



CHESAPEAKE BAY FOUNDATION
Saving a National Treasure

Testimony of Matthew J. Ehrhart
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**Pennsylvania Senate Environmental Resources and Energy and
Senate Agriculture & Rural Affairs Committees
Regarding the Proposed Nutrient Credit Trading Program Act**

August 20, 2008

Chairman White, Chairman Musto, Chairman Brubaker, Chairman O'Pake and distinguished members of the Committees, my name is Matt Ehrhart and I am the Executive Director of the Pennsylvania Office of the Chesapeake Bay Foundation (CBF). I would like to thank you for the opportunity to express our views concerning The Pennsylvania Nutrient Credit Trading Program and Senate Bill 1493.

CBF is the largest non-profit organization dedicated to the protection and restoration of the Chesapeake Bay, its tributaries, and its resources. With the support of over 200,000 members, our staff of scientists, attorneys, educators, and policy experts work to ensure that policy, regulation, and legislation are protective of the quality of the Chesapeake Bay and its watershed.

Within this watershed, the Susquehanna River is a dominant influence. Draining half of the Commonwealth, the Susquehanna is the single largest tributary to the Bay, contributing half of the fresh water to the estuary. Since the inception of the Chesapeake Bay restoration effort twenty five years ago, reducing nutrient and sediment pollution in the Susquehanna has been a central focus.

I'd like to take a moment to thank Senator Vance for introducing SB 1493. I'd also like to thank everyone here who has worked with CBF and the Fair Share Coalition on Nutrient Credit Trading and the Coalition's broader issues of funding for clean water.

Given the depth of insight and partnership amongst those testifying today, and in order to not duplicate the testimony of others in the Fair Share Coalition, I thought I would step back and briefly cover the events that led to the critical need for a robust, functional trading program. I'll provide a bit of the context for how the Fair Share Coalition came to be advocating some process changes in Pennsylvania's Nutrient Credit Trading Program.

The Chesapeake Bay is listed as "impaired" by the Federal 303(d) list, triggering a Federal Clean Water Act mandated process for clean-up. The process involves the establishment of a Total Maximum Daily Load (TMDL) – a pollution budget for the Chesapeake Bay watershed. In 2000, Pennsylvania, Maryland, Virginia, Washington

DC, and the Environmental Protection Agency signed the Chesapeake 2000 Agreement (C2K), which enabled a 10 year window for the entities to make voluntary progress in order to avoid the mandated TMDL. While much progress has been made, we are not nearly on pace to meet the pollution reduction goals of the Agreement.

One of the goals of C2K that has been met is the establishment of new Water Quality Standards for the Chesapeake Bay. C2K required all tidal states to establish new Water Quality Standards for the Bay based on the full body of science that has been gathered as part of the Bay restoration effort. In 2005, Maryland finalized its new Water Quality Standards for the Chesapeake Bay. As a result of these new standards, all NPDES permits for sewage treatment plants that discharge into the Bay watershed, including those in Pennsylvania, must now contain limits on nitrogen and phosphorus in order to comply with the Clean Water Act.

These limits operate in a similar fashion as the TMDL pollution budget to “cap” the maximum amount of pollution that can be discharged into the Chesapeake Bay watershed. The TMDL pollution budget will establish an overall annual cap on the amount of nitrogen, phosphorous, and sediment which Pennsylvania can send downstream to the Chesapeake Bay, now and into the future. The presence of that annual cap load, and the need to continue Pennsylvania’s economic growth and prosperity, lead to a singular conclusion. Pennsylvania must have a functional nutrient credit offset or trading program to ensure we meet our water quality goals while still accommodating growth and development.

Each pollution load sector has received a target reduction goal proportional to amount of the load generated by that sector. The attached Chart 1 shows the reduction goals for nitrogen from each sector. Chart 2 graphs those reduction goals against the 2006 loads. Chart 3 shows rough cost estimates for compliance in each sector. There are a number of salient points to note. First, NPDES permit holders, including industrial operations and wastewater treatment facilities were not required to treat for total nitrogen loads until the new water quality standards went into place. Most facilities are not presently designed to treat for nitrogen, and thus are faced with practical challenges to meeting the new permit limits. Second, on the agricultural side, work has been underway to reduce sediment and nutrient runoff for decades. Since 1985, it is estimated that PA agricultural operations in the watershed have reduced the nitrogen load by over 18 million pounds. This reflects the reality that progress has been made, but the resources have not been allocated at the level necessary to achieve the goals.

Following the legislative resolutions in 2006, PA Department of Environmental Protection (DEP) and a multitude of stakeholders embarked on a dialogue about the Chesapeake Bay Tributary Strategy. The majority of the meetings and discussion were focused on establishing a viable nutrient credit trading program. The stakeholders were committed to the success of the endeavor and spent countless hours working in meetings and on our own to resolve the issues. In the end, many issues were resolved in what was broadly viewed as a reasonable compromise (if no one is completely happy, but no one stomps out of the room, it must be a step in the right direction). This is particularly true

of the online mechanism used to track and register credits and the way a nutrient credit is defined and counted.

The key issue that went unresolved was the structure of the marketplace for trading. DEP expressed a clear preference for a "free market" approach. Many of the stakeholders expressed a strong desire for a more managed system, a bank or structured exchange to reduce uncertainty and manage risk, both real and perceived. DEP moved ahead with their preferred approach over the objections of many stakeholders.

There are a number of reasons why the trading program is experiencing difficulty, some of which have to do with timing. Pennsylvania NPDES permit holders have several years of compliance schedule built into their permits. Those permit holders will not need to actually own credits (or be meeting permit limits through treatment technology) until the compliance period is over. The market demand for credits to meet that need will not be fully developed until 2010 at the earliest. While initial conversations focused on nutrient credits as a mechanism for wastewater treatment plants to avoid infrastructure upgrades, it is new development that will be required to offset increased nutrient loads in the shortest term. In addition to addressing fundamental issues around buying and selling credits and managing risk and uncertainty, the development community needs tools and acceptable practices to transfer the long term compliance to with nutrient load caps to homeowners. Without clear guidance on how to manage this issue, builders and developers have a very real risk of being tied to each development project in perpetuity.

But the heart of the current concern over PA's trading program is risk and uncertainty. The constituencies that must utilize the Commonwealth's nutrient credit trading program to meet permit requirements and those constituencies that we need to generate nutrient credits so that the system works, have repeatedly requested a structure, or bank, to help manage uncertainty and risk. Buyers of credits want to know that there will be a dependable supply of credits over the long term so that they can effectively evaluate the costs of trading versus capital investment.

Potential credit generators want to know that a stable market exists before they invest in best management practices (BMPs) on farms and property. The certainty of a market in which to sell those credits is critical to making decisions on investing capitol resources.

I'd like to make an additional point on agriculture as a generator of credits. In order for a PA farm to be eligible to sell credits, they must be fully in compliance with the all pertinent laws and regulations and implement additional BMPs to provide additional water quality improvement to meet the trading threshold. From that point forward, additional nutrient reductions, consistent with the trading program, may be sold as credits. Many of our farms have a lot of work to do to reach the threshold. Chart 3 indicates that we will need to spend approximately \$600 million to achieve the agricultural loading goals. Ultimately, tradable credits will need to be reductions that exceed, on a farm by farm basis, that goal. The Fair Share Coalition had strenuously advocated for additional state funding, matched by resources from the agricultural community, to assist in meeting those goals. Without additional resources in the REAP

program and funding for Pennsylvania's county conservation districts, there will not be sufficient farms eligible to trade to meet the Commonwealth's needs.

Senate Bill 1493 established a Nutrient Credit Trading Board and enables the establishment of a banking function which can address the issues of risk and uncertainty. The legislation also provides for the establishment of a technical committee to facilitate the process and the establishment of new credits and instructs the Environmental Quality Board to establish procedures by which credits may be established – clarifying and streamlining the process.

It is important to note that the legislation maintains DEP's role in defining a credit and managing the tracking, certification, verification, and registration, as well as all regulatory functions in regard to applying nutrient credits to permit requirements. It's also important to point out that SB 1493 in no way impacts the ability of the "free market" system to work. It is conceivable, if not probable, that in five or ten years when trading is routine and the market is more robust, non-bank transactions dominate the marketplace. Because this is a new market where real people are investing real money, it is not unreasonable to provide some economic "training wheels" while we get this moving. This system must work to enable the Commonwealth's future economic growth.

As we've all stated, PA's trading program has had some difficulties. This was not unexpected. There are over 45 trading pilot programs across the country. None are implementing point to non-point source trades under a TMDL situation with complexities of the Chesapeake Bay issues. While the four trades to date are not enough, and we have significant work to do, they do establish Pennsylvania as a leader in a new venue and marketplace. States across the nation will pick up and emulate our nutrient credit trading program. We have cleared many of the hurdles associated with making this program viable. It's time to work together to finish the job of establishing a functional structure for a trading program that will serve Pennsylvania.

Chart 1: 2006 Total Nitrogen Load Reductions from PA Sources Required to meet Tributary Strategy Cap Loads

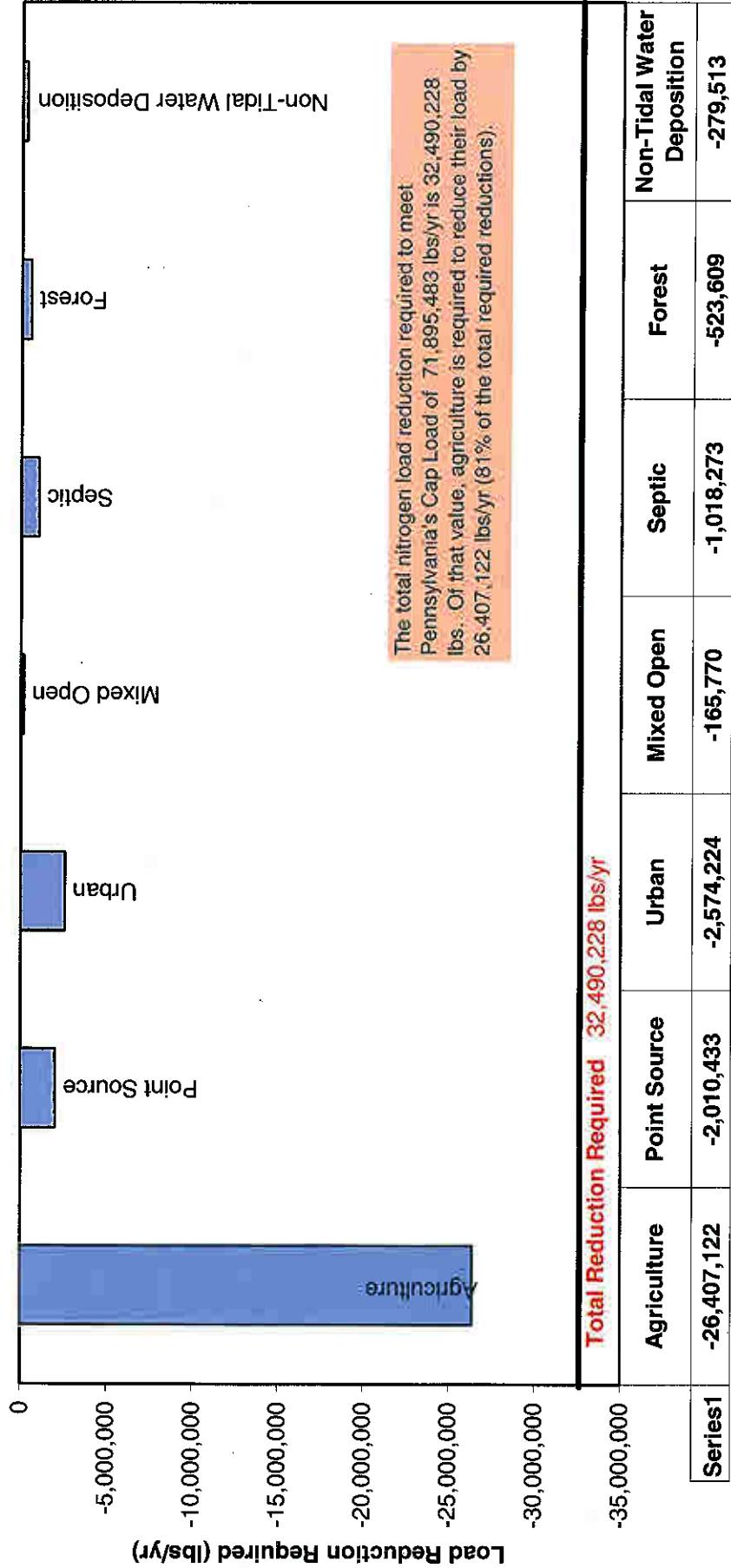


Chart 2: 2006 PA Total Nitrogen Load versus Tributary Strategy Cap Load per Source

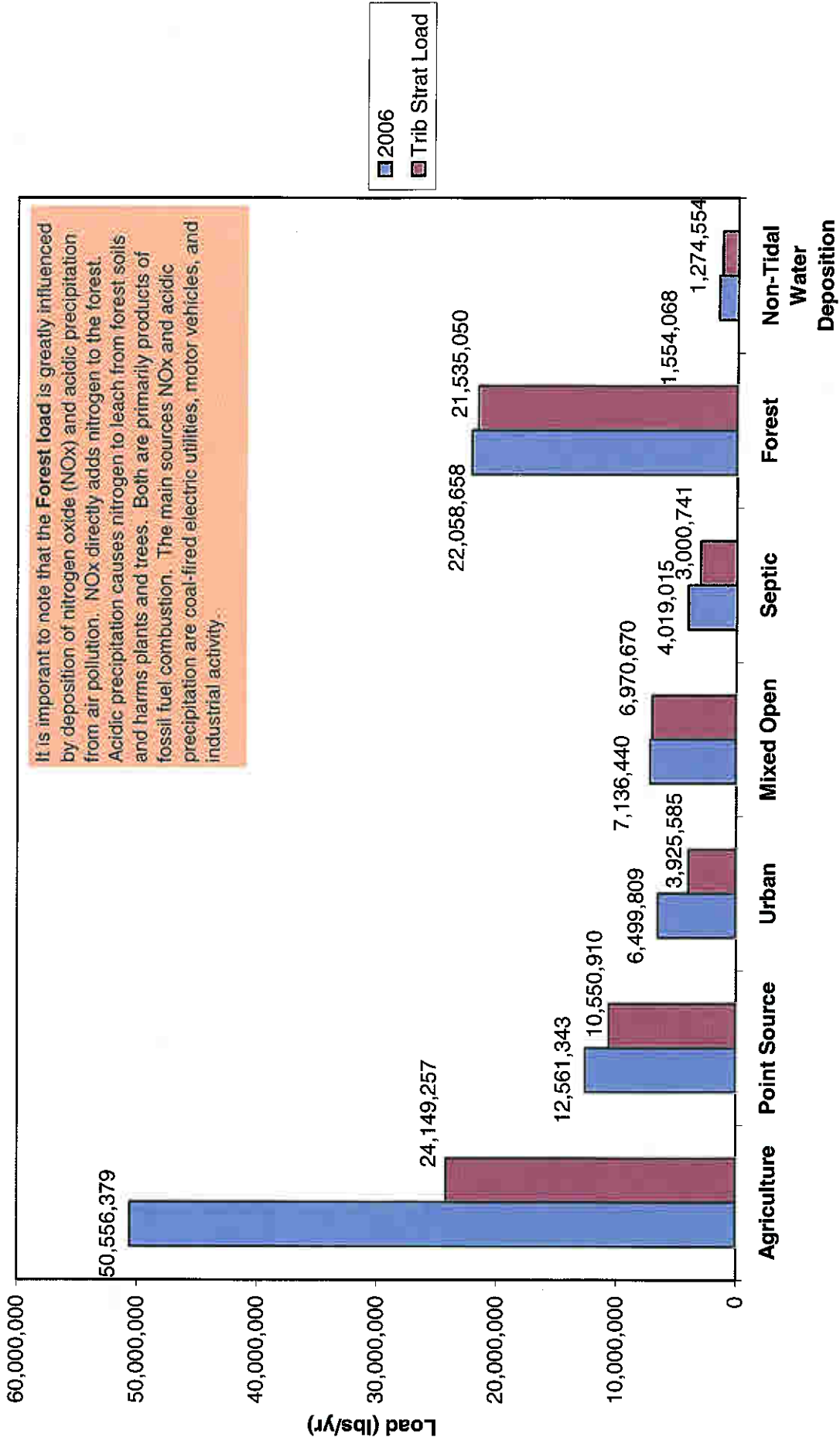


Chart 3: Estimated Total Cost for Tributary Strategy Implementation for All Sources based on 2004 Implementation and Revised Point Source Cost

