

New interagency agreement facilitates habitat credit trading

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Looking to build a golf course in the middle of 88.5 acres of high-quality endangered species habitat? Well, you're not out of the woods yet, but your project may have a greater likelihood of success with the issuance of a new interagency partnership agreement on habitat credit trading.

In April 2007, the Natural Resources Conservation Service, the U.S. Fish and Wildlife Service (FWS), and the Association of Fish and Wildlife Agencies signed a "partnership agreement" designed to further habitat credit trading as a regulatory tool. The agencies have agreed to develop an operational definition of "habitat credit trading," as well as standards for habitat credit trading programs. The agreement also calls for the agencies to identify programs that may be suitable for habitat credit trading and to develop at least one pilot project (which probably won't include your planned golf course).

Habitat credit trading isn't a new concept. California has had a conservation bank policy since 1995. FWS issued federal guidance for habitat conservation banks in 2003 and has approved habitat banks in areas as diverse as the Texas hill country, California's San Joaquin Delta, lower Alabama, and Colorado's front range. But the new partnership agreement brings in new participants to the concept and seeks to expand its scope.

Why trade habitat credits?

The idea behind habitat credit trading is to apply a market-based approach to the conservation of at-risk species and their habitats. A market-based program creates an economic incentive to attain an environmental objective. In theory, rational actors working within a well-designed environmental program will apply innovative, disciplined methods for compliance, knowing they will reap the financial rewards of efficiency. As a result, the regulated community is able to achieve greater environmental benefit per dollar spent, compared to prescriptive regulations.

There are different market-based models. The choice of model in a given case depends on the nature of the market and the environmental values at stake. A model tends to be more straightforward where the market is large and the "product" is fungible. Consider the acid rain trading program. While there are some complexities, the basic idea is simple: Determine an acceptable quantity of sulfur dioxide emissions from participating sources, and let them figure out how best to reduce emissions to the budgeted amount. If the market is well-designed and participants are economically rational, participants will work toward the most

cost-effective means of compliance. This trading model works well and functions much like a futures exchange, but it does so only because there are multiple buyers and sellers and transparent rules, and there is uniformity in the product.

In contrast, natural resource credits tend to be site-specific and less fungible, something that calls for a different market-based model. For example, in the case of wetlands mitigation banks, the quality of the wetlands encompassed by the bank affects the value of the credits that can be sold and the ability to use them for a given project. In addition, credits are generally available only for projects in the same watershed as the bank.

Further, for a site-specific "product" to deliver on its environmental promise, it has to be perpetually tied to the property. A factory owner could theoretically close the plant and sell air-quality credits associated with the facility, but wetlands mitigation credits, once issued, are linked to a specific off-site development. The environmental integrity of the transaction in wetlands credits depends on both the mitigation bank and the project developer honoring their commitments, which may include long-term, site-specific monitoring obligations.

Although a habitat conservation bank is likely to function similarly to a wetlands bank in many respects, there is at least one key difference. Generally, regulators have required the *creation* or *restoration* of wetlands to generate credits. The notion is to provide at least as much new functionality to replace what is lost. A habitat program is more likely to provide credit for preserving *existing* habitat. There are at least two reasons why this is so. First, it is critically important to the long-term protection of many species that further loss of their existing habitat be stopped. Second, existing habitat is a known quantity, meaning regulators know that it supports the species. To create habitat is a gamble, because one cannot be sure the project is a success unless and until the species begins to thrive there. That can take a long time to determine.

The site-specific nature of a habitat credit program raises particular challenges and concerns. However, it also raises opportunities—not just for cost efficiency, but also for high-quality conservation actions that are not possible through traditional, on-site mitigation.

Questions of implementation

The main challenges in setting up a habitat conservation bank are not unlike those associated with a wetlands bank. They have to do with how to measure the bank's benefits, compare them to pro-

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ject impacts, and make a fair exchange of the two.

In the wetlands context, regulators have worked their way through these details and have promulgated regulations and issued guidance. By identifying various characteristics of the wetlands and designing metrics to measure their quality, regulators are able to make reasonable comparisons to determine compensation requirements. The ultimate outcome of the analysis is a ratio of credits required for acres impacted. The ratio selected is likely to account for risk; for example, even assuming comparable quality at the bank and the project, a developer may be required to acquire credits at a higher ratio, such as 1.5:1.

There is no theoretical barrier to the development of similar methods and metrics for habitat. This means the goal of the new partnership agreement of establishing habitat credit trading standards is both achievable and desirable. From a programmatic perspective, the task may be somewhat more complex for habitat than for wetlands because the diversity of species exceeds the diversity of wetlands. Every new habitat bank for a new species will present its own unique challenges.

As with the so-called “additionality” problem in the context of the Kyoto Protocol, regulators will need to ensure that the establishment of a given bank creates benefits in addition to what would occur under the status quo. Otherwise, nothing is truly gained in exchange for the approval of adverse impacts to habitat elsewhere. The most likely area for a bank is one that, if not enrolled, could be vulnerable to development pressure or other threats.

This means conservation banks aren’t necessarily suitable for most federal public lands—a potentially huge reservoir of habitat credits. Federal land managers are already restricted by statute as to what types of development activities can occur on their respective lands. In considering whether to approve a habitat bank on public land, regulators are likely to take into account any additional habitat protections that can be provided and approve only those banks that alleviate threats to species despite the higher conservation standards already applicable to those lands.

Another challenge is supply and demand. A habitat bank will work only when it provides a product at a price the market will bear. For example, the Hickory Pass Ranch Conservation Bank, which FWS approved in 2002, set aside large tracts of land for the conservation of the golden-cheeked warbler. The ranch is within the path of development sprawling from the high-growth, high-income area of Austin, Texas. To the extent this bank proves to be successful, one factor will be that there are developers and home buyers who want to be in that specific area badly enough to pay what the market can bear. A high demand could mean a high price for the credits.

These considerations suggest that while habitat banks won’t work everywhere, there are applications that seem to make great

sense. A prime example is greenfield lands that already contain habitat and are being rapidly converted to residential and commercial use. Habitat banks in these areas could be attractive to developers and conservationists alike.

Potential conservation advantages

An alternative to off-site mitigation techniques, such as a habitat mitigation or conservation bank, is on-site conservation. However, the sum of individual on-site conservation efforts may be somewhat less than the whole. For many species, habitat fragmentation is a problem. When it comes to habitat, scale matters. A conservation bank can allow the creation of a large, unified habitat area that would otherwise become fragmented by on-site mitigation.

For example, assume that there are a hundred proposals for 1-acre projects on a 100-acre tract. Suppose further that FWS would require an applicant for an incidental take permit under Endangered Species Act § 10 to set aside half the land to mitigate for adverse impacts to habitat. If the entire 100 acres were developed on that basis, then the result would be a checkerboard pattern of development and habitat. On the other hand, conservation banking could allow a single banker to establish a unified habitat area on one half of the tract, with the projects located on the other. For most species, this is clearly the preferable outcome.

Further, depending on the species, it may be possible to approve low-impact uses within the conservation area. For example, in the 100 acres mentioned above, it may be possible to build a jogging trail for the project owners through the conservation area. In the real-world example of Hickory Pass Ranch, the owners are able to continue using the property as a ranch, subject to some additional restrictions. That not only helped project economics, it also satisfied the ranch owners’ personal desire to keep the family property together, rather than selling it off and subdividing it piecemeal.

There is also a benefit to having a single entity manage the conservation area. Let’s return to the 100-acre example. From a regulatory perspective, it is easier and more effective to identify and regulate a single habitat banker than to police a hundred small landowners. Among other things, the larger entity is more likely to have the resources necessary to meet financial assurance requirements than small landowners and be more sophisticated in negotiating and drafting appropriate documentation.

In sum, habitat credit trading won’t work for all species and at all locations. It may be very effective, however, at those critical junctures where protected species and high-dollar projects coincide. With the new partnership agreement, state and federal conservation agencies now have an opportunity to facilitate the use of a new tool that may help to resolve those difficult conflicts.

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