in condemnation proceedings are not recoverable. The legislature should be encouraged to follow this progressive trend and afford protection to a businessman's right of customer access.

The "Police Power" Argument

An abutting property owner has a lawfully protected personal right of access to and from his property—ingress and egress. When a businessman sues for injury to this right, as distinguished from a right of customer access, he may still be denied compensation on the ground that there has been a lawful exercise of the police power. An example is People v. Ayon. In this case, the plaintiff's supermarket business was damaged as a result of the construction of a

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90 Id. at 429, 432 P.2d at 15, 62 Cal. Rptr. at 413.
91 Id. at 428-29, 432 P.2d at 15, 62 Cal. Rptr. at 413.
92 Id.
93 CAL. PUB. UTIL. CODE §§ 29110-117. The legislative history concerning these sections exemplifies the necessity for their enactment: "This act is an urgency measure necessary for the immediate preservation of the public peace . . . and shall go into immediate effect. The facts constituting such necessity are: The acquisition of private property by the San Francisco Bay Area Rapid Transit District for public purposes is being felt by an increasing number of citizens who are required to relocate their . . . businesses. These persons incur moving expenses which are not presently compensated for under California law. The expeditions, payment of moving expenses and the efficient operation of the right-of-way acquisition program by said district requires the immediate authorization to pay moving expenses to those eligible persons displaced by district construction projects." 1966 JOURNAL OF THE ASSEMBLY 1522.
dividing strip in the middle of the highway abutting his property. In denying compensation for the impairment of the plaintiff's lawful right of access—actual damage being caused by the denial of the plaintiff's right of customer access—the court said the damage was non-compensable because there had been a lawful exercise of the police power in regulating traffic: "If a loss of business ... results, that is noncompensable. It is simply a risk the property owner assumes when he lives in modern society ... ."\footnote{Id. at 223-24, 352 P.2d at 522, 5 Cal. Rptr. at 154.}

Recognizing that it had rather off-handedly dismissed the plaintiff's claim for business losses, the court hastened to add: "Moreover, the location of the alley ... greatly mitigates any inconvenience to appellants' customers."\footnote{Id. at 226, 352 P.2d at 524, 5 Cal. Rptr. at 156.}

A more reasonable statement as to when the police power should be invoked to deny compensation was laid down in Rose v. State.\footnote{19 Cal. 2d 713, 123 P.2d 505 (1942).} In that case a result opposite from Ayon was reached when the state impaired the traffic flow on the street abutting the plaintiff's property. The court said that the building of such a highway improvement was not an "emergency" and did not qualify, therefore, as a noncompensable exercise of the police power. To invoke the police power indiscriminately in the construction of a public improvement would "[d]estroy the protection guaranteed by our Constitution against the taking or damaging of private property for a public use without compensation."\footnote{Id. at 730-31, 123 P.2d at 516.}

Although this statement reflects a reasonable invocation of the police power, it has not been applied uniformly. The courts have drawn a distinction between physical and nonphysical injury to property, invoking the police power to deny compensation only in the latter case.\footnote{Compare People v. Ayon, 54 Cal. 2d 217, 352 P.2d 519, 5 Cal. Rptr. 151 (1960), with Albers v. Los Angeles County, 62 Cal. 2d 250, 398 P.2d 129, 42 Cal. Rptr. 89 (1965).}

This distinction is unsound law because both tangibles and intangibles are property—specifically a property owner's personal right of access—and should be compensable when damaged by a public entity under the eminent domain clause.\footnote{See text accompanying notes 28-29 supra.} Logic dictates that all forms of property should be treated uniformly whether there has been a physical injury or not.\footnote{See text accompanying note 105 infra.}

The "Speculation" Argument Revisited

The speculation argument for denying compensation for business losses has been found unsound as applied to a physical taking upon
the following grounds: (1) the admission of proper evidence will provide a reasonable degree of certainty;\textsuperscript{107} and (2) other jurisdictions have successfully overcome the uncertainties in measuring business losses.\textsuperscript{108} Although no cases have been found employing this argument where there has not been a taking of real property, the following discussion of one California case will serve to emphasize the unsoundness of the "speculation" argument where no real property is taken and the condemnee claims lost profits.

In \textit{Natural Soda Products Co. v. Los Angeles},\textsuperscript{109} the plaintiff manufacturer brought an action for trespass to land in the nature of inverse condemnation for damages caused by the city's flooding of a dry lake, which inundated the manufacturer's brine wells, pipelines and processing plants. The plants had never made a profit, but evidence was admitted showing a loss of future profits based upon anticipated operational revenue. Damages of $153,578.85, which included loss of future profits, were awarded.\textsuperscript{110} Justice (now Chief Justice) Traynor mentioned several requirements that had to be met in order to justify the award of lost profits: (1) past sales records, (2) price stability, and (3) past operational expenses, including labor costs, depreciation, insurance and taxes.\textsuperscript{111}

Although \textit{Soda} appears to support a property owner's claim for lost profits in inverse condemnation when no real property has been "taken," the condemnor in that case did not question the propriety of awarding damages for lost profits. The case has since lain dormant, never having been followed or cited when other condemnees have claimed lost profits.\textsuperscript{112} Further, the case could be restricted to its

\textsuperscript{107} See text accompanying note 54 \textit{supra}.  
\textsuperscript{108} See note 69 \textit{supra}.  
\textsuperscript{109} 23 Cal. 2d 193, 143 P.2d 12 (1943).  
\textsuperscript{110} It is interesting to note that the court spoke in terms of inverse condemnation when awarding compensation. \textit{Id}. However, no argument was raised by the defense alleging that damage to business was noncompensable. This argument could have been based on prior case law. \textit{Oakland v. Pacific Coast Lumber Co.}, 171 Cal. 392, 153 P. 705 (1915).  
\textsuperscript{111} "In addition to other items, plaintiff was awarded damages for loss of profits, which defendant contends was not proved with certainty. The award of damages for loss of profits depends upon whether there is a satisfactory basis for estimating what the probable earning would have been . . . . In the present case plaintiff's probable gross receipts could be estimated from its sales in the preceeding two years, in view of the evidence that prices were stable. Its unit cost could be estimated on the basis of detailed figures concerning actual expenses, such as labor, depreciation, insurance, taxes, and royalties for the limited operations carried on . . . . Its plant capacity was conservatively estimated at 90 tons per day . . . . Awards of prospective profits have been sustained on the basis of much less satisfactory evidence." \textit{Natural Soda Products Co. v. Los Angeles}, 23 Cal. 2d 193, 199-200, 143 P.2d 12, 17 (1943).  
\textsuperscript{112} See \textit{People v. Dunn}, 46 Cal. 2d 639, 297 P.2d 964 (1956). \textit{Soda} has been cited as authority for the recovery of lost profits in contract and tort actions between private litigants. See cases cited in note 32 \textit{supra}. 

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specific facts, i.e., a direct physical intrusion of flood waters, and thus distinguished from the hypothetical situations above.\textsuperscript{113} It is doubtful, therefore, that this isolated case could be used successfully today to recover lost profits even under the same facts as Soda. However, if the case were given life by the California Supreme Court, the requirements outlined by Justice Traynor for the compensability of lost profits could easily be met by \( B \) in the hypothetical above as he has had 10 years of operating experience which would demonstrate his expenses, sales and profit.

\textbf{Summary and Conclusion}

This note has attempted to establish the unsoundness of judicially imposed restrictions in denying compensation for lost profits and goodwill by analyzing the weaknesses of the arguments supporting such restrictions. The interpolation of a distinction between tangible and intangible property is invalid;\textsuperscript{114} the fiction embodied in holding that a business is not property and, therefore, is not taken is specious.\textsuperscript{115} Non-recognition of the right of customer access is a denial of just compensation that imposes an unfair burden upon the property owner, a burden that should be borne by the taxpayers as a whole.\textsuperscript{116} Use of the police power to deny compensation for intangible property rights is inconsistent, resulting in unjust losses that are offensive to the constitution.\textsuperscript{117} Finally, the speculation argument as applied to a taking or a damaging is inapplicable when proper evidence is presented.\textsuperscript{118}

Clearly the court has not shown the way for proper relief to the property owner in condemnation proceedings. In the hypotheticals, \( A \) would presently be denied the value of his goodwill—\$40,000—and \( B \) would be denied compensation for his lost profits—\$15,000. There has been no attempt to pursue the trend established by the Michigan court in the \textit{Grand Haven}\textsuperscript{119} case, that lost profits are an element of compensation when real property is “taken” precluding any “sacrifice” by the property owner, thereby satisfying the constitutional requirement of just compensation. The result in the \textit{Colberg}\textsuperscript{120} case, that the property owner is denied any compensation for destruction of his business in the absence of a protected property interest, was an

\textsuperscript{113} See Albers v. Los Angeles, 62 Cal. 2d 250, 262, 398 P.2d 129, 136, 42 Cal. Rptr. 89, 96 (1965). \textit{But see} Cal. Gov't Code § 815 (Legislative Comm. Comment), where it is stated that all government liability arising out of tort is abolished except for liability as may be required by inverse condemnation.

\textsuperscript{114} See text accompanying notes 24–54 supra.

\textsuperscript{115} See text accompanying notes 38–44 supra.

\textsuperscript{116} See text accompanying notes 55–60 supra.

\textsuperscript{117} See text accompanying note 89 supra.

\textsuperscript{118} See text accompanying notes 99–100 supra.

\textsuperscript{119} \textit{In re} Grand Haven H'way, 357 Mich. 20, 97 N.W.2d 748 (1959).

\textsuperscript{120} Colberg, Inc. v. State, 67 Cal. 2d 408, 432 P.2d 3, 62 Cal. Rptr. 401 (1967).
absolute denial of justice, as pointed out by Justice Peters in his dissenting opinion, and must be prevented from recurrence. This burden can better be shared by the taxpayers as a whole rather than by any one individual.

The words of the eminent domain clause demand proper interpretation and application. Since there are no express restrictions within the clause itself, the plain meaning of the language should be supported. The constitution is a viable document that cannot be used to justify the anachronisms present in judicial decisions. The courts have constructed a judicial maze of inconsistent and arbitrary opinions dealing with business damage and property rights. Thus, the California Legislature now has the responsibility to enact remedial legislation that will give the California businessman just compensation. In drafting such legislation, the California lawmakers would do well to heed the language of the Vermont court, which interpreted the motives of its own legislature as follows:

We are convinced that the overriding purpose of the Legislature in enacting a new condemnation law was to see to it that the landowner should receive fair treatment. . . . To this end and in keeping with this purpose, it provided for damages for business loss, something which almost no other jurisdiction had set out to do. The whole spirit of the Act was to see to it that the landowner would get just treatment and fair compensation . . . .

The California businessman deserves no less.

Leon Stuart Sange*

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121 Id. at 426, 432 P.2d at 15, 62 Cal. Rptr. at 413 (dissenting opinion).
122 Id.
123 See text accompanying notes 74-75 supra.
124 See text accompanying notes 53-55 supra.
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