



## *Mertens Valuation Review*

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The *Mertens Valuation Review* is a bi-monthly publication providing our clients and other interested readers with topical information on business valuation and financial litigation support.

### **Introduction**

With increasing activity in public works projects we can expect a large number of businesses to be affected by expropriation of property and related business disruption over the coming months and years. As such, we thought an overview article on expropriation and business disturbance damages may be of particular interest to many of our readers.

### **Expropriation**

An expropriation is the taking, or partial taking, of property by a public agency (i.e. provincial or municipal authorities) for a purpose deemed to be in the public interest without the consent of the property owner. In British Columbia, the rights of the property owner and expropriating authority (the “authority”), including the entitlement to and method of determining compensation are set out in the *Expropriation Act* (the “Act”).

In many situations the property owner and the authority will reach agreement on the amount of compensation to be paid and the property will be transferred in a manner analogous to a private transaction. Even when there is disagreement over the amount of compensation to be paid, an expropriation may be avoided by entering into an agreement to transfer the property with only the amount of compensation to be determined by the Courts<sup>1</sup>.

Prior to March 18, 2005, the Expropriation Compensation Board (“ECB”) - an independent body made up of chairman, vice chair and ten other members - had the authority to determine the amount of compensation to be paid in respect of an expropriation (or a section 3 agreement footnoted below) when the property owner and the authority failed to reach an agreement. On March 18, 2005, the B.C. Government passed a series of Regulations to implement the *Expropriation Amendment Act, 2004*,

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<sup>1</sup> This type of arrangement is made pursuant to section 3 of the Act. The methods of determining compensation under the *Act* will still apply, but the time and cost of following the required procedures for an actual expropriation will be avoided.

with the most significant change being the transfer of the ECB's authority to the BC Supreme Court. There are certain transitional rules to allow the ECB to conclude certain "in progress board proceedings", which are generally proceedings that were already before the ECB on March 18, 2005.

When business premises are expropriated, the owner is generally entitled to compensation under the following two broad categories of damages:

- The market value of the property (or portion thereof) taken at the date of the expropriation; and
- Business disturbance damages.

Determining the market value of the property taken is the domain of qualified real estate appraisers. The quantification and reporting of business disturbance damages falls under the expertise of a Chartered Business Valuator ("CBV"). The balance of this article deals exclusively with business disturbance damages.

We would like to stress that a property/business owner should first seek advice from their legal counsel when notified by an authority in respect of a potential expropriation. A CBV will generally be engaged through the owner's legal counsel to provide independent expert advice in regards to the quantification of business disturbance damages.

### ***Business Disturbance Damages***

A property owner (or tenant) who carries on a business on land that is expropriated is generally entitled to reasonable "disturbance damages" directly attributable to the expropriation. The components and methods of determining disturbance damages are set out under section 34 of the *Act* as follows:

*34 (1) An owner whose land is expropriated is entitled to disturbance damages consisting of the following:*

*(a) reasonable costs, expenses and financial losses that are directly attributable to the disturbance caused to the owner by the expropriation;*

*(b) reasonable costs of relocating on other land, including reasonable moving, legal and survey costs that are necessarily incurred in acquiring a similar interest or estate in the other land.*

*(2) If a cost, expense or loss is claimed as a disturbance damage and that cost, expense or loss has not yet been incurred, either the claimant or the expropriating authority may, with the consent of the board (Court), elect to have the cost, expense or loss determined at the time, not more than 6 months after the date of expropriation, that the cost, expense or loss is incurred.*

*(3) If an owner whose land is expropriated carried on a business on that land at the date of expropriation and, after the date of expropriation, relocates the business to and operates it from other land, reasonable business losses directly attributable to the expropriation must not, unless that person and the expropriating authority otherwise agree, be determined until the earlier of*

*(a) 6 months after the owner has operated the business from the other land, and*

*(b) one year after the date of the expropriation.*

*(4) If the board (Court) determines that it is not feasible for an owner to relocate his or her business, there may be included in the compensation that is otherwise payable, an additional amount not exceeding the value of the goodwill of the business.*

Where a tenant carries on business from leased premises (with a term greater than one year) that is expropriated, the lessee is entitled to reasonable business disturbance damages (pursuant to section 39 of the *Act*), as determined by the ECB (Court), having regard to the following factors:

- The term of the lease and the length of the unexpired portion;
- The rights to renew the lease or the reasonable prospects of renewal (assuming the expropriation had not occurred);
- The nature of the business; and
- The extent of the lessee's investment in the premises.

#### Business Relocation

Assuming that a business is able to relocate, the business will be entitled to claim disturbance damages caused by the expropriation and relocation of the business. The following items cover some of the more general aspects that may form part of a claim for disturbance damages<sup>2</sup>:

- Costs associated with locating and securing new premises;
- Depending on the nature of the business, there may be a short period of operating the business simultaneously from the old and new location, which would result in duplicate / excess operating costs;
- Moving costs, which may include fees paid to a moving company, employee time, setting up machinery and equipment at the new location, etc;
- Other relocation costs such as new stationary and marketing materials with the business' new address, time spent notifying customers and suppliers, etc;
- Management time spent dealing with the expropriation and relocation;
- Loss of profits caused by disruption to the business during the period of relocation (the specific relocation costs identified above would need to be excluded from the loss of profits analysis to prevent double counting). Generally, the loss of profits will be the reduction in "contribution margin" during the relocation period. Contribution margin equals revenues less variable expenses – fixed expenses that would be incurred irregardless of the disturbance should generally be ignored;
- Loss of profits for a period of time following the relocation (i.e. due to a temporary decline in walk-in customers, temporary loss of some regular customers, ongoing expenses related to getting customers back, increased marketing costs, etc); and

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<sup>2</sup> Each specific circumstance will be different and the claim for damages will depend on the facts.

- Permanent reduction in the goodwill value of the business (i.e. caused by ongoing loss of profits due to permanent loss of regular customers, permanent decline in revenues as new location is less desirable – even though it was the best alternative available, higher cost structure at new location, etc).

Where it is not feasible to relocate the business (i.e. it will be wound up following the expropriation), subsection 34(4) of the *Act* provides that compensation may include an additional amount not to exceed the goodwill value of the business. This situation may arise, for example, when the nature of the business is such that it requires specially zoned land of which there is none available for purchase or lease within reasonable / practical proximity to the expropriated land.

A business valuation as at the date of the expropriation would be required to determine the quantum of goodwill (when it is not feasible to relocate the business).

#### Partial Taking – No Business Relocation

With a partial taking, a business may face a period of disruption caused by the construction work on the project for which the land was expropriated (i.e. road expansion, new train line, etc). The disruption may be more or less continual throughout a given period, or may be intermittent with varying degrees of interruption. The following items cover some of the more general aspects that may form part of a claim for disturbance damages caused by a partial taking and the proximate project work:

- Loss of profits during the disruption period. Generally, the loss of profits will be the reduction in contribution margin during the disruption period. The reduction in contribution margin may be quantified by determining the “projected” earnings that would have been earned during the disruption period (if not for the disruption)<sup>3</sup> and subtracting the “actual” earnings realized during that period (the difference being the consequential reduction in earnings);
- Continued loss of profits beyond the disruption period (i.e. a reduction in earnings attributable to the project work disruption may continue for several months or even years beyond the project work period itself);
- Permanent loss of profits resulting in a reduction in the goodwill value of the business. For example, the configuration of the remaining property after the partial taking and the completed project (i.e. wider / changed road) may impact negatively on the earning potential of the business – such as where it becomes less convenient for drive-by / walk-in customers to notice and access the business.

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<sup>3</sup> As part of a complete and supportable analysis, other factors (internal and external) must be carefully examined to determine the impact they may have had on earnings during the affected period. For example, a business may report significantly lower earnings during the disruption period (as compared to earlier periods) with the business owner attributing the poor results solely to the disruption caused by project work. However, the expert may find other factors that may be attributable, in whole or in part, to the decline in earnings (i.e. industry recession, new competitor taking market share, external pressure on pricing, lack of owner/ manager attention to the business, etc).

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## **Summary**

A CBV can assist the property / business owner and his or her legal counsel in a variety of ways throughout the expropriation process, including:

- Early planning, including an indication of the types of compensable damages the business may expect to incur given the nature of the business (and the public project);
- Strategies for recording events and financial results during and following the disruption period;
- Preliminary calculation or estimate of damages to help facilitate early settlement;
- Preparation of an expert report providing an independent opinion of the quantum of business disturbance damages (to be submitted as expert evidence);
- Review of reports prepared by the expert hired by the authority and assist counsel with preparing for cross-examination of that expert witness; and
- Appear as an expert witness.

## **Economic Watch**

Next Bank of Canada interest rate announcement - September 7, 2005 (current rate 2.50%)

Next U.S. Federal Reserve interest rate announcement – August 9, 2005 (current rate 3.25%)

The Cdn / U.S. dollar exchange (closing) rate on July 21, 2005 was 1.2179

Statistics Canada will release the July 2005 CPI figures on August 26, 2005 (Core CPI for June 2005 was 1.7% year-over-year)

Statistics Canada will release the July 2005 Leading Indicators data on August 23, 2005 (the Composite Index grew by 0.3% in June 2005)

In its July 2005 Monetary Policy Report (Update) the Bank of Canada projects annual domestic economic growth to come in at 2.7% for 2005 and 3.3% in 2006

As at July 21, 2005 the Chartered Banks' prime lending rate remained unchanged at 4.25%

As at July 21, 2005 the Government of Canada Benchmark Bond Yields were 3.21%, 3.41% and 3.96% for 3-year, 5-year and 10-year respectively

The *Mertens Valuation Review* provides topical information on business valuation and financial litigation support and is not intended to render any form of professional advice. The reader should consult with a professional advisor to determine the relevance of any comments contained herein to a particular circumstance.

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