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A REEXAMINATION OF VALUE, GOOD WILL, AND BUSINESS LOSSES IN EMINENT DOMAIN

Frank A. Alois† and Arthur Abba Goldberg‡

An expensive piece of equipment located in Mr. Smith's industrial plant is necessary for the conduct of his business. The state decides to condemn his property, thus forcing discontinuation of the business at its present location. The equipment in question was specifically constructed for use at the present location and cannot be put to profitable use elsewhere in a comparable business operation. Nevertheless, it is physically removable from Mr. Smith's plant,¹ although the cost of removal would be so great that even the equipment's salvage value is negligible.² In addition, the relocation or forced discontinuation of the business may cause the loss of the favorable customer relations and market positions incidental to the established location.

Since a going business is an integrated whole, a condemning authority ought to compensate a condemnee sufficiently for the provable losses resulting from the interruption or forced discontinuation of his business. If, as has uniformly been the case in the absence of remedial legislation or constitutional amendment, the courts are unwilling to accept this position, then they at least ought to permit the condemnee to prove and collect damages for the difference between the value of his equipment on the day of condemnation and its value after removal from the plant, without regard to whether it is classified as a fixture in terms of real property law. Unfortunately, there is little authority for

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¹ See, e.g., *State v. Gallant*, 42 N.J. 583, 202 A.2d 401 (1964); *Glen & Mohawk Milk Ass'n v. State*, 2 App. Div. 2d 95, 153 N.Y.S.2d 725 (3d Dep't 1956).

² The facts of *State v. Gallant*, 42 N.J. 583, 202 A.2d 401 (1964), graphically illustrate this situation. A condemned factory contained several four-ton looms that could only be moved to a new location if they were dismantled. To reassemble them would be a complex engineering problem because of the wear pattern on the machines from forty years of use. The cost of moving and reassembling would approach \$40,000, a figure equal to 4/5 the value of the looms. See also *People v. Johnson & Co.*, 219 App. Div. 285, 219 N.Y.S. 741 (1st Dep't 1927).

either proposition. The cases generally speak in terms of an arbitrarily determined "market value" standard for compensation, which erroneously analyzes the condemnor-condemnee relationship in terms of existing real and personal property concepts without regard to the economic implications of the situation. This article examines possible solutions to this dilemma, some operating within the common law, others within the realm of legislative or constitutional action.

I

THE PROBLEM OF FIXTURES—A HYBRID OF LAND AND CHATTELS

One axiom of condemnation law is that the condemning authority compensates not only for the land taken but also for permanent improvements found upon it, *i.e.*, buildings and any fixtures found therein.³ A creature of common law used to determine which items,

³ See 4 NICHOLS' EMINENT DOMAIN § 13.11 (3d ed. J. Sackman 1962).

The word "fixture" is derived from the Latin "affixum" meaning "a thing attached to or fastened to." The most widely cited definition of "fixture" is that stated in the leading case of *Teaff v. Hewitt*, 1 Ohio St. 511, 527 (1853): "A fixture is an article which was a chattel, but which by being physically annexed or affixed to the realty, became accessory to it and part and parcel of it."

Three general tests have developed to determine whether an article is a fixture: (1) annexation of the article to the land or something appurtenant thereto; (2) adaptation of the article to the use of the property to which it is affixed; and (3) intention of the annexing party to make the article a permanent accession to the land. With respect to the first test, some states have passed statutes that define methods of annexation sufficient to render the article a fixture. *See, e.g.*, CAL. CIV. CODE § 660 (West 1954), providing:

A thing is deemed to be affixed to land when it is attached to it by roots, as in the case of trees, vines, or shrubs; or imbedded in it, as in the case of walls; or permanently resting upon it, as in the case of buildings; or permanently attached to what is thus permanent, as by means of cement, plaster, nails, bolts, or screws.

Such statutes, however, have generally been held merely directory, and a determination of annexation by other means remains possible. *See, e.g.*, *M.P. Moller, Inc. v. Wilson*, 8 Cal. 2d 31, 63 P.2d 818 (1936).

The second test focuses on whether the article by its nature and common acceptance is essential to the use and enjoyment of the land, or whether it is for the convenience of the particular business conducted on the realty. The former makes it a fixture, the latter a chattel. *See Roseville Pottery, Inc. v. County Bd. of Revision*, 149 Ohio St. 89, 77 N.E.2d 608 (1948).

For use of the third test see *Citizens Bank v. Mergenthaler Linotype Co.*, 216 Ind. 573, 25 N.E.2d 444 (1940); *DeCharette's Guardian v. Bank of Shelbyville*, 218 Ky. 691, 291 S.W. 1054 (1927).

What is a fixture in one set of circumstances may not be a fixture in a different set of circumstances. Thus, chattels may be deemed fixtures as between grantor and grantee or mortgagor and mortgagee, but may be deemed personalty as between landlord and tenant. *See, e.g.*, *Commonwealth v. Polk*, 389 S.W.2d 928 (Ky. 1965); *Handler v. Horns*, 2 N.J. 18, 24-25, 65 A.2d 523, 526-27 (1949); *Hays v. Doane*, 11 N.J. Eq. 84, 96 (Ch. 1855).

otherwise classified as personalty, would be considered part of the land, the fixture concept had three distinct purposes: (1) to determine which heir took when realty and personalty passed to different heirs,⁴ (2) to determine the rights of competing creditors in a debtor's property,⁵ and (3) to determine the relative rights of landlords and tenants concerning items attached to the building or land by the tenant.⁶ Developed in cases of rival claims to ownership, the fixture concept is inappropriately utilized in condemnation cases, where the primary questions are those of valuation.⁷ Nevertheless, the courts treat as compensable only equipment that meets the criteria of a fixture in terms of real property law. This rationale is defective insofar as the fixture concept is divorced from modern economic analysis and thus is incapable of providing economically sound solutions to the complex problems of valuation arising in today's condemnations.⁸

⁴ The fixture concept also determined the ability of decedent's creditors to reach estate property, since at common law, real estate vested in the heir immediately upon the death of the ancestor. *Jenks v. Liverpool & London & Globe Ins. Co.*, 206 Mass. 591, 92 N.E. 998 (1910); *Satcher v. Grice*, 53 S.C. 126, 31 S.E. 3 (1898). Real estate (and hence fixtures) were beyond the reach of decedent's creditors. *See Wilson v. Channell*, 102 Kan. 793, 175 P. 95 (1918).

⁵ *Security Trust Co. v. Temple Co.*, 67 N.J. Eq. 514, 58 A. 865 (Ch. 1904).

⁶ *Wright v. DuBignon*, 114 Ga. 765, 40 S.E. 747 (1902) (domestic fixtures); *Lindsay Bros. v. Curtis Publishing Co.*, 236 Pa. 229, 84 A. 783 (1912) (trade fixtures); *Carver v. Gough*, 153 Pa. 225, 25 A. 1124 (1893) (trade fixtures).

⁷ Similarly, the fixture concept seems an inappropriate tool for classifying property in situations where the ad valorem tax is different for real and personal property. *See generally Roseville Pottery, Inc. v. County Bd. of Revision*, 149 Ohio St. 89, 77 N.E.2d 608 (1948); Note, *Defining Real Estate for the Tax Gatherer: Two Important Aspects of the Problem in Pennsylvania Today*, 12 U. PITT. L. REV. 604-07 (1951); *cf. Commissioner of Corps. & Taxation v. Assessors of Boston*, 324 Mass. 32, 84 N.E.2d 531 (1949).

⁸ In limited instances legislatures have recognized the economic problems of destroying a going concern and have passed statutes authorizing payment of damages beyond those traditionally awarded in condemnation cases. *FLA. STAT. ANN. § 73.071* (Supp. 1966) provides that additional damages may be assessed and added to the value of the land taken when (1) the taking is for right of way purposes, (2) the taking damages a business in existence more than five years, (3) the business is owned by the condemnee, and (4) less than the entire property is sought to be appropriated. To the same effect, see 19 *Vt. STAT. ANN. tit. 19, § 221(2)* (1959), and the *Water Supply Act*, *N.Y. CITY ADMIN. CODE § K51-44* (1963).

As early as 1933, Congress authorized the TVA to provide assistance to persons forcibly displaced by TVA acquisitions. Also, under the federally aided urban renewal program and under a number of highway programs, certain "incidental damages" are compensable. In 1961 the Select Subcommittee on Real Property Acquisitions of the House Committee on Public Works was established to analyze the wide variation in compensation under the many federal property-taking programs. *See SELECT SUBCOMM. ON REAL PROPERTY ACQUISITIONS OF THE HOUSE COMM. ON PUBLIC WORKS, 88TH CONG., 2D SESS., STUDY OF COMPENSATION AND ASSISTANCE FOR PERSONS AFFECTED BY REAL PROPERTY ACQUISITION IN FEDERAL AND FEDERALLY ASSISTED PROGRAMS* (Comm. Print 1965); *cf. N.J. STAT. ANN. § 52:31B-1* (Supp. 1967).

True value of a going concern and market value of the individual parts may differ. But the difference apparently is overlooked by the courts when they attempt to place a market value on land taken. Although they purport to treat the state and the property owner as vendee and vendor bargaining at arm's length in the private market,⁹ the courts generally miss the crucial point that a willing buyer normally pays for the value of the business as a going concern, including the value of equipment especially designed for the building in which the business is housed.¹⁰ The state can *force* a sale on a reluctant owner and, through application of arbitrary valuation rules, become, in effect, a strong-arm buyer. Since traditional condemnation law does not compensate the property owner for going concern value, the inevitable result is that the state gets a bargain price.

II

NEW YORK'S ATTEMPT TO REACH THE DESIRED RESULT: THE SPECIALTY THEORY¹¹

Through a line of cases stretching over a hundred years, the New York courts have evolved a partial method of paying for business losses by compensating a landowner for business property that would lose substantially all its value when removed from the premises, even though such property might not be classified as a fixture. In the leading case of *Jackson v. State*,¹² Judge Cardozo recognized that property used as a part of a business may have a value in excess of market value. Machinery attached to a going plant "may produce an enhancement of value as

See generally Comment, *Eminent Domain Valuations in an Age of Redevelopment: Incidental Losses*, 67 YALE L.J. 61 (1957).

⁹ "The State stands toward the owner as buyer toward seller." *Jackson v. State*, 213 N.Y. 34, 35, 106 N.E. 758 (1914). *See also* *Sparkill Realty Corp. v. State*, 254 App. Div. 78, 4 N.Y.S.2d 679 (3d Dep't), *aff'd*, 279 N.Y. 656, 18 N.E.2d 301 (1938).

¹⁰ In *State v. Gallant*, 42 N.J. 583, 590, 202 A.2d 401, 405 (1964), however, this point was made clearly by Justice Haneman:

The value of a factory containing industrial equipment employed in the business for which the property is being used is ordinarily greater than that of an empty and idle building. Such equipment in place adds more to the value of the realty than its second-hand salvage value separated from the premises. An owner who is under no duress, and where the building and machinery are a functional unit, would undoubtedly sell only at a price which would reflect that increased value.

¹¹ What is here called the specialty theory has also been referred to as the institutional theory by New Jersey courts and the industrial plant doctrine by Pennsylvania courts. *See* *Robinson, McGough, & Scheinholtz, The Effect of the Uniform Commercial Code on the Pennsylvania Industrial Plant Doctrine*, 16 U. PITT. L. REV. 89, 94 (1955); Note, *supra* note 7.

¹² 213 N.Y. 34, 106 N.E. 758 (1914).

great as it did when new. The law gives no sanction to so obvious an injustice as would result if the owner were held to forfeit all these elements of value."¹³ His decision was followed by a classic series of cases refining and limiting this concept. New York easily could have reached the same result, however, through analysis of the problem in terms of the marginal efficiency of factors of production.¹⁴ But such an approach would have required a complete repudiation of prior authority—in other words, a master stroke of judicial "legislation." New York has not taken this route, but rather has evolved a "specialty theory" of compensation, the most advanced common law development to date.

In distinguishing between fixtures and personal property for purposes of valuation in condemnation proceedings, the early New York cases, like those in other jurisdictions, placed special emphasis on the element of physical attachment.¹⁵ The more substantial or permanent the degree of affixation, the more likely the item would be classified as a fixture and therefore be compensable. Later New York cases used the intention of the owner, viewed in terms of permanence and adaptability, as the primary test.¹⁶ In addition to compensation for the land and buildings, this theory allowed compensation for any machinery that the owner intended to retain upon the realty and was essential to his use of the land.¹⁷ The physical attachment became of incidental importance.

The earliest condemnation case focusing on the factor of special construction and use was *In re City of New York (North River Water Front)*,¹⁸ which involved condemnation of a building fitted with machinery for the manufacture of boiler equipment. The city contended

¹³ *Id.* at 36, 106 N.E. at 758. See also *In re City of New York (Seward Park Slum Clearance Project)*, 10 App. Div. 2d 498, 200 N.Y.S.2d 802 (1st Dep't 1960). Many cases, however, give sanction to this unjust disposition of condemnation awards. Thus, *City of Los Angeles v. Siegel*, 230 Cal. App. 2d 982, 41 Cal. Rptr. 563 (1964), rejected the lessee's contention that he should be reimbursed for items of personal property that were severed from his restaurant and former liquor business by a condemnation action, thus becoming essentially valueless. See also *United States v. 116.00 Acres of Land*, 227 F. Supp. 100, 106 (W.D. Ark. 1964).

¹⁴ See pp. 622-25 *infra*.

¹⁵ *In re City of New York (Twelfth Ward)*, 39 App. Div. 589, 57 N.Y.S. 657 (1st Dep't 1899); *Walker v. Sherman*, 20 Wend. 636 (N.Y. Sup. Ct. 1839); *Phipps v. State*, 69 Misc. 295, 127 N.Y.S. 260 (Ct. Cl. 1910).

¹⁶ See *In re City of New York (North River Water Front)*, 118 App. Div. 865, 103 N.Y.S. 908 (1st Dep't), *aff'd mem.*, 189 N.Y. 508, 81 N.E. 1162 (1907).

¹⁷ *McRea v. Central Nat'l Bank*, 66 N.Y. 489 (1876) (a vendor-vendee situation).

¹⁸ 118 App. Div. 865, 103 N.Y.S. 908 (1st Dep't), *aff'd mem.*, 189 N.Y. 508, 81 N.E. 1162 (1907).

that it was liable only for the land and building, since it did not take any of the machinery located in the building. The machinery was constructed on foundations sunk into the ground and was connected by shafting to either steam or croton water pipes. Most of the machinery could have been removed from the building without seriously damaging the land or the building. In holding the machinery compensable, the court stated the general rule as follows:

[O]n the condemnation of property the owners of the buildings and leasehold are entitled to be paid the fair market value of the buildings as they exist, together with such permanent machinery as has been built into the buildings and used in connection with the leasehold estate for business purposes.¹⁹

Conceding that personal property readily removable from the building and having a substantial value if disconnected from it would not be compensable, the court cautioned that:

[A]s far as the property has become a real part of the building constructed for the particular use to which it is put by the tenant, it seems . . . that the tenant is entitled to what that property in use in connection with his leasehold is reasonably worth.²⁰

The eloquence and analysis of Judge Cardozo made *Jackson v. State*²¹ the leading early case developing the specialty theory, even though *North River Water Front* preceded it by seven years. Claimant's warehouse containing machinery, shafting, elevators, and conveyors was appropriated for the use of the Barge Canal. The building was valued at \$9,000 and the land at \$4,353.20. In awarding compensation for the machinery, the court of appeals stated two interrelated, yet separable, theories. The first simply emphasized that the former chattels had become compensable fixtures.²² But Judge Cardozo went on to comment:

Condemnation is an enforced sale, and the State stands toward the owner as buyer toward seller. On that basis the rights and duties of each must be determined. It is intolerable that the State, after condemning a factory or warehouse, should surrender to the owner a stock of second-hand machinery and in so doing discharge the full measure of its duty. Severed from the building, such machinery commands only the prices of second-hand articles; attached to a going plant, it may produce an enhancement of value as great as it did when new. The law gives no sanction to so obvious an injustice

¹⁹ *Id.* at 866, 103 N.Y.S. at 909.

²⁰ *Id.* at 867, 103 N.Y.S. at 909 (dictum). This dictum enunciates the specialty theory by adding the value of the special equipment to the land.

²¹ 213 N.Y. 34, 106 N.E. 758 (1914).

²² *Id.* at 35, 106 N.E. at 758.

as would result if the owner were held to forfeit all these elements of value.²³

Though still operating within the traditional realty-personalty dichotomy, Cardozo's core concept was "enhancement of value." He seemed less concerned with the fixture concept than with a unit theory of valuation that considered the land and everything on it as a whole.²⁴

Eleven years later, in *Banner Milling Co. v. State*,²⁵ the court of appeals again hinted at an enhancement-of-value theory in determining what items were compensable in a flour milling operation. Holding that the land and fixtures were to be valued as a whole, the court not only stated what has become known as the unit rule of valuation²⁶ but also appeared to go further by quoting from the opinion below:

The claimant is entitled to recover the value of its physical property as it existed at the time of the appropriation. That does not mean that its value is to be arrived at by taking the value of the various elements and items making up the property separately, and considering them without reference to each other, and then adding together these sums. The claimant is entitled to compensation, not merely for so much land, so much brick, lumber, materials and machinery considered separately, but if they have been combined, adjusted, synchronized and perfected into an efficient functioning unit of property, then it must be paid for that unit, so combined, adjusted, synchronized and perfected, as it existed at the moment of appropriation. In that limited sense, it is entitled to the "going value"—if such a term is permissible—of its physical property.²⁷

Although on its face the quoted language can be read as a *carte blanche* endorsement of a "going value" theory, subsequent decisions continued to have difficulty with the meaning of *Banner Milling* and with the going-value concept generally.

²³ *Id.* at 35-36, 106 N.E. at 758.

²⁴ It should also be noted that the opinion placed emphasis not on what the state took but rather on what the owner lost. *Jackson* is cited for this interpretation in *Sparkill Realty Corp. v. State*, 254 App. Div. 78, 82, 4 N.Y.S.2d 679, 682 (3d Dep't), *aff'd*, 279 N.Y. 656, 18 N.E.2d 301 (1938), where the court said:

It is settled beyond question that respondents are entitled to recover the fair market value of their property based on the most advantageous use to which it could be put. In the case appellant occupies the status of a purchaser.

This should be the core concept of the law of eminent domain, since the purpose of condemnation proceedings is "to fix an amount of money that will roughly indemnify the owner for the loss of his condemned property." 1 L. ORGEL, VALUATION UNDER THE LAW OF EMINENT DOMAIN 2 (2d ed. 1953).

²⁵ 240 N.Y. 533, 148 N.E. 668, *cert. denied*, 269 U.S. 582 (1925).

²⁶ The unit rule of valuation is spelled out in 4 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 13.12(1), at 366-67.

²⁷ 240 N.Y. 533, 544, 148 N.E. 668, 692, *cert. denied*, 269 U.S. 582 (1925).

*People v. Isaac Johnson & Co.*²⁸ limited the going-value interpretation of *Banner Milling*. The *Johnson* court did not view *Banner Milling* as sanctioning compensation for personal property merely because that property contributed to the going value of the parcel. Only those items of property that qualify as fixtures under the traditional property definition or the permanence and adaptability definition can contribute to the calculations of going value.²⁹

Thus, *Johnson* focused upon "fixture-ness" and thereby read *Banner Milling* restrictively. But the court did not seem entirely satisfied with its conclusion. After stating the claimant's argument for recovery, Judge McAvoy commented:

While this is a substantial item of damage and would appear as a matter of first impression to be a proper basis for an award, yet the rule in this State . . . is against the payment for any personal property in a condemnation of land by the State which remains the property of the claimant³⁰

Thus, if the *Johnson* court had not been burdened by precedent, it might have allowed the claim for so-called personal property. But, as an intermediate court, it felt compelled to follow what it comprehended to be pronouncements of the court of appeals in *Banner Milling* and *Jackson*. To the *Johnson* court, the *Jackson* case simply held that "an appropriation of land . . . is an appropriation of all that is annexed to the land, whether classified as buildings or as fixtures."³¹ Though technically correct, this reading of the *Jackson* case ignores Cardozo's statements that the state must compensate the owner of a factory or warehouse for the machinery used in its operations, because after severance the machinery would command only the price of a second-hand article, whereas when attached to a going plant it could produce an enhancement of value as great as it did when new.³²

Jackson, *Banner Milling*, and *Johnson* all used some form of going-value yardstick within the traditional limitations of the fixture cases.

²⁸ 219 App. Div. 285, 219 N.Y.S. 741 (1st Dep't), *aff'd*, 245 N.Y. 627, 157 N.E. 885, *cert. denied*, 275 U.S. 571 (1927).

²⁹ *Id.* at 288-89, 219 N.Y.S. at 744.

³⁰ *Id.* at 288, 219 N.Y.S. at 744. If Judge McAvoy is taken literally, the problem can be solved by having the state take title to the personal property.

³¹ *Id.* at 289, 219 N.Y.S. at 744-45.

³² See pp. 609-10 & note 23 *supra*. It may be significant that in this particular part of the *Jackson* opinion, Cardozo did not refer to fixtures but rather spoke only about machinery. It is therefore possible that Cardozo was proposing a new theory based upon equitable considerations in which machinery, even if technically classified as personal property, would be compensable if integrated into the operation of a going concern. If this be so, then *Johnson* is clearly over-restrictive.

But not until 1956, in *Glen & Mohawk Milk Association v. State*,³³ did a New York court admit that the going-value theory might be different from the fixture theory. The case involved a claim arising out of the appropriation of a plant specially constructed to receive and process milk.³⁴ The court of claims awarded damages on the basis that "[t]he buildings on this property were especially built and equipped for the receiving and processing of milk, and constituted an 'adjusted, synchronized and perfected' unit."³⁵ On appeal, the state argued that much of the property for which compensation was awarded was noncompensable personal property. Rejecting this contention, the Appellate Division for the Third Department held:

An allowance was made for the "difference between the value of the machinery and equipment . . . and the value which such machinery and equipment added to the real property when used in connection therewith as a 'going concern' in full operation." This was done upon the theory that the machinery and equipment when in the buildings *enhanced the value of the real property and permanent fixtures*.³⁶

The court thus placed primary emphasis on a specialty concept, valuing a unitary, specially constructed business entity as a whole. The items in dispute were treated not as permanent fixtures but merely as enhancing the value of the fixtures. The court, however, subjected its holding to two important limitations: (1) the use in question (milk processing) was the *only use* for which these items were adaptable, and (2) compensation was not allowed for personal property as such.³⁷ Liberally construed, *Glen & Mohawk* can be cited as a complete repudiation of the realty-personalty dichotomy, with a new emphasis on going-concern value as the standard of valuation. Narrowly interpreted, the opinion merely utilizes the specialty concept to avoid the personal property limitation by creating a dual classification of fixtures: permanent fixtures³⁸ and some other undefined fixtures that add to the value of the realty and the permanent fixtures.³⁹

³³ 2 App. Div. 2d 95, 153 N.Y.S.2d 725 (3d Dep't 1956).

³⁴ The property is described in detail in *id.* at 96-97, 153 N.Y.S.2d at 727.

³⁵ *Glen & Mohawk Milk Ass'n v. State*, 207 Misc. 1130, 1132, 143 N.Y.S.2d 125, 126 (Ct. Cl. 1955).

³⁶ 2 App. Div. 2d at 97, 153 N.Y.S.2d at 727 (emphasis added).

³⁷ *Id.*

³⁸ The landmark American fixture case, *Teaff v. Hewitt*, 1 Ohio St. 511, 524 (1853), stated that anything other than a permanent fixture was a contradiction in terms.

³⁹ The court apparently substituted the criterion of "special construction" for the prior liberal definition of fixtures in terms of "permanence" and "adaptability." Thus,

The theory formulated in *Glen & Mohawk* has had a discernible impact on later decisions. Increasingly the courts have expressly recognized going-concern value as a compensable item of damages in a condemnation award.⁴⁰ Two subsequent decisions illustrate this liberalization of judicial attitude.

*In re City of New York (Lincoln Square Slum Clearance Project)*⁴¹ compensated a landowner for readily detachable personalty in an ice-making plant; each item was found to contribute to "an efficiently functioning unit, usefully employed in the manufacture of ice."⁴² In awarding compensation for all machinery in the plant, the court used the liberal theory of fixture⁴³ and implied that it would have awarded additional damages had the claimant introduced competent proof of going-concern or specialty-operation value.⁴⁴

an indirect and perhaps unintentional result of the court's effort to avoid conflict with the maxim that personal property is not compensable is a further liberalization of the definition of fixture⁴³ for condemnation purposes. Stretching this theory to its outer limits, an item of property that would not qualify as a fixture under either the "affixation" test or the "permanence" and "adaptability" test could conceivably become compensable if specially constructed for use in a "going concern."

⁴⁰ Admittedly, there is some confusion over terminology; the terms "going concern," "going value," and "specialty operation" appear to have been used interchangeably in describing the same theory of compensation. However, we believe specialty operation to be most descriptive of the specific theory of compensation under discussion.

⁴¹ 24 Misc. 2d 190, 201 N.Y.S.2d 443 (Sup. Ct. 1959), *modified*, 15 App. Div. 2d 153, 222 N.Y.S.2d 786 (1st Dep't 1961), *aff'd*, 12 N.Y.2d 1086, 190 N.E.2d 423, 240 N.Y.S.2d 30 (1963).

⁴² *Id.* at 192, 201 N.Y.S.2d at 448. The items included transformers, panel boxes, distillers, chemical tanks, water filters, sump pumps, and an ice cube hoisting machine. *Id.* at 205, 201 N.Y.S.2d at 462-63. Significantly, the court also concluded that the plant had an excellent business location. *Id.* at 192, 201 N.Y.S.2d at 448.

⁴³ All of the machinery and equipment in dispute . . . were put in the buildings by the owner with the intention that they should remain upon the land and were essential to the use which the owner made of it. The necessary tests of permanence and adaptability having thus been met, it is not necessary to prove immovability, since we are dealing with an owner rather than a tenant.
Id. at 195, 201 N.Y.S.2d at 451. On the basis of this rule of valuation, the court concluded:

Since the character of the structures was well adapted to the land, and since earning capacity is not applicable in view of their specialized nature, the measure of the value which they added to the land is the "testimony of structural value, which is but another name for cost of reproduction, after making proper deduction for wear and tear"

Id. at 192, 201 N.Y.S.2d at 448.

⁴⁴ I believe that the foregoing awards . . . give full consideration to whatever "going value" was proved to exist in this plant. In the *Banner Milling* case . . . the proof established that the business had produced for the claimant average earnings of over \$50,000 annually. In the case at bar, claimant offered no competent proof of earnings, so that the only test of value is reproduction cost, less depreciation.

Id. at 204, 201 N.Y.S.2d at 461.

*In re City of New York (Seward Park Slum Clearance Project)*⁴⁵ provides one of the clearest statements of a specialty theory. After conceding that the owner of a funeral parlor could receive compensation for fixtures, the court stated that "it seems that an award in condemnation may also be made for property, albeit readily removable without damage to the freehold, *if such property were used for business purposes and would lose substantially all of its value after severance . . .*"⁴⁶ The court's emphasis on use for business purposes rather than on the traditional adaptation and permanence criteria is an indication of the direction in which New York may go.

In sum, it is clear that New York courts hold, consistently with other jurisdictions,⁴⁷ that an owner of personal property is not entitled to compensation for the damage to or removal cost of personal property when land is taken in a condemnation proceeding. Yet, contrary to most jurisdictions, New York seems to hold that, when removal of custom-built personal property would destroy its value, it should be deemed a fixture and therefore compensable.⁴⁸ New York is straining to escape the realty-personalty distinction in order to compensate for an item that is an integral part of a business operation regardless of the label pinned on it. In short, New York is attempting a functional approach to the problem.

⁴⁵ 10 App. Div. 2d 498, 200 N.Y.S.2d 802 (1st Dep't 1960).

⁴⁶ *Id.* at 500, 200 N.Y.S.2d at 804 (emphasis added). See also *People ex rel. Hotel Paramount Corp. v. Chambers*, 298 N.Y. 372, 83 N.E.2d 839 (1949) (valuing hotel property in a tax case); *In re City of New York (Kramer Realty Corp.)*, 16 App. Div. 2d 148, 226 N.Y.S.2d 288 (1st Dep't 1962), *aff'd*, 12 N.Y.2d 1094, 240 N.Y.S.2d 160, 190 N.E.2d 533 (1963) (valuing a formica plant as a specialty); *In re City of New York (Newoak Realty Co.)*, 13 App. Div. 2d 668, 213 N.Y.S.2d 973 (2d Dep't 1961) (holding that the plant might be "integrated" and valued as a specialty while the building in which the plant was operated was not unique); *In re City of New York (Field's Baking Corp.)*, 27 App. Div. 2d 539, 275 N.Y.S.2d 119 (2d Dep't 1966) (valuing a bakery as a specialty).

⁴⁷ *E.g.*, *State v. Hansen*, 80 Idaho 201, 327 P.2d 366 (1958); *In re Appropriation for Highway Purposes*, 167 Ohio St. 463, 150 N.E.2d 30 (1958).

⁴⁸ *Marraro v. New York*, 12 N.Y.2d 285, 189 N.E.2d 606, 239 N.Y.S.2d 105 (1963); *In re City of New York (Seward Park Slum Clearance Project)*, 10 App. Div. 2d 498, 200 N.Y.S.2d 802 (1st Dep't 1960). In addition to the specialty theory, New York also added a new wrinkle to the traditional fixture rules for compensation by holding that where a condemnation forces the premature removal of a fixture the owner (or tenant, as the case may be) is entitled to an award in the amount of the value of the fixture less salvage, notwithstanding that the fixture was actually removed by the owner. *City of Buffalo v. Michael*, 16 N.Y.2d 88, 209 N.E.2d 776, 262 N.Y.S.2d 441 (1965); *Cooney Bros., Inc. v. State*, 27 App. Div. 2d 93, 276 N.Y.S.2d 337 (3d Dep't 1966).

Other courts have occasionally compensated for damage to all personal property caused by removal. *Chicago, M. & St. P.R.R. v. Hock*, 118 Ill. 587, 9 N.E. 205 (1886). The problem with this approach is that even if not damaged, the item may still be valueless when removed.

III

A SURMISE ON APPRAISAL JUGGLING: ANOTHER METHOD
OF REACHING THE DESIRED RESULT

At the risk of elevating what at best is conjecture or an educated guess to the level of fact, the authors believe that the courts are compensating for damages to equipment and for an overall going-concern value necessarily including good will through a liberal application of certain appraisal techniques. Specifically, appraisal by means of capitalizing income⁴⁹ and estimating reproduction cost less depreciation⁵⁰ are the villains or heroes of the piece, depending upon one's point of view.

The "market data" or "comparable sales" approach, a third method, is considered the most reliable way of establishing market value.⁵¹ It purports to be objective, "because records are easily available and because it is a good criterion of what the fictitious willing seller will accept for his property and what the fictitious willing buyer will pay for it."⁵² The courts seem unperturbed by what some of their brethren term the essential "subjectivity" of determining the comparability of any two pieces of property;⁵³ and they seem unaware that

⁴⁹ 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.

See generally *Doner v. State*, 49 Misc. 2d 796, 798, 268 N.Y.S.2d 503, 505-06 (Ct. Cl. 1966) (discussing the Inwood Method of capitalizing income); G. SCHMUTZ, CONDEMNATION APPRAISAL HANDBOOK 60-64 (rev. ed. E. Rams 1963) (discussing the Ellwood Analysis for projecting the value of property); 19 N.Y. JUR. *Eminent Domain* § 191, at 430 (1961).

⁵⁰ The reproduction-cost-less-depreciation method has been described as "the price a reasonable man would pay to reproduce the structure less depreciation from all causes, physical wear, functional obsolescence, economic obsolescence." G. LEFCOE, LAND DEVELOPMENT LAW 114 (1966). Obviously, this method is inapplicable to valuation of land, which neither costs money to build nor depreciates. Thus, when both buildings and land are condemned, the reproduction-cost-less-depreciation method may be used for the structure and another method may be used for the land. *Id.* See generally *In re City of New York (Blackwell's Island Bridge)*, 198 N.Y. 84, 87-88, 91 N.E. 278, 279 (1910); 19 N.Y. JUR. *Eminent Domain* § 180 (1961).

⁵¹ See, e.g., ABA REPORT OF COMMITTEE ON CONDEMNATION AND CONDEMNATION PROCEDURE 38 (1962).

⁵² ABA REPORT OF COMMITTEE ON CONDEMNATION AND CONDEMNATION PROCEDURE 35 (1966).

⁵³ *But cf.* *Weber v. State*, 25 App. Div. 2d 584-85, 267 N.Y.S.2d 152, 153 (3d Dep't 1966):

We find without merit the State's contention that proof of sales of comparable properties was conclusive as against expert testimony of higher values; . . . sales that are "comparable" are just that and proof thereof by no means assumes identical location or identical value.

the sales price of so-called comparable property often contains increments attributable to such "noncompensable items" as going concern value, good will, and business location.⁵⁴ Preference for the comparable sales technique has limited the use of other valuation techniques.⁵⁵

In general, capitalization of income is used only when rental property, rather than business profits, is involved.⁵⁶ And reproduction cost less depreciation is used only with specialty property, *i.e.*, specially constructed or otherwise unique property for which there is no readily determinable market.⁵⁷ These restrictions may be rooted in a distrust for the "economic" nature of these methods. Also, capitalization of business profits seemingly goes against the rule that only the land on which the business is conducted, not the business, is taken. The comparable sales technique, on the other hand, is apparently viewed as a part of conveyancing law, and thus fits with the notion that eminent domain is merely an offshoot of real property law and should have "standard objective" rules.⁵⁸ In recent years, however, the courts have

⁵⁴ See pp. 626-36 *infra*.

⁵⁵ 19 N.Y. JUR. *Eminent Domain* § 180, at 410 (1961), prefaces its discussion of structural or reproduction costs with the following comment: "As a general rule, the measure of compensation upon the appropriation of land and buildings or improvements is the value of the land as enhanced by such improvements, and not the cost of the improvements." (Emphasis added; footnote omitted.) See also *Village of St. Johnsville v. Smith*, 184 N.Y. 341, 350, 77 N.E. 617, 620-21 (1906).

⁵⁶ 19 N.Y. JUR. *Eminent Domain* § 189 (1961). See also *Sill Corp. v. United States*, 343 F.2d 411 (10th Cir. 1965); *United States v. Certain Interests in Property*, 239 F. Supp. 822 (D. Colo. 1965); A. JAHR, *EMINENT DOMAIN: VALUATION AND PROCEDURE* § 150, at 232-33; 4 NICHOLS' *EMINENT DOMAIN*, *supra* note 3, § 12.3121[3], at 124-25.

⁵⁷ See 19 N.Y. JUR. *Eminent Domain* § 180, at 411-12 (1961).

Kendall v. State, 168 So. 2d 840 (La. Ct. App. 1964), is a classic example of a unique improvement. The property there included an artificial lake that appreciably enhanced its market value. The court awarded the cost of restoring the lake. See also *State v. Ouachita Parish School Bd.*, 162 So. 2d 397 (La. Ct. App. 1964), where the proper measure of damages for appropriation of a school's playground was held to be the reproduction cost less depreciation and residual value for other purposes of the entire plant.

The various departments of New York's Appellate Division are split on whether proof of reproduction cost less depreciation should be allowed in most cases. See, *e.g.*, *Case v. State*, 27 App. Div. 2d 704 (4th Dep't 1967) (especially Record on Appeal and Briefs); *Guthmuller v. State*, 23 App. Div. 2d 597, 256 N.Y.S.2d 526 (3d Dep't 1965); *In re City of New York (Newoak Realty Co.)*, 13 App. Div. 2d 668, 213 N.Y.S.2d 973 (2d Dep't 1961), *modified on other grounds*, 12 N.Y.2d 1007, 189 N.E.2d 627, 239 N.Y.S.2d 133 (1963); *In re City of Rochester (Smith Street Bridge)*, 234 App. Div. 583, 586, 255 N.Y.S. 801, 807 (4th Dep't 1932).

The term "specialty," as used in determining the propriety of reproduction cost less depreciation, generally describes a structure with a "limited, if any, market." 19 N.Y. JUR. *Eminent Domain* § 180, at 412 (1961); see *Nissenbaum v. State*, 24 App. Div. 2d 807, 263 N.Y.S.2d 756 (3d Dep't 1965).

⁵⁸ Professor Lefcoe points out many difficulties with this so-called "objective" standard:

The sales method directs attention to "recent sales of similar property." Hence,

expanded the use of both the capitalization-of-income and reproduction-cost-less-depreciation techniques, perhaps with a view toward eventually changing the underlying substantive rules.⁵⁹

This trend is clearest in the cases that use these theoretically impermissible techniques as a method of "checking" the accuracy of the market data approach.⁶⁰ In *In re City of Rochester v. Friedman*⁶¹ an urban renewal project required condemnation of a parcel that was almost entirely occupied by a profitable baby furniture store. The owner's expert capitalized income using a "hypothetical" rental for the premises, based upon rentals for comparable structures.⁶² He also used replacement cost less depreciation to value improvements, and both experts used the market data approach based on comparable sales.⁶³ The court, however, discounted all "comparables" on the ground that they differed substantially from the subject premises in "location, nature, condition of the improvements, utilization factors leading to sale

a relevant time span must be chosen, that is when land prices were roughly the same level as at the date of valuation. Temporary "fluctuations" must be discounted. If the date of valuation occurs during a temporary fluctuation, what adjustment, if any, should be made when comparing similar sales? More than the changing values in land prices must be considered; the purchasing power of money fluctuates as well. What if the date of valuation falls during an inflation or a depression? Is the landowner's claim the same and equally valid in an inflation as it would be in a depression; in a long run as opposed to a short run depression or inflation?

Since we are to consider only similar properties, adjustments must be made for those inevitable differences: location, quality of construction, materials, and design; amenities like a view or freedom from noise; and so on. How are zoning differences to be treated? The terms and conditions of these other sales must be studied; for example, were they for cash or credit? Once upon a time, the price was lower when paid all in cash; the Internal Revenue Code now places a premium on the credit transaction, so that in some cities a buyer who insists on paying cash must pay a five to ten percent premium. In determining "just compensation," should it matter that, in fact, the government pays the condemnee in cash?

G. LEFCOE, *supra* note 50, at 122.

⁵⁹ See, e.g., *City of St. Louis v. Union Quarry & Constr. Co.*, 394 S.W.2d 300 (Mo. 1965) (evidence of profits allowed in valuation of dump); *United States v. Eden Memorial Park Ass'n*, 350 F.2d 933 (9th Cir. 1965) (capitalization applied to funeral parlor).

⁶⁰ Thus, in *In re Huie*, 2 N.Y.2d 168, 171, 139 N.E.2d 140, 142, 157 N.Y.S.2d 957, 960-61 (1956), the New York Court of Appeals asserted:

In the determination of that just compensation, there is no single element which is controlling, and it is competent for the commissioners of appraisal to consider all factors indicative of the value of the property, such as its fair market value as of the date of appropriation . . . , the reproduction cost of improvements . . . , sales of similar property . . . , location . . . , income . . . , highest suitable use . . . , and consequential damages to property not taken but affected by the condemnor's use

See also *Bond v. State*, 24 App. Div. 2d 778, 263 N.Y.S.2d 732, 733 (3d Dep't 1965).

⁶¹ No. 7612-64, Memorandum decision filed in office of Monroe County Clerk (Sup. Ct., July 12, 1967).

⁶² *Id.* at 4.

⁶³ *Id.* at 4-5.

and time of sale"⁶⁴ The city strenuously objected to the use of replacement cost less depreciation to value the improvements, but the court explained that, although the improvements "were neither unique nor a specialty,"⁶⁵ the replacement-cost-less-depreciation data were admissible insofar as they "were used simply as a means of checking their estimate of value and were not deemed controlling."⁶⁶ Without breaking down its computation, the court concluded that the "sound market value" at the time of taking was \$125,000, a figure closer to the owner's estimate of \$149,000 than to the city's figure of \$69,700. The court commented that it "regarded the preponderance of the evidence as favoring a finding that the subject premises should be treated as a single unit, both as to the valuation of the land and the improvements which fully covered it."⁶⁷

Capitalization of income based upon hypothetical rentals necessarily involves some element of going-concern value, since such rentals must be based not on the rental of dormant space but rather on the rental of the premises as an operating entity at its highest and best use. The court in *Friedman* may have regarded these rentals as including going-concern value, since it talked of the "location, character of the neighborhood and proximity to other furniture and appliance stores [as] . . . factors throwing light on fair market value."⁶⁸ Although unsupported by the opinion's express language, this conclusion gains strength from the court's apparent use of the capitalization-of-income technique.

*Norman's Kill Farm Dairy Co. v. State*⁶⁹ demonstrates that similar wonders can be worked solely through the use of the replacement-cost-less-depreciation technique.⁷⁰ *Norman's Kill* involved the appropria-

⁶⁴ *Id.* at 5.

⁶⁵ *Id.* at 6.

⁶⁶ *Id.* at 4.

⁶⁷ *Id.* at 7.

⁶⁸ *Id.* at 6; cf. *Sunnybrook Realty Co. v. State*, 11 App. Div. 2d 888, 203 N.Y.S.2d 286 (3d Dep't 1960), *aff'd*, 9 N.Y.2d 960, 176 N.E.2d 203, 217 N.Y.S.2d 227 (1961), which involved, among other things, the appropriation of property upon which was operated a gasoline station and tire sales agency. The claimant's expert used the capitalization method while the state's expert insisted on examining only comparable sales and reproduction cost less depreciation. On appeal by the state, the court reduced the award but did not disapprove the claimant's use of capitalization.

This court recently pointed out . . . that capitalization of net rental value is a factor which may be taken into consideration in arriving at the fair market value of property. There, as here, the rental value was based on profit derived from the business conducted on the property and the property was unusual because of its location and the installation thereon.

Id. at 889, 203 N.Y.S.2d at 287.

⁶⁹ 53 Misc. 2d 578, 279 N.Y.S.2d 292 (Ct. Cl. 1967).

⁷⁰ A comment in *Gurwitz v. State*, 27 Misc. 2d 731, 211 N.Y.S.2d 641 (Ct. Cl. 1961),

tion of an old but unusually profitable dairy products processing plant. As a prerequisite to utilizing the replacement-cost-less-depreciation method, the court first determined that the property was a "specialty."⁷¹ Though in theory this method should be used to determine only the cost of replacing the physical plant, without any consideration of the business actually carried on,⁷² the court emphasized:

The uncontroverted fact that claimant's profits were substantial as well as substantially above the norm for dairy businesses would tend to support the conclusion that the structural improvements were well-adapted to the site, and it is clear that income or profits produced in a "specialty" operation are relevant on that particular issue.⁷³

Bowing to the maxim that good will is not compensable, the court paused to caution:

Although claimant's business could be categorized as very successful, the court has given due consideration to the obvious importance of skilled management and good will which, of course, were not affected by the appropriation of claimant's property.⁷⁴

Since the state is paying only for the cost of replacing the physical plant and not for loss of profits, business interruption, and destruction of good will, the court's reliance solely upon cost of replacement seems inadequate. The suspicion remains that relying on a past record of profits to indicate adaptability to a particular use must eventually manifest itself in a dollars and cents increment in the value of the property. But paying for profits upon the taking of a going business, though economically sound,⁷⁵ is legally improper.⁷⁶ Or is it?

aff'd, 15 App. Div. 2d 712, 223 N.Y.S.2d 854 (3d Dep't 1962) gives rise to a suspicion that profits are included in reproduction-cost-less-depreciation valuations: "It is a fact that evaluation of fixtures on the basis of reproduction cost less depreciation results *invariably* in assigning a higher value to the fixture than it would be worth at its normal market value." *Id.* at 736, 211 N.Y.S.2d at 647 (emphasis added).

⁷¹ 53 Misc. 2d at 580, 279 N.Y.S.2d at 295.

⁷² See note 50 *supra*.

⁷³ 53 Misc. 2d at 581, 279 N.Y.S.2d at 296.

⁷⁴ *Id.* at 582, 279 N.Y.S.2d at 297.

⁷⁵ See pp. 629-30 *infra*.

⁷⁶ The New York Court of Appeals in *St. Agnes Cemetery v. State*, 3 N.Y.2d 37, 143 N.E.2d 377, 163 N.Y.S.2d 655 (1957), distinguished between payment for lost profits, which it recognized as not allowable, and consideration of "clearly to be expected future earnings" as a means of valuing condemned cemetery lots. With reference to cases in which awards were based on the stated rental of land to be received under outstanding leases, the court stated:

Superficially it would appear in these cases that the trial court reached a value derived from capitalization of profits, a theory of appraisal which has been condemned (*United States ex rel. T.V.A. v. Powelson*, 319 U.S. 266) but actually

Some courts, perhaps tiring of the circumspection incident to the appraisal juggling game,⁷⁷ have taken cautious, though undeniably direct, steps toward payment for business losses—specifically, lost profits.⁷⁸

In *City of St. Louis v. Union Quarry & Construction Co.*,⁷⁹ the

this court, conscious that business profits are not allowable, adopted the rule that present value of "clearly to-be-expected future earnings may be considered" (*Brooklyn Eastern Dist. Term. v. City of New York*, 139 F.2d 1007, 1013 [C.A. 2d], Ann. 152 A.L.R. 296, 307, cert. denied, 322 U.S. 747). The method of valuing real property on the basis of earnings past as well as prospective was considered appropriate in those cases. The Court of Claims has utilized that method as supported by actual sales. In this case the theory of damage and method of appraisal are based upon a proof of loss of the value of the land itself, not a capitalization of profits.

Id. at 45, 143 N.E.2d at 382, 163 N.Y.S.2d at 662-63. But how "clearly to-be-expected" must future profits be before they are compensable? If one concedes that nothing is more certain than death and taxes, the key to certainty in the foregoing case may be that it involved appropriation of a cemetery.

⁷⁷ Occasionally a court rebukes those involved in producing appraisals with wide and unsubstantiated discrepancies.

This court has said repeatedly, that a citizen whose property is taken away without his consent is entitled to receive by either direct negotiation with the condemnor or through a court decree the top *honest* dollar—no more and no less. The condemning authority has no moral right to seek out cheap or low appraisals but should be willing and prepared to pay the property owner full and just compensation. Those representing the property owner are just as guilty if they seek to obtain experts who will testify to exorbitant and unbelievable values. *Murphy v. State*, 41 Misc. 2d 906, 908, 247 N.Y.S.2d 453, 456 (Ct. Cl. 1964) (emphasis in original). It is perhaps because of this concern that the claimant receive the top honest dollar compensation that the courts themselves are on occasion compelled to indulge in appraisal juggling in order to avoid archaic valuation limitations.

⁷⁸ In *In re City of New York (School of Industrials Arts)*, 2 Misc. 2d 403, 154 N.Y.S.2d 402 (Sup. Ct. 1956) the advantages of an income approach were described:

Those who would endeavor to extend this principle so as to limit "value" to the original cost of construction or the current cost of reconstruction less depreciation are adopting an economic theory which derives from Adam Smith's classic doctrine that the value of an article equals the cost of its production. The modern appraiser has learned that the law of supply and demand will furnish a more correct index of value and that "market value," the standard in condemnation, is determined not so much by cost as by the relative desirability, abundance and utility of the particular property in the community.

.....

We thus arrive at the capitalization of income method. It is obvious, of course, that the prime factor in the mind of the buyer who invests in real property is the realizable income therefrom. This is truly the product of the interplay of the forces of supply and demand. It is necessary, of course, to keep in mind that it is property which is being valued and not the business conducted thereon, and hence goodwill or elements of income influenced by management or method of operation in determining the basic income attributable to the property as such or its rental value. This concept of valuation is based on the idea that the net income derivable from a use of the property to which it is best adapted, when capitalized at the prevailing local rate of investment return, will produce a sum which is the practical equivalent of its true value.

Id. at 407-08, 154 N.Y.S.2d at 407.

⁷⁹ 394 S.W.2d 300 (Mo. 1965). See note 59 *supra*.

court applied the capitalization-of-profits method to a dump-yard in what may prove to be a noteworthy departure from generally applied restrictions.

The general rule [that business profits are inadmissible as evidence of the value of the land on which the business is operated], however, must be given an exception *ex necessitate* in this case, where the business is inextricably related to and connected with the land where it is located, so that an appropriation of the land means an appropriation of the business; where the evidence of net profits apparently is clear, certain and easily calculable, based upon complete records; where past income figures are relatively stable, average and representative, and future projections are based upon reasonable probability of permanence or persistence in the future, so that conjecture is minimized as far as possible⁸⁰

Earlier in its opinion the court had commented that:

[W]here the character of the property is such that a profit is produced by the property itself without the labor of the owners being expended thereon, and where the profits derived from its use are the chief source of its value, evidence of such profits was properly admitted and is relevant as a criterion of the value of the property.⁸¹

Whether the business of operating a dump is any more "taken" than, for example, an ordinary manufacturing business, is debatable. In both cases, the physical plant, be it land alone or land and buildings, is in fact appropriated. Perhaps the court was unimpressed with its own distinction, since it noted that the operation of the dump did not require "any considerable skill, wisdom, ingenuity or labor on the part of the owners."⁸² The fact remains, however, that in many ordinary condemnation cases detailed business records, a history of stable profits, and the probability of predictable future profits may be present. Even that personal unknown, management, would probably present no real problem, since the valuation equation could at least in theory include a percentage deduction for the so-called "human" element. Notwith-

⁸⁰ 394 S.W.2d at 306 (footnote omitted).

⁸¹ *Id.* at 305-06 (footnote omitted).

⁸² *Id.* at 305 n.l. *But see* *Shelby County R-IV School District v. Hermian*, 392 S.W.2d 609, 613 (Mo. 1965), in which the same court reiterated the old rule that "[e]vidence of profits derived from a *commercial* business upon land taken for public use is ordinarily inadmissible as a basis upon which to ascertain market value in condemnation proceedings because it is too speculative, remote and uncertain." (Emphasis in original.) Two cases decided by the Supreme Court of Arkansas in 1958 illustrate this seemingly ambivalent attitude of the courts; while generally holding that profits cannot be capitalized, they appear to leave room for exception where profits supposedly are derived from the land itself. *See* *Hot Spring County v. Crawford*, 229 Ark. 518, 316 S.W.2d 834 (1958); *Arkansas State Highway Comm'n v. Addy*, 229 Ark. 768, 318 S.W.2d 595 (1958).

standing its limitations, *Union Quarry* is another example of an increasing judicial tendency to use novel and economically sound appraisal techniques to cut through old prohibitions.⁸³

Use of these appraisal techniques may, of course, be the result of a reexamination of the underlying substantive valuation rules. But the courts probably have not yet become sufficiently disenchanted with the old rules—or perhaps not sufficiently aware of the injustices they produce—to overturn an entire body of so-called “settled” law. Whether this results from inadequate advocacy and commentary or from judicial conservatism—possibly aggravated by a fear of bankrupting condemnors⁸⁴—need not be resolved here. The narrow theoretical approach of the evolving specialty theory can be utilized by courts to provide payment for equipment and machinery that otherwise might not be compensable. But why should not the courts or legislatures confront the entire problem directly and redefine the old rules in terms of modern economic theory rather than use the indirect techniques of appraisal manipulation or the specialty theory?

IV

THE PROPER MEANS TO THE DESIRED RESULT: AN ECONOMIC PARALLEL

The complexities of modern business have made traditional property distinctions cumbersome and inappropriate in condemnation cases.⁸⁵ Recent developments moving away from emphasis on a fixture

⁸³ See also, e.g., *Paper v. District of Columbia Redev. Land Agency*, 287 F.2d 141, 142 (D.C. Cir. 1960), permitting valuation of a retail liquor store by a method which included evidence “that by a custom of the trade particularly in the operation of a liquor store, 2.2% of the gross income over a 4-year period would properly reflect the fair market rental”; *Phillips Petroleum Co. v. City of Omaha*, 171 Neb. 457, 477, 106 N.W.2d 727, 739 (1960), holding testimony of business volume admissible; *Mattydale Shopping Center, Inc. v. State*, 279 App. Div. 704, 108 N.Y.S.2d 832 (4th Dep’t 1951), modified on other grounds, 303 N.Y. 974, 106 N.E.2d 59 (1952), which is read by the editors of 19 N.Y. JUR. *Eminent Domain* § 189, at 429 & n.17 (1961), as permitting the intimation that “potential income to be derived from property if developed to its highest and best use is an element in determining market value.” But see the lengthy rebuttal of this interpretation of *Mattydale* in 4 NICHOLS’ *EMINENT DOMAIN*, *supra* note 3, § 12.3121[3], at 124-25, in which the editors conclude that *Mattydale* does not, under any interpretation, permit capitalization of future income.

⁸⁴ See pp. 625, 647 *infra*.

⁸⁵ At common law, the doctrine of eminent domain first found expression in the sovereign exercise of the basic right to enter upon property in the defense of the realm. *George v. Consolidated Lighting Co.*, 87 Vt. 411, 89 A. 635 (1914). The development of eminent domain in the United States differed from that in England. In both nations, the

theory and toward a more economically oriented theory of going concern or specialty operation are steps in the right direction. Nevertheless, modern-day economic concepts reveal that these developments constitute only partial solutions to the problem.

Productive capital is simply a combination of the factors of production, including land, buildings, machinery, workers, and good will.⁸⁶ Working together, these factors are worth more than the total acquisition costs of the individual components. The "marginal efficiency" of a machine is the ratio of its value in an integrated operation divided by its market value.⁸⁷ For example, assume that the cost of borrowing money to buy a machine that produces widgets is six percent per year and that the widget factory earns ten percent on invested capital. The marginal efficiency of the widget machine is 1.67 (10/6). Thus, the machine is worth 1.67 times its current market value when used in combination with the other factors of production.

Yet, unless the widget machine is held to be a fixture, its loss may

growth of railroads prompted use of this "inherent and necessary right of sovereignty of the state." *Valentine v. Lamont*, 13 N.J. 569, 575, 100 A.2d 668, 670 (1953). But in England it was necessary to acquire highly developed industrial and commercial areas, instead of the wilderness common to America at that time. As a result, English courts awarded damages for incidental losses under a standard of "value to the owner." They further increased this amount by 10% to compensate the condemnee for general inconvenience. Comment, *supra* note 8, at 66.

Europe as a whole recognizes to a far greater extent than the United States that the expense of relocation of condemnees is a public responsibility. European condemnation awards dwarf American. GREBLER, *URBAN RENEWAL IN EUROPEAN COUNTRIES: ITS EMERGENCE AND POTENTIALS* 84-85 (1964). Grebler points out that the difference in American and European attitudes may be due to the "excessive urge of Americans to get things done without bothering to consider the burdens falling upon individuals" and the American willingness to accept mobility as a condition of life. Europeans, on the other hand, consider leaving a long established business location a major tragedy. *Id.* at 87.

⁸⁶ See generally W. CATLIN, *THE PROGRESS OF ECONOMICS* (1962).

⁸⁷ John Maynard Keynes spelled out the theory of the marginal efficiency of the factors of production in J. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 135-46 (1936). Modern economists no longer use the term "marginal efficiency" in the same manner as Keynes and the authors, but there is little disagreement that the concept has continuing validity. B. GRAHAM, D. DODD & S. COTTLE, *SECURITY ANALYSIS* (4th ed. 1962), discuss marginal efficiency in terms of "asset or book value" and "going concern value." The difference between book value and sale price is accounted for by the "efficiency" of the integrated operation. *Id.* at 217, 359. See also P. SAMUELSON & G. ACKLEY, *MACROECONOMIC THEORY* 460-504 (1961).

Marginal efficiency is measured as follows. If we assume that the current rate of interest is a proper measure of the efficiency of capital and also a factor in determining how to use capital, then converting capital into factors of production is attractive until the rate of return equals or is less than the current interest rate—*i.e.*, until it would be more profitable to lend capital to others than use it to produce a product or service.

go uncompensated in eminent domain proceedings. Even if held to be a fixture, the landowner may be improperly compensated, because the market value of the land as enhanced by the machine, rather than the marginal efficiency of the machine itself, is the standard of compensation.⁸⁸ The marginal efficiency of each factor of production, however, has been destroyed, because it is no longer being used in combination with the other factors.

Apparently our courts do not consider marginal efficiency when grappling with the problems of valuation. Instead, they strain for a just and equitable result within the strictures of property law. In many cases, they sense that compensation must be more than market value, as when they take into consideration all the uses to which the land might be put.⁸⁹ New York holds that property that is integrated into the operation of a going business and that would lose substantially all its value when separated from the land is in effect part of the land (a fixture), even though it is essentially free-standing and removable without damage to the land.⁹⁰ Thus, our courts sense that, when factors of production are used in combination to produce a product of service, their value is increased. Unfortunately, marginal efficiency is not recognized as such and the theories used are inadequate for according full compensation. Despite language of the courts to the effect that for purposes of valuation a condemnation is viewed as a voluntary sale between the state-buyer and the owner-seller, the truth is that a condemnation is a forced sale—the state buys at its own inadequate price.

These economic conclusions are complemented by several policy considerations. The state reduces the economic base for any industry when it fails to compensate for the marginal efficiency that is destroyed by the taking of land, buildings, and fixtures. In effect, a part of the profit potential is lost. A business may be able to recreate its marginal efficiency at a new location, but doing so is never certain. At least its cost of relocating and its ability to recreate its original marginal efficiency ought to be considered in determining to what extent there is a taking of marginal efficiency.

Encouraging industry is in the public interest; not only the busi-

⁸⁸ The unfairness of this approach is revealed in the analysis of fixtures at pp. 607-14 *supra*.

⁸⁹ See *Boom Co. v. Patterson*, 98 U.S. 403 (1878); *Teele v. Boston*, 165 Mass. 88, 42 N.E. 506 (1896); *City of Cleveland v. Langenau Mfg. Co.*, 159 Ohio St. 525, 530, 112 N.E.2d 658, 660 (1953); 30 C.J.S. *Eminent Domain* § 446, at 607-08 (1965).

⁹⁰ *In re City of New York (Seward Park Slum Clearance Project)*, 10 App. Div. 2d 498, 200 N.Y.S.2d 802 (1st Dep't 1960); *In re City of New York (North River Water Front)*, 118 App. Div. 865, 103 N.Y. Supp. 908 (1st Dep't 1907).

nessman but also society as a whole suffers when losses are left with the individual.⁹¹ The plight of the individual businessman is all the more compelling, since the rationale for these takings involves no undesirable private conduct as in nuisance cases.⁹² Rather, the public is enriched through public use of the land, and the cost should be apportioned among citizens generally.⁹³ The oft-repeated complaint that full compensation might bankrupt governmental authorities is not very impressive. Given the social cost of injury to business from inadequate compensation, it would probably be cheaper in the long run for society to distribute the cost through the tax structure to those who benefit from the taking.⁹⁴

Naturally, redistribution of actual costs may not lend itself to mathematical precision, because both the actual value of property taken and the particular group or member of the public benefited are not exactly determinable. Nonetheless, an attempt at such reapportionment, however imperfect, should be undertaken.⁹⁵ Ideally, the owner should be entitled to the full value of the property taken, *i.e.*, market value and marginal efficiency of unrelocatable property, plus the diminution in marginal efficiency of property retained by the owner.

⁹¹ President Johnson recognized the problem and urged reforms concerning the human costs of displacement in the urban renewal context during his 1964 Housing Message: "Similarly, small business men . . . often incur economic loss and hardship as a result of displacement by urban renewal or public housing which is not offset by current compensation practices and moving expense reimbursements." 110 CONG. REC. 1047 (1964). See generally Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1171-72 (1967).

⁹² Attorney General v. Williams, 174 Mass. 476, 55 N.E. 77 (1899) (nonconforming use found to be undesirable private conduct); State v. Sportmen's Club, 214 Minn. 151, 7 N.W.2d 495 (1943) (gaming and use as a tavern found to be undesirable private conduct); Black v. Circuit Court, 78 S.D. 302, 101 N.W.2d 520 (1960) (house of prostitution as a nuisance).

⁹³ There is no reason why a man whose land is taken for a public improvement should be made to contribute more for the public and common benefit than his neighbor, whose lands are not taken but who is equally benefited by the improvement.

Ridgewood v. Sreel Inv. Corp., 28 N.J. 121, 131-32, 145 A.2d 306, 313 (1958). See generally U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, RELOCATION: UNEQUAL TREATMENT OF PEOPLE AND BUSINESSES DISPLACED BY GOVERNMENTS (1965) [hereinafter cited as ADVISORY COMM'N]; Dunham, *A Legal and Economic Basis for City Planning*, 58 COLUM. L. REV. 650, 663-69 (1958); Kratovil & Harrison, *Eminent Domain—Policy and Concept*, 42 CALIF. L. REV. 596, 609 (1954).

⁹⁴ Kaldor, *Welfare Propositions of Economics and Inter-Personal Comparisons of Utility*, 49 ECON. J. 549 (1939); Spies & McCoid, *Recovery of Consequential Damages in Eminent Domain*, 48 VA. L. REV. 432, 452-54 (1962).

⁹⁵ See generally Coons, *Approaches to Court Imposed Compromise—The Uses of Doubt and Reason*, 58 NW. U.L. REV. 750 (1964).

V

GOOD WILL: A NECESSARY EXCURSION INTO THE
VALUATION THICKET

Good will compensation problems parallel those of marginal efficiency. What follows is not intended to be an extensive analysis of public policy considerations relevant to the compensability of good will. Rather, the concern is to dispel old myths and approach a proper definition of value and business losses. The result is a pragmatic case for compensation of all or part of the good will of a business.

The similarity of the good will concept to what Keynesian economists have labelled "value in use," or the marginal efficiency of capital, is illustrated by Judge Swan's statement in *Haberle Crystal Springs Brewing Co. v. Clarke*:⁹⁶

A going business has a value over and above the aggregate value of the tangible property employed in it. Such excess of value is nothing more than the recognition that, used in an established business that has won the favor of its customers, the tangibles may be expected to earn in the future as they have in the past. The owner's privilege of so using them, and his privilege of continuing to deal with customers attracted by the established business, are property of value. This latter privilege is known as good will.⁹⁷

Judge Swan's definition measures good will in terms of an "excess of value" over and above the market value of the tangible property employed in the business. The indicator of good will is favorable customer relations, and the specific value to the owner is the privilege of maintaining all factors unchanged. This analysis, however, focuses on the end product, good will, and it leaves unidentified the factors that give rise to and sustain good will. Accounting texts formulate these factors as follows:

[S]ince good will is dependent upon earnings, and since many things other than customer satisfaction contribute to earnings, there are many sources of goodwill. Some of these sources are: location; manufacturing efficiency; satisfactory relations between the employees and the management . . .; adequate sources of capital and a credit standing . . .; advertising; monopolistic privileges; and, in general, good business management.⁹⁸

⁹⁶ 30 F.2d 219 (2d Cir. 1929), *rev'd on other grounds*, 280 U.S. 384 (1930).

⁹⁷ *Id.* at 221-22. This formulation is analyzed in depth in Comment, *An Inquiry into the Nature of Good Will*, 53 COLUM. L. REV. 660 (1953).

⁹⁸ H. FINNEY & H. MILLER, *PRINCIPLES OF ACCOUNTING* 216-17 (6th ed. 1963). See also *People ex rel. A.J. Johnson Co. v. Roberts*, 159 N.Y. 70, 83, N.E. 685, 689 (1899), and Justice Story's famous definition in *Metropolitan Bank v. St. Louis Dispatch Co.*, 149 U.S.

To the extent that good will is dependent upon location and customer regularity incidental thereto, its value would be included as a part of the composite price that the property would bring in a private sale.⁹⁹ Judge Cardozo observed:

Men will pay for any privilege that gives a reasonable expectancy of preference in the race of competition . . . Such expectancy may come from succession in place or name or otherwise to a business that has won the favor of its customers. It is then known as good will.¹⁰⁰

The question remaining is whether good will, at least insofar as produced by locational factors, is similarly important to the computation of the "forced" sale price of a business after a condemnation or appropriation.

A. Valuation Problems

Upon condemnation of a parcel of land, the owner is generally entitled to compensation in terms of the highest and best use to which the land could be put.¹⁰¹ The measure of damages is the market value of the land on a hypothetical open market in which willing buyers and willing sellers deal at arm's length and without compulsion.¹⁰² Nevertheless, the courts do not feel compelled to compensate for injury to either the going concern value or the good will of a business.¹⁰³ ✕

436, 446 (1893). Although locational factors and incidental customer regularity are of great importance in the establishment and continuation of good will, some courts have completely discounted them and rather have emphasized the "business name" as the crucial factor. See *Mutual Life Ins. Co. v. Menin*, 115 F.2d 975, 977 (2d Cir. 1940).

⁹⁹ The validity of this statement is demonstrated in the governmental context by the disappearance or liquidation of businesses in urban renewal areas. The Advisory Commission on Intergovernmental Relations points out that 35.3% of displaced businesses discontinued operations. ADVISORY COMM'N, *supra* note 93, at 53. This is, of course, significantly above the normal rate of business liquidations. A primary factor for this large discontinuance rate was found to be "[t]he inability of many small (one or two person) tenant businesses to transfer their 'good will' to a relocation site . . ." *Id.* at 54.

The locational aspect of good will has been given constitutional protection. *E.g.*, *Mitchell v. United States*, 267 U.S. 341, 344-45 (1925). See generally *Housing Authority v. Lustig*, 139 Conn. 73, 76-77, 90 A.2d 169, 171 (1952).

¹⁰⁰ *In re Brown*, 242 N.Y. 1, 6, 150 N.E. 581, 582 (1926).

¹⁰¹ *E.g.*, *St. Agnes Cemetery v. State*, 3 N.Y.2d 37, 143 N.E.2d 377, 163 N.Y.S.2d 655 (1957); *Sparkill Realty Corp. v. State*, 254 App. Div. 78, 4 N.Y.S.2d 679 (3d Dep't), *aff'd*, 279 N.Y. 656, 18 N.E.2d 301 (1938); see *United States v. Miller*, 317 U.S. 369, 373 (1943).

¹⁰² 1 L. ORGEL, *supra* note 24, § 20; see also G. SCHMUTZ, *supra* note 49, ch. 1.

¹⁰³ *Sgarlat Estate v. Commonwealth*, 398 Pa. 406, 158 A.2d 541, *cert. denied*, 364 U.S. 817 (1960); *Banner Milling Co. v. State*, 240 N.Y. 533, 148 N.E. 688, *cert. denied*, 269 U.S. 582 (1925); *In re Huie*, 7 App. Div. 2d 24, 180 N.Y.S.2d 449 (3d Dep't 1958); *Humbert v. State*, 278 App. Div. 1041, 107 N.Y.S.2d 507 (4th Dep't 1951), *aff'd*, 303 N.Y. 929, 105 N.E.2d 504 (1952).

The rationale behind the noncompensability of these items is that an appropriation of land makes the state liable to compensate only for the taking of land itself and any buildings and fixtures appurtenant thereto.¹⁰⁴ The loss of good will and going concern value are viewed merely as the incidental loss of noncompensable intangibles. That the owner may lose his customers and favorable materials markets and may be unable to regain his position in the business community at a different location has been held to be irrelevant.¹⁰⁵ Damage to good will is held noncompensable on the ground that it is too speculative a loss. Alternatively, the courts argue that good will is attached to the business name and the proprietor rather than the location of the business and therefore is not seriously damaged by condemnation.¹⁰⁶ This proposition, of course, is contrary to the economic analysis of the factors contributing to good will. In addition, to deny compensation because of the so-called "speculative" nature of good will is contrary to the thrust of private law.¹⁰⁷ Good will can be the subject of a testamentary bequest or a private sale,¹⁰⁸ and it is generally a valued asset of a partnership devisable on the dissolution of the partnership.¹⁰⁹ Good

Loss of "going concern value" and any good will included therein is, however, compensable upon the taking of a public utility where the condemnor intends to continue the operation. The theory is that such a taking includes both the land and business, whereas the ordinary taking of business property without continued operation by the condemnor is a taking of the land only. See 2 L. ORGEL, *supra* note 24, ch. XIX. But see *City of Omaha v. Omaha Water Co.*, 218 U.S. 180, 202 (1910), stating that good will is not an element of value in operating public utilities insofar as such enterprises ordinarily are monopolistic and hold their customers by compulsion rather than choice. The rule of compensation for "going concern value" has even been extended to an admittedly unprofitable public utility, where the reason for unprofitability was unreasonable rate regulation. See *In re City of New York (Fifth Ave. Coach Lines, Inc.)*, 18 N.Y.2d 212, 219 N.E.2d 410, 273 N.Y.S.2d 52 (1966); Note, *Going Concern Value in Condemnation of Unprofitable Public Utilities*, 52 CORNELL L.Q. 752 (1967). In an apparent misunderstanding of the going concern rule, the New York Court of Appeals awarded a bankrupt commuter facility the going concern value to the condemnor rather than the going concern value to the condemnee. *Port Authority Trans-Hudson Corp. v. Hudson Rapid Tubes Corp.*, 20 N.Y.2d 457, 231 N.E.2d 734, 235 N.Y.S.2d 24 (1967), *cert. denied*, 36 U.S.L.W. 3382 (Apr. 1, 1968).

¹⁰⁴ *Mitchell v. United States*, 267 U.S. 341 (1925) (going concern value not compensable); *Matter of Jeffries Home Housing Project*, 306 Mich. 638, 651, 11 N.W.2d 272, 276 (1943) (good will not compensable). But see *Kimball Laundry Co. v. United States*, 338 U.S. 1 (1948) (diminution in going concern value resulting from a "temporary" taking compensable). *Kimball* is discussed in 1 L. ORGEL, *supra* note 24, § 80, at 344-50.

¹⁰⁵ See cases cited note 136 *infra*.

¹⁰⁶ See the discussion and cases cited in 1 L. ORGEL, *supra* note 24, § 76.

¹⁰⁷ See generally 4 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 13.31, at 452-57.

¹⁰⁸ See generally *In re Whalen*, 41 Misc. 2d 825, 246 N.Y.S.2d 327 (Sur. Ct. 1963); Comment, *supra* note 97; Annot., 7 A.L.R. 1365 (1920).

¹⁰⁹ *In re Brown*, 242 N.Y. 1, 150 N.E. 581 (1926); Crane, *Partnership Good Will*, 18 VA. L. REV. 651, 656 (1932).

will is an element in corporate accounting and is a taxable item for purposes of both estate and income tax.¹¹⁰ In addition, it can be both an asset subject to the powers of a trustee in bankruptcy,¹¹¹ and property within the meaning of a statute regulating the issuance of corporate shares.¹¹² Thus, in many areas the courts have not hesitated to place a value on good will.

All of the generally accepted formulas for estimating the dollars-and-cents value of good will in private law turn on the amount of future excess profits.¹¹³ The first step is to determine the average annual earnings of the business, usually by reviewing earnings over a period of from two to six representative years. To insure that the record of past earnings is representative, the years selected should include both years of prosperity and years of decline, and allowances should be made for any overstatements in earnings through inadequate depreciation or salary allowances or changes in wage and tax rates.

Once a representative record of past earnings is determined, at least two formulas can be used to estimate the value of good will.¹¹⁴ In the first, the income return from a capital investment is determined, six percent being used as the normal rate. This figure, reflecting the normal profit for the investment, is then deducted from the average net earnings. The resulting figure is called the "average excess profits," which is then multiplied by the number of years' excess profits that an ordinarily prudent purchaser would be willing to pay for in order to acquire the good will. The product is the salable value of the good will. Selection of the number of years for this multiplier is dependent upon circumstances determining the probability of continued future excess earnings, three to five years generally being considered average.

¹¹⁰ E.g., Kripke, *A Good Look at Goodwill in Corporate Acquisitions*, 78 *BANKING L.J.* 1028 (1961); Weiss, *The Tax Treatment of a Disposition of Professional Goodwill*, 73 *YALE L.J.* 1158 (1964).

¹¹¹ *Mutual Life Ins. Co. v. Menin*, 115 F.2d 975 (2d Cir. 1940), cert. denied, 313 U.S. 578 (1941); *Thomas Day Co. v. King*, 42 F.2d 421 (9th Cir. 1930); *Freeman v. Freeman*, 86 App. Div. 110, 83 N.Y.S. 478 (4th Dep't 1903); 4 *NICHOLS' EMINENT DOMAIN*, *supra* note 3, § 13.31, at 456-57.

¹¹² *Washburn v. National Wall-Paper Co.*, 81 F. 17, 20 (2d Cir. 1897).

¹¹³ The two formulas to be discussed in the text are substantially the same as those in *H. FINNEY & H. MILLER*, *supra* note 98, at 217-18. For an example of a formula given judicial approval for estate tax purposes, see *In re Estate of Whalen*, 41 Misc. 2d 825, 829, 246 N.Y.S.2d 327, 331-32 (Sur. Ct. 1963).

¹¹⁴ The question may arise how these formulas compare with those used to compute marginal efficiency discussed at pp. 622-25 & notes 87-95 *supra*. The value of good will is a component of the value of marginal efficiency, which is the value of the excess the factors of production working together return over and above the return from capital at the current rate of interest. Thus, good will contributes to the ability of capital to generate a profit, which is marginal efficiency.

A second common method involves averaging the net earnings of the business over a period of time, generally not less than five years. Usually from eight to ten percent of the average net earnings, depending on the nature of the business and the risks involved, is then taken as an allowance on the average of net tangible assets. The allowance is deducted from the average net earnings to arrive at an excess attributable to intangible assets, which is then capitalized at a fixed rate between ten and twenty percent, again depending on the character of the business and the risks involved.

Both of the foregoing formulas are subject to revision when the good will element depends principally on the personal efforts of an individual, as in the case of a physician or lawyer.¹¹⁵ In such case, the good will element does not inhere in the location or the component parts of the business. Nevertheless, in the ordinary appropriation cases, in which the human or personal element is only one of many factors, the foregoing formulas could be utilized to put a dollar-and-cents figure on good will. If necessary, the personal, nontransferable element could then be eliminated by using a percentage deduction.

Thus, the reluctance of the courts to compensate for good will is based on policy and not the speculative nature of the valuation process. This is confirmed by noting the many areas of the law in which recovery for damage to good will is granted even though speculative.¹¹⁶ Moreover, market value, the basic measure of damages in condemnation suits, is not necessarily an easily determinable, objective fact, although the courts persist in treating it that way.¹¹⁷

¹¹⁵ See, e.g., *In re Case*, 122 App. Div. 343, 106 N.Y.S. 1086 (3d Dep't 1907); *In re Bluestein*, 197 Misc. 616, 95 N.Y.S.2d 874 (Sur. Ct.), modified on other grounds, 277 App. Div. 385, 100 N.Y.S.2d 350 (1st Dep't 1950), aff'd, 302 N.Y. 760, 98 N.E.2d 886 (1951); *Coffey v. Metro-Goldwyn-Mayer Corp.*, 160 Misc. 186, 189, 289 N.Y.S. 882, 886 (Sup. Ct. 1936). But see J. MACNEILL, ACCOUNTING PRACTICE MANAGEMENT HANDBOOK 473 (1962) (stating that there is no goodwill in a personal service partnership); *Caufield, How Can Professionals Establish Goodwill in the Sale of Their Practices*, 23 J. TAXATION 268 (1965).

¹¹⁶ See, e.g., *Nims, Damages and Accounting Procedure in Unfair Competition Cases*, 31 CORNELL L.Q. 431 (1946); *Wright, Tort Responsibility for Destruction of Good Will*, 14 CORNELL L.Q. 298 (1929).

¹¹⁷ For striking examples of how divergent the estimates of many expert witnesses are concerning market value in particular takings, see *State Roads Comm'n v. Novosel*, 203 Md. 619, 625-26, 102 A.2d 563, 566 (1954) (\$2,000 as against \$54,348); *In re Civic Center*, 335 Mich. 528, 531-32, 56 N.W.2d 375 376 (1953) (\$300,000 as against \$600,000); *Oklahoma City v. Wilson*, 310 P.2d 369, 372 (Okla. 1957) (\$4,200 as against \$42,400); *Tulsa County Drainage Dist. v. Stroud*, 198 Okla. 688, 181 P.2d 1000 (1947) (\$600 as against \$30,000); *Reeves v. City of Dallas*, 195 S.W.2d 575, 580 (Tex. Civ. App. 1946) (\$20,000 as against \$100,000). See also *United States v. 37.15 Acres of Land*, 77 F. Supp. 798, 800-01 (S.D. Cal. 1948); *Dolan, New Federal Procedure in Condemnation Actions*, 39 VA. L. REV. 1071, 1077 (1953).

B. *The Criterion of Constitutionality*

Failure to compensate for good will has been justified by constitutional arguments. It is said that neither the business nor its good will is actually taken, but only the land itself.¹¹⁸ Thus, going concern value and good will supposedly are not "property" within the contemplation of the eminent domain clauses of the federal and state constitutions.

This view, in effect, assumes that just compensation is an in rem rather than an in personam right,¹¹⁹ a limitation neither expressly nor impliedly present in the Federal Constitution. The Constitution speaks of the taking of private property for public use, and conditions the taking upon the payment of just compensation. "Property" is rarely defined in any constitution, federal or state. Although the draftsmen of the original constitutions may have had a limited, eighteenth century conception of property, inclusion of the term could not have been intended to freeze the concept for all time. The courts themselves have never adhered to so limited an interpretation of this constitutional provision. The federal provision and most of the state provisions are generally found in the Bill of Rights. Such sections were designed to protect individuals and their property against arbitrary actions of the state, such as uncompensated appropriation of valuable items. Clearly, property rights are an aspect of an individual's rights; the Constitution deals "with persons, not with tracts of land."¹²⁰ Good will, admittedly intangible, has been specifically designated as property in private law.¹²¹ Why is this concept not transposed to the law of eminent domain?

Supporters of the view that good will is not property within the meaning of the Constitution further reason that, since all property is owned subject to an implied condition that it be surrendered whenever the public interest requires, any expense or inconvenience incidental to the surrender of possession on a taking is not a compensable

¹¹⁸ United States *ex rel.* TVA v. Powelson, 319 U.S. 266, 282 (1943). The basis for this argument is that the interests taken are not property vis-à-vis the government.

¹¹⁹ The classic statement of this view is in *Monongahela Nav. Co. v. United States*, 148 U.S. 312, 326 (1893). It has been explicitly followed in *United States v. Building Known As 651 Brannan St.*, 55 F. Supp. 667, 670 (N.D. Cal. 1944); *State Highway Comm'n v. Burk*, 200 Ore. 211, 244-45, 265 P.2d 783, 789 (1954). See also *A.W. Duckett & Co. v. United States*, 266 U.S. 149, 151 (1924); *United States v. Dunnington*, 146 U.S. 338, 352-53 (1892).

¹²⁰ *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189, 195 (1910).

¹²¹ See, e.g., *Red Wing Malting Co. v. Willcuts*, 15 F.2d 626 (8th Cir. 1926), recognizing good will as property but disallowing an income tax deduction for loss of good will, principally on the ground of statutory construction.

damage.¹²² In addition to its lack of constitutional basis, this proposition suffers from both a misunderstanding of the component elements of good will¹²³ and an unwarranted emphasis on what might be termed a "physical" conception of taking.¹²⁴ Moreover, even if it is concluded that property is held subject to an implied condition that it be surrendered when the public interest so demands, a second, and perhaps more important, condition is that property be surrendered for public use only upon the payment of just compensation.

The physical concept of taking, of course, has been considerably undermined by the airport overflight cases decided under the Federal Constitution.¹²⁵ In those cases, ownership of the land remained in the property owners, but the use of the land was severely impaired by the noise and vibrations incidental to the normal operation of adjoining airports. Evidence showed loss of property *value*. Property damage and business losses were held to be compensable. Also, many cases have turned on the related "constructive taking" theory.¹²⁶ *Pennsylvania Coal Co. v. Mahon*¹²⁷ held that police power regulation can be so severe as to constitute a taking resulting in compensable damage, despite the lack of an actual physical taking.¹²⁸

The last theory supporting the no-compensation rule is centered on the previously discussed notion that the Constitution does not mandate compensation for the taking of purely personal property, since such property can be removed from the condemned or appro-

¹²² 4 NICHOLS' EMINENT DOMAIN, *supra* note 3, §§ 13.3, 13.31, at 433, 452.

¹²³ See pp. 627-30 *supra*, discussing the component elements of good will and analyzing the importance of "locational" factors.

¹²⁴ See *Monongahela Nav. Co. v. Coons*, 6 W. & S. 101, 114-15 (Pa. 1843), containing a classic statement of the "physical" concept of taking. See also the discussions in A. JAHR, *supra* note 56, § 51, at 73-74; Cormack, *Legal Concepts in Cases of Eminent Domain*, 41 YALE L.J. 221, 223-24 (1931).

¹²⁵ See, e.g., *United States v. Causby*, 328 U.S. 256 (1946); *Griggs v. Allegheny County*, 369 U.S. 84 (1962); *Stoebuck, Condemnation by Nuisance: The Airport Cases in Retrospect and Prospect*, 71 DICK. L. REV. 207 (1967). But see *Batten v. United States*, 306 F.2d 580 (10th Cir. 1962), *cert. denied*, 371 U.S. 955.

¹²⁶ The modern and prevailing view is that any substantial interference with private property which destroys or lessens its value, or by which the owner's right to its use or enjoyment is in any substantial degree abridged or destroyed, is, in fact and in law, a "taking" in the constitutional sense, to the extent of the damages suffered, even though the title and possession of the owner remains undisturbed.

2 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 6.3, at 407.

¹²⁷ 260 U.S. 393, 415 (1922).

¹²⁸ See generally Sax, *Takings and the Police Power*, 74 YALE L.J. 36 (1964); Mayberry & Aloï, *Compensation for Loss of Access in Eminent Domain in New York: A Re-evaluation of the No-Compensation Rule with a Proposal for Change*, 16 BUFF. L. REV. 603, 624-30 (1967).

priated property and used again on another site by the owner. The argument proceeds that there is even less reason for compensating for the loss of *intangible* personal property resulting from the change in location of the business.¹²⁹ Personal property, however, may be compensable when used in a specialty operation; the locational aspect of good will is, in fact, taken by an appropriation; and through manipulation of appraisal techniques, courts have apparently been compensating for such losses.¹³⁰

C. *The Standard of Market Value*

Though reference may be made to real or imagined constitutional limitations and occasionally to the speculative nature of good will, the real basis for the no-compensation rule seems to be an unwillingness or inability of courts to use true market value as the standard of compensation. In *R.J. Widen Co. v. United States*,¹³¹ the United States Court of Claims stated:

It is settled law that in the absence of specific statutory mandate, compensation under the Fifth Amendment may be recovered only for property taken and not for incidental or consequential losses, the rationale being that the sovereign need only pay for what it actually takes rather than for all that the owner has lost. . . . Hence the incidental spoilage of plaintiff's inventory and equipment, the reduction or loss of its good will and profits, and the expenses incurred in having to re-adjust its manufacturing operations are non-compensable under long-established legal principles.¹³²

Quoting *United States v. General Motors Corp.*,¹³³ the *Widen* court continued:

The sovereign ordinarily takes the fee. The rule in such a case is that compensation for that interest does not include future loss of profits, the expense of moving removable fixtures and personal property from the premises, the loss of good-will which inheres in the location of the land, or other like consequential losses which would ensue the sale of the property to someone other than the sovereign. *No doubt all these elements would be considered by an owner in determining whether, and at what price, to sell. No doubt, therefore, if the owner is to be made whole for the loss consequent on the sovereign's seizure of his property, these elements should properly be considered.* But the courts have generally held

¹²⁹ See *Gauley & E. Ry. Co. v. Conley*, 84 W. Va. 489, 100 S.E. 290 (1919).

¹³⁰ See pp. 627-30 & notes 101-17 *supra*.

¹³¹ 357 F.2d 988 (Ct. Cl. 1966).

¹³² *Id.* at 994.

¹³³ 323 U.S. 373 (1945).

that they are not to be reckoned as part of the compensation for the fee taken by the Government.¹³⁴

This language reveals that the *Widen* court was troubled with its analysis of the noncompensability of good will and other losses incidental to the fee-taking. To justify its analysis, the court quoted in a footnote the following language from *United States v. Petty Motor Co.*:¹³⁵

"[I]t has come to be recognized that just compensation is the value of the interest taken. This is not the value to the owner for his particular purposes or to the condemnor for some special use but so-called 'market value.' It is recognized that an owner often receives less than the value of the property to him but experience has shown that the rule is reasonably satisfactory. Since 'market value' does not fluctuate with the needs of the condemnor or condemnee but with the general demand for the property, evidence of loss of profits, damage to good will, the expense of relocation and other such consequential losses are refused in federal condemnation proceedings."¹³⁶

The courts frequently emphasize that the Constitution and special statutes do not mandate compensation based upon any special value of the property to the owner.¹³⁷ The inference is drawn that good will is a special value to the owner, is nontransferable, and, accordingly, noncompensable.¹³⁸ Good will, however, comprehends far more than merely personal values instilled in a business by the owner, especially in businesses not dealing in personal services. Locational factors and incidental customer regularity cannot be discounted. Just compensation in eminent domain proceedings should be based upon what the owner lost, not what the condemnor gained or received. Special value to the owner should not be compensable, but the key factor should be what the owner lost as measured by a true, rather than an arbitrarily qualified, market value. In the words of the Supreme Court:

[T]he value of the property to the Government for its particular use is not a criterion. The owner must be compensated for what is taken from him, but that is done when he is paid its fair market value for all available uses and purposes.¹³⁹

¹³⁴ 357 F.2d at 994, quoting *United States v. General Motors Corp.*, 323 U.S. 373, 379 (1945) (emphasis added).

¹³⁵ 327 U.S. 372 (1946).

¹³⁶ 357 F.2d at 994 n.11, quoting *United States v. Petty Motor Co.*, 327 U.S. 372, 377-78 (1946). See also *Joslin Mfg. Co. v. City of Providence*, 262 U.S. 668 (1923); *Bothwell v. United States*, 254 U.S. 231 (1920)

¹³⁷ See, e.g., 2 J. LEWIS, *EMINENT DOMAIN IN THE UNITED STATES* § 706 (3d ed. 1909).

¹³⁸ See 1 L. ORGEL, *supra* note 24, § 75.

¹³⁹ *United States v. Chandler-Dunbar Water Power Co.*, 229 U.S. 53, 81 (1913).

The question, of course, is whether utilization of the standard of market value for some reason precludes compensation for going concern value and good will.

Each of the major treatises on eminent domain contains a rather lengthy section defining and qualifying the term market value.¹⁴⁰ The definition by Nichols is characteristic:

By fair market value is meant the amount of money which a purchaser willing but not obliged to buy the property would pay to an owner willing but not obliged to sell it, taking into consideration all uses to which the land was adapted and might in reason be applied.¹⁴¹

In arriving at the market value of the property as actually used, or at its highest and best use, if different, it is improper to value the component elements separately and then add them. Rather, an aggregate evaluation of all the property integrated into the use in question must be made.¹⁴² As we have seen, however, the courts have made a number of arbitrary assumptions and exclusions contrary to the hypothetical open market standard of valuation. Although a separate price tag is never placed on each component part of the business in a private sale with certain items being discounted as speculative in nature or personal to the seller and therefore nontransferable, this is precisely what the federal government or the states and municipalities do when they assume the position of a "strong arm" buyer in eminent domain. The governmental authority invokes the concept of the hypothetical open market to deny an owner compensation for the unique value the premises hold for him, but emasculates that concept when confronted with the problem of compensating for the taking of a going business.

Whereas the locational aspects of good will are physically taken, other component elements, such as managerial skill, are not. Nevertheless, these elements are damaged by the taking. The finding of an actual taking of business property cannot turn solely on whether the condemnor intends to continue the business in operation. Nor should the possibility that the owner may subsequently relocate his business and again develop a profitable operation have any real bearing on determining whether there has in the first instance been a taking. The

¹⁴⁰ *E.g.*, 2 J. LEWIS, *supra* note 137; 1 L. ORGEL, *supra* note 24, § 20, at 90-96; G. SCHMUTZ, *supra* note 49, ch. 1.

¹⁴¹ 4 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 12.2[1], at 48-54. *See id.* § 12.2[3], at 64.

¹⁴² 4 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 13.12[1]. This "unit rule" has been followed in, *e.g.*, *United States v. City of New York*, 165 F.2d 526 (2d Cir. 1948); *Banner Milling Co. v. State*, 240 N.Y. 533, 148 N.E. 688 (1925), *cert. denied*, 269 U.S. 582 (1924).

taking unquestionably destroys or interrupts the operation of the physical plant. At best the result is a forced hiatus during which managerial skill or business acumen, divorced from the other factors of production, must remain sterile and unproductive. Even when relocation is possible, good will as manifested in managerial skill has been so severely interfered with that, in effect, it has at least temporarily been taken. The owner has no assurance after the taking that he can again combine all the factors of production into his previously efficient and profitable operation. Thus, the owner should be entitled to prove and to be compensated for the difference, if any, in the value of his business good will before and after the taking. On the other hand, perhaps the state should be permitted to prove renewed profitable operation in mitigation. To this end, the prosecution of that portion of the owner's suit perhaps could be delayed until a year after the taking.

A revision of the no-compensation-for-good-will rule is clearly warranted. Utilization of the specialty concept or masking economically sound, though legally suspect, awards through adroit manipulation of appraisal techniques are, as we have seen, two limited judicial responses to the problem. But these measures, however well intentioned, are inevitably imprecise, subject to varying application by different courts, and, in fact, incapable of placing proper economic values on the totality of factors identified as the marginal efficiency of capital. Further, judicially initiated change seems impossible, since most courts are unwilling or unable to overturn the substantial body of precedent to the contrary. Legislative or constitutional change may be the only means of redressing the inequities common to the present compensation scheme.

VI

BREAKING THE JUDICIAL IMPASSE THROUGH REMEDIAL LEGISLATIVE OR CONSTITUTIONAL AMENDMENT

A. Remedial Legislation

Legislative change may permit an otherwise impossible fresh examination of the problem of compensation for business losses and therefore a more rational choice of values. The legislature has greater freedom than the courts to analyze all aspects of the problem through its committee system, powers of investigation, and law revision commissions. Several statutes currently in force and at least one proposed statute provide alternative approaches.

One approach is exemplified by the Administrative Code of the City of New York, which provides that:

The owner . . . of any *established business* . . . *directly or indirectly* decreased in value by reason of the acquiring of land by the city for an additional water supply or by reason of the execution of any plans for such additional water supply by the city . . . shall have a right to damages for such decrease in value.¹⁴³

This statute focuses on the effect of the governmental action upon the business. Whether by legislative intent or otherwise, the generality of the language required judicial interpretation; and an examination of the cases construing it provides some insight into its usefulness as a model for a statute creating a general right of compensation for business losses.

The first case was *People ex rel. Burhans v. City of New York*,¹⁴⁴ in which the city contended that the statute extended only to losses suffered by businesses located on lands adjoining the condemned land and not to businesses actually located on the condemned parcel. Rejecting this contention, the court commented that "[n]either the language nor the purpose of the statute indicate that the Legislature intended to accomplish such an incongruous and unjust result."¹⁴⁵

The question of the methods and limits on proof of business losses under this provision was raised four years later in *In re Board of Water Supply*.¹⁴⁶ Stating that "the commission shall not be limited

¹⁴³ N.Y. CITY ADMIN. CODE § K51-44.0(a) (1963) (formerly N.Y. City Water Supply Act § 42, as amended, L. 1928 ch. 525, § 7) (emphasis added). For a modern comment on the scope of the statute, see *In re Huie* (Liddle), 14 App. Div. 2d 613, 218 N.Y.S.2d 370, 371 (3d Dep't 1961), *appeal dismissed*, 12 N.Y.2d 886, 188 N.E.2d 263, 237 N.Y.S.2d 997 (1963), stating that business losses resulting from a water supply condemnation for New York City are compensable even if "resulting indirectly from acquisition." For a typical example of the common law view, see *Schriebman v. State*, 31 Misc. 2d 392, 223 N.Y.S.2d 670 (Ct. Cl. 1961), where upon the condemnation of approximately one-third of the acreage of an egg farm, the condemnee sought recovery for losses allegedly resulting from the termination of valuable contracts to supply eggs to a large grocery chain and of an advantageous contract for the purchase of feed. The court held, in the absence of a statute, that there could be no recovery since "the State did not appropriate the contract with either company. . . . The claimant cannot recover for their loss, nor can he be compensated for the loss of business . . . nor may we consider net profits." *Id.* at 394, 223 N.Y.S.2d at 674.

With respect to the so-called water supply condemnation statutes, see generally 1 L. ORGEL, *supra* note 24, § 79. For a collection of various statutory responses to the problem, see 2 NICHOLS' EMINENT DOMAIN, *supra* note 3, §§ 6.41-43.

¹⁴⁴ 198 N.Y. 439, 92 N.E. 18 (1910).

¹⁴⁵ *Id.* at 447, 92 N.E. at 20.

¹⁴⁶ 211 N.Y. 174, 105 N.E. 213 (1914).

in the reception of evidence to the rules regulating the proof of direct damages,"¹⁴⁷ the court set the following guidelines:

Where an established business is decreased in value without being wholly destroyed, the *best evidence procurable* to show the decrease must be produced. When . . . the decrease amounts to a total destruction of the business at the place where it has been conducted, *it is essential in showing its value to ascertain the profit that was derived from it.*¹⁴⁸

Significantly, the court also eliminated any set-off attributable to relocation profits.¹⁴⁹ Apparently the court refused to promulgate specific limitations on this statutory power to compensate for business losses. Rather, the limitations, if any, were placed under the overworked umbrella of "speculative" damages.¹⁵⁰

The language of the statute is liberal both in its assumption of liability and in its delineation of the range of compensable damage. Precise refinement is left to case-by-case construction by the courts. Generally, this approach has worked, and perhaps this alone suffices to recommend it. All manners of proof on the direct or indirect decrease in the value of a business are admissible, subject only to the limitation that speculative losses will not be considered. For our purposes, the phrase "directly or indirectly decreased in value" certainly would comprehend losses to good will, and, in any event, awards based on capitalization of net profits necessarily would include good will. The fear of astronomical costs eventually bankrupting condemnors can perhaps be allayed by including a provision permitting the condemnor to introduce evidence of relocation and renewed profitable operation. The theory would be that only loss of actual profits incident to the business interruption together with the cost of relocation should constitute damages rather than a general capitalization of net profits.¹⁵¹

¹⁴⁷ *Id.* at 185, 105 N.E. at 216.

¹⁴⁸ *Id.* at 185, 105 N.E. at 217 (emphasis added).

¹⁴⁹ If a person making a claim for decrease in the value of an established business is fortunate in developing a business at another place or obtaining favorable employment it cannot be used to mitigate or lessen the damages for which the city . . . is liable. A claim for such damages should be ascertained as of the date when the established business is taken or decreased.

Id. at 186, 105 N.E. at 217.

¹⁵⁰ "[T]he damages allowed should . . . be real, and not speculative or merely fanciful. . . . It is not the purpose of the statute to give gifts or grant pensions." *Id.* at 185, 105 N.E. at 216-17. Subsequent cases have refined the guidelines set by *In re Board of Water Supply*. See, e.g., *In re Huie (White)*, 13 App. Div. 2d 596, 597, 212 N.Y.S.2d 925, 927 (3d Dep't 1961).

¹⁵¹ 2 LEWIS, *supra* note 137, § 820, argues that the ascertainment of damage and payment of compensation for such damage resulting from the taking should be left open for adjudication until after the taking and construction of the public improvements. The

Alternatively, a maximum ceiling on the amount of recoverable damages might be set, as one commentator suggests, at ten times the average net earnings of the business.¹⁵² Other problems of construction of the water supply statute might be eliminated by codifying some of the holdings that have interpreted it. For example, a statutory presumption placing a business within the coverage of the statute might arise whenever a business has been in operation for five years preceding the filing of plans or the entry of a judgment condemning the property. Inclusion of businesses in operation for less than five years could then be left to the sound discretion of the courts. Also, a provision might be included making clear that the statute covers losses, both direct and indirect, caused by displacement of clientele,¹⁵³ even if the physical plant is not disturbed. No doubt further refinements will be developed by legislative hearings or law revision commission studies.

An alternative to a general statute is narrow remedial legislation similar to that passed in Pennsylvania and New York dealing with condemnations for highway construction. The Pennsylvania statute provides that "just compensation" shall consist of fair market value of the real property taken plus other specified damages, including: (1) reasonable expenses of removal, transportation, and reinstallation of machinery, equipment, or fixtures, not to exceed \$25,000 and in no case to exceed market value; (2) business dislocation damages, where it is shown that the business cannot be relocated without substantial loss of clientele; compensation in such a case is the monthly rental multiplied by the number of months remaining in the lease, not to exceed two years, with a maximum payment of \$5,000 and a minimum of \$250; and (3) moving expenses for personal property other than machinery, equipment, or fixtures, not to exceed \$500 for residential and \$25,000 for business moves, and in no case to exceed the market value of the personal property.¹⁵⁴ This statute is at best a limited response to the problem and suffers from two basic shortcomings. First, many injustices may be caused by the specific dollar limitations. Second, the statute is unduly restrictive, since it does not purport to provide compensation for general losses to going concern value or good will. In any event,

underlying rationale for this delay apparently is that courts will then be better able to base awards on actual damage rather than upon present and capitalized future losses. *But see In re Bensel (Baker)*, 151 App. Div. 451, 453-54, 135 N.Y.S. 915, 917 (2d Dep't 1912).

¹⁵² Note, *An Act To Provide Compensation for Loss of Goodwill Resulting from Eminent Domain Proceedings*, 3 HARV. J. LEGIS. 445, 446, 463 (1966).

¹⁵³ This is the position taken in § 101(b) of the act proposed in *id.* at 445.

¹⁵⁴ PA. STAT. ANN. tit. 26, §§ 1-601 to 1-610 (Supp. 1966).

business dislocation or relocation losses caused by condemnations other than for highway purposes are not covered.

New York's remedial statutes have the limited objective of extending compensation for certain losses resulting from deprivation of access caused by highway construction¹⁵⁵ or grade crossing eliminations.¹⁵⁶ They have not been extended, expressly or by interpretation, to the problem of business dislocation or relocation losses, going concern value, or good will. In addition, some of the losses arguably within the coverage of these statutes have remained noncompensable because of ambiguous statutory language and narrow judicial interpretations.¹⁵⁷ Apparently both the legislature and the courts have been confused as to whether the New York statutes assumed additional liability or merely expanded state or municipal power of condemnation for highway purposes.

While the Pennsylvania and New York experiences have produced somewhat different problems, it should be clear that limited legislation—*i.e.*, for highways, urban renewal, water supply, etc.—fails to isolate and solve the particular compensation problem and tends rather to result in a multiplicity of vague, overlapping legislation. If the narrow remedial legislation approach is to be of use, the statute must focus directly on the particular elements of loss sought to be redressed, rather than upon the purposes for which the condemnation proceeding is instituted.

A statute modeled on the New York City water supply ordinance might be enacted to compensate for business losses generally, with specific emphasis upon manufacturing establishments and wholesale operations. A separate statute might be passed covering retail businesses or other enterprises that sell directly to the public. A model statute of this type has been proposed in the *Harvard Journal on Legislation*.¹⁵⁸ Specifically directed at damages resulting from loss of good will, the model statute would compensate for business losses resulting from the taking of the business location and/or the displacement of a regular clientele.¹⁵⁹ Before damages will be awarded, the claimant must prove (1) "that prior to the taking a major portion of its income came, and was expected to continue to come, from its regular clientele;" (2) "that

¹⁵⁵ N.Y. H'WAY LAW § 197 (McKinney 1962); N.Y. SECOND CLASS CITIES LAW § 99 (McKinney 1952); N.Y. VILLAGE LAW § 159 (McKinney 1966).

¹⁵⁶ See, *e.g.*, Buffalo Grade Crossing Elimination Act, ch. 576, § 12, [1916] N.Y. Laws 1932.

¹⁵⁷ See Mayberry & Aloï, *supra* note 128, at 614-19.

¹⁵⁸ Note, *supra* note 152, at 445-47.

¹⁵⁹ *Id.* at 445 (§ 201).

the regular clientèle will not continue to patronize the injured business as a direct result . . . of the taking of the business location" and/or the scattering or displacement of the regular clientele; and (3) "that the injured business cannot serve the regular clientele from the same or a new location without a decrease in profits."¹⁶⁰ Where these conditions are met, claimant is entitled upon the permanent discontinuance of the business to the "expected future earnings" of the business "capitalized at the judgment rate of interest less the actual sale value of the assets of the business."¹⁶¹ If the business is continued, claimant may recover damages equal to

the expected future earnings of the injured business capitalized at the judgment rate of interest less the actual future earnings of the injured business capitalized at the judgment rate of interest (a) plus any increase in the net assets of the injured business, or (b) less any decrease in the net assets of the injured business.¹⁶²

Provisions are included in the act defining methods for the estimation of average earnings,¹⁶³ expected future earnings,¹⁶⁴ and actual future earnings.¹⁶⁵ In addition, the act provides for a maximum ceiling on any award in an amount not exceeding the greater of "ten times the average earnings of the injured business; or . . . an amount equal to the value of the physical assets of the injured business."¹⁶⁶

It seems necessary only to make a simple change in terminology to integrate the provisions of this model statute into a general statute

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 446 (§ 301).

¹⁶² *Id.* (§ 302).

¹⁶³ "Average earnings" means the average annual net income of a business during the last five years prior to the valuation date. The salary of an owner-manager to the extent that such salary is available to him in the same or similar employment shall be treated as an expense of the business and not as part of net income. If the salary of an owner-manager does not reflect his economic value to the injured business, additional salary, to the extent indicated in the preceding sentence, shall be imputed to him and treated as an expense of the injured business.

Id. (§ 303).

¹⁶⁴ The expected future earnings of the injured business shall be estimated from its average earnings, adjusted to take into account extraordinary circumstances which indicate that the level of earnings would have changed in the future if there had been no eminent domain proceedings.

Id. (§ 304).

¹⁶⁵ The actual future earnings of the injured business shall be estimated from its average earnings and earnings subsequent to the valuation date, so as to fairly reflect the prospects for the business under the changed conditions caused by the eminent domain proceedings.

Id. (§ 305).

¹⁶⁶ *Id.* at 446-47 (§ 306). An important question under this provision is what method to use in determining the value of the physical assets.

compensating for business losses. The model act defines good will as "the expectation of continued patronage by a regular clientele."¹⁶⁷ Business losses could be substituted for good will, with the introductory definition then reading: "Business losses are a decrease in net earnings caused by destruction of or damage to the expectancy of continued patronage by a regular clientele." The elimination of good will from the express terminology of the act would be of no real consequence, because awards based on capitalization of expected future earnings necessarily would include that item.¹⁶⁸

Another approach to legislative change is to look at the problem from the viewpoint of the business or personal relocation made necessary by a condemnation.¹⁶⁹ This has been the approach of the federal government¹⁷⁰ and of some of the states.¹⁷¹ The 1966 State Legislative

¹⁶⁷ *Id.* at 445 (§ 102(a)).

¹⁶⁸ See pp. 629-30 & notes 113-17 *supra*.

¹⁶⁹ For a general discussion of the effects of displacement on small business by the urban renewal and highway programs, see B. ZIMMER, *REBUILDING CITIES: THE EFFECTS OF DISPLACEMENT AND RELOCATION ON SMALL BUSINESS* (1964).

¹⁷⁰ For an analysis of the federal relocation practices, see Millspaugh, *Problems and Opportunities of Relocation*, 26 *LAW & CONTEMP. PROB.* 6 (1961). The various Federal Housing Acts have constantly expanded the amount available for relocation expense. Under the 1956 Act, local public agencies receiving federal funds were authorized to make payments to dislocated business "for their reasonable and necessary moving expenses and any actual direct losses of property," to a maximum of \$2,000 per business firm. Act of Aug. 7, 1956, ch. 1028, § 305, 70 Stat. 1100. A 1957 amendment raised the limit to \$2,500, Act of July 12, 1957, § 304, 71 Stat. 300, and the 1959 Act raised it to \$3,000. Act of Sept. 23, 1959, § 409(b), 73 Stat. 674. The 1961 Act changed the ceiling to "the total certified actual moving expenses." Act of June 30, 1961, § 304(3), 75 Stat. 167.

The Office of the Secretary, Department of Housing and Urban Development, has, however, placed the ceiling at \$25,000. 24 C.F.R. § 3.109(a)(2) (1967). Any payment over \$10,000 requires the approval of the Administrator. 24 C.F.R. § 3.104(g) (1967). An interesting footnote to these amendments is that such relocation payments are covered by 100% federal grant because of doubt concerning state constitutions and statutes permitting the local bodies to extend compensation in excess of an acquisition award. In a recent case in which the state in question had its own relocation reimbursement statute, it was held that claims under both the state statute (*N.Y. GEN. MUNIC. LAW* § 74-b (McKinney 1965)) and under the Federal Housing Act should be asserted in administrative proceedings prior to the primary court adjudication of the damage claim arising from the taking. *City of Buffalo v. Mollenberg-Betz Mach. Co.*, 53 Misc. 2d 849, 857, 279 N.Y.S.2d 842, 851 (Sup. Ct. 1966).

Several other federal programs have provisions for relocation. The Small Business Administration may give below-market interest loans of up to 30 years to assist small businesses reestablish, if they suffer substantial economic injury as a result of construction financed by the federal government. Act of June 30, 1965, 15 U.S.C. § 636(b) (Supp. II, 1965-66), amending 15 U.S.C. § 636(b) (1964).

The TVA was the first federal body empowered to provide relocation assistance. Though it does not have authority to make direct relocation payments, it grants a monetary allowance for moving expenses in determining its offer for property to be acquired. See *ADVISORY COMM'N*, *supra* note 93, at 83.

Program of the Advisory Commission on Intergovernmental Relations¹⁷² recommends legislation that would either reimburse a displaced person or business for the actual and reasonable expenses involved in moving himself and his business, or give the claimant a fixed payment in accordance with a fixed schedule under allowable maximums.¹⁷³ In addition to those actually displaced by a governmental program, those "adjacent to the real property acquired [who] are caused sub-

Relocation payments and assistance are provided to compensate a landowner or tenant for public works projects of the military or acquisitions either by the Interior Department (such as for water conservation) or the National Aeronautics and Space Administration. Act of July 14, 1952, ch. 726, § 401(b), 66 Stat. 624; Act of May 29, 1958, 43 U.S.C. § 1231 (1964); National Aeronautics and Space Admin. Act, 42 U.S.C. § 2473 (1964). All of the above statutes have language authorizing the agency in question to pay for "expenses and . . . losses and damages incurred . . . as a direct result of . . . moving."

Acquisition by the Bureau of Public Roads under Act of Oct. 23, 1962, 23 U.S.C. § 133 (1964) has been extensive, and the Secretary of Commerce may approve, as part of the cost of construction of any federal aid highway program, payments for moving expenses to a business displaced from real property acquired for the project. A \$3,000 maximum is established with the further limitation to a maximum distance of 50 miles.

¹⁷¹ According to information gathered by the Department of Commerce, 22 states have statutory authorization for payment of moving costs. Several others pay such costs pursuant to an attorney-general directive or decision of a state court. ADVISORY COMM'N, *supra* note 93, at 69.

An illustrative statute is the N.Y. CONDEM. LAW § 14 (McKinney Supp. 1967) which provides:

In fixing the amount of such compensation the commissioners shall also include the reasonable and necessary expenses, not in excess of three hundred dollars, incurred or to be incurred by a resident owner in moving household furniture to his new residence.

A more comprehensive provision, extending also to the expenses of moving a business, is contained in the N.Y. GEN. MUNIC. LAW § 74-b (McKinney Supp. 1967).

¹⁷² Each fall the ACIR publishes a program of suggested state legislation designed to improve the workings of our federal system. The Commission is a permanent bipartisan group established under federal law enacted in 1959 to give continuing study to the relationships among the three levels of government. Its membership is drawn from all three levels, and it has a permanent staff in Washington.

¹⁷³ U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, 1966 STATE LEGISLATIVE PROGRAM 266-67 (1965), sets forth "An Act to provide for uniform, fair, and equitable treatment of persons, businesses, and nonprofit organizations displaced by state and local programs" [hereinafter referred to as the Model Act]. Model Act § 2, "Relocation Payments," provides:

(a) If the state or any unit of local government acquires real property for public use, it shall make fair and reasonable relocation payments to displaced persons and business concerns as required by this act.

(b) A relocation payment to a displaced person shall be (1) for actual and reasonable expenses in moving himself, his family, business, farm operation, or other personal property, . . . or (2) a fixed payment in accordance with a schedule of fixed amounts approved by the [Governor].

One problem under the Model Act is the definition of "person" in § 11(2) as "any individual, family, or owner of a business concern or farm operation." Quære: Is a corporate owner includable? It should be noted that New Jersey adopted the model statute with few revisions. N.J. REV. STAT. § 52:31B-1 to -12 (Supp. 1967).

stantial economic injury because of the public improvement for which property is acquired"¹⁷⁴ may receive relocation services. The only limitation on the type of business affected is that the definition of "business concern" excludes those engaged in the "activity of holding property for the production of income."¹⁷⁵

Depending on the sufficiency of the payments determined in the fixed schedule, this approach may be most equitable in terms of placing the parties in the position they were in prior to the dislocation. Under a relocation cost program all business losses incident to the move, such as nonfixture machinery and good will, would be compensable. Insofar as a statutory award depends on the determination of "reasonable" moving expenses, however, implementation may be hindered by unnecessarily restrictive interpretations similar to those under the common law. Therefore, if such a statute is passed, its effectiveness may depend on how emphatically the legislative intention to assume liability is stated on the face of the statute.

Legislative enactments in this area are not a simple matter and no doubt will require careful preliminary analysis and drafting. Nonetheless, not only is legislative change possible, but, in some instances, statutory language with a detailed body of judicial interpretations already exists. If legislatures are persuaded as a matter of policy to undertake statutory revision, there is simply no practical reason why they should not enact a workable statute.

B. *Constitutional Amendment*

One axiom in the law of eminent domain is that not every governmental interference with a person's economic interests is equivalent to a compensable taking in the constitutional sense. This principle has led the courts to develop the questionable distinction that the condemnation of business property results in a "taking" of only the land, not the business conducted on the land. A typical state constitution reads: "[p]rivate property shall not be taken for public use without just compensation."¹⁷⁶ Many states have held that "taking," as used in the constitutional formula, can only be viewed in terms of what the states

¹⁷⁴ Model Act, *supra* note 173, § 3(a).

¹⁷⁵ *Id.* § 11(4).

¹⁷⁶ N.J. CONST. art. I, ¶ 20. The fifth amendment of the United States Constitution mandates: "nor shall private property be taken for public use, without just compensation." A similar limitation is imposed upon the states through the fourteenth amendment due process clause, regardless of whether they have similar provisions in their own constitutions. *Chicago, B. & O. R.R. v. Chicago*, 166 U.S. 226, 233-34 (1897); *Scott v. City of Toledo*, 36 F. 385, 395 (C.C.N.D. Ohio 1888).

physically receive as a result of the condemnation, not what the owner is forced to give up.¹⁷⁷ At least in theory, however, this rule of decision can be eliminated by changing the constitutional "taking" language to "taken or damaged."¹⁷⁸ Under this terminology the claim for business losses could be included in the "or damaged" language.

Unlike the legislative revisions proposed above, constitutional amendment would not have the advantage of statutory definitions and guidelines. This would be of little consequence, however, since the courts have never shown timidity in devising methods of compensation when the propriety of such compensation was not in question. It should be possible to calculate business losses proximately caused by a taking, even in the absence of express formulas, by using the differences in capitalized income before and after the condemnation. Legislative studies and drafters' notes, however, would be indispensable to the courts, since constitutional amendments in the area of compensation for business losses, unlike those in other areas, have not been viewed as self-implementing.¹⁷⁹

Constitutional amendment may be superior to legislative revision in some areas of eminent domain valuation, since courts more often have been spurred to substantial revision and innovation under the former, while too often tending under the latter to indulge in nit-picking limitation and restriction.¹⁸⁰ On the other hand, the generality of constitutional amendment must be admitted, as must the possibility that targets other than those initially intended will be hit by the amendment. But this possibility should not deter the legislators, since the propriety of further expansion lies in the sound discretion of the courts, which more often than not have turned a deaf ear to such pleas.¹⁸¹

¹⁷⁷ In the view of these courts, the only item received by the state is the land itself. See pp. 631-33 *supra*. The Florida courts have taken the most direct approach in opposition to this view. See *Jacksonville Expressway Auth. v. Henry G. Dupree Co.*, 108 So. 2d 289, 292 (Fla. 1958). With respect to the Florida practice, see generally Comment, *Compensation for Moving Expenses in Eminent Domain*, 6 ST. LOUIS U.L.J. 232, 245 (1960).

¹⁷⁸ See 2 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 6.44 (listing states that have enacted the "taken or damaged" formulation). But see 1 L. ORGEL, *supra* note 24, § 78.

¹⁷⁹ Although the "damage" clause would be self-executing in that the owner could recover in any ordinary civil action without additional legislative or judicial implementation, 2 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 6.441[4], it apparently would not automatically provide compensation for business losses without some specific explanation of intent on the part of the draftsmen. See *id.* § 6.4432[2]; 1 L. ORGEL, *supra* note 24, § 78.

¹⁸⁰ For example, the following cases illustrate the Illinois experience with the "or damaged" amendment in changing the common law no-compensation rule for damages resulting from loss of access: *Chicago v. Taylor*, 125 U.S. 161 (1888); *City of Chicago v. Union Bldg. Ass'n*, 102 Ill. 379 (1882); *Rigney v. City of Chicago*, 102 Ill. 64 (1882).

¹⁸¹ See, e.g., the discussion of the judicial interpretation of New York statutes and

Methods of limiting the scope of the "or damaged" provision are further available in the already large number of cases decided under such provisions. These cases have held that compensation will be paid only if the damage affects the property owner specifically and is not merely a part of that suffered by the public generally.¹⁸² Also, compensation for highly speculative and remote damages is uniformly denied under the "or damaged" formulation.¹⁸³ Of course, a constitutional amendment of this kind might be deemed "enabling" rather than "mandatory" and as such dependent upon legislative implementation, possibly in the form of one or a combination of the proposed statutes discussed previously. Despite this possibility, constitutional amendment, like remedial legislation, should in all probability provide a vehicle capable of at least partially solving the problem of compensating for business losses in eminent domain. Without debating the relative merits of these alternatives, suffice it to say that a solution to the problem, regardless of the method, is long overdue.

CONCLUSION

Business losses, including damages to or destruction of good will, should be compensable in eminent domain when proximately caused by a condemnation. The courts of New York have apparently gone as far as possible without remedial legislation or constitutional amendment in making compensable a limited going concern value. Through use of what we have designated a "specialty" theory, they have compensated for damage to or destruction of nonfixture machinery and equipment integrated into a going business. Constitutional challenges could be raised to the failure to compensate for these losses, but it is extremely unlikely that the United States Supreme Court would overturn a half century of its own precedent, not to mention cases from most of the states.¹⁸⁴ Constitutional arguments can have a glitter all

municipal ordinances concerning change-of-grade or deprivation-of-access in *Mayberry & Aloï*, *supra* note 128, at 608-19.

¹⁸² See 2 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 6.441[3]; Lenhoff, *Development of the Concept of Eminent Domain*, 42 COLUM. L. REV. 596, 613 (1942).

¹⁸³ See, 4 NICHOLS' EMINENT DOMAIN, *supra* note 3, § 14.241. In addition to the "speculative" damage theory, other theories regulating compensation under the taken or damaged provision have been espoused by various courts. See 2 NICHOLS' EMINENT DOMAIN, *supra* note 3, §§ 6.441[1]-[2].

¹⁸⁴ Any number of valuation cases can be cited in which certiorari was denied or an appeal dismissed by the United States Supreme Court. *E.g.*, *Baldwin-Hall Co. v. State*, 16 N.Y.2d 1005, 212 N.E.2d 899, 265 N.Y.S.2d 664 (1965), *cert. denied*, 385 U.S. 818 (1966) (change of grade and resultant deprivation of access); *Northern Lights Shopping Center*,

their own as intellectual exercises, but the nation's highest court has consistently elected not to trip the existing valuation balance. Perhaps there is method to this apparent judicial madness: judicial policy makers may sympathize with the cause but view action at the state level, through legislative or constitutional amendment, as the proper vehicle. Moreover, public outcry for the compensation of business losses in eminent domain is conspicuously absent, and, insofar as courts appear to be influenced by public outrage and frustration or at the very least by vociferous scholastic commentary, the lack of such may be fatal to judicial change.

Regardless of these problems with judicial revision, state-originated remedial legislation and constitutional amendment does appear to provide a ready-made vehicle for solving the problem. Why the continued difficulty? Quite simply, the states must be persuaded of the general utility of initiating change. Failure to compensate for business losses upsets the interaction of factors that otherwise could be combined by entrepreneurs to produce marginal efficiency and resulting profits. Although public uses presumably benefit society generally, the present compensation balance offsets these gains by disproportionate taxing of costs to those engaged in business. The old chestnut that increased compensation will bankrupt the states has absolutely no validity. If additional funds are necessary, they can easily and more rationally be obtained by distributing the costs of public improvements through the tax structure to the segment of the public sharing in the benefit. This expedient is unlikely to overburden taxpayers generally, because the potential of increased state financial exposure will no doubt persuade public authorities to be more responsible in their planning, bypassing businesses where possible. When the reason for a rule disappears, the rule should be discarded. There never was a valid reason for the no-compensation rule, which is all the more reason for discarding it. Artificial distinctions without basis other than in semantics must be replaced by an economically viable solution.

Inc. v. State, 15 N.Y.2d 688, 204 N.E.2d 333, 256 N.Y.S.2d 134, *cert. denied*, 382 U.S. 826 (1965) (deprivation of access); *National Biscuit Co. v. State*, 11 N.Y.2d 743, 181 N.E.2d 457, 226 N.Y.S.2d 455, *cert. denied*, 370 U.S. 924 (1962) (deprivation of access); *Banner Milling Co. v. State*, 240 N.Y. 533, 148 N.E. 688, *cert. denied*, 269 U.S. 582 (1925) (loss of going concern value and good will).

Compare *Stoebuck*, *supra* note 125, at 238, where the argument is made, on the basis of projecting the results of the federal airport condemnation cases, that the Supreme Court is likely to extend the range of compensable damage through application of the theory that governmental action that would be a "nuisance" if done privately constitutes a "taking."