

B. Text of Water Quality Trading Policy

I. Background and Purpose of the Policy

The Clean Water Act (CWA)¹ was enacted in 1972 to restore and maintain the chemical, physical, and biological integrity of the nation's waters. It established a national policy that called for the discharge of pollutants to be eliminated and established interim goals for protecting fish, wildlife and recreational uses. The CWA also established a national policy for development and implementation of programs so the goals of the Act could be met through controls of point and nonpoint sources of pollution. Congress recognized and preserved the primary responsibilities and rights of the States to prevent, reduce and eliminate pollution.

The application of technology and water quality based requirements through the National Pollutant Discharge Elimination System (NPDES) permit program has achieved and remains critical to success in controlling point source pollution and restoring the nation's waters. Despite these accomplishments approximately 40% of the rivers, 45% of the streams and 50% of the lakes that have been assessed still do not support their designated uses². Sources of pollution such as urban storm water, agricultural runoff and atmospheric deposition continue to threaten our nation's waters. Nutrient and sediment loading from agriculture and storm water are significant contributors to water quality problems such as hypoxia in the Gulf of Mexico and decreased fish populations in Chesapeake Bay. Population growth and development place increasing demands on the environment making it more difficult to achieve and maintain water quality standards.

Finding solutions to these complex water quality problems requires innovative approaches that are aligned with core water programs. Water quality trading is an approach that offers greater efficiency in achieving water quality goals on a watershed basis. It allows one source to meet its regulatory obligations by using pollutant reductions created by another source that has lower pollution control costs. Trading capitalizes on economies of scale and the control cost

differentials among and between sources.

The United States Environmental Protection Agency (EPA) believes that market-based approaches such as water quality trading provide greater flexibility and have potential to achieve water quality and environmental benefits greater than would otherwise be achieved under more traditional regulatory approaches. Market-based programs can achieve water quality goals at a substantial economic savings. EPA estimates that in 1997 annual private point source control costs were about \$14 billion and public point source costs were about \$34 billion.³ The National Cost to Implement Total Maximum Daily Loads (TMDLs) Draft Report estimates that flexible approaches to improving water quality could save \$900 million dollars annually compared to the least flexible approach. (EPA, August 2001). Nitrogen trading among publicly owned treatment works in Connecticut that discharge into Long Island Sound is expected to achieve the required reductions under a TMDL while saving over \$200 million dollars in control costs.

Market-based approaches can also create economic incentives for innovation, emerging technology, voluntary pollution reductions and greater efficiency in improving the quality of the nation's waters.

The purpose of this policy is to encourage states, interstate agencies and tribes to develop and implement water quality trading programs for nutrients, sediments and other pollutants where opportunities exist to achieve water quality improvements at reduced costs. More specifically, the policy is intended to encourage voluntary trading programs that facilitate implementation of TMDLs, reduce the costs of compliance with CWA regulations, establish incentives for voluntary reductions and promote watershed-based initiatives. A number of states are in various stages of developing trading programs. This policy provides guidance for states, interstate agencies and tribes to assist them in developing and implementing such programs.

This policy addresses issues left open by and limitations encountered implementing projects and programs under EPA's January 1996 Effluent Trading In Watersheds Policy and May 1996 Draft Framework for Watershed-Based Trading ("Draft Framework"). This policy should be given precedence

over any inconsistencies with the Draft Framework.

This policy draws upon lessons from a number of recent pilot trading projects and state experiences in developing water quality trading programs. These initiatives demonstrate how trading can occur under the CWA and existing federal regulations. They illustrate the importance of voluntary watershed-based partnerships, inter-agency cooperation and public participation in implementation of trading programs. They show that flexible market-based approaches can facilitate states and tribes finding solutions to complex and diverse water quality and socioeconomic issues. These efforts have also highlighted the importance of keeping transaction and administrative costs manageable while retaining accountability. The lessons learned from these efforts have informed the development of this policy.

This policy describes various requirements of the CWA and implementing regulations that are relevant to water quality trading, including: requirements to obtain permits (Sections 402 and 404), antibacksliding provisions (Section 303(d)(4) and Section 402(o)), the development of water quality standards including antidegradation policy (Section 303(c)), federal NPDES permit regulations (40 CFR Parts 122, 123 and 124), TMDLs (Section 303d(1)) and water quality management plans (40 CFR Part 130). These CWA provisions and regulations contain legally binding requirements. This policy does not substitute for those provisions or requirements. In addition, this policy identifies general elements and provisions that EPA believes are important for creating credible water quality trading programs.

When EPA makes a decision with regard to any particular permit, TMDL, water quality standards or water quality management plan that includes provisions for trading to occur, it will make each decision on a case-by-case basis guided by the applicable requirements of the CWA and implementing regulations and the specific facts and circumstances involved.

II. Trading Objectives

EPA supports implementation of water quality trading by states, interstate agencies and tribes where trading:

A. Achieves early reductions and progress towards water quality standards pending development of TMDLs for impaired waters.

¹ Federal Water Pollution Control Act (Public Law 92-500, as amended), 33 U.S.C. Sec. 1251, *et seq.*

² About 33 percent of the nation's water have been assessed by States and tribes pursuant to Section 305(b) of the Clean Water Act (National Water Quality Inventory: 2000 Report, EPA). The proportion of non-assessed water that do not meet designated uses is likely lower since assessments tend to be focused in known problem areas.

³ A Retrospective Assessment of the costs of the Clean Water Act: 1972-1977 (EPA, October, 2000).