

The Demise of The Environmental Trust

by Sherry Teresa

After 15 years in business, with 4,621 acres under management and over four million dollars in endowment funds, The Environmental Trust in California filed for bankruptcy on July 29, 2005. The organization listed "unperformed obligations" exceeding \$13 million. Sherry Teresa, Executive Director of the Center for Natural Lands Management, delves into what happened and pulls out some lessons for conservation organizations everywhere.

Winston Churchill once said: "Man will occasionally stumble over the truth, but most of the time he will pick himself up and continue on." We have many opportunities on a daily basis to learn from our mistakes. The greatest mistake, however, is to ignore the lesson and just continue on unenlightened. This story—the demise of The Environmental Trust—presents an interesting lesson. It is the story of an environmental mitigation land management organization in the US that set out to achieve great things and in the end, set the example of how not to run a nonprofit organization.

Don "Doc" Hunsaker, a former San Diego State University biology professor, organized The Environmental Trust (TET) as a California 501(c) (3) (non-profit) private foundation in 1990 to acquire environmentally threatened and sensitive properties and then assume perpetual responsibility for their maintenance, monitoring, and management. TET operated primarily in San Diego County where its properties included mitigation lands, conservation easements, conservation and mitigation banks, and lands within the Multiple Species Conservation Plan (MSCP) created for endangered species listed under the state and federal Endangered Species Act (ESA).

After 15 years in business, with 4,621 acres under management and over four million dollars in endowment funds, TET filed for bankruptcy under Chapter 11 of the United States code on July 29, 2005 for "unperformed obligations" exceeding \$13 million. A liquidating plan for reorganization was filed on December 30, 2005 and called for the sale or distribution of all TET assets to qualified parties. TET's president at the time observed "TET's liquidation marks a very sad event from both the commercial as well as from an environmental perspective. Environmentally, TET's winding up and closure represents a failure to maintain sensitive habitat entrusted by many interested parties with TET for perpetual maintenance, monitoring and preservation."

What Went Wrong?

I remember the first time I met Doc. He is an affable guy, the favorite uncle type. He came up to Sacramento to talk about our organizations joining forces. While I immediately liked him, the more we spoke the more I realized how vastly different were our philosophies of conservation land management and stewardship. These philosophical differences embodied the core issues, described below, that I believe eventually led to TET's decline and demise.

I believe that five factors contributed to TET's fate:

- (1) TET failed to develop and execute a realistic business plan;
- (2) TET, and arguably the wildlife agencies, had a vague definition of what constituted best management practices for habitat stewardship;
- (3) State and federal regulators did not adequately monitor TET's business practices, its compliance with accepted nonprofit fiduciary duty standards, or monitor its habitat management practices;
- (4) TET's staff and board had poor or non-existent internal financial management controls; and
- (5) The organization made clear departures from sound corporate governance principles.

Lack of a Business Plan: TET failed to appreciate that it was in the business of conservation. It did not have a well-considered and well-crafted business plan that addressed both current conditions and changes that might occur in the future. TET had no strategic plan, no clear set of overarching guiding principles, and a limited understanding of its habitat protection mission. These failings had practical, serious consequences. For example, with some frequency, TET's Executive Director would enter into negotiations for the perpetual maintenance of habitat lands without performing any serious due diligence regarding the conservation property or the business transaction. Little consideration was given to the full range of stewardship tasks TET would have to assume or their actual costs. TET's key managers frequently disregarded their own staff's recommendations concerning the management and funding of property.

Stewardship endowments were frequently based on a fixed "dollar per acre" estimate, not upon any disciplined task-based analysis tied to an actual property. As a result, "deals" were too frequently negotiated far below actual cost, but justified by the overriding desire to add to the number of properties and total acreage under management. Sadly, TET often chose to underbid the competition to add property and money to its portfolio, the general approach was 'We'll make it up on the next deal.'

Lack of a Model for Conservation Land Stewardship: There remains a lack of clarity about what constitutes adequate habitat stewardship. In my mind, TET's bankruptcy was caused largely by the failure of resource agencies to define "the work" of the steward—the long-term mitigation requirements of a proponent's permit, as well as monitoring obligations and responsibilities. The goals or intent of "the work" are usually straightforward and well defined in the law and various project-specific documents, such as biological opinions. Actually setting forth tasks that achieve the goals is a different matter. Few entities know how to do that. Thus definitions became a ground for contentious negotiations. If you are a project proponent, you probably believe that stewardship ceases at the end of mandatory 5-year monitoring periods. A large number of people, including some in resource agencies, believe nature preserves are, or should be, self-sustaining after some minimal re-vegetation or restoration. Hunsaker's definition of TET's stewardship was simple: it will maintain fences (when funding was available), pick up trash, and conduct drive-by "monitoring" visits. Indeed, most mitigation permits set forth broad perpetual habitat management goals—leaving the interpretation of what actually must be done to achieve them to a land manager.

Adaptive management is an emerging issue that is not clearly addressed in permit conditions or property management plans. We have struggled to educate project proponents (who are dedicating land and contributing endowment funding as a condition of receiving permits to develop land) and define stewardship and to explain why certain activities are necessary—not just to maintain habitat, but to fend off invasive and exotic plants and animals, to control visitor use and trespass issues, to adequately monitor a property's biology, to maintain gates, fences and roads, to educate the public, to anticipate the need for and maintain fuel breaks and to conduct controlled burns, and a myriad other stewardship tasks that are rarely if ever specifically identified in any permit.

Habitat managers will tell you how challenging it is to maintain and enhance endangered species habitat that are next to urbanized areas. How do you allow people to use and enjoy these sites while trying to protect species? At the Center's preserves, we have dealt with many totally unanticipated issues. They have ranged from dealing with marijuana plantations, to eliminating motocross and BMX tracks established by local teenagers, to stopping gangs target shooting concrete-encased telephone poles with machine-guns, to removing illegal migrant camps, to dealing with arson, to stopping the dumping of unwanted pets, to overcoming the results of ruptured oil pipelines—and the list goes on. We are constantly presented with new challenges. A funding strategy that anticipates the unanticipated—what we often call contingencies and adaptive management is the only way to manage preserves that are adjacent to or surrounded by urban areas.

Global issues such as climate change and local issues such as nitrogen deposition from smog have profound implications for habitat preservation and may totally change ecotypes. It is impossible to predict what unique things will

occur over time and what impact those changes may have on the land. Stewardship is not easy, and it is not for the fainthearted! TET, in my opinion, was neither prepared nor willing to meet the challenges of modern day habitat management.

The California Department of Fish and Game (CDFG) and the U.S. Fish and Wildlife Service (USFWS) jointly composed a letter to TET in 2003 that clearly identified TET's most serious stewardship deficiencies. For the first time, state and federal natural resource agencies jointly gave specific directions on habitat stewardship and outlined what they expected from a manager. While CDFG/USFWS made numerous requests of TET for habitat management and financial information, their entreaties were frequently unanswered.

Failure of Regulatory Agencies to Act: It was evident early on that TET was not conducting sound business or habitat management practices. Many resource agency personnel knew this and requested information from TET that would clarify what they were doing, and the results of those actions. Requests were frequently ignored and the agencies failed to take action. Was there blatant procrastination by the agencies in dealing with TET? Even today, months after TET's demise, there still exists a serious lack of oversight of habitat managers by the regulatory agencies. This external oversight problem is compounded by a lack of internal oversight by stewardship organizations. Reports are not submitted, or are poorly researched and written. Violations are not enforced. In fairness to the regulatory agencies, they have few trained personnel to address these issues. Yet they have failed to create a process to whereby they might know if a land manager is or is not doing their job.

Financial: TET failed to take its fiduciary responsibility seriously. An organization that relies on the income from endowments to fund its work must have a sound investment management strategy. Newly formed organizations and those with small endowments face different risks and have different investment obligations than larger, more stable entities. TET lacked a reliable investment policy—one that would assure adequate inflation-adjusted perpetual income from endowments to fund current and future preserve management.

TET endowments were pooled for investment purposes. That is lawful, typical and an efficient and appropriate practice. However, TET failed to account for each preserve's income and expense--something that is generally required by permits. Every preserve needs an original cost estimate and annual budgets. Because TET may have deliberately underbid projects, its endowments were "short". Money for annual management had to come from somewhere. That meant TET had a choice: it could either do less work than was required, or it could use funding from another preserve to make up the difference.

TET often used the PAR® program, software created by the Center for Natural Lands Management, to estimate its future stewardship costs, but TET's bids to proponents included endowment requests based not on long-term inflation-adjusted earning rates of balanced debt and equity portfolios, ("capitalization rates"), but on guesses about investment earnings from its endowment. Incorrect cost and income assumptions allowed proponents to put up endowments that almost immediately began to waste. Investing endowments is complex, and generally requires the assistance of highly skilled, professional financial management experts. The Ford Foundation provides excellent advice for endowment holders on its website www.fordfound.org and see [Investment Management for Endowed Institutions](#).

Under California's Nonprofit Integrity Act of 2004, charitable corporations with assets of \$2 million or more must prepare annual financial statements audited by an independent certified public accountant (CPA). The statements must use generally accepted accounting principles (GAAP). The independent CPA must follow generally accepted auditing standards. The audited financial statements must be made available to the Attorney General and the public no later than nine months after the close of the fiscal year. It appears TET never obtained a formal annual opinion letter from any auditor.

TET's Board Abdicated Fiduciary Responsibility. Several of TET's board members have stated that they were not given complete financial reports and were not aware of the gravity of the situation until told so by a new executive director

who realized that the organization could no longer sustain itself. However, board minutes show that prior to 2002 and following a special report in 2002, TET's dire financial situation and lack of sound management practices was brought before the board. Even if there was not complete financial information presented to the board, its members are not absolved—it is their responsibility to have asked questions. Nonprofit board members are accountable for any wrong doing in the organization and can be held personally liable. The California Attorney General could sue TET's board members personally. If this sends a chill down the spine of nonprofit board members everywhere, it should.

So What Now?

According to proceedings to "wind up" the The Environmental Trust, it appears that fee title to some properties will be offered back to the original owners, along with a portion of the endowment they provided. However, all habitat management and monitoring obligations and encumbrances (typically conservation easements) would remain with the land. According to information disclosed in bankruptcy proceedings (case# 05-02321-LAI-I), TET failed to record many of these conservation easements and frequently deposited only 80% of endowment funds into investment accounts, keeping the other 20% as some kind of overhead reimbursement. Hunsaker, who had stated earlier, "basically, we are protectionists who wanted to grab land and save it," now believes TET "did not receive enough moneys to fund the obligations that it assumed and the services it agreed to provide."

This, according to Hunsaker, was due in large part to "under funding its services, poor planning, inefficiency in executing of its tasks, poor investment decision making and the general decline of the U.S. equity markets." The corporation's books were in disarray and its endowments without adequate funds. When push came to shove, most of TET's real estate could not be sold, and the wildlife agencies refused to renegotiate stewardship obligations. No entity will willing assume TET's habitat management obligations without adequate funding.

Under the bankruptcy proposal, if the original owners do not agree to take the property back, TET's nature preserves will be offered to a local agency. But that agency must comply with regulatory permits. How will they, absent funding? If local agencies are not interested, TET property will be offered to the wildlife agencies, and if they pass, to qualified nonprofits.

TET properties were scheduled to be disposed of in this manner starting on February 9, 2006. It is unclear what will happen to the properties. Without adequate endowments, other organizations are unlikely to accept them. The owner of last resource may end up being the State of California. This may mean that the public may ultimately assume responsibility for the properties. And yet again, the public will end up subsidizing private development by paying for the perpetual maintenance of the habitat lands. Without recorded conservation easements, many of these mitigation properties could be in jeopardy of being developed or used for purposes other than nature preserves.

Ensuring the Future

A New York Times article estimates that by 2025 the population of the US will increase by 70 million people. This increase equals the current population of New York, Florida and California combined. All the population growth in the US in the last decade didn't equal the growth of just two Southern California counties, Riverside and San Bernardino. We are in the throes of a \$25 trillion building boom. The needs and requirements to set aside lands to compensate for development impacts to endangered species and wetlands will only increase. The need for experienced, credible and professional land management entities will also increase. It is imperative that stringent guidelines and standards be established for these stewards, as well as for public agencies that hold mitigation lands. Regulatory agencies must find a way to correctly define stewardship goals and provide consistent and thorough oversight of the steward's work.

Private land trusts and conservation organizations are great innovators. They undertake groundbreaking work typically not found in any government controlled land conservation program. Therefore we cannot afford to lose the energy, effectiveness and efficiency of private stewards. Government is not the solution to the TET problem. But government is

a key partner. The government needs the private sector to ensure the long-term sustainability of these lands and cost-effective protection of resources for future generations. Government must create a flexible and responsible regulatory framework for mitigation. It can provide oversight itself, or by outsourcing to qualified organizations. Indeed, oversight can probably be delegated to qualified private entities.

Organizations and individuals in California representing private and public conservation entities have developed a model: Standards and Guidelines for Managing Endowment Funds and Mitigation Lands. Legislation has been introduced to formally allow nonprofits and other public conservation entities to hold and manage mitigation endowment funds under these strict standards and guidelines. However, all this will be for naught and we could have many more failures like TET if the regulatory agencies fail to set goals and do not provide the necessary oversight to monitor an organization's activities.

Mitigation banks receive oversight from a committee made up of USFWS, U.S. Army Corps Of Engineers, CDFG & U.S. Environmental Protection Agency called the Mitigation Banking Review Team (MBRT). Perhaps a Mitigation Stewardship Review Team (MSRT) should be formed to review mitigation manager's biological and financial reports and audits, and to conduct site visits to ensure stewardship is being carried out under clearly defined best management practices. This would allow nonprofits concerned with conservation to conduct the day-to-day conservation land management, while allowing the regulatory agencies the oversight to ensure that these lands are properly managed. As new nonprofit organizations spring up to offer stewardship services and land trusts enter the mitigation land management arena, it is imperative they will have learned lessons from the demise of TET.

Private stewardship is an experiment. Perhaps the private sector cannot assume all funding obligations in perpetuity. But it is equally clear that government has few mechanisms in place to assure perpetual funding. Most budgets are subject to annual appropriation. Government can rarely invest in a balanced portfolio of assets that has an adequate inflation and risk-adjusted return. If government does not earn enough to manage land, the land is not managed. We are back to TET. Only time will tell. But I think the answer must be a responsible partnership among all the players.

The Business of Conservation

I believe the lesson learned from TET is this: we are in the business of conservation. In order to be successful and accomplish our mission, however, we must conduct our activities using strong ethical, financial and professional standards. No nonprofit can abandon its fiduciary and moral responsibilities. As we have seen from Congressional hearings and legislation surrounding The Nature Conservancy's recent troubles, non-profits involved in conservation assume significant societal obligations under a sacred trust that cannot be abused. This means we must be absolutely open and operate transparently, meeting the highest of ethical and professional standards. To do anything less is to abdicate our fiduciary trust; worse yet, it is a breach of public trust.

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