

MINUTE ITEM

This Calendar Item No. C70 was approved as Minute Item No. 70 by the California State Lands Commission by a vote of 3 to 6 at its 12-3-99 meeting.

**CALENDAR ITEM
C70**

A 1

12/03/99

PRC 7845.2

S 2

J. Adams

**CONSIDER APPROVAL OF AN AMENDMENT MODIFYING
THE ROYALTY AND BONDING PROVISIONS OF
STATE GEOTHERMAL RESOURCES LEASE NO. PRC 7845.2,
THE GEYSERS GEOTHERMAL FIELD,
LAKE COUNTY**

LESSEE:

Silverado Geothermal Resources, Inc.
c/o Calpine Corporation
Attn.: Mr. Kevin Talkington
1421 Guerneville Road, Suite 108
Santa Rosa, CA 95403

AREA, LAND TYPE, AND LOCATION:

Approximately 440 acres of State fee-owned School Land in The Geysers Geothermal Field, Lake County.

BACKGROUND:

State Geothermal Resource Lease No. PRC 7845.2 was issued by the Commission effective July 1, 1995, to Santa Fe Geothermal, Inc. (Santa Fe), as a negotiated subsurface (no surface use) lease. The Lease requires that all drilling and production operations be conducted on adjacent federally owned or privately owned leased lands. In April 1997, Santa Fe was purchased by a partnership of ESI Energy, Inc. and Caithness Corp., and its name changed to Silverado Geothermal Resources, Inc. (Lessee). In October 1999, Lessee was purchased by Calpine Corporation (Calpine). Lessee, through its new parent, has requested Commission approval of an amendment modifying the royalty provision of the Lease.

The current royalty provision specifies a royalty of twelve and one-half percent (12.5%) of the value of the steam resources, less any overriding royalty cost associated with the surface location of wells on other lands and paid to third parties under arms-length lease agreements; provided however, the overriding

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royalty cost shall not exceed one percent (1%) of the value of the steam produced from such wells directionally drilled from other lands into the leased land. Commission staff recommends the royalty be fixed at twelve and one-half percent (12.5%) of the value of the steam resources. Lessee has agreed to the elimination of its right to deduct any overriding royalty costs from the State's royalty.

The current royalty provision also specifies the value of the steam resources be based upon a price formula contained in a steam sales contract between Calpine and Pacific Gas and Electric (PG&E). That contract, and its price formula, are now obsolete owing to the sale of all PG&E power plants to Calpine. In May 1999, the Commission approved the modification of the royalty provision of four other State Geothermal Resource Leases held by another related entity of Calpine in order to establish the value of the steam as a percentage of the value of the electricity generated from it. Lessee has proposed, and Commission staff recommends, that this valuation method be adopted for State Geothermal Resources Lease No. PRC 7845.2.

Accordingly, Commission staff proposes to modify the current royalty provision under State Geothermal Resources Lease No. PRC 7845.2 as follows: Lessee shall pay a royalty of twelve and one-half percent (12.5%) of the gross value of the geothermal steam produced from or attributable to the leased lands. The gross value of the steam for purposes of calculating royalty payments shall be, during the first year beginning December 1, 1999, thirty-six percent (36%) of the total gross value associated with the sale of the electrical power generated from the steam. This percentage would increase to thirty-eight percent (38%) in the second year, thirty-nine percent (39%) in the third year, forty percent (40%) in the fourth year, forty-one percent (41%) in the fifth year, and forty-two percent (42%) thereafter. The gross value associated with the sale of electrical power will include, without limitation, sales of electricity to the California Power Exchange, bilateral power sales contracts, payments from Reliability Must Run and/or Ancillary Services contracts with the California Independent System Operator, subsidies from the California Energy Commission's Existing Renewable Resources Account, and/or green power premiums.

The bonding provision of the Lease requires the Lessee provide a bond in the amount of \$50,000 to guarantee the faithful performance of the terms and conditions of the Lease. Lessee, through its new parent Calpine, has provided such a bond to replace the bond previously provided through their former parent.

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Commission staff believes greater flexibility and protection can be achieved by combining the bonding for the subject lease under a blanket bond with other State leases held by a related entity of Lessee. In April 1999, as part of the assignment of State Geothermal Resources Lease Nos. PRC 4596.2, PRC 4597.2, PRC 6422.2, and PRC 6423.2, Commission approved a blanket bond for the four leases in the amount of \$600,000. The blanket bond was further supported by a Corporate Guaranty from Calpine regarding covering performance of the terms and conditions of the leases.

Accordingly, Commission staff proposes to modify the current bonding provision under State Geothermal Resources Lease No. PRC 7845.2 as follows: As an alternative to posting an individual bond or other approved security, State may, in its sole discretion, permit Lessee to add the Lease to an existing bond or security covering other State Geothermal Resource Leases held by Lessee or a related entity. As a condition of its consent to aggregate this Lease with others under a blanket bond or security, State may require any related entity of Lessee execute a Corporate Guaranty, guaranteeing the faithful performance of all of Lessee's covenants and obligations under the Lease. If the Lease is added to an existing bond or other approved security, the amount of said bond or security shall be increased by \$50,000.

Lessee, together with Calpine, has agreed to the above bonding modifications. The \$50,000 bond already provided by Lessee will not be released until the new bonding arrangement is in place.

STATUTORY AND OTHER REFERENCES:

- A. Public Resources Code, Section 6913.
- B. State Geothermal Resources Lease PRC 7845.2, Paragraphs 4 and 29.

OTHER PERTINENT INFORMATION

- 1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (Title 14, California Code of Regulations, Section 15061), the Commission staff has determined that this activity is exempt from the requirements of the CEQA because the activity is not a "project" as defined by CEQA and the State CEQA Guidelines.

Authority: Public Resources Code, Section 21065, and Title 14 California Code Regulations, Section 15378.

EXHIBIT:

- A. Location Map

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PERMIT STREAMLINING ACT DEADLINE:

N/A

RECOMMENDED ACTION:

IT IS RECOMMENDED THAT THE COMMISSION:

CEQA FINDING:

FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15061 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:

APPROVE THE AMENDMENT OF STATE GEOTHERMAL RESOURCES LEASE NO. PRC 7845.2 AS FOLLOWS:

1. MODIFY THE ROYALTY PROVISION TO ELIMINATE THE RIGHT OF LESSEE TO DEDUCT ANY OVERRIDING ROYALTY COSTS FROM THE STATE'S ROYALTY.
2. MODIFY THE ROYALTY PROVISION TO PROVIDE THAT THE VALUE OF THE GEOTHERMAL STEAM PRODUCED FROM THE LEASE DURING THE FIRST YEAR BEGINNING DECEMBER 1, 1999, FOR PURPOSES OF CALCULATING ROYALTY PAYMENTS FOR THE LEASE, SHALL COMMENCE AT THIRTY-SIX PERCENT (36%) OF THE TOTAL GROSS VALUE ASSOCIATED WITH THE SALE OF THE ELECTRICAL POWER GENERATED FROM THE STEAM, INCREASING ANNUALLY TO FORTY-TWO PERCENT (42%).
3. MODIFY THE BONDING PROVISION TO PROVIDE THAT LESSEE ADD THE LEASE TO AN EXISTING BOND COVERING OTHER STATE GEOTHERMAL RESOURCES LEASES HELD BY LESSEE OR A RELATED ENTITY, AND EXECUTION OF A CORPORATE GUARANTY BY A RELATED ENTITY OF LESSEE, FOR PERFORMANCE UNDER THE LEASE.
4. AUTHORIZE THE EXECUTIVE OFFICER OR HIS DESIGNEE TO EXECUTE ALL DOCUMENTS TO AFFECT THIS AMENDMENT.

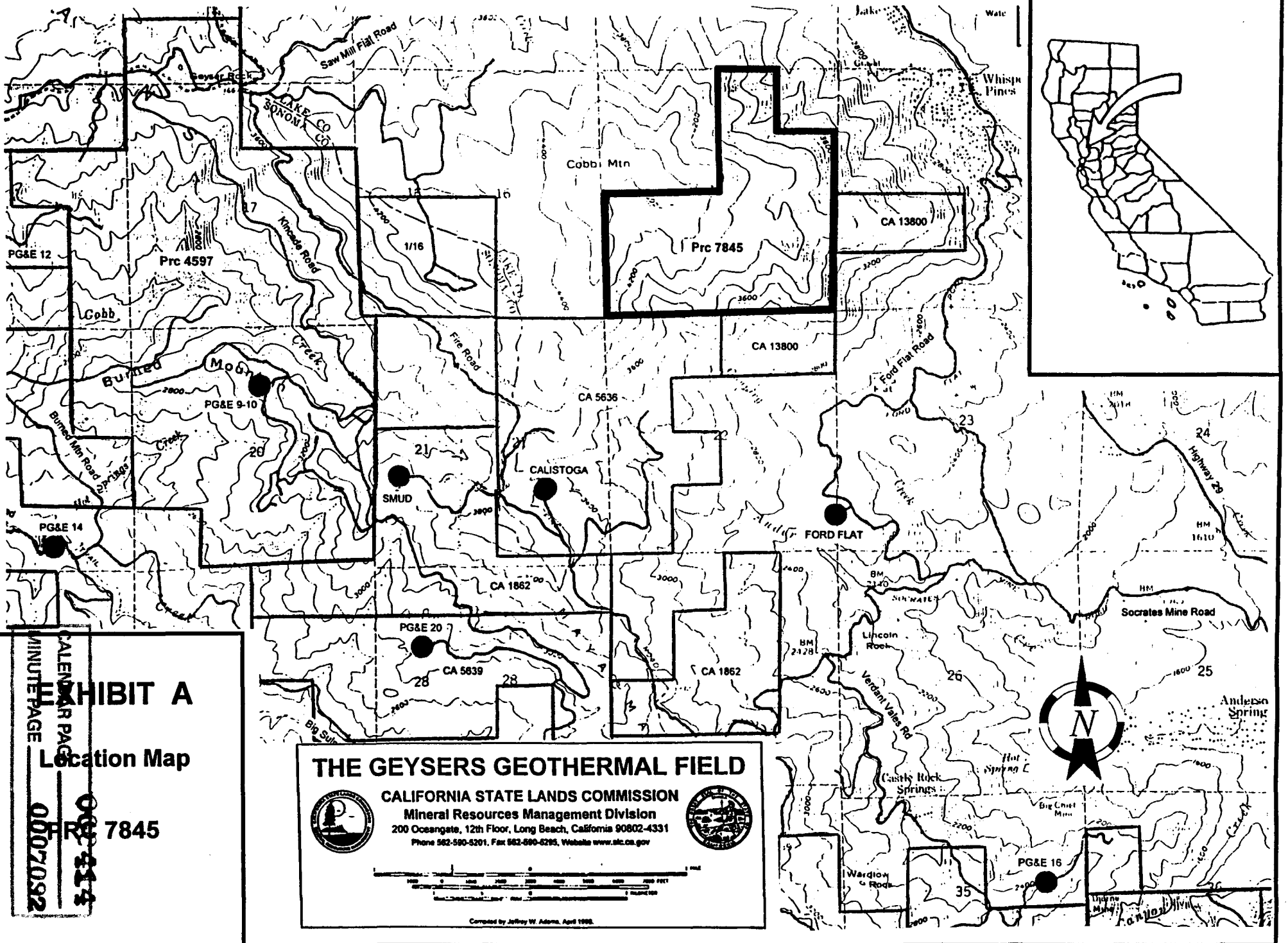


EXHIBIT A
Location Map
7845

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THE GEYSERS GEOTHERMAL FIELD

CALIFORNIA STATE LANDS COMMISSION
 Mineral Resources Management Division
 200 Oceangate, 12th Floor, Long Beach, California 90802-4331
 Phone 562-590-5201, Fax 562-590-5285, Website www.slc.ca.gov

Compiled by Jeffrey W. Adams, April 1998.

