



## **July 2, 2003 Conference Call**

Representatives from the following organizations participated in the conference call: Brown and Caldwell (John Ricketts, Nashville, Tennessee); EarthBalance (Nancy Ross, Northport, Florida); GT Energy-Environmental Products (Marcus Krembs); Jones Day (Brent Fewell); Kieser & Associates (Mark Kieser and Andrew Fang); Massachusetts Department of Environmental Protection (Marcia Sherman); Michigan Dept. of Environmental Quality (Rick Hobrla); National Association of Conservation Districts (Gerald Talberty); Ohio Environmental Protection Agency (Gail Hesse); Pennsylvania Department of Environmental Protection (Andy Zemba); Resource Strategies Inc. (Joe Kramer); Texas A&M University (Richard Woodward); University of Maryland and King & Associates (Dennis King); US EPA National Center for Environmental Economics (Barry Korb); US EPA Office of Water (Lynda Hall Wynn); USDA-NRCS (Kari Cohen and Mark Colosimo); Pennsylvania Environmental Council (Scott Van de Mark).

Mark Kieser chaired the call.

### **Water Quality Trading Forum Update**

Lynda Wynn gave an update on EPA's National Forum on Water Quality Trading, to be held in Chicago on July 22 & 23. Registration for the forum has been closed as the conference capacity (275 seats) has been reached. There will be 30 states attending the forum, with representatives from their environmental agencies as well as natural resources and agricultural agencies.

For the panel discussion on July 23, Brent Gregory from Illinois American Water System (IAWS) will replace David Merkel (Menasha Corporation) as one of the panel members. IAWS has entered a sediment trading agreement under the NPDES permit for its new drinking water plant. When IAWS built new facilities to replace its 100-year old drinking water plant, they originally planned to treat waste sediment (river water sediment and water treatment flocculations) with a lagoon system and subsequent landfill of lagoon sediment. However, it's costly (\$7 million in capital and \$0.5 million in annual maintenance and sediment trucking) and the local community did not like the potential truck traffic especially because the main truck route had been recently designated a scenic drive. This sediment trading allows IAWS to invest in upstream sediment reduction practices (e.g., land easement, sediment basins, and riparian

buffers) to offset its sediment discharge with a trading ratio of 2:1. It is a 10 year, \$4 million project with an interim review scheduled at Year 5.

### **EPRI Water Quality Trading Report**

Joe Kramer indicated that the report by EPRI (the Electric Power Research Institute) on water quality trading did not have an executive summary (see Call Summary of May, 2003). Joe and Mark Kieser will continue working on obtaining a copy of the report and making it available to the Network.

### **Outreach on Trading by National Association of Conservation Districts (NACD)**

Gerald Talberty presented on his work on "Outreach on Trading to the Agricultural Community", one of the 11 EPA-funded trading projects announced with the release of EPA's Trading Policy in January.

Gerald started with a brief introduction to the nation's Conservation Districts. Conservation Districts (CD) were established over 60 years ago by individual states with a federal model. Most of them are county level organizations, with some being multi-county districts. There are about 17,000 elected and appointed CD staff members in the nation. Conservation Districts work closely with state conservation agencies and USDA-NRCS. To private landowners, they are the local gateway to government assistance programs.

Conservation Districts have long preferred voluntary and incentive-driven approaches to soil and water conservation. For the last 10 years or so, CD have been promoting environmental awareness of landowners and encouraging the implementation of agricultural BMPs, which have a full array of environmental benefits. The agricultural community has been interested in carbon trading, regarding it as one variety of market driven approach to and a new funding opportunity for conservation.

Gerald initially got the idea to undertake this outreach project on trading during a conference in the World Resources Institute where Paul Faeth introduced water quality trading. Gerald believes that if properly designed and enforced, water quality trading can help the implementation of TMDLs and other soil and water conservation goals. It could become another factor encouraging voluntary improvements. The cost-sharing and economic incentives may persuade some landowners to participate in applying BMPs.

Gerald indicated that when established, water quality trading could bring buyers other than governments (e.g., local environmental groups) to purchase credits and retire them to secure the environmental benefits. The voluntary nature of trading would give more options to landowners on how to conserve. Properly designed margins of safety (e.g., a trading ratio of 3:1) could be used to overcome the uncertainty in credit quantification.

Gerald, at a meeting with Dave Bachelor from EPA, raised the issue of multiple environmental benefits by certain BMPs. For example, a riparian buffer can sequester carbon, retain nutrients and provide wildlife habitat. The question is, can a riparian buffer be "sold more than once" for

its multiple environmental benefits. If yes, then the investment/return ratio will increase. This has significant economic and political ramifications. For example, when considering the 1996 Farm Bill, the Congress raised the question of whether environmental returns in dollar value were worth the projected \$2 billion CRP program. In this case, if more than one environmental benefit in dollar values (with the trading of these benefits) can be counted against the investment, it's likely that the \$2 billion CRP program would be well justified.

Issues to be addressed in water quality trading involving the agricultural community include the compatibility of BMPs used in trading and other farm practices that are important sources of farmer income; and the credit eligibility of the cost-sharing portion of BMPs (e.g., if a BMP is implemented with 70% federal funds and 30% private funds, some current trading projects only allow 30% of the generated credits to be traded). The latter became an issue mostly because of the opinion against using governmental funds by private parties to make profits. Gerald believes the government portion of the credits should be trading-eligible because water quality trading is all about incentive and environmental benefits are the ultimate goal of trading. Another concern is that landowners would need some kind of liability protection against unexpected failure of BMPs, particularly weather related losses of BMP structures (e.g., by floods). Landowners should have an option to reestablish BMPs with new funds.

The following are questions and answers during the ensuing discussion on NACD's trading outreach project.

*Q:* What are the key objectives of the project?

*A:* The targeted audience is CD staff and the rest of the agricultural community.

*Q:* What are the responses so far from CD staff and the agricultural community?

*A:* It's still early to summarize the responses. However, one of the questions often raised is where we can find real trades that have actually taken place. Gerald sees water quality trading as an opportunity for CD to become the catalyst to get all parties together and move trading forward. A report on the project can be found at <http://www.nacdnet.org/special/market.htm>

*Q:* Do you envision the role of CD as the third party credit monitoring/verification in trading?

*A:* CD are willing to play such a role.

*Q:* Is NACD willing to serve as an overarching credit broker in trading?

*A:* Probably not. The current relationship between landowners and CD does not support such a role for NACD. Conservation Districts do not want to be perceived by landowners to be some sort of commodity dealers.

*Q:* Who would you see could be the legitimate and trustworthy credit dealers?

*A:* Someone like the current dealers of agricultural products, whom farmers know are involved in trading and who have already had a business network.

*Q:* Would allowing the trading of credits generated with cost-sharing government funds flood the market with cheap credits?

A: This is an economics issue. However, trading with full credits is a big incentive to put BMPs on the ground and incentive is what trading promises to offer.

Q: What are your thoughts on the baseline issue?

A: It seems that we are penalizing conservation role models and providing perverse incentives by only giving new BMP implementers credits with a baseline of what would be if there wasn't trading. Maybe the current regulations should serve as the baseline and anything beyond regulatory requirements should be credited. The Tar-Pamlico payment model is probably a better way to trade because paying into a state fund and then distributing the fund by the government can avoid the baseline issue and offer simplicity to landowners to participate in BMP implementation.

Q: Is there an example of a Conservation District actually doing trading?

A: The Colonial Soil and Water Conservation District (CSWCD) in Virginia has been in the past several years pursuing funding for using water quality trading to promote continuous no-till. (Mark Kieser: Brain Noyes and Jim Wallace from CSWCD can be contacted for further information. Their contact information can be found on ETN website at [http://www.envtn.org/cgi-bin/contacts/display\\_users.cgi](http://www.envtn.org/cgi-bin/contacts/display_users.cgi) )

Barry Korb commented that as we often talk about “get the market going”, water quality trading can actually be conducted in settings that are not strict “markets”. Some intermediate non-market approaches may actually work better under current conditions.

Brent Fewell commented that as demand stimulates supply, with TMDLs and NPDES renewals facing substantial capital costs in meeting water quality goals, trading will take off.

Dennis King commented that trading ratios may eventually “kill” the water quality trading market. For example, the Maryland Department of the Environment has recently set a trading ratio of 4:1 when exploring a state nutrient trading program. This is simply too high to provide incentives for trading. Some sort of market insurance mechanism may work better than trading ratios in solving the uncertainty issue in trading.

For further information on the project or to interact with Gerald directly, he can be reached at 410-247-1973 or [gtalbety@nrcdnet.org](mailto:gtalbety@nrcdnet.org)

## **Next Call**

The next call will be at 10:30 EDT, Wednesday, August 20, 2003.