



Comment on the Advanced Notice of Proposed Rulemaking on Compensatory Mitigation Mechanisms

Property and Environment Research Center (PERC)

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Main points:

- Conservation banking is a market solution that can lower the cost of conservation and proactively recover species.
- But costs matter. Any proposed regulation should limit transaction costs for bankers and credit buyers to encourage the establishment of and competition between conservation banks.
- Any rule should also embrace opportunities for markets to promote voluntary conservation on public lands.
- Finally, the Service should consider opportunities to further reward conservation banking through positive incentives.

Introduction

The Property and Environment Research Center (PERC) respectfully submits this comment in response to the advanced notice of proposed rulemaking on compensatory mitigation mechanisms consistent with the Endangered Species Act. Conservation banking is a powerful and important tool for recovering species and conserving habitats through markets. Regulation could help facilitate the use of this tool—or hold it back. That’s why it is critical that any rule minimizes transaction costs for bankers and credit buyers and encourages competition among bankers. The agency should also embrace opportunities for conservation banking on public lands. And, ultimately, the Service should consider how additional positive incentives can expand the work of conservation banks and grow the restoration economy.

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Conservation banking is an important market solution to recover endangered species

Conservation banks proactively conserve and restore habitat for endangered and threatened species, making them a valuable tool for recovering species. At sufficient scale, they can make habitat or the potential to restore it a source of value for landowners. In Solano County, CA, for instance, the Landbank Group established a conservation bank on land previously used as a landfill. Because of the contamination, the site had little development value and likely would have been a perpetual liability. But biologists found endangered Callippe silverspot butterflies on the land and saw potential to introduce the threatened California red-legged frog. Developing a conservation bank allowed the owner to capture the value of this habitat and transform a liability into an asset.¹

Conservation banks also solve a significant problem for private landowners and industry. Avoiding impacts from their activities to endangered and threatened species may be impossible or cost-prohibitive. And mitigating these impacts on their own may be just as difficult because landowners and businesses lack the time, experience, and resources needed to restore habitat. Conservation banks can lower the cost of regulatory compliance for landowners and industry by finding and acquiring land that can contribute to species conservation at lower cost, performing restoration work at scale, navigating the federal approval process, and generating credits that can be sold to individual permittees.²

In comparing conservation banking to other mitigation strategies, the Service's focus should be on valuing conservation benefits, rather than covering costs. The advanced notice asks for feedback on how to establish equivalent standards for different strategies to, among other things, address differences in the costs of each.³ Presumably, the Service references costs with the implicit understanding that it reflects differences in conservation benefits. But this should be made explicit.

Standards should focus on outputs rather than inputs. And this is true not only across different mitigation strategies but also between conservation banks. Instead of focusing on whether any one or group of conservation banks can recoup their costs, the Service's priority should be promoting competition that would drive down costs while improving conservation outcomes. If conservation banks and other mitigation strategies are rewarded for the conservation benefits they generate rather than the costs they incur to do so, a functioning market will drive them to produce those benefits at the lowest cost.

¹ See Ben Guillon, Geoff Smick, Rob Schell, and Liz Agraz, *Banking on Endangered Species: How assigning property rights to protected species turned a landfill into a conservation bank*, 34 PERC Reports 14 (2015), <https://www.perc.org/2015/12/28/banking-on-endangered-species/>.

² See *id.*

³ See 87 FR 45,076, 45,077 (July 27, 2022).

Moreover, the Service should adopt a broad understanding of a bank's conservation benefits. Several comments urge the agency to adopt additionality requirements that set strict ratios for comparing the habitat conserved or restored by a bank to that adversely modified by development. There may be situations where this is the proper approach, but it should not be treated as a universal truth.

In some cases, conserving the same amount of habitat—or even a smaller amount of habitat—than that which would be lost to development may be more meaningful to reducing a species' extinction risk and promoting its recovery. For the Utah prairie dog, for instance, one of the essential conservation strategies is to conserve and restore habitat in areas that can support the species for the long term, while reducing reliance on urban and developed areas that cannot.⁴ In cases like this, an acre of protected habitat in a long-term recovery area may be significantly more valuable than a lost acre of habitat in an unsuitable area.

Ultimately, the contributions of a bank to a species' conservation and recovery depend on the unique circumstances of the species, the bank, and the area where it is located. Therefore, the Service should ensure that the standards it adopts are flexible enough to fully reward conservation banks for their contributions to species recovery.

Transaction costs should be minimized

While the Service should generally concern itself more with a bank's conservation benefits than the costs to produce those benefits, the Service should take great care to limit transaction costs in establishing banks. Conservation banking is underused relative to other mitigation strategies due, in part, to these high transaction costs. And they can undermine competition that is essential for lowering costs and boosting conservation benefits. Uncertainty in the process of establishing and approving a bank and other transaction costs are, in effect, a tax on conservation.

One way that the Service can reduce transaction costs is to give early guidance to bankers about the conservation and restoration actions most essential for a particular species and any concerns that bankers would need to address in an effective bank. In practice, these burdens have fallen on the party developing the initial bank for a species, which sets the model for future banks. A more proactive approach to encourage conservation banking would be for the Service to identify early on in the process—such as when developing a 4(d) rule for a threatened species or preparing an initial recovery plan—the critical features it is looking for in any mitigation project and the type of assurances needed to show that conservation and restoration would be effective and enduring. While this would increase burdens

⁴ See Jonathan Wood, *Recovering the Utah Prairie Dog*, PERC.org (Apr. 18, 2018), <https://perc.org/2018/04/18/recovering-the-utah-prairie-dog/>.

on the Service when developing these documents, it would be offset by reductions in the cost to negotiate and review conservation banks later.

Another way to reduce transaction costs would be for the Service to commit to a standard process and timeline for reviewing bank proposals. As the Environmental Policy Innovation Center highlights in its comments, conservation banks currently face extended wait times. In California, which has the most active conservation banking market, the state meets its deadline for reviewing bank proposals only 28% of the time. An inefficient process for approving conservation banks discourages their use.⁵

Some costs likely cannot be avoided, such as financial assurances and monitoring. Nonetheless, the Service should look for ways to reduce these liabilities and, where possible, convert them into assets for conservation banks. The Service should not require financial assurances until credits are released, to avoid imposing these costs unnecessarily early when the bank is focused on implementing its conservation and restoration efforts. The Service should also consider ways to reward banks for differences in the quality of enforcement mechanisms rather than imposing uniform standards on dissimilar banks.

Additionally, the Service should consider whether there are opportunities for conservation banks to profit from third-party monitoring rights. Other conservation markets, such as land purchases, conservation leases, and purchased conservation easements, suggest that many conservation groups value the right to monitor and enforce conservation commitments. If the third-party monitor was given the exclusive (other than the Service's) right to enforce compliance, this right may be valuable enough for banks to sell.

High transaction costs also serve as a barrier to entry to any market. Therefore, keeping these costs in check will allow more conservation banks to form, compete against each other, and potentially find innovative ways to recover species. Competition would lower the price of credits for buyers, making them more attractive compared to other mitigation strategies. It would also mitigate the risk of restoration activities failing, thus potentially reducing the need or expense of financial assurances. A species for which several banks produce credits will be less vulnerable to a failure in any one bank than a monopolized market.

Public lands could play a significant role if “use it or lose it” rules were addressed

The advanced notice and several comments suggest unease about including public land in compensatory mitigation because the value of public-land banks may be artificially inflated by existing restrictions on that land and unrelated public

⁵ See Env'tl. Policy Innovation Ctr., *Build Conservation Banking Back Better*, policyinnovation.org (Sept. 13, 2022), <https://www.policyinnovation.org/blog/build-conservation-banking-back-better>.

investments in habitat. While these concerns justify carefully analyzing a bank's benefits, public lands can play a significant role in mitigation. As the Service has recognized in other contexts, habitat conservation on federal land should be prioritized because of "the unique obligations that Congress imposed for Federal agencies in conserving endangered and threatened species."⁶

However, there are obstacles to conservation banking on federal land that the Service should work with Congress and other agencies to address. For instance, federal laws and regulations for many categories of natural resources impose "use it or lose it" requirements that preclude voluntary conservation on federal lands.⁷ In the grazing context, for instance, ranchers and conservation groups cannot contract over the modification of grazing practices to enhance wildlife habitat or reduce wildlife-livestock conflicts because agency rules penalize ranchers who fail to use substantially all of their permit.⁸ Eliminating this requirement would open up opportunities for conservation bankers to acquire grazing permits or contract with permittees to conserve and restore habitat.

Second, conservation banking on federal land, especially to offset impacts from federal-agency projects, can avoid some of the property rights concerns that have arisen over compensatory mitigation. In 2018, the Service withdrew its mitigation policy citing constitutional concerns with a requirement that private landowners more than offset the impacts of their activities.⁹ The Service may ultimately reverse that position, although that reversal would likely be challenged. But, relevant here, the important point is that these concerns do not apply to mitigating the impacts of federal agency projects on federal land. Thus, conservation banking on federal land may be a useful opportunity to produce net-benefits to species.

Positive incentives could expand the market and reduce reliance on coercion

As discussed earlier, a key benefit of conservation banking is that it creates a market for habitat or the potential to restore habitat, thus making it a source of value for private landowners. But this benefit is diluted by the fact that demand for mitigation credits is coerced; it exists because regulatory restrictions make habitat features a significant liability for other property owners.¹⁰ And, because the

⁶ Policy Regarding Implementation of Section 4(b)(2) of the Endangered Species Act, 81 Fed. Reg. 7226 (Feb. 11, 2016).

⁷ See Bryan Leonard, et al., *Allow "nonuse rights" to conserve natural resources: "Use-it-or-lose-it" requirements should be reconsidered*, 373 Science 958 (2021).

⁸ See Shawn Regan, Temple Stoellinger & Jonathan Wood, *Opening the Range: Reforms to Allow Markets for Voluntary Conservation on Federal Grazing Lands*, ____ Utah L. Rev. ____ (forthcoming 2023), <https://perc.org/2022/09/19/opening-the-range-reforms-to-allow-markets-for-voluntary-conservation-on-federal-grazing-lands/>.

⁹ 83 Fed. Reg. 36,469 (July 30, 2018).

¹⁰ See Jonathan Wood & Tate Watkins, *Critical Habitat's "Private Land Problem": Lessons From the Dusky Gopher Frog*, 51 Env'tl. L. Rep. 10,565 (2021).

regulatory restrictions affect vastly more land than conservation banks, the disincentive likely exceeds the positive incentive. Finding additional ways to reward proactive conservation and restoration activities by conservation banks (and others) would help to right this imbalance.

The Service should make clear that conservation banks can receive compensation and participate in additional incentive programs for producing benefits beyond what's required to mitigate projects. It may be cost effective, for instance, for the Service, a state, or a conservation group to compensate a bank to further enhance habitat on its property than to undertake a separate restoration project elsewhere. The Service, other federal agencies, states, and private conservation groups have developed substantial programs to provide positive incentives for conservation. The Service should consider how these programs can enhance the work of mitigation banks and shift the approach from mitigating development to directly rewarding conservation. That's the key to building a robust restoration economy.