



# “Court of Appeal Determines Entitlement to Compensation Must be Decided by Judge, Not Jury”

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## INTRODUCTION

Since the 1980’s, the Emeryville Redevelopment Agency had plans to redevelop an area of vacant and existing industrial properties as a mixture of retail, housing, hotel and entertainment uses. After purchasing several sites in the project area, the Agency had to acquire the land on which a pigment factory operated. Acquisition of the property required the Agency to file a condemnation action pursuant to its power of eminent domain. To acquire the property through condemnation potentially required payment for three distinct property assets from the property owner (who was also the business owner): real estate, immovable fixtures and equipment on the property, and any lost goodwill value the business might incur as a result of the need to relocate. Through the condemnation action, the Agency determined that the site was highly contaminated. The Agency could not reach a settlement with the property and business owner for the value of the property, fixtures and equipment, and goodwill, and so the case went to trial. In 1999, an Alameda County jury awarded \$12.5 million to the property owner. The decision was appealed.

On September 6, 2002, the First Appellate District of the California Court of Appeal released for publication its opinion and order reversing the \$12.5 million judgment. The Court of Appeal also set aside an award of an additional \$1.7 million in litigation costs to the property owner. The Court of Appeal’s decision, *Emeryville Redevelopment Agency v. Harcos Pigments, Inc. et al.*, makes this case the most significant new eminent domain decision in California in quite some time. In particular, the Court of Appeal considered and resolved several critical issues that commonly arise in eminent domain litigation, including the following:

- ◆ Whether entitlement to goodwill is decided by the court or the jury.



- ◆ Whether a property owner may seek compensation for loss of goodwill when the owner's commercial use of the property is inconsistent with the property's highest and best (i.e., more valuable) use; and
- ◆ The admissibility of evidence regarding agency development plans for the site and agency purchases of neighboring properties.

As discussed on the next page, the Court of Appeal decided each of these issues in the Agency's favor. This included rulings that: **(1)** the threshold determination of whether a property owner had established entitlement to lost business goodwill is for the judge to decide, not the jury, and **(2)** a property owner may not seek compensation for lost business goodwill when the alleged, interim commercial use is not consistent with the valuation of the property for a higher and better use. This favorable decision establishes new law and achieves a positive result for the Agency. In addition, it sends a strong message that the evidentiary rules applicable to condemnation proceedings must be enforced to prevent inflated verdicts.

### **TRIAL COURT PROCEEDINGS**

At issue in the *Emeryville Redevelopment Agency* case was a 13-acre, highly contaminated property. The property, once the site of an ancient Indian burial shellmound, had more recently been used as a pigment factory. The Emeryville Redevelopment Agency obtained an order of possession for the 13-acre property in 1998 and proceeded with a multi-million dollar clean-up effort. The Emeryville Redevelopment Agency acquired the property for use in a mixed-use retail, housing, hotel and entertainment redevelopment project as part of a redevelopment plan to transition blighted, formerly industrial properties to higher and better land uses.

The trial court was confronted with many difficult decisions regarding the admissibility of evidence. The trial court decided the goodwill entitlement issue in the Agency's favor. Specifically, the court ruled that the business was not entitled to lost of goodwill when the property upon which it operated was being valued assuming a higher and better use. However, the trial court decided several controversial evidentiary issues against the Agency, thus giving rise to the Agency's appeal. For example, the trial judge excluded evidence of the cost of soil contamination remediation and its effect on the value of the property (even though he admitted evidence of the cost of groundwater remediation).



The judge also allowed evidence of the price paid by the Agency for the purchase of neighboring properties, and permitted the property owner's appraiser to assign different values per square foot of a comparable property straddling the boundary between the cities of Emeryville and Oakland (based on the theory that the portion in Emeryville was more valuable per square foot). In addition, the trial judge allowed the jury to hear extensive evidence of the Agency's redevelopment plans.

The jury awarded the property owner \$12.5 million. Both parties appealed, challenging the trial judge's decisions regarding the admissibility of the evidence.

### **COURT OF APPEAL DECISION**

In decisive victory for the Agency, the Court of Appeal rejected the property owner's appeal, affirming the trial court's ruling that the property owner was not entitled to present its lost goodwill evidence to the jury. The Court of Appeal declared that when entitlement to goodwill is disputed, the court, not the jury, must decide whether the condemnee has established entitlement. The Court of Appeal ruled that entitlement disputes must be decided by the trial judge even though some courts had allowed juries to make entitlement determinations and the eminent domain jury instructions include an entitlement instruction. This precedential ruling is consistent with the general rule that judges must decide all disputed issues in condemnation cases except for actual determination of value.

Further, the Court of Appeal determined that the trial court had correctly decided that the condemnee had not established entitlement, and therefore could not present evidence of lost goodwill to the jury. The Court of Appeal explained that the property owner's claim for lost business goodwill necessarily assumed that the property would continue to be used for industrial purposes. However, the property owner simultaneously appraised the property based upon its conversion to a higher and better (i.e., more valuable) use, which necessarily assumed the business would no longer operate on the property. Accordingly, the condemnee could not prove two of the entitlement factors set forth in the Eminent Domain Law: (1) that the loss of goodwill is the result of the taking (because the loss was due to the assumed change in land use), and (2) that the condemnee would not receive a compensation windfall by means of a double recovery (because the land uses for the goodwill and property value claims were mutually exclusive). The Court agreed with the Agency on its appeal, ruling that the judgment as to the value of the real estate and



fixtures and equipment must be reversed due to several errors regarding the admission of evidence prejudicial to the Agency. The court of Appeal determined that the trial judge erred by allowing the property owner to offer evidence regarding Agency purchases of neighboring properties, permitting the property owner's appraiser to "appraise the comparable" by assigning different "zones of value" to the comparable property, and admitting evidence of the redevelopment project. The Court of Appeal also reversed the trial court's award for the fixtures and equipment because it was based on an assumption of continued use that was inconsistent with the determination of the highest and best use, a ruling that is consistent with the goodwill ruling described above.

### **THE ENVIRONMENTAL CONTAMINATION ISSUE REMAINS UNDECIDED**

As discussed above, one of the principal grounds for the Agency's appeal was the trial court's decision to admit evidence of the cost of remediating groundwater contamination, but to exclude evidence of the cost of remediating soil contamination. The trial court further stayed a portion of the judgment, pending resolution of a federal cost recovery action filed by the Agency. The Agency maintained that the exclusion of evidence of the cost of soil contamination remediation would preclude the jury from accurately determining the highest value a willing buyer would pay a willing seller for the property on the date of valuation. The Agency also objected to the trial court's stay of a portion of the judgment. While the case was on appeal, the Agency and the property owner reached a settlement on the federal action.

Although it reversed the \$12.5 million judgment on the several grounds discussed above, the Court of Appeal did not decide the soil contamination issues. The Court of Appeal noted that since the parties reached a settlement on the federal action, it would leave the issue to be decided at another time. The Agency continues to maintain that the jury must be entitled to hear evidence on all the costs of contamination remediation, not just groundwater remediation. This is consistent with the language from one prior California appellate decision that addressed the issue in the condemnation context.<sup>1</sup> Moreover, the Agency's position is supported by the great weight of authority from other jurisdictions throughout the country that considered this issue.

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<sup>1</sup> SEE *REDEVELOPMENT AGENCY V. THRIFTY OIL CO.* (1992) 4 CAL. APP. 4<sup>TH</sup> 469, 474, N.9: ("NOR ARE WE PERSUADED BY THE CONTENTION THAT THE REMEDIATION ISSUES WAS NOT PROPERLY BEFORE THE JURY. THE CONTAMINATION OF THE PROPERTY WAS USED BY ALL EXPERTS IN DETERMINING THE FAIR MARKET VALUE OF THE PROPERTY...AS A CHARACTERISTIC OF THE PROPERTY WHICH WOULD AFFECT ITS VALUE, *THE REMEDIATION ISSUE WAS PROPERLY BEFORE THE TRIER OF FACT.*" [EMPHASIS ADDED]).