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May 26, 2016

Peter MacLaggan
Poseidon Channelside
5780 First Street, Suite 140
Carlsbad, CA 92008

RE: Condition compliance determination for Coastal Development Permit ("CDP") E-06-013 **Special Condition 10** and *Energy Minimization and Greenhouse Gas Reduction Plan* ("GHG Plan") for Poseidon Channelside Carlsbad desalination facility.

Dear Mr. MacLaggan,

Thank you for your letter of March 1, 2016 responding to our December 8, 2015 evaluation of Poseidon's Initial Annual Report that you submitted in November 2015 pursuant to the above-referenced GHG Plan.[1] Our evaluation in December determined that Poseidon had not yet provided sufficient credits to offset the facility's first year of GHG emissions, due to the Initial Annual Report covering approximately six months rather than the required year of expected emissions, and due to Poseidon taking credit at a 1:1 basis for presumed reduced emissions from displaced water imports.

We have reviewed the additional information provided in your March letter regarding these condition compliance issues and appreciate that Poseidon has made significant efforts to comply with the CDP requirements. For example, we requested during our December evaluation that you promptly provide sufficient offsets to address these identified shortfalls and then continue to discuss what changes were needed to ensure that this Initial Annual Report and subsequent annual reports would be fully consistent with Poseidon's CDP. Our December review identified a shortage of about 50,000 tonnes worth of emission offsets, and we understand that Poseidon purchased on December 10, 2016 about 80,000 credits in response to the identified shortage. We also concur with Poseidon's request to base its required future annual reports on the San Diego County Water Authority ("SDCWA") fiscal year (July 1 through June 30) instead of the calendar year. We understand you will shortly submit an annual report for this upcoming July-June fiscal year to supplement the initial report you filed in November. There are, however, remaining condition compliance issues, as discussed below.

Noncompliance regarding offset credits for reduced imported water
Poseidon proposes to continue including these credits at a 1:1 ratio compared to the production volumes at the Carlsbad facility. As we have previously discussed and as described below, this proposed approach is inconsistent with the CDP and the GHG Plan.

[1] Poseidon Resources, *First Annual Energy Minimization and Greenhouse Gas Reduction Report*, November 23, 2015.

Background: The Commission's Final Adopted Findings for the CDP describe a number of adverse impacts caused by the indirect greenhouse gas emissions resulting from Poseidon's electrical use during project operations and require that Poseidon's facility and water deliveries be "net carbon neutral." The Commission included in the CDP **Special Condition 10**, which required Poseidon to submit a plan for subsequent Commission review and approval that showed how Poseidon would meet this "net carbon neutral" standard.

In August 2008, the Commission approved Poseidon's proposed GHG Plan. The Plan identified Poseidon's expected annual electrical use and the GHG emissions expected to result from that use, identified various measures Poseidon would implement to reduce or offset those emissions, and established ongoing monitoring and reporting requirements that would identify changes in electrical use and emissions to ensure that facility operations would continue to meet the "net carbon neutral" requirement. The GHG Plan required Poseidon to submit, prior to facility operations, an Initial Annual Report that identified the project's expected first year of electricity use and the resulting indirect GHG emissions from that electricity use, and that provided evidence of Poseidon having sufficient offsets to reduce to zero the first year's net GHG emissions.

The GHG Plan's single largest emission reduction measure, representing about two-thirds of Poseidon's expected indirect emissions, was based on Poseidon's proposal to credit its facility at a 1:1 basis for decreasing GHG emissions through reduced water imports delivered from the State Water Project to the Metropolitan Water District ("MWD") – that is, for every acre-foot of water Poseidon produced, it would be credited for reduced electricity and emissions from an acre-foot of water <u>not</u> delivered by the State Water Project. The GHG Plan stated that Poseidon's participation in an MWD program to subsidize Poseidon's water costs would be based on Poseidon producing water that would offset an equivalent amount of imported water and that MWD would conduct recordkeeping and audits to ensure these offsets occurred.

We understand, however, that after the Commission's approval of the CDP and the GHG Plan, Poseidon, MWD, and the San Diego County Water Authority did not reach agreement over participation in the MWD program referenced in the GHG Plan. Therefore, the expected offsets, recordkeeping, and audits presumed in the GHG Plan have not occurred as described and the project is not meeting the CDP's "net carbon neutral" requirement.

Recommendation: We request that Poseidon submit a revised GHG Plan for Commission review and approval that removes the presumed 1:1 imported water offset credit. Alternatively, Poseidon may propose to provide documentation showing that the offsets have occurred as presumed by the current GHG Plan. Any documentation provided will need to be adequate to establish that Poseidon will meet the Commission's required "net carbon neutral" standard.

Noncompliance with the GHG Plan's requirement for sufficient offsets
The GHG Plan requires Poseidon to submit its Initial Annual Report prior to project operations and requires that the report provide evidence of sufficient mitigation measures and offsets to reduce to zero the project's estimated net indirect GHG emissions for the upcoming first year of Poseidon's operations. Among the mitigation options the GHG Plan allows to meet the "net carbon neutral" standard are offsets obtained through the Climate Action Reserve ("CAR").

Poseidon states in its March 1, 2016 letter that it has purchased sufficient CAR carbon offsets to have a balance of 89,849 tonnes of offsets in its CAR account and that it expects to need about 78,048 tonnes of offsets for its first year of operations prior to consideration of any of the other mitigation options identified in the GHG Plan. As noted by CAR, however, purchased offsets do not fulfill a mitigation requirement until they are "retired."[2] We understand from CAR that Poseidon has not yet retired the offsets needed to "zero out" its first year emissions prior to operations. As a result, Poseidon is not yet in conformity with the GHG Plan's requirement to provide evidence that sufficient offsets have been provided to meet the required "net carbon neutral" standard.

Recommendation: We request that Poseidon promptly provide evidence from CAR that it has retired sufficient offsets to reduce to zero the facility's expected first year of operations. As noted above, that appears to be approximately 78,048 tonnes worth of offsets. Once Poseidon retires the necessary offsets, we will apply them to the first full year of project operations and can adjust them as necessary for subsequent reporting years, as provided by the GHG Plan.

Conclusion
Thank you for your attention to these issues. We are happy to answer any questions you may have or discuss other options Poseidon may wish to propose.

Sincerely,

Tom Luster

Tom Luster
Energy, Ocean Resources, and Federal Consistency Division

[2] As stated by CAR, for example, "[r]etirement means CRTs have been permanently removed from further transactions after being used to offset an equivalent tonne of emissions. Retirement of CRTs is necessary to ensure that the environmental benefit actually occurs. Because of this, retirement is permanent. Once a CRT is transferred into a retirement account, it cannot be reactivated and transferred again."