

CPD
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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

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MEMORANDUM FOR: Joan Morgan, Director, Relocation and Real Estate Division, Office of Community Planning and Development, DGH

FROM: *Kathleen M. Bialas*
Kathleen M. Bialas, Assistant General Counsel for Community Development, Office of General Counsel, CAHBA

SUBJECT: Loss of Goodwill: URA Treatment of Loss of Goodwill Recoverable in a Condemnation Action or Settlement Pursuant to State Law

The purpose of this memorandum is to address the recurring question of whether compensation for loss of goodwill made recoverable by state law is an eligible cost or expense for purposes of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, Pub. L. No. 91-646 (codified, as amended, at 42 U.S.C. §§ 4601-4655) (hereafter, "URA"). This issue has been raised most recently by the City of Bakersfield, California ("the City"). The City had used a Section 108 loan and Brownfields Economic Development Initiative ("BEDI") grant to acquire certain property through condemnation. California state law provides a cause of action to recover compensation for goodwill lost through eminent domain. Legal action was filed against the City to recover this amount resulting in a settlement by the parties. The City has asked HUD to advise on the permissibility of using the remaining balance of its BEDI grant funds to pay for the loss of goodwill settlement amount as part of the just compensation award. Just compensation is an eligible acquisition cost under the URA.

Goodwill refers to "a business's reputation, patronage, and other intangible assets that are considered when appraising the business, esp. for purchase." See Black's Law Dictionary 715 (8th ed. 2004). Loss of goodwill refers to a diminution in a business's goodwill. The City's primary concern relates to an apparent inconsistency between its obligations under California state law and the treatment of loss of goodwill in the URA regulations at 49 C.F.R. part 24. When a non-federal governmental entity condemns private property in California, section 1263.510(a) of the California Civil Procedure Code provides a cause of action for recovery of any resultant loss of goodwill. The only explicit mention of loss of goodwill in the URA government-wide regulations appears at 49 C.F.R. § 24.301(h)(3), which deems loss of goodwill an ineligible payment for "moving and related expenses." This limitation stems from section 202 of the URA, which states more generally that eligible moving and related expenses are limited to "direct losses of *tangible* personal property as a result of moving or discontinuing a business." 42 U.S.C. § 4622(a)(2)(emphasis added). However, the URA statute and regulations are silent on the permissibility of incorporating an amount for loss of goodwill into the just compensation offer, that is, as an acquisition cost, rather than treating it as a "moving [or] related expense." For the reasons given herein, it is our opinion that when a taking of private property causes a loss of goodwill, and such loss is recoverable under applicable state law, a non-federal governmental entity that condemns property for a program or project assisted with HUD funds may factor loss of goodwill into the just compensation amount payable with HUD funds as an eligible cost of acquisition.

The U.S. Constitution provides that private property shall not be taken for public use except when just compensation is paid to the owner. See U.S. Const. amend. V, cl. 5 (“Takings Clause”). State constitutions generally contain a similar clause—see, e.g., Cal. Const. § 19(a)—though construction of state constitutions, including what just compensation means, may differ from construction of the U.S. Constitution. The Supreme Court has consistently interpreted the federal Takings Clause to hold that when government condemns real property, the constitutional mandate of just compensation does not include loss of goodwill:

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

United States v. General Motors Corp., 323 U.S. 373, 379 (1944). Additionally, the Court has held that loss of goodwill is not compensable in federal condemnation actions. See, e.g., United States v. 1,377 Acres of Land, 352 F.3d 1259, fn. 5 (9th Cir. 2003)(“...this panel would not be entitled to reverse well-established Supreme Court precedent which makes clear that the loss of goodwill is not compensable in federal condemnation actions”).

The lack of federal constitutional mandate for compensating loss of goodwill in a taking and the exclusion of loss of goodwill from just compensation in condemnation actions by the Federal Government does not resolve the instant inquiry. The traditional rule that loss of goodwill is not recoverable as part of just compensation in a condemnation action continues to be the majority position at the federal and state levels. However, some states have altered the traditional rule by statute or constitutional construction to allow for recoverability of loss of goodwill in state and local government condemnations. See, e.g., Cal. Civ. P. Code § 1263.510(a) (Deering 2010) (California statute providing cause of action to recover loss of goodwill in a taking upon sufficient showing).

While the URA is a federal law, it applies to federally-assisted projects administered by state and local governments. State law remains relevant to the computation of just compensation in such projects. In states that have abandoned the traditional rule on treatment of loss of goodwill in a taking, non-federal governmental actors are compelled to factor loss of goodwill into just compensation provided to owners. Indeed, section 305 of the URA provides that the acquisition policies of the URA are specifically limited by their “practicability” under state law. See 42 U.S.C. § 4655 and 49 C.F.R. § 24.101(d) (providing that, for federally-assisted projects, URA acquisition policies apply to the “greatest extent practicable under state law”). The URA provides that an agency seeking to acquire real property must establish an amount that it believes to be just compensation before the initiation of negotiations and make a written offer to the property owner for that amount. See 42 U.S.C. § 4601(3) and 49 C.F.R. § 24.102(d). Just compensation may not be less than the “fair market value” of the property, as determined by an appraisal conducted in

accordance with requirements established at 49 C.F.R. part 24, subpart B. Id. Additionally, the initial offer may exceed the appraisal amount "if the Agency determines that a greater amount reflects just compensation for the property." 49 C.F.R. part 24, App. A, § 24.102.

Because loss of goodwill arising out of a taking is recoverable pursuant to the laws of some states, compensation for loss of goodwill in those states, including payments in satisfaction of a court order or a settlement in lieu thereof, will be considered an eligible acquisition cost for purposes of the URA payable with HUD funds. This characterization respects the URA acquisition policies' deference to practicability under state law and observes that an amount of compensation inclusive of loss of goodwill "reflects just compensation for the property" in those states whose laws have departed from the traditional rule.

If you have any questions or wish to further discuss this issue, please contact Brian Stecker, Attorney-Advisor, of my office at (202) 402-3270.

