

## **Credit Definition and Price Details – March 2014**

### **What is a stewardship credit?**

A “stewardship credit,” like any other water quality credit, is a quantified and verified representation of a reduction of a pollutant. The stewardship credits being transacted in March 2014 are a “bundle” of benefits, including nitrogen and phosphorous reductions, as well as ancillary ecosystem benefits. At this time in the pilot program, credits sold by EPRI cannot be used to satisfy regulatory permit obligations and must be retired by the buyers. Therefore, in this case, a stewardship credit can create a net gain in water quality and support ecosystems.

### **Who might purchase stewardship credits and why?**

Anyone who would like to support water quality and ecosystems in the Ohio River Basin or that would like to test how the EPRI pilot project operates might purchase these credits. The primary business case reasons for corporations to purchase stewardship credits are to:

- Advance corporate sustainability goals by buying quantified nutrient reductions as well as supporting other ecosystem and social benefits.
- Secure a flexible compliance schedule in the future if stricter permit limits are assigned.
- Participate in the pilot program to gain experience for future compliance requirements.

### **Who were the first buyers of credits?**

The first corporate buyers were American Electric Power, Duke Energy and Hoosier Energy. In the purchase of stewardship credits, these companies have reduced nutrient loading and may have provided ancillary benefits such as improved soil health, habitat enhancement, reduced greenhouse gas emissions, and social and economic support to farmers. Purchasing these credits represents an important contribution to the watersheds and communities in the Ohio River Basin, and could provide ecosystem benefits all the way to the Gulf of Mexico.

### **How many credits have been traded so far?**

On March 11, 2014, EPRI sold a total of 9,000 stewardship credits for \$10.00 each. The breakdown of the 9,000 credits consists of approximately 6,500 lbs. total nitrogen (TN) reductions and 2,500 lbs. total phosphorus (TP) reductions for delivery over three years. Additional credits are available for purchase, up to approximately 66,000 lbs. of TN and 30,000 lbs. of TP during the pilot period through 2015.

### **How was the price determined for the initial transactions?**

The Ohio River Basin Water quality trading project is a new program so there is little market-based pricing information available. Therefore, we chose to use a cost-based price model. Our goal was to use a pricing method that incorporates the full costs associated with implementing practices, managing the infrastructure and protocols, and documenting all credits including serial numbers.

**What are the costs that were included in the pricing model?**

At a summary level, we included: (1) the cost of project **activity** done on the farm, (2) the cost of project **administration**, and (3) the cost of addressing project **risk**.

Examples of what was included in the costs include:

1. The cost of the project activity includes the cost of implementing best management practices (BMPs) at the farm such as cover crops, filter strips (hay coverage), and heavy use area protection (HUAP), among others.
2. Administrative costs include project management, regulatory oversight, agency overhead, and infrastructure costs.
3. Project risk includes the cost of credits set aside for a reserve pool to account for non-performing BMPs and a safety factor to account for modeling uncertainty.

**Since this pilot program is supported by grants, why do you need to recapture costs?**

EPRI is grateful for multiple grants from USEPA and USDA dating back to 2009. We have also raised an equal amount of private funding in the program. The private money is what has paid for the conservation projects on-the-ground, while the federal grants have supported critical infrastructure development, watershed modeling, and stakeholder engagement. It is the leveraging of the two funding sources that has allowed for robust advancement of the project. In order for the program to continue, it is important for the pilot transactions to reflect the full unsubsidized cost of the program. Our goal is to have a sustainable, replicable and independent program less reliant on grant funding.

**Does a credit price of \$10 meet your objectives of recovering full costs?**

No. The price of \$10 is a good start for signaling to the true cost of each credit. However, the pilot project still needs to reassess the full costs for states and the soil and water conservation districts for implementing the program, including engineering, planning, and oversight. Since we are still in the middle of the pilot program, we could only estimate a portion of these costs for the cost-based pricing model that supported the sale of Stewardship credits in March 2014.

**What will happen with the proceeds from the sale of these credits?**

The proceeds will be used for two purposes: (1) to re-invest and broaden the program for greater nutrient reductions, and (2) to fund the post-pilot transition to a compliance program.

**Do you anticipate moving to market-based pricing?**

Yes, market-based pricing is an important element to test the long-term success of this project. In fact, during the pilot program, we plan to conduct an auction for the stewardship credits in the fourth quarter of 2014. Auctions help to concentrate liquidity – which is important for an emerging market and critical for establishing a real market-based price signal.