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Mitigation Enforcement, Breach of Contract, and the Law of Unintended Consequences

By Royal C. Gardner

When a permittee purchases a wetland credit from a mitigation bank, it is actually purchasing a release of liability. With the approval of the regulatory agency, the legal responsibility to provide the ecological offset shifts to the mitigation banker. The whole premise of the wetland credit market is predicated on risk to the permittee. The permittee can avoid the risk of enforcement actions related to compensatory mitigation by simply writing a check.

Let's consider three related questions concerning enforcement of mitigation conditions. First, is there actually a legal risk to permittees that fail to perform their mitigation obligations? (Spoiler alert—yes.) Second, since mitigation banks are not permittees, can they be held liable under the Clean Water Act (CWA)? The answer, somewhat surprisingly, is probably not. Accordingly, in one enforcement action, the government sued the wayward mitigation banker based on a breach of contract theory. And the third question is if a mitigation banking instrument is viewed as a contract, does that unintentionally give the mitigation bankers more leverage over the regulatory agencies?

Two consent decrees demonstrate that permittees do bear significant legal risk if they fail to provide promised permittee-responsible mitigation. As recounted in a 2013 consent decree in the U.S. District Court for the District of Puerto Rico, the Authority for the Port of the Americas failed to acquire 693 acres that was supposed to offset wetland impacts.[1] It also neglected to provide offsets to sea grass impacts. And for good measure, there were some endangered species and historic property problems as well. The civil judicial enforcement action brought against the Authority was settled for $150,000 in civil penalties (which went to the U.S. Treasury) and a $4.2 million payment to an in-lieu fee entity (to accomplish what was promised in the first place). Clearly, permittees may be subject to huge penalties, as well as high legal fees, if they do not perform required mitigation, at least when it is large-scale mitigation, the absence of which cannot easily be overlooked.

The second case, which is out of the U.S. District Court for the Southern District of Florida (and brought by one of my former students), illustrates that there is significant risk for a permittee even if it meets almost all of its mitigation requirements.[2] In this case, Century Homebuilders, a developer, received a permit that required it to provide approximately 168 functional credits as compensatory mitigation to offset impacts. The developer purchased 160 functional credits from a mitigation bank, and the remaining eight or so credits were to come from onsite enhancement. The developer, however, did not complete the onsite enhancement. The ensuing civil judicial enforcement action resulted in a 2012 consent decree calling for the completion of the enhancement project, plus $400,000 in civil penalties and up to another $60,000 in mitigation bank credits to offset the temporal loss associated with the delay in providing the mitigation. So, from a permittee's risk-avoidance perspective, it is better to satisfy mitigation conditions by purchasing mitigation bank credits, thereby shifting the obligation to the banker.

But are the civil enforcement provisions of the CWA applicable to mitigation banks if banks fail to follow through with their mitigation promises? As I have noted previously, the answer is no. Mitigation bankers are not CWA §404 permittees, and thus there is no legal hook to make them susceptible to the civil penalties that a permittee might face. Although more than 1,500 banks have been established, the government has rarely brought a judicial action against a mitigation bank. One out of the Western District of Kentucky back in 2005 illustrates the challenges in doing so.[3]

The Wetland Bank of Kentucky was approved to begin operation pursuant to a skeletal memorandum of agreement (MOA) with the U.S. Army Corps of Engineers (the Corps). (This was well before today's current and more comprehensive regulations governing mitigation banks.) While the MOA lacked detail, it did impose certain obligations on the mitigation bank, starting with the removal of cattle from the site. Eleven credits were released early and sold, but the banker did not do anything other than remove the cows. A restrictive covenant or conservation easement was not even placed on the site. Accordingly, after years of discussions, the local U.S. attorney brought a civil enforcement action against the bankers. But the complaint did not allege a CWA violation, as there was none. Instead, the government proceeded under a breach of contract claim. The defendants eventually settled, and the consent decree required them to pay $70,000 to a state-operated in-lieu fee fund.

While the court never ruled on whether breach of contract was indeed an arrow in the government's enforcement quiver, the question was nevertheless raised: is a mitigation banking instrument a contract?

In 2013, Davis Wetlands Bank in Virginia sought to use the contract theory to its advantage. The banker disagreed with the Corps' determination of how many credits should be released, and it filed a breach of contract action against the federal government in the U.S. Federal Court of Claims, which has jurisdiction to handle federal contracting issues.[4] The United States filed a motion to dismiss, contending that a mitigation bank approval is not a contract, but a regulatory instrument. The court rejected the government's motion, explaining that the instrument looked like a contract and therefore the case would proceed. Ultimately, in October 2014, the court dismissed the case—but on statute of limitations grounds stating that the banker had waited too long to bring the breach of contract claim.

Pioneer Reserve Mitigation Bank in Alaska has also made a breach of contract claim against the Corps.[5] In late November 2014 (subsequent to the ELI-Stetson workshop), the U.S. Court of Federal Claims rejected the government's motion to dismiss. The court again characterized the mitigation banking instrument as a contract, and thus the bank could proceed with its complaint that alleged the Corps improperly reduced its number of credits. The bank claims it lost $12 million as a result.

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No appellate court has ruled on whether mitigation banking instruments may be treated as a contract for enforcement or other purposes. Nevertheless, the early trend in the U.S. Court of Federal Claims is favoring mitigation bankers. While the government may have wanted to characterize a banking instrument as a contract (at one time), it now recognizes the downside of that approach. Ordinarily, if a banker wished to formally challenge the Corps' interpretation of a mitigation banking instrument, it would have to sue under the Administrative Procedure Act in U.S. District Court. To prevail, the banker would have to establish that the agency had behaved arbitrarily and capriciously, which is a very high hurdle. Courts are generally deferential to the agency's expertise in such cases.

A breach of contract claim, however, alters the playing field (and the court). A banker need not demonstrate that the agency has been arbitrary and capricious; rather, it just has to show the government has not complied with the terms of the contract. Courts are less deferential to agencies in such circumstances. Furthermore, if the banker wins under a breach of contract theory, it may be entitled to money damages.

To deal with this matter, in July 2014, Corps headquarters issued national guidance stating that all new mitigation banking instruments and in-lieu fee instruments must have a provision specifically clarifying that they are regulatory instruments. In other words, the Corps wishes to make clear that mitigation bank approval does not establish a contractual relationship and a banker should not be expecting money damages if it disagrees with how things are proceeding.

An interesting question remains, however: what about the more than 1,250 active mitigation banks, such as the Pioneer Reserve Mitigation Bank, operating without this clarifying provision?

If the government regrets the unintended consequence of once treating a mitigation bank MOA as a contract, mitigation bankers should be cautious as well. If mitigation banking instruments are truly federal contracts, then a whole host of other federal regulations come into play. Under these regulations, a Corps district engineer may not even be the proper contracting officer for a mitigation banking "contract." Moreover, if a mitigation banker is a federal contractor, then it may need to comply with a multitude of other regulatory requirements (contained for example in the Federal Acquisition Regulations) as well as Executive Orders. One can easily envision this road leading to greater delays in mitigation bank approvals and administration and perhaps opening mitigation banks up to different forms of liability under government contracting law. Accordingly, a short-term advantage for an individual banker or two could have grave unanticipated consequences for the industry as a whole. ■

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