

New Regulations could mean Big Business for US Mitigation Bankers?

by Ricardo Bayon

A bill passed by the US Congress calls on the US Army Corps of Engineers to prepare new regulations on wetlands mitigation and mitigation banking, regulations that could mean huge increases in business for mitigation bankers in the US. One observer calls these new regulations "the most significant piece of legislation to come out in the short-lived history of the mitigation banking industry."

John Ryan, the President of Land and Water Resources Inc. in Chicago, Illinois, is the perfect example of how environmental markets are transforming the way people do business in the US. In Ryan's particular case, not only has his business been radically transformed, but so has his life, his career, and even his legacy.

Ryan, you see, comes from a long line of earth moving contractors based in southern Wisconsin. His father was an earth-moving contractor, as were his grandfather, and his great grandfather. In fact, Ryan Inc., the company that bears his family's name, is still one of the largest earth moving companies in the US. Ten years ago, however, Ryan left his family's profitable business to set up a construction company of a very different sort: one that builds, maintains, protects, and restores ecosystems, or, to be more precise, wetlands.

He is able to make a living building wetlands because of a unique environmental market that exists in the US that is sometimes referred to as "mitigation banking", or "wetlands mitigation banking." The system works roughly like this: Whenever a developer wants to impact a wetland, the US Clean Water Act says they need to obtain a permit for this work from the US Army Corps of Engineers. In issuing that permit, the Corps is supposed to look first at whether the damage is truly necessary. Then, if it determines that the damage is indeed necessary, the Corps is supposed to require that the developer minimize any potential harm to the wetland. Finally, where damage is unavoidable, the developer is required to compensate (or mitigate) for this damage by restoring a former wetland, enhancing a degraded wetland, creating a new wetland, or, in some very rare cases, preserving an existing wetland.

The law states that developers can fulfill this "compensatory mitigation" themselves (usually at or near the development site), or they can pay third parties to do this in their stead. If they decide to pay someone else to do the work for them, they have several options: (1) They can buy "wetland credits" from a mitigation bank, usually a for-profit entity that "creates, enhances, or restores" a wetland and then is allowed by the Corps to sell credits for these wetlands -measured in acres- to needy developers. (This is how Ryan makes a living.); or (2) they can pay fees established by the Corps to public entities or private not-for-profit organizations that, in agreement with the Corps, use the money to "protect, enhance, or restore" wetlands. These are known as "in-lieu-fee" arrangements; or (3) They can pay a third party that is neither a mitigation bank nor an in-lieu fee provider to undertake the mitigation. These are referred to as "ad-hoc" arrangements. [For more on mitigation banking, see the attached article]

As a result of these requirements for wetlands mitigation, there has developed in the US a burgeoning market for wetlands mitigation. Indeed, a report by the Environmental Law Institute (<http://www2.eli.org/wmb/index.html>) estimates that between 1992 and 2002 there has been a 376 percent increase in the number of private wetlands banks in the US. They estimate that in 2002 there were 219 approved banks, with some 95 more pending approval. Although no one knows for sure, the market for environmental mitigation in the US is almost certainly worth hundreds of millions -perhaps even billions- of dollars.

That is the market that John Ryan moved into when he left his family's business way back in 1990. As he describes it, the idea to go from earth-mover to earth-saver came in the form of an epiphany born of frustration. "In doing the earth moving work," he says, "it always seemed that we negotiated a contract to do some building and then the people would say, 'Well, gee, we'll get started just as soon as we can get our wetlands permits sorted out.' And when people said that, we knew it would be six months to a year before the work would begin. Then, when the work began, we were asked to help build this small wetland on-site. After a bit of this I woke up one night thinking to myself that it would be better for everyone concerned -the developers, the contractors, the environment- if we were to build a small number of real functioning wetlands instead of a large number of small pieces of wet dirt. The very next day I started talking to people, brewing the idea for my company."

He adds that the transformation hasn't been easy. "It was a gamble," he comments. "I sold my shares in my family company's stock, a successful company, and invested in a new business that no one knew existed." He says he got strange looks and no doubt his family was mortified, but as it turns out, the gamble paid off. His company now owns 22 mitigation banks across the country and does a comfortable \$5-6 million dollars in business a year. He says he is quite happy the way things are going.

As well he should be. Not only has the mitigation banking business grown considerably since Ryan opened his business, but now some observers believe it is poised to grow even more rapidly, thanks largely to a bill that was passed by the US Congress in December of 2003. George Kelly, the Managing Director of Environmental Banc and Exchange LLC (EBX), a mitigation banking company based in Maryland, calls the bill "the most significant piece of legislation to come out in the short-lived history of the mitigation banking industry."

The bill he praises so highly is, oddly enough, the National Defense Authorization Act for Fiscal Year 2004, and the language in question comes in Section 314 (http://www.congress.gov/cgi-bin/cpquery/?&dbname=cp108&&r_n=hr354.108&sel=TOC_249908&). It calls on the Army Corps of Engineers to "issue regulations establishing performance standards and criteria for use? of on-site, off-site, and in-lieu fee mitigation and mitigation banking" by two years after the passage of the act, in other words by December 2005. The real bombshell, however, comes a few lines later, when the law states that the regulatory

standards and criteria shall seek to do three things: First, they "shall maximize available credits and opportunities for mitigation." Secondly, they shall "provide flexibility for regional variations in wetland conditions, functions, and values." Most importantly for the mitigation bankers, however, the bill finally says that the regulations shall "apply equivalent standards and criteria to each type of compensatory mitigation."

The reason that Kelly, Ryan, and other mitigation bankers are excited about this law is that they see it as helping correct a fundamental problem with the way wetlands mitigation is conducted in the US; a problem that directly affects their profit margins and -they argue- the environmental integrity of the entire mitigation process.

It all goes back to the various mitigation options that are open to developers intent on impacting a wetland. As was discussed above, developers have essentially four options: they can do the mitigation themselves, they can pay a bank to mitigate, they can enter into in-lieu fee arrangements and pay the government or a non-profit to mitigate, or they can get someone else to do the mitigation. From the perspective of the developer, all of these options are the same, they all allow the developer to continue building, they all fulfill a regulatory requirement. As far as they are concerned, they will look for the cheapest, easiest, and most expedient option.

As far as the Army Corps of Engineers is concerned, however, each of these options is treated differently. If a developer decides to do the mitigation on its own, they are required to submit plans to the Corps for approval, but once they receive this approval, they can go ahead and damage a wetland before any mitigation is undertaken. Also, they are not held to stringent ecological standards in terms of wetland quality, wetland function, etc. Sometimes the result isn't even monitored to ensure that it exists several years later.

In-lieu-fee arrangements, likewise, are held to relatively lax standards. To participate in an in-lieu-fee arrangement, it used to be that the public agency or non-profit simply had to say that they were going to mitigate, they would then receive approval by the corps and they could begin collecting the money. There was no real oversight on how the money was used, and there were no real biological standards that projects were expected to uphold (though guidelines were issued in 2000 that address some of these issues). As a result, says Ryan, there have been cases where money was being collected by in-lieu-fee providers "in hope and prayer" that wetlands would someday, somehow be protected, enhanced, or restored. There were even cases where the money collected by in-lieu-fee arrangements went, not to a wetland, but rather to education, research and the like. "Education and research are great," says Ryan, "but they don't directly protect wetlands."

By contrast, mitigation banks are usually held to the strictest of standards. Not only do they usually have to complete their projects before being able to sell credits, but completion of the project generally requires that they establish conservation easements legally setting aside their land in perpetuity, and that they set aside a substantial amount of cash, a form of bond, to ensure the project's long-term viability. In addition,

mitigation banks tend to be closely watched by the Army Corps of Engineers and are, by law, forced to meet a pretty strict set of ecological standards. By way of example, Ryan explains that mitigation banks need to reduce the amount of exotic species on their wetlands to 5% or less, whereas other mitigation arrangements can get away with having as much as 20% exotic species. "And each percentage point," he adds, "adds a tremendous amount of work and cost."

Craig Denisoff, the Vice President for Government Affairs and New Project Development at Wildlands Inc., a California-based mitigation banking company, who is currently serving as President of the National Mitigation Banking Association (NMBA), says that these differences in treatment have artificially held back the mitigation banking industry. "Because we are held to such high biological, financial, and legal requirements," he says, "we just cannot compete with other forms of mitigation. They can often afford to charge thousands of dollars less per acre than we can? Besides, they can be up and running right away whereas it can often take us 2 to 3 years to get permitted? And to make matters worse, the government imposes all kinds of capricious restrictions on mitigation bankers; restrictions on the size of our projects, restrictions on who can purchase credits from mitigation banks, restrictions on the use of fines and other mitigation money for mitigation banks, among others."

For all these reasons, he estimates that private, for-profit, mitigation banks today make up only about 6% of all the mitigation done in the US. "I would guess," he says, "that in-lieu-fee arrangements account for about 4% of the industry, while mitigation done by individuals, usually for their own projects, accounts for the other 90%."

Beyond being bad for the industry, Denisoff argues, the current set-up is bad for wetlands and bad for the environment. He explains that when the standards are low, the job is often done badly. "In fact," he adds, "the Government Accounting Office (GAO) did a study recently which found that the system for in-lieu-fee arrangements is not working? And we have seen time and time again that permittee-responsible mitigation [where a developer is responsible for their own mitigation] is also not working. It is not tracked, there are no provisions for long-term stewardship, and the performance standards are low."

Denisoff says that mitigation bankers see the new regulations being drafted by the Corps as an important opportunity to "level the playing field", not by lowering standards, but by raising all of them up to the levels currently applied to mitigation banks. To the "94% of people in this business that have lower standards than we do" Denisoff has one thing to say: "Stop playing in the minor leagues and come join us in the major league."

Rich Mogensen, who preceded Denisoff as President of the NMBA and is Director for the Mid-Atlantic Region at the EarthMark Companies, believes that any new regulations that that apply equivalent standards across all forms of mitigation will strongly stimulate the US mitigation banking industry. "I know of no definitive study," he says, "that estimates how much mitigation is done by private banks as opposed to

other actors. If I had to hazard a guess, however, I would say that mitigation banks account for less than 15% of the mitigation market. But if mitigation standards are all brought up to the same level, and if there is follow-through and enforcement, this will definitely change. If that happens I think we could easily see, within 3 to 5 years, a situation where private mitigation banks make up 50% of the market."

And what does the Army Corps of Engineers say about all this? According to David Olson, one of the people working on the new regulations at the Corps, it is still too early to say much about the new regulations. The drafting hasn't even begun. "At this stage," he says, "we are in the process of doing some early scoping to see what the regulations should contain. We have talked to the National Mitigation Banking Association; we have talked to people involved in in-lieu-fee arrangements such as the Virginia Chapter of the Nature Conservancy. And we are talking to others. We are also talking to the legislators who drafted the [DOD appropriations] bill to get a better sense of the law's intent. So we are still just gathering ideas."

He explains that after an initial round of consultations, a draft of the regulations will go to several other government agencies, including the Environmental Protection Agency (EPA), the Fish and Wildlife Service (US FWS), the National Oceanic and Atmospheric Administration (NOAA), among others. The regulations will also go through a consultation process managed by the government's Office of Management and Budget (OMB) before being released for comment by the interested public. All in all, they should, he says, be ready in time for the December 2005 deadline.

The slow and arduous process of drafting the new regulations doesn't daunt John Ryan. He's seen it all before. "I was involved in the consultations surrounding many of the regulations that exist in this industry," he recounts. He first went to Washington to talk about differences in mitigation standards back in 1999 and remembers that when he started in the business, there weren't really any rules whatsoever. "Rules," he says, "take time."

Regardless of how long they take to write, Ryan is convinced the new regulations will be good for his business. But more importantly, he says, they will be good for the environment. He explains that over the years he has seen many bad mitigation sites: wetlands that were squeezed, as it were, in between buildings or shopping malls; wetlands built where they don't make sense; wetlands that were built by developers who then leave without providing for its ongoing survival. His stories are legion. Mitigation done badly, he concludes, doesn't help anyone.

And no one -least of all John Ryan, a man who gambled his entire family legacy to turn wetlands protection into a business- wants to see mitigation done badly. "When I was a dirt mover," he muses, "I looked on wetlands as soft spots that needed to be dug out and filled in with good solid stuff. They were nothing but bad pieces of dirt that needed to be dealt with. Now I understand the beauty, the values, the services they provide. Now I am happy to be leaving behind a living legacy of wetlands that will still be there long after I'm gone."

In short, Ryan wants mitigation done right and he expects that whatever regulations the Army Corps of Engineers eventually comes up with, they will do at least that. Beyond that he hopes that they will also help strengthen and sustain an industry that has radically transformed his life and his environment.