

MINUTE ITEM

This Calendar Item No. C67 was approved as Minute Item No. 67 by the California State Lands Commission by a vote of 3 to 0 at its 09-13-07 meeting.

**CALENDAR ITEM
C67**

A 1

09/13/07

S 2

PRC 8556.2

D. Dudak

**CONSIDER APPROVAL OF AN AMENDMENT TO STATE
GEOTHERMAL RESOURCES LEASE NO. PRC 8556.2
TO EXTEND THE DRILLING TERM, INCREASE THE ANNUAL RENT
UNTIL PRODUCTION IS ESTABLISHED, AND PROVIDE FOR THE
TYPES OF WELLS THAT SATISFY THE DRILLING OBLIGATION,
THE GEYSERS GEOTHERMAL FIELD,
SONOMA AND MENDOCINO COUNTIES**

LESSEE:

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

AREA, LAND TYPE, AND LOCATION:

Approximately 1,881.43 acres of State 100 percent (100%) reserved mineral interest School Lands at The Geysers Geothermal Field, Sonoma and Mendocino Counties.

BACKGROUND:

State Geothermal Resources Lease No. PRC 8556.2 was issued to WHR, Inc., owner of the surface estate, and then assigned to Geysers Power Company, LLC (Lessee), both actions effective September 1, 2004.

The lease was amended effective May 1, 2005, to add an adjacent tract of reserved mineral interest land and to allow the Lessee to develop and use geothermal resources from that tract via existing drill sites on adjacent private lands controlled by the Lessee. The lease was amended effective September 1, 2006, to allow the Lessee to develop and use geothermal resources from the leased land in accordance with a plan covered by a Conditional Use Permit issued by Sonoma County.

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The leased lands are depicted on Exhibit A, attached hereto, and consist of several non-continuous tracts identified as Parcels 1, 2, 3, and 4. The lease will expire with respect to any of the four parcels not producing, or capable of producing, at the end of the seven-year primary term. This prevents the non-contiguous tracts from being held beyond the primary term by virtue of a single commercial well on only one tract. The reason for combining these tracts into one lease is that the tracts have a common surface owner, WHR, Inc. The Lessee has an agreement with WHR covering both the leased land and more than 2,000 additional acres of adjacent land that WHR owns in fee.

The Lessee, a wholly-owned subsidiary of Calpine Corporation, holds all seven of the State's geothermal leases at The Geysers. The seven leases cover a total of 6,862 acres. The Lessee also controls a private 360-acre parcel in which the State retained a 1/16th mineral interest. The Lessee uses geothermal steam produced from its State, Federal, and private leaseholds to generate approximately 1,000 megawatts of electricity. Although the subject lease is not yet producing, the other six State leases and the 1/16th parcel currently yield more than \$5.0 million per year in royalty revenue to the State. Public Resources Code section 6217.5 provides that net revenues derived from School Lands benefit the State Teachers' Retirement Fund.

STATUS OF LESSEE:

In December 2005, Calpine and over 200 subsidiaries, including the Lessee, filed for protection under Chapter 11 of the Bankruptcy Code. In May 2006, Calpine filed a motion authorizing the Lessee to assume all of its geothermal leases and related obligations. Although Calpine and its subsidiaries are still undergoing restructuring efforts, the Lessee has continued its operations without noticeable curtailment of steam production or electrical generation. The Lessee has continued to pay rentals and royalties due under the terms of all its State geothermal leases and remains in good standing with the State.

REQUEST FOR AMENDMENT:

The lease was granted for a primary term of seven years, subject to the requirement that the Lessee commence drilling operations within the first three years. The Lessee has requested this drilling term be extended two years because it cannot commence drilling by the September 1, 2007, deadline. The Lessee has also requested the lease be amended to clarify the types of wells that can satisfy the drilling obligation.

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JUSTIFICATION FOR EXTENSION OF DRILLING TERM:

The Lessee has been unable to commence drilling operations on the leased land during the first three years of the lease. During 2004 and 2005, its parent company Calpine was undergoing financial difficulties that affected all subsidiaries, including those that were otherwise performing well. Although the Lessee was one of Calpine's most profitable subsidiaries, it was not allowed to undertake capital expenditure projects such as development drilling during that period. The restriction became more acute following the bankruptcy filing in late 2005. Despite the recent lifting of this restriction, the Lessee has faced an additional impediment. The demand for drill rigs throughout the oil & gas and geothermal industries rose sharply during 2005 and 2006. Therefore, the Lessee has had difficulty securing rigs and scheduling the various drilling and development projects that it was forced to postpone, including the drilling obligation for this lease.

However, the Lessee has been active in seeking new agreements with major utilities like Pacific Gas and Electric Company and Southern California Edison to provide new electrical generation from The Geysers. Such agreements will allow the Lessee to undertake new development drilling, particularly in the area of this lease and adjacent private lands. If the Lessee is successful in securing new power contracts, it may propose one or more new 25-megawatt power plants at The Geysers that will require the drilling of many new wells. The Lessee also envisions new drilling to augment the steam supply at its existing power plants.

The Lessee has advised Commission staff that it now has capital funds available to resume drilling operations at The Geysers, and it now anticipates drilling on the leased lands within the next year. However, because its drilling schedule will not result in a well being initiated by the September 1, 2007, date specified in the lease, an extension of the drilling term has been requested. Therefore, Commission staff recommends a two-year extension be granted to the Lessee.

In exchange for the extension of the drilling term, the Lessee shall compensate the State by increasing the annual rent payment from \$10.00 per acre to \$25.00 per acre on Parcels 1, 2, and 3, until production is established on one or more of those parcels. Parcels 1, 2, and 3 total 1,657.43 acres. The rent will revert to \$10.00 per acre once production is established. The rent for the 224.00-acre Parcel 4 is already \$50.00 per acre until production is established. The higher rent for that parcel is a result of its addition to the lease in 2005. Parcel 4 had previously been under lease, but it expired without being developed. The drilling term for that prior lease had been extended three times, with the rent increased from \$10.00 to \$25.00 to \$50.00 per acre. The higher rent was later adopted

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when Parcel 4 was added to this lease.

STIPULATION OF WELL TYPES:

The leased lands were previously under lease decades ago, and some portions were previously developed. A total of seven wells were drilled on the leased lands between 1981 and 1994. Six of the wells were productive through 1996. Prior to quitclaiming its leases in 2000, the former leaseholder plugged the wells with cement and abandoned them in accordance with requirements of the California Division of Oil, Gas, and Geothermal Resources.

The current Lessee intends to re-drill and re-complete one or more of these abandoned wells by drilling out the cement plugs, deepening the wells if necessary, and equipping them to re-establish production. The Lessee may also use one or more of these wells to inject water into the leased lands to extend the productive life of the geothermal reservoir and mitigate the detrimental effects of the non-condensable gases and corrosive constituents sometimes found in steam at The Geysers.

The Lessee has requested the lease be modified to provide that re-drilling a plugged and abandoned well will satisfy the drilling obligation in the same manner as a newly drilled well. The Lessee has also requested the term "exploratory" be removed from the lease as there is no valid reason to label or characterize a well as such. The term "exploratory" was used in the lease when it was issued because the initial authorization included only three specific wells. Those wells were approved based on an environmental document that characterized them as "exploratory" merely because the surface locations were to be greater than one-half mile from the nearest active well. Subsequent authorization for drilling via the 2005 and 2006 amendments to the lease removed any need for characterizing a well as exploratory or otherwise.

Commission staff concurs with these proposed changes. However, under no circumstances shall wells drilled or re-drilled for the purpose of injection satisfy the drilling requirement under the lease.

AMENDMENT TERMS:

The proposed amendment to State Geothermal Resources Lease No. PRC 8556.2 will incorporate the following modifications:

1. The drilling term will be increased from three (3) years to five (5) years, meaning drilling must commence by September 1, 2009.

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2. The annual rent for Parcels 1, 2, and 3 will be increased from \$10.00 per acre to \$25.00 per acre. The rent will revert to \$10.00 per acre the year after production is established on Parcels 1, 2, or 3.
3. The drilling requirement will be amended to provide that it may be satisfied by re-drilling previously plugged and abandoned wells, but the drilling or re-drilling wells for injection shall not satisfy the requirement. Further, the words "exploratory" and "exploration" will be deleted wherever they occur in the lease.

All other material terms and conditions of the lease will be unchanged.

STATUTORY AND OTHER REFERENCES:

- A. Public Resources Code: Division 6, Parts 1 and 2; and Division 13.
- B. California Code of Regulations: Title 2, Division 3; and 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 exempt from the requirements of the CEQA because the activity 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.

EXHIBIT:

- A. Location Map

PERMIT STREAMLINING ACT DEADLINE:

N/A (not a "development project" subject to the Act).

RECOMMENDED ACTION:

IT IS RECOMMENDED THAT THE COMMISSION:

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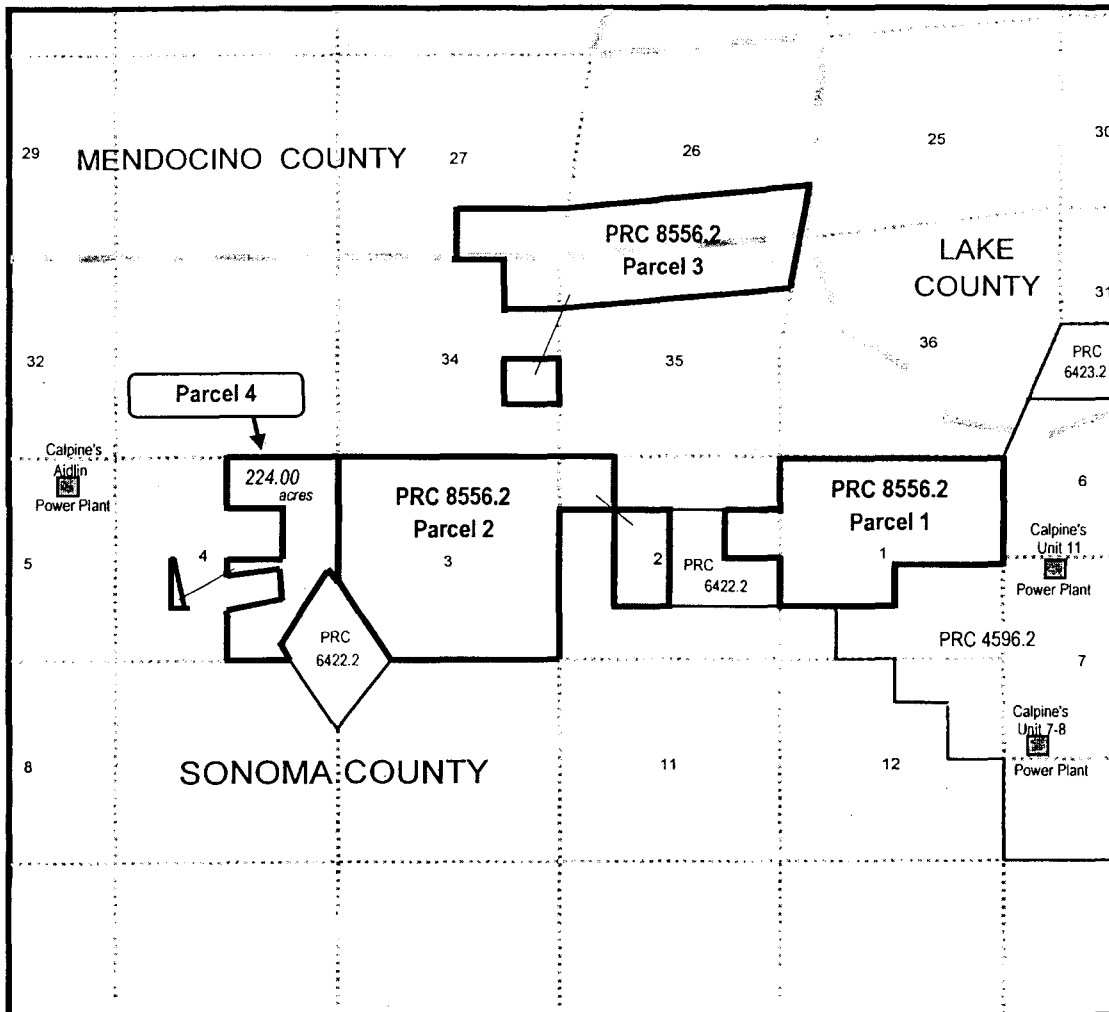
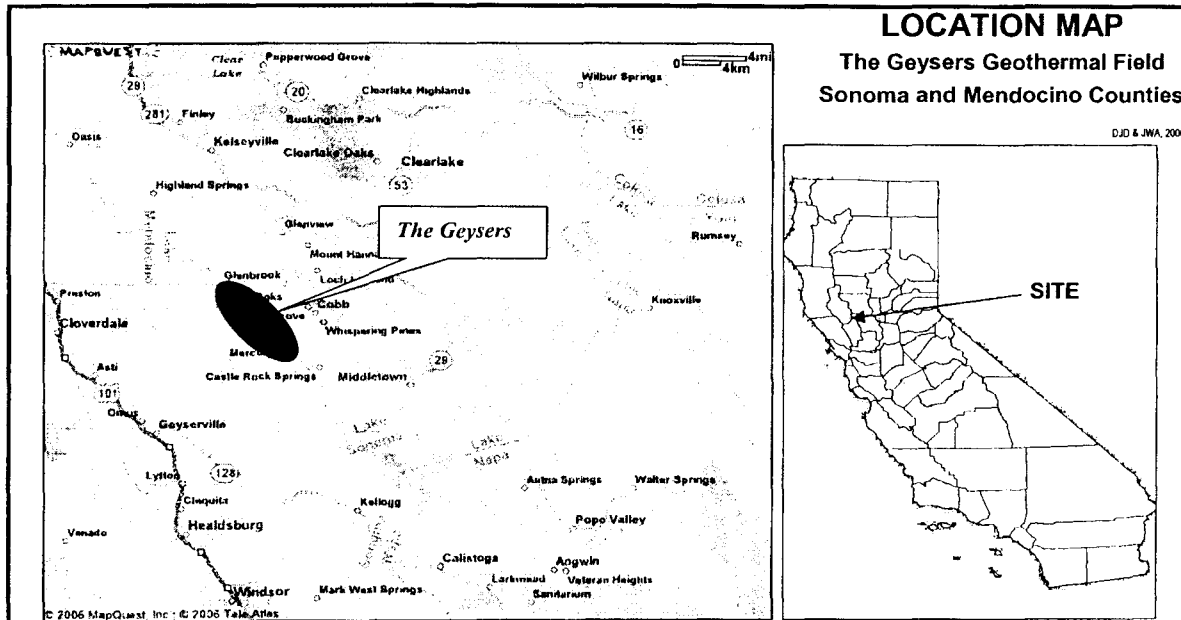
CEQA FINDING:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM 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 8556.2 UPON THE TERMS AND CONDITIONS OUTLINED IN THIS CALENDAR ITEM AND IN THE FORM ON FILE IN THE LONG BEACH OFFICE OF THE COMMISSION, THE AMENDMENT TO PROVIDE FOR A TWO-YEAR EXTENSION OF THE DRILLING TERM, AN INCREASE IN THE ANNUAL RENT FROM \$10.00 TO \$25.00 PER ACRE ON PARCELS 1, 2, AND 3 UNTIL PRODUCTION IS ESTABLISHED, AND STIPULATION AS TO THE TYPES OF WELLS THAT SATISFY THE DRILLING REQUIREMENTS UNDER THE LEASE.
2. AUTHORIZE THE EXECUTIVE OFFICER OR HIS DESIGNEE TO EXECUTE ANY DOCUMENTS NECESSARY TO IMPLEMENT THE COMMISSION'S ACTION.

EXHIBIT A



This Exhibit is solely for purposes of generally defining the parcel premises 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.