

Trudy Johnston, President, Material Matters, Inc
Testimony to the Senate Environmental Resources & Energy Committee
Senate Bill 1493
September 17, 2008

Chairman White and members of the Senate Environmental Resources & Energy Committee:

I appreciate the opportunity to provide testimony today regarding Senate Bill 1493 - the Nutrient Credit Trading Program. My name is Trudy Johnston and I am President of a small business and Pennsylvania certified woman owned business, Material Matters. Our office is located in Elizabethtown, Lancaster County, where we have a staff of 5 fulltime employees. We operate an environmental consulting firm that has been in business for 11 years. A majority of our work involves interaction with the Department of Environmental Protection (DEP) on behalf of our clients.

Personally, I have been involved with municipal government since 1982 and have also worked closely with the agricultural community for over 18 years. During my career, I worked frequently with various regulatory agencies, including DEP. In addition, I have been following the Chesapeake Bay Program initiative and nutrient trading program development for over four years. Recently, Metcalf and Eddy subcontracted our firm to study the Nutrient Trading Program, as part of the Senate Legislative Budget and Finance Committee's Study on the PA Chesapeake Bay Tributary Strategy. That final report is scheduled to be released during October 2008.

I want to be clear about our firm's interest and my personal interest in the nutrient trading program. After all, we are an environmental consulting firm and we pride ourselves in looking at the overall environmental aspects and carbon footprint of each of our projects. We believe in the importance of improving the water quality of the Chesapeake Bay, and we believe that a nutrient trading program is an excellent approach, although participation in water quality trading programs in the United States has been disappointing. I applaud DEP for having the vision to create the foundation for the trading program. Our firm has expressed interest in conducting verification (independent auditing) for nutrient trades and conducting studies related to the purchase of credits by municipal agencies and homebuilders. We are perfectly positioned and qualified to conduct this type of work.

General comments on Senate Bill 1493 are related to the:

- Viability of third party verification when government agencies are sought to perform these same activities
- Impact of uncertain future requirements to establish TMDLs for point sources
- Make up of the Board that includes only interested parties and no independent members experienced in risk modeling or financing from the private sector
- Board's powers and duties where no clear goals are established and the function of the Board is not clearly defined
- Impact of setting prices for buying and selling credits administratively absent market driven factors

Specific comments on Senate Bill 1493 are as follows.

Chapter 3 – Nutrient and Sediment Reduction Credits

Section 304 – Verification

The Department will be charged with a process to verify nutrient and sediment reductions under SB 1493. The bill states that the Department MAY allow approved third parties to perform verification. We suggest that third parties are more appropriate entities to perform this service for several reasons. First, third parties have a view of risk and performance of duties that are controlled by their business insurance demands. Verification responsibilities are critical when considering the confidence of the buyers and sellers of credits, and of getting actual reduction of nutrient loads to the Bay. Second, third parties have extreme difficulty in competing with government agencies that are subsidized with public monies. The true cost of verification may not be known if public agencies are verifying pollution reduction activities. Consequently, it is unlikely that third parties will become involved with the process of verification. It is strongly suggested that if this program is to include third parties for verification that providing support to government agencies (in the form of grants and other public funding) to perform that duty be considered very carefully.

Chapter 5 – Nutrient Credit Trading Board (Board)

Section 502 – Board Established

The bill charges the board with trading within the Chesapeake Bay watershed. Many comments received previously and documents written over the past 3 years discuss the issues related to Total Maximum Daily Loads (TMDL) for other watersheds within the Chesapeake Bay Watershed. Those issues have been cited as one obstacle to trading. Until the TMDL issue with smaller watersheds within the Bay watershed is fully addressed and resolved, there is little need for a Board.

Section 503 – Board Composition

The bill defines the membership of the Board. As written, the Board shall consist of many interested parties such as the Department of Agricultural, Environmental Protection, Pennvest, political representatives, and other interested parties. The other interested parties include conservation districts, local government, agricultural sector, municipal authorities, housing industry, water quality engineer, and environmental organizations. What we see on the Board are competing interests with their own agenda. On most Boards, that would make sense. But this Board should be expert in assessing risk and modeling risk, and financial opportunities related to that risk. Would it make sense to include an environmental economist as a member of the Board who understands market forces? If the entity charged with creating a “Bank” for buying and selling credits was a private enterprise, it likely would contain individuals who’s main focus was on responding to market demands and doing so in a profitable way, after assessing risk in setting prices for buying and selling credits. It is strongly suggested that establishing a government sponsored Board (verses a market driven Board who is familiar with modeling risk), with no expertise in financial or risk modeling, is not a wise use of taxpayer funds.

Section 504 – Powers and Duties

The bill describes the duties of the Board related to buying and selling credits, setting fees for those activities, and keeping credits in reserve. All of these activities involve risk modeling. The bill also states that the Board will operate by balancing revenues and expenses. However, since there will be government monies involved with its operation, can this Board truly reflect the “actual” cost of a credit? Again, what is the true cost to taxpayers for operation of this Board and the execution of trades? In addition, what is the risk of failure? Do market forces enter into this approach? What data will be used to develop a model that predicts the price of credits and the number of credits that need to be held in reserve? It appears that the prices will be set administratively, and not set by the marketplace? Interestingly, the bill also includes a reference to preserving the private market. It is not clear how that might be possible, based on the contents of the bill. It is suggested that the goals and function of the Board be carefully reconsidered. It is strongly suggested that the supporters of this legislation consider the impact of creating another government entity that may be better managed in the private sector.

The bill also leaves unanswered who will be responsible for verifying credits that are sold to the Board. Will the verification be conducted by the entity bringing the credits to the Board? If that is the case, the standards for verification will be difficult to compare and may not be uniform. It is strongly suggested that a clear and strong set of standards be established for verification of pollution reduction activities.

Section 506 – Private Market Preserved

The bill addresses private markets and the notion that they will be preserved. As noted above, a private market may not be able to function in this environment (compete with a government agency). So, by merely stating that this bill will preserve private markets, doesn't mean that it is possible or probable.

In conclusion, there has been an inordinate amount of debate regarding the Pennsylvania Chesapeake Bay Program, from its inception. Many groups have been urging the legislature to provide support for the nutrient trading program by creating a stable, central clearinghouse for buying and selling nutrient credits, i.e. a bank. The Senate responded to their constituent's urging by introducing Senate Bill 1493. However, we believe that by creating a Board (to act as a bank) that does not function in a market driven approach, that private financial groups, experienced with financial risk, may not choose to compete. Furthermore, until the many other program barriers are addressed, the likelihood of trading program success is small. We suggest that this bill not move forward until program barriers are identified and addressed. We also suggest that a task force be enlisted to consider the study report due to the LB&FC (by Metcalf and Eddy) in October and that the task force make recommendations for approaches in removing barriers to nutrient trading.

Thank you for the opportunity to provide testimony today.