CALENDAR ITEM
C78

A 1 | 03/25/08
PRC 4596.2
PRC 6423.2
R13107
S 2 | D. Dudak

CONSIDER APPROVAL OF THE AMENDMENT OF STATE GEOTHERMAL RESOURCES LEASE NO. 4596.2 TO: ADD LANDS PRESENTLY HELD UNDER STATE GEOTHERMAL RESOURCES LEASE PRC 6423.2, ESTABLISH A TIME FOR THE SURRENDER OF SUCH LANDS IF LESSEE FAILS TO CONDUCT OPERATIONS UNDER THE LEASE, AND MODIFY OTHER TERMS OF THE LEASE; AND ACCEPTANCE OF THE SURRENDER OF GEOTHERMAL RESOURCES LEASE NO. PRC 6423.2 AS TO THE REMAINING LANDS; THE GEYSERS GEOTHERMAL FIELD, SONOMA AND LAKE COUNTIES

LESSEE:

Geysers Power Company, LLC
Attn.: Mr. Kevin Talkington
10350 Socrates Mine Road
Middletown, CA 95461

AREA, LAND TYPE, AND LOCATION:

Approximately 2,543.43 acres of State 100 percent (100%) reserved mineral interest School Lands in PRC 4596.2 and approximately 172.36 acres of State fee-owned School Lands in PRC 6423.2 at The Geysers Geothermal Field, Sonoma and Lake Counties, as depicted on Exhibit A. The lands within PRC 6423.2 are described on Exhibit B. The lands within PRC 4596.2 and those lands to be added to it are described on Exhibit C.

BACKGROUND:

State Geothermal Resources Lease No. PRC 4596.2, totaling 2,543.43 acres, was issued by the California State Lands Commission (Commission) to Union Oil Company of California, et al (Unocal) in 1971 through the conversion of

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geothermal prospecting permits issued by the Commission in the 1960s. PRC 4596.2 provides for a royalty of ten percent (10%) of the gross value of geothermal steam attributable to the leased lands, where the value of steam is defined to be forty-two percent (42%) of the gross value of the electric power generated from that steam. The lease also provides for a minimum annual royalty payment of two dollars ($2.00) per acre and an annual rental of one dollar ($1.00) per acre.

The lands within State Geothermal Resources Lease No. PRC 6423.2, totaling 172.36 acres, were leased to Unocal in 1974 as a federal lease CA-953 by the U.S. Bureau of Land Management (BLM). The State acquired title to the lands from the BLM as a School Lands indemnity selection in 1983 and thereby succeeded to the BLM's interest in the federal lease. The State re-designated the lease as PRC 6423.2. Following the State's acquisition, the lease has continued to be administered in accordance with federal laws, rules, and regulations. The lease provides for a royalty of twelve and one-half percent (12.5%) on the amount or value of steam, with a minimum annual royalty of two dollars ($2.00) per acre. Annual rental payments no longer are required under the lease.

In 1999, the Commission approved the assignment of both leases to Geysers Power Company, LLC (Lessee), a wholly-owned subsidiary of Calpine Corporation. The Lessee had previously purchased all of Unocal's geothermal leaseholds at The Geysers, along with the electrical-generating facilities owned by Pacific Gas and Electric Company and other companies. The Lessee presently holds all seven State geothermal leases at The Geysers, totaling nearly 6,900 acres. The Lessee uses geothermal resources from State leases, together with numerous private and federal leases, to generate approximately 725 megawatts of electricity.

The State's geothermal leases at The Geysers have yielded more than $165 million in cumulative royalty revenue since 1972. The active leases currently provide more than $5 million in royalty revenue per year. This revenue benefits the State Teachers' Retirement Fund pursuant to Public Resources Code section 6217.5.

SURRENDER OF LEASE PRC 6423.2:

Lease PRC 6423.2 had a primary term of ten years from 1974 and for so long thereafter as geothermal resources were produced in commercial quantities. In 1984, Unocal completed a commercial well and began paying a production

royalty to the State. After the well ceased producing in 1994, Unocal began paying an annual minimum royalty equivalent to $2.00 per acre. In 1995, Commission staff approved Unocal's program to abandon the well. In 1996, Unocal abandoned the well pursuant to that approval and in accordance with California Division of Oil, Gas, and Geothermal Resources regulations. In 1999, the Commission approved the assignment of PRC 6423.2 to the Lessee. The Lessee continued paying an annual minimum royalty, but has not undertaken any operations to re-establish commercial production of geothermal resources from the lease.

In 2007, Commission staff notified the Lessee that the lease had lapsed due to Lessee's failure to re-establish production in a timely fashion. The Lessee contested that assertion, contending the lease had been held by payment of annual minimum royalties and that pursuant to the Geothermal Steam Act and other federal and State laws, rules, and regulations, the lease could not be terminated without providing notice of default and the opportunity to cure. The Lessee requested Commission consideration of a compromise resolution to the issue.

Pursuant to negotiations with Commission staff, a proposed agreement was reached, the principal components of which are: 1) a portion of the lands presently covered by PRC 6423.2 (158.05 acres, to be identified as "Parcel A") would be transferred to and administered under the terms of PRC 4596.2; 2) the remaining lands covered under PRC 6423.2, along with the lease itself, would be surrendered to the State; 3) an annual rental would be established for Parcel A; and 4) PRC 4596.2 would be amended to provide a date for the surrender of Parcel A if the Lessee fails to conduct operations to return the lands to production.

Public Resources Code sections 6914 and 6804.1, and paragraph 23 of lease PRC 6423.2, permit the Lessee at any time to make a written quitclaim of all rights under the lease. The quitclaim becomes effective when it is filed with the State subject to the continued obligation of the Lessee and its surety to pay all accrued rentals and royalties and to abandon all wells drilled on the leased lands. Commission staff has received from the Lessee the document "Lease Quitclaim Deed for State Geothermal Resources Lease," executed January 17, 2008, surrendering to the State all of the Lessee's right, title, and interest in PRC 6423.2. The quitclaim was submitted on the condition that the Commission approves the modification of PRC 4596.2 as provided in this Calendar Item. A review of the Commission's files reveals that no default exists on PRC 6423.2

and that the Lessee has complied with all applicable laws and provisions of PRC 6423.2 and has paid all rentals and royalties.

AMENDMENT OF LEASE PRC 4596.2:

The proposed amendment will add Parcel A (158.05 acres) to PRC 4596.2 and provide that the lease will expire as to such lands if the Lessee fails to commence drilling a well for geothermal resources into Parcel A within six (6) months of the effective date of the amendment. Upon approval of this item, the Commission's Executive Officer may grant an extension of up to six (6) additional months based on information provided by the Lessee justifying the need for an extension. If the Lessee fails to commence drilling operations before the required date or to prosecute those operations diligently after commencement, PRC 4596.2 will terminate with respect to Parcel A. If the initial well drilled into Parcel A fails to encounter geothermal resources in commercial quantities, then the Lease will lapse as to Parcel A unless the Lessee has commenced the drilling of a second well into Parcel A within six (6) months from cessation of drilling operations on the initial well. If the second well fails to encounter geothermal resources in commercial quantities, the Commission's Executive Officer may authorize the Lessee to convert one or both wells or to drill new wells for the purpose of injecting geothermal fluids, water, treated effluent, or other approved fluids into Parcel A. Such authorization will be based on Commission staff's review of information provided by the Lessee justifying the use of Parcel A for injection. Provided the Lease has not terminated earlier as to Parcel A, if, within two (2) years of the effective date of the amendment, the Lessee is not producing geothermal resources in commercial quantities from Parcel A or utilizing Parcel A for injection pursuant to authority granted by the State through the Commission's Executive Officer, PRC 4596.2 will terminate with respect to Parcel A.

The amendment will require the Lessee to pay an annual rental for Parcel A of one hundred dollars ($100.00) per acre or fraction of an acre for each year or fraction of a year the lease is in effect with respect to Parcel A. When the Lessee begins producing geothermal resources from Parcel A, the annual rental for Parcel A will be reduced to ten dollars ($10.00) per acre or fraction of an acre. If the Lessee obtains approval from the Commission's Executive Officer to hold Parcel A by injection rather than production, the annual rental for Parcel A will be increased to two-hundred fifty dollars ($250.00) per acre or fraction of an acre.

The amendment will authorize the Lessee to drill geothermal wells into Parcel A only from existing or approved drill sites permitted in accordance with and subject to all of the terms, conditions, and limitations of: 1) Use Permit #79-115 granted

by the County of Lake in March 1981 and subsequently extended in March 1987; 2) Use Permit #85-8 issued by the County of Lake in July 1985; and 3) Use Permit #2180 issued by the County of Sonoma in October 1967 and amended in October 1976. The Lessee will be authorized to produce geothermal resources from Parcel A into its existing steam-gathering system or use Parcel A for injection operations if authorized by the Commission's Executive Officer. All other terms and conditions of PRC 4596.2 will remain unchanged.

STATUTORY AND OTHER REFERENCES:

A. Paragraph 23 of State Geothermal Resources Lease No. PRC 6423.2.
B. Public Resources Code, Division 6, Parts 1 and 2; Division 13.
C. California Code of Regulations, Title 2, Division 3; Title 14.

OTHER PERTINENT INFORMATION:

1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines [Title 14, California Code of Regulations, section 15060(c)(3)], the staff has determined that this activity is not subject to the provisions of the CEQA because it is not a "project" as defined by the CEQA and the State CEQA Guidelines.

   Authority: Public Resources Code section 21065 and Title 14, California Code of Regulations, sections 15060 (c)(3) and 15378.

2. This activity involves lands which have NOT been identified as possessing significant environmental values pursuant to Public Resources Code sections 6370, et seq. However, the Commission has declared that all State School Lands and submerged lands are "significant" by nature of their public ownership (as opposed to "environmentally significant"). Since such declaration of significance is not based upon the requirements and criteria of Public Resources Code sections 6370, et seq., use classifications for such lands have not been designated. Therefore, the finding of the project's consistency with the use classification as required by Title 2, California Code of Regulations, section 2954 is not applicable.

EXHIBITS:

A. Location Map

B. Land Description for PRC 6423.2
C. Land Description for PRC 4596.2

PERMIT STREAMLINING ACT DEADLINE:
N/A (not a "development project" subject to the Act)

RECOMMENDED ACTION:
IT IS RECOMMENDED THAT THE COMMISSION:

CEQA FINDING:

1. FIND THAT THE ACTIVITY IS NOT SUBJECT TO THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15060(c)(3) BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY PUBLIC RESOURCES CODE SECTION 21065 AND TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15378.

AUTHORIZATION:

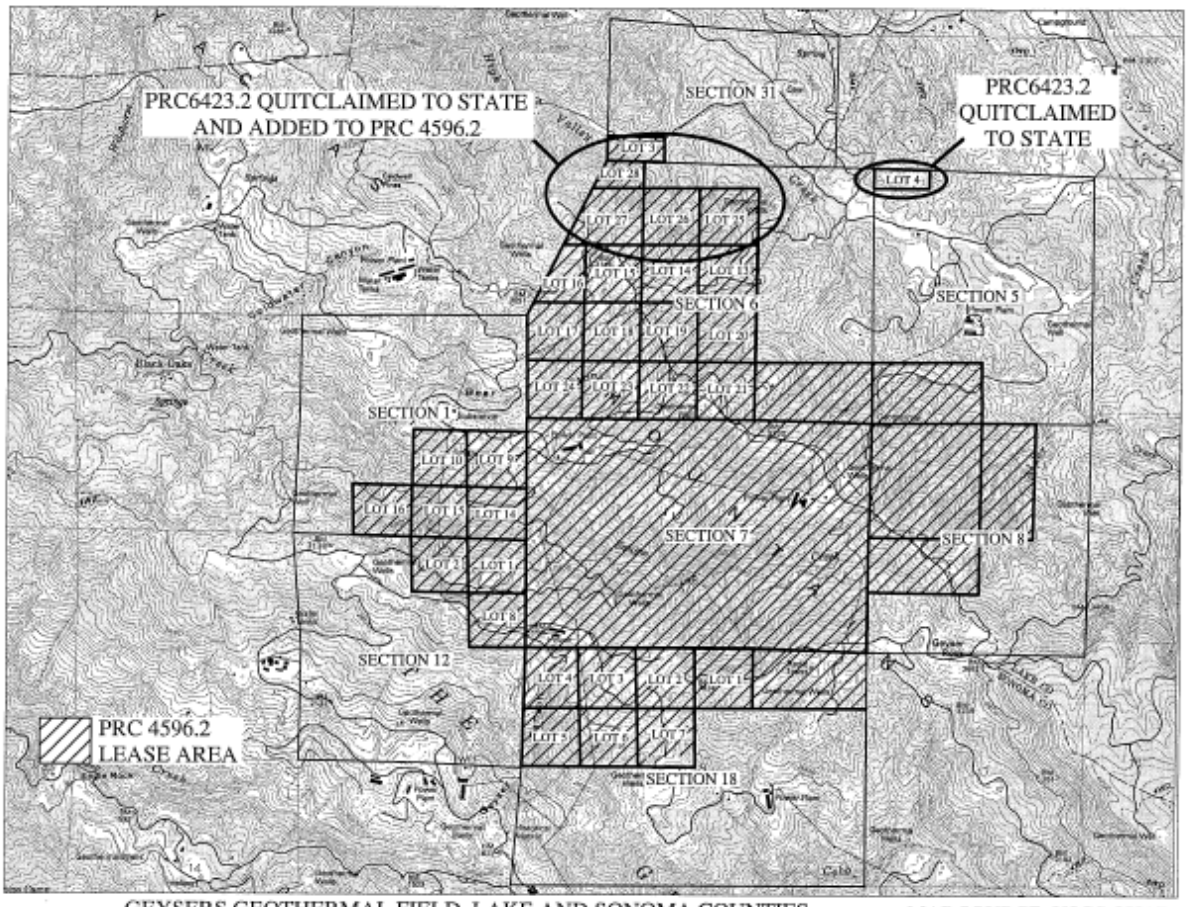
1. AUTHORIZE THE AMENDMENT OF STATE GEOTHERMAL RESOURCES LEASE NO. PRC 4596.2 UPON THE TERMS AND CONDITIONS OUTLINED IN THIS CALENDAR ITEM AND IN FORM ON FILE IN THE OFFICES OF THE COMMISSION, TO PROVIDE FOR: 1) THE ADDITION TO THE LEASE OF PARCEL A LANDS COMPRISED OF 158.05 ACRES, MORE OR LESS, AS DESCRIBED IN EXHIBIT C; 2) A TIME FOR THE SURRENDER OF PARCEL A IF THE LESSEE FAILS TO CONDUCT DRILLING OPERATIONS TO RE-ESTABLISH PRODUCTION FROM PARCEL A; 3) THE AUTHORIZATION FOR THE EXECUTIVE OFFICER TO GRANT ONE SIX-MONTH EXTENSION OF THE LESSEE'S TIME TO INITIATE DRILLING OPERATIONS ON PARCEL A; 4) THE AUTHORIZATION FOR THE EXECUTIVE OFFICER TO APPROVE, PROVIDED THE LESSEE DRILLS TWO WELLS INTO PARCEL A THAT FAIL TO ENCOUNTER GEOTHERMAL RESOURCES IN COMMERCIAL QUANTITIES, THE CONVERSION OF ONE OR BOTH WELLS OR THE DRILLING OF NEW WELLS FOR THE PURPOSE OF INJECTING GEOTHERMAL FLUIDS OR OTHER APPROVED FLUIDS INTO PARCEL A; AND 5) THE ESTABLISHMENT OF AN ANNUAL RENTAL APPLICABLE TO PARCEL A.

2. ACCEPT FROM GEYSERS POWER COMPANY, LLC, THE FULL QUITCLAIM DEED DATED JANUARY 17, 2008, WHEREIN THE LESSEE SURRENDERS TO THE STATE ALL ITS RIGHT, TITLE, AND INTEREST IN STATE GEOTHERMAL RESOURCES LEASE NO. PRC 6423.2, AND RELEASE GEYSERS POWER COMPANY, LLC, FROM ALL OBLIGATIONS UNDER STATE GEOTHERMAL RESOURCES LEASE NO. PRC 6423.2 EFFECTIVE MARCH 25, 2008.

3. AUTHORIZE THE EXECUTIVE OFFICER OR HIS DESIGNEE TO EXECUTE ANY DOCUMENTS NECESSARY TO IMPLEMENT THE COMMISSION'S ACTION.

NO SCALE

SITE

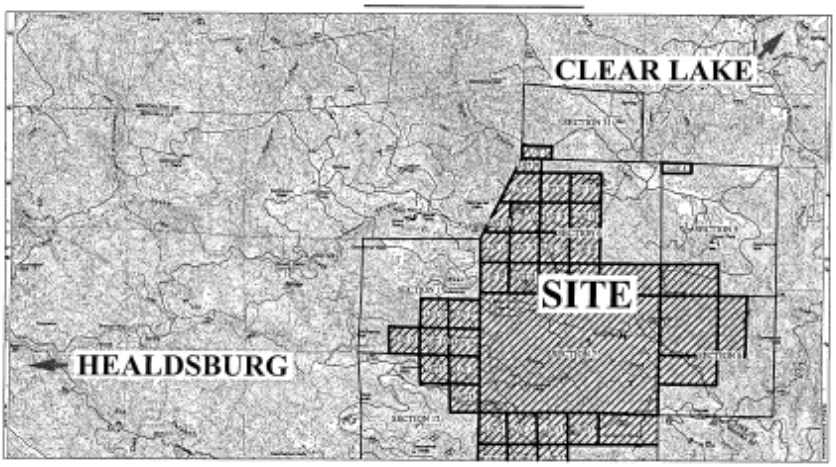


GEYSERS GEOTHERMAL FIELD, LAKE AND SONOMA COUNTIES
PORTIONS OF SECTIONS 5, 6, 7, 8, 18, T 11 N, R 8 W
PORTIONS OF SECTION 31, T 12 N, R 8 W
PORTIONS OF SECTIONS 1, 12, T 11 N, R 9 W

MAP SOURCE: USGS QUAD

NO SCALE

LOCATION



MAP SOURCE: USGS QUAD

This Exhibit is solely for purposes of generally defining the lease premises, is based on unverified information provided by the Lessee or other parties and is not intended to be, nor shall it be construed as, a waiver or limitation of any State interest in the subject or any other property.

Exhibit A

PRC 4596.2/6423.2
GEYSERS POWER CO. LLC.
GEOTHERMAL LEASE
SCHOOL LANDS
SONOMA AND LAKE COUNTIES

CJH 2/19/2008