

The History and Science behind the Legal Defense Reserves Calculator

The Land Trust Alliance's Legal Defense Reserves Calculator is the latest in a series of efforts over the last ten years to help land trusts prepare for legal challenges to conservation easements and land owned outright. Conserved properties are only as safe as the organizations protecting them. So the reserves calculator was designed help make land trusts resilient. If you are interested in the development of the calculator, then keep reading the details.....

Historical Conditions

After many protracted legal disputes involving conservation lands over the past decade, most land trusts understand that the cost of resolving disputes will be higher than initially anticipated. The Land Trust Alliance is committed to finding creative ways to help land trusts manage these risks and to tailor their legal defense reserve to reflect the specific risks each land trust faces. Holding the minimum level of reserves will prepare a land trust for average challenges but will not cover catastrophic challenges. To prepare for these challenges, prudent land trusts hold additional reserves and use general liability, directors and officers and Terrafirma insurance.

Land Trust Standards and Practices requires land trusts to determine the long-term stewardship and enforcement expenses and to secure adequate funds to cover those costs. In an effort to help land trusts use data to assess legal defense reserves, in 2007 the Alliance published a research report, "Conservation Capacity and Enforcement Capability" which recommended a minimum legal defense fund of \$50,000 for an organization's first 15 easements and an additional minimum \$1,500 for each additional easement. Since then, land trusts have progressed in building these funds and better understand the full costs of lasting conservation defense.

Much has changed in the past decade: the scope of conservation has increased, risks have multiplied, and there has been an increase in violations and legal challenges to conserved lands. In response, land trusts have risen to the challenge. With accreditation, there is an increased emphasis on meeting *Land Trust Standards and Practices* and more and more land trust professionals and volunteers are implementing best practices in all areas of land conservation. Land trusts have new insurance options such as Terrafirma, which affects reserve calculations. Terrafirma is a safety net that helps pay for the cost of litigation for covered claims, including legal costs, expert costs and court fees. Land trusts and foundations also have invested more than \$4 million dollars in the start-up costs and capitalization for Terrafirma.

However, Terrafirma is not a substitute for adequate reserves. Land trusts must cover premiums, deductibles, and there are exclusions to its coverage. Terrafirma's policy form contains 33 exclusions from coverage, which could result in uninsured risks and costs for land trusts, land trusts must cover exclusions from reserves some of which can be very expensive. As the land conservation movement gains ground, land trusts present attractive targets, so prudent land trusts must maintain adequate reserves on top of their insurance coverage.

In light of all of these factors, the Alliance has updated recommendations for adequate legal defense reserve in *Land Trust Standards and Practices*. The Alliance recognizes that there is no one-size-fits-all solution and has created a tool which reflects variations in size, geography and risk factors.

Risks increasing

- Since 2007 when the Alliance released the first recommendations, land trusts have progressed in building adequate funds and better understand the full costs of lasting conservation. Land trusts will want to test their defense reserve calculations at least annually to account for additions to their portfolio and other changes to their risk profile.
- The risk is not all about costs of trial and experts either. Too often now we see neighbors to land owned by land trusts bulldoze roads, build ponds, erect structures and cut 100 year old trees on the land trust land. Land trusts need to be able to fund remediation in the event they are unable to obtain full reimbursement of the cost of repairing damage.
- Pipelines and powerlines across the country are being blasted through at a breathtaking rate. Land trusts need funds ready to respond appropriately with public awareness campaigns and appropriate experts.
- And of course, having to go to court can be the only alternative left. Scenic Hudson in NY and the New Jersey Conservation Foundation led the litigation to stop an international corporation from building a skyscraper on the height of the Palisades between their two states. The land was not conserved but allowing that building to occur would have ruined the scenic vista that they had worked so hard to preserve for everyone forever.

Surviving a Tsunami

Insurance as a supplement to reserves provides a land trust with greater confidence that it can withstand either multiple simultaneous challenges or a single catastrophic one. Having experienced the expensive, unpredictable costs of litigation, Dan Pike, the immediate past president of Colorado Open Lands, feels that conservation defense liability insurance (TerraFirma) is an essential safety net for prudent land trusts **and** that continuing to maintain adequate reserves is essential to survive unexpected catastrophes. Some examples:

- ◆ Westchester Land Trust (NY) conservation easement enforcement cost over \$1,000,000.
- ◆ Mesa Land Trust (CO) had three simultaneous challenges after 27 years without any significant challenges which cost more than \$175,000 and one case is still ongoing.
- ◆ French & Pickering Creek Conservation Trust (PA) conservation easement enforcement cost over \$500,000, even with pro bono attorneys, and took 12 years to prevail.
- ◆ Lyme Land Conservation Trust (CT) has contended with an extensive and disruptive conservation easement violation for over 8 years that so far has cost over \$300,000 just for the trial and the successor owners of the land have appealed despite losing on every count.

Long Range Forecast

During 2015 the Alliance obtained comments from many varied stakeholders regarding the new calculator and the underlying data. The calculator will ultimately be part of *Land Trust Standards*

and Practices. The Alliance will review and update the calculator every three to six years and will synchronize that process with the *Land Trust Standards and Practices* revisions cycle as much as possible. Actual use of the calculator by land trusts will begin in January 2016 or now if a land trust wishes.

Caveats

Note that this new approach addresses reserves for legal challenges to conservation easements and land owned outright, but does not address funds for routine stewardship or land management. Land trusts must calculate these funding needs using a different tool.

This tool does not distinguish if a land trust will decide to combine or segregate legal defense and stewardship funds. Most land trusts have not established separate legal defense funds. Some land trusts add enforcement expenses to their joint endowment calculation for every property they acquire and then manage the funds as a unit. Other land trusts have established separate legal defense funds so that a serious legal challenge does not drain the money to pay for day-to-day stewardship. This new calculator only changes the *minimum amount* for legal defense, not how a land trust may choose to manage the money.

Finally and most importantly, this *new tool is not a substitute for the independent assessment* of the land trust board. Each board must carefully weigh additional factors such as greater risks of adverse results, more costly local conditions or a more complex portfolio of easements. While *this calculator yields a minimum adequate reserve*, each land trust board is responsible for looking beyond the minimum amount to use its own best judgment to determine any *higher* actual amount needed for its own land trust's defense requirements. For example, land trusts in the urban areas of California may feel that the calculator minimum amount is too low for their comfort given potential court costs for a drawn-out case with a determined challenger.

The Alliance current analysis, which updates a 2009 study from the University of Wisconsin, shows that an adequate reserve calculation requires a variable formula based on actuarial data. The Alliance recognizes that the community will need to reassess this analysis periodically (probably on a three to six-year cycle) to take into account new data and refine the calculation. We also recognize that TerraFirma has only completed two years of coverage. The calculator does include an inflation factor based on legal fees from 2009 when the Alliance commissioned the first data study and 2014, the last full year of data available.

Additionally, not all land trusts are TerraFirma members, nor did all current members start coverage in the same year. This means that land trusts have varying degrees of shifting some risk costs to insurance coverage, thus adding to coverage gaps for legal defense.

How the Science Works

Understanding what characteristics drive the number and cost of legal challenges and how land trusts can mitigate expenses will be critical for the ongoing success of land trusts. Also understanding how various types of insurance can buffer against some risks is critical. In

particular, the Terrafirma coverage has a direct effect on what is considered an adequate reserve, according to the actuaries.

At the request of the Alliance and Terrafirma, Pinnacle Actuarial Resource, Inc. (Pinnacle) has used advanced statistical modeling techniques to identify some key trends in predicting challenge frequencies and severities. Pinnacle looked at data provided by more than 400 land trusts from across the country. They reviewed this data for both frequency (how many challenges per parcel) and severity (how much these challenges cost).

The actuaries used the results of this analysis to create the *calculation sheet* for legal challenge expenses. The resulting calculator takes into account state trends, population density and land trust risk factors. The Alliance, with the actuaries, designed the calculator to assist its members to better assess what it costs now to uphold lasting conservation but this is not an authoritative accounting document nor does it account for the time-value of money, annual inflation or catastrophic challenges.

Land trusts will want to test their defense reserve calculations at least annually to account for additions to their portfolio and other changes to their risk profile. The Alliance with the actuaries will revisit the underlying data periodically.

Three-part calculator forecast

In **Part I**, the calculator determines the base **minimum** of an adequate reserve by taking the overall historic average cost of all challenges (shown in previous research) and deducting certain different amounts for general liability, directors and officers and Terrafirma insurance policies. Because insurance mitigates the costs of risk, a well-insured land trust needs less money in reserve. Part I of the calculator retains the base portfolio amount of 15 properties established in the 2007 guidance and adds a factor for legal fee inflation differentiated by region based on census data for legal costs.

In **Part II**, the land trust enters specific information about its portfolio of easements and land owned outright and enters specific information about its total organizational risk profile. Based on the answers, the calculator fine-tunes the reserve amount based on actuarial data. The findings of the Pinnacle analysis include the following factors, which are integrated into the calculator to enable the land trust to determine a per parcel reserve amount.

1. A few states have higher than average claim frequencies per parcel thereby increasing risks to land trusts. These states include California, Michigan, Florida and New Jersey. Colorado displays significantly fewer challenges per parcel count, but California, Michigan and Colorado display higher than average severities, and a few particularly high severity claims appear in other states.
2. Risk increases with time. The risk that a land trust will be involved in a lawsuit jumps after five years of operation.
3. Challenge rates matter. Land trusts who had three or more challenges within a five-year period were at a higher risk of another challenge than land trusts with fewer challenges.

4. Challenge severity matters. Land trusts that had a challenge that cost more than \$10,000 within the previous five years were more likely to encounter another costly challenge.
5. Land trusts operating in rural areas (as designated by U.S. census data on parcels locations) had fewer lawsuits and spent less money on legal expenses. In urban and suburban areas, challenge frequencies per parcel are almost 50 percent higher than rural areas, and the average external challenge costs are almost 90 percent higher.

The calculator also has special sections for the very largest land trusts with portfolios in excess of 500 properties. Only those land trusts complete these additional sections; all others skip these extra risk balancing assessments.

Part III brings everything together. The land trust enters the number of easements and fee properties in line 84 and the calculator provides a total **minimum**. If you read the entire Pinnacle historical analysis report, you will see that they identify many other statistical risks. However, the risks not included in the calculator have been accounted for in Terrafirma discounts or have been determined to offset other positive risk factors.

Prudent land trust boards will exercise their best independent judgment to determine additional reserves necessary for the land trust's particular location, portfolio or organizational risks not addressed in the calculator and a factor for catastrophic challenges or series of challenges that exceed \$500,000. Add additional reserves in line 86.

Terrafirma is a strong safety net but it has exclusions and caps. Land trusts must consider what Terrafirma doesn't cover in order to defend challenges without Terrafirma's help. Replenishing reserves may be more difficult in the future too. Many land trusts operate in highly-developed, confrontational and expensive locations. A land trust will want to add extra reserves for those circumstances. Then line 89 yields the total reserves fund.

In the storm alone

Self-insurance is a risk management strategy in which the organization sets aside money every year in anticipation of future losses. All prudent organizations should self-insure to some extent which is what the calculator helps you determine and will vary depending on the land trust's risk profile and how much risk the land trust has shifted through insurance programs.

Recognizing that some organizations would like to self-insure **all** risks, the new recommendations provide guidance for reserve funding with insurance and for reserve funding without insurance. According to actuarial data, land trusts that carry both Terrafirma and general liability insurance will see a substantial reduction in their legal reserve needs. The recommended reduction for land trusts with both Terrafirma and general liability insurance depends on the land trust's history and the size of its portfolio.

Realistically, the recommended reserves only allow a land trust to insure for non-catastrophic risks. A catastrophic legal event will cost far more but is highly unpredictable and, therefore, not contemplated in this analysis. Land trusts should assess how to prepare for catastrophic legal

events such as lawsuits that experience multiple appeals, lawsuits from multiple parties at the same time, or acrimonious lawsuits that involve numerous countersuits and a decade or more to conclude. In those cases, risk shifting through insurance may be more desirable than reserve recommendations alone suggest.

In this assessment, organizations should seriously consider purchase of conservation defense liability insurance ([Terrafirma](#)), as well as commercial general liability, directors and officers (over 600 land trusts are now participating in the [Conserv-a-nation \(link is external\)](#) insurance program, which offers special group rates to Alliance member land trusts) and title insurance. Combinations of these coverages may come into play with any legal challenge.