

**CALENDAR ITEM
C64**

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04/06/11
PRC 7621.0
R 13309
J. Adams

**CONSIDER APPROVAL TO: (1) AMEND AND RESTATE
STATE GEOTHERMAL RESOURCES LEASE NO. PRC 7621.0
INCLUDING REMOVAL OF A PORTION OF THE LEASED LAND;
AND (2) ISSUE A NEW, SEPARATE STATE GEOTHERMAL
RESOURCES LEASE FOR THE REMOVED LAND,
SALTON SEA GEOTHERMAL FIELD,
IMPERIAL COUNTY**

LESSEE:

Magma Power Company
Attn.: Mr. Mark Gran
551 W. Main St., Suite 1
Brawley, CA 92227

LAND OWNER:

California Department of Fish and Game
Attn.: Mr. Chris Hayes
3602 Inland Empire Blvd., Suite C-220
Ontario, CA 91764

AREA, LAND TYPE, AND LOCATION:

Approximately 615 acres of State proprietary land under the jurisdiction of the California Department of Fish and Game, and situated within the Hazard Unit of the Imperial Wildlife Management Area near the southeast shore of the Salton Sea, as depicted in Exhibit A and described in Exhibit B (attached hereto).

BACKGROUND:

State Geothermal Resources Lease No. PRC 7621.0 (Lease) was issued by the California State Lands Commission (Commission) in 1992 to Magma Power Company (Lessee), a wholly-owned subsidiary of CalEnergy Operating Corporation, part of MidAmerican Energy Holdings Company. CalEnergy owns and operates ten power plants that use geothermal resources to generate 340 megawatts (MW) of electricity at the Salton Sea Geothermal Field. Its operations

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involve about 20 production and 30 injection wells. The Salton Sea field is the largest geothermal development in the Imperial Valley, and the second largest in California after The Geysers.

The Lease was issued pursuant to provisions of Public Resources Code sections 6919 and 6924. Section 6919 allows the Commission to issue geothermal leases through negotiation rather than competitive bidding when certain conditions exist. Section 6924 allows the Commission to issue geothermal permits or leases on State-owned lands where the surface is under the jurisdiction of another department or agency, but only with the consent of and subject to reasonable terms and conditions prescribed by that other department or agency.

The original 1992 Lease included 80 acres of surface land owned by the California Department of Fish and Game (CDFG). The State's interest equates to 40 "net mineral" acres as the State owns a fifty percent (50%) reserved mineral interest. The Lease prohibited all surface use, and wells would have to be drilled into the leased land from adjacent land controlled by the Lessee. However, the Lease was issued without a specific obligation to drill. Instead, the Lessee agreed to add the leased land to the pre-existing Elmore "geothermal unit." As used by the Lessee, the term geothermal unit means a collection of leases whose production is dedicated to a particular electrical-generating facility. The Elmore unit involves 880 acres owned or leased to the Lessee. The State's mineral interest in the leased land comprises 40 acres of that total, or a 4.545 percent (4.545%) unit participation. The Elmore power plant generates about 40 MW of electricity that is sold by contract to Southern California Edison. The State began receiving monthly royalty payments immediately after the Lease was issued in 1992. Through 2010, the State has collected more than \$934,000 in royalty revenue from the Lease. Public Resources Code section 6924 provides that fifty percent (50%) of the annual revenue is available for appropriation by the Legislature for programs administered by the CDFG.

In 2001, the Commission approved an amendment and restatement (First Restatement) of the Lease, which added 535 acres of surface land also owned by the CDFG. The added property is referred to as the "Hazard Tract," while the original 80-acre parcel is referred to as the "Campbell Property." Due to prior conveyances and varying reserved mineral interests, the State's interest in the Hazard Tract equates to 443 net mineral acres. The combined 615 gross acres of the Hazard Tract and Campbell Property are part of the "Hazard Unit" of the Imperial Wildlife Management Area, the surface of which is administered by the U.S. Fish and Wildlife Service (FWS) and serves as a refuge and breeding area for migratory birds and other wildlife. The term "unit" as used by the FWS means

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a specific part of its wildlife management area, and should not be confused with the term "unit" as used by the Lessee to designate a collection of geothermal leases supplying a power plant, such as the Elmore Unit.

The 2001 First Restatement specified a ten-year primary term with respect to the Hazard Tract, through April 30, 2011. The Campbell Property continues to be held by production by virtue of its inclusion in the still active Elmore Unit. The First Restatement required Lessee to begin constructing, by 2006, the foundation for a new generating facility that would use resources from the Hazard Tract, or else the Lease would be subject to termination with respect to those mineral interests. When the construction obligation was not met, the Commission approved, in 2008, an amendment waiving and relinquishing the right to terminate. In exchange, the Lessee agreed to pay a greatly increased annual rental until the Hazard Tract could be developed or included in a geothermal unit.

REQUEST TO REMOVE LAND TO CREATE NEW, SEPARATE LEASE:

In 2009, the Lessee advised Commission staff that the Hazard Tract could not be developed by the end of the primary term due to economic difficulties and permitting delays. In 2010, the Lessee formally requested the Hazard Tract be removed from the Lease and put into a new, separate lease, with a new primary term. The Lessee submitted an application and began negotiations with Commission staff on specific lease terms. Those negotiations were recently completed to the satisfaction of both the Lessee and Commission staff.

KEY TERMS OF AMENDED AND RESTATED LEASE PRC 7621.0 (CAMPBELL):

1. **Leased Land** – 80 acres (equivalent to 40 net mineral acres).
2. **Effective Date** – May 1, 2011
3. **Term** – held by production, for so long as geothermal resources are being produced from leased land or from a unit in which leased land participates.
4. **Royalty** – ten percent (10%) of value of geothermal resources, where geothermal resources represent twenty-five percent (25%) of value of electrical power generated from them, and two percent (2%) of value of mineral products (for example, zinc, lithium, etc.) in first marketable form.
5. **Annual Rent** - \$2 per net mineral acre.
6. **Renegotiation of Royalty** – no later than tenth anniversary, and at ten-year intervals thereafter.

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7. **Drilling and Development Requirement** – none required, as land is already participating in a unit.
8. **Unitization** – land already dedicated to a producing unit. If leased land is removed from the unit, or the unit is terminated, Lessee has three years to commit the leased land to a replacement unit, during which time the annual rent increases to \$200 per net mineral acre, or the State may terminate the lease.
9. **Reimbursement for Inspection** – maximum of \$5,000 per year for periodic inspection of leased land by Commission staff, subject to adjustment based on change in Consumer Price Index.
10. **Bond** - \$50,000 in favor of State, subject to review every five years.
11. **Insurance** – liability policy naming both State and CDFG as additional insured, with coverage of at least \$2,000,000 per occurrence and a general aggregate limit of at least \$5,000,000.

KEY TERMS OF NEW LEASE (HAZARD TRACT):

1. **Leased Land** – 535 acres (equivalent to 443 net mineral acres).
2. **Effective Date** – May 1, 2011
3. **Term** – ten-year primary term, and for so long thereafter as geothermal resources are being produced from leased land or from unit in which the leased land participates.
4. **Royalty** – (same as lease above).
5. **Annual Rent** - \$150 per net mineral acre in the first year, increasing by \$25 per net mineral acre each year thereafter, provided that once the State begins receiving production royalty, annual rent becomes \$2 per net mineral acre, and also provided that all payments beyond \$200 per net mineral acre will be treated as an “advance royalty” which Lessee can credit against production royalty through the fifteenth year of the term.
6. **Renegotiation of Royalty** – no later than fifteen years after initial commercial operation of generating facility that uses resources from the leased land or a unit in which the leased land participates, and at ten-year intervals thereafter.

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7. **Drilling and Development Requirement** – none required, though lease will expire if leased land is not producing or dedicated to a producing unit at end of primary term.
8. **Unitization** – Lessee will have flexibility to commit all or any part of leased land to one or more geothermal units without having to obtain subsequent consent from the State. If after the end of the primary term, leased land is removed from a unit, or the unit is terminated, Lessee has three years to commit the leased land to a replacement unit, during which time the annual rent increases to \$200 per net mineral acre, or State may terminate lease.
9. **Reimbursement for Inspection** – (same as lease above).
10. **Bond** - \$100,000 in favor of State, subject to review every five years.
11. **Insurance** – (same as lease above).

JUSTIFICATION FOR NEGOTIATED LEASES:

Public Resources Code section 6919 provides that geothermal leases may be issued through negotiation, rather than through competitive bid, when certain criteria are met. Both the Campbell Property and the Hazard Tract are considered unsuitable for competitive bidding for the following reasons:

- (1) The CDFG presently uses the surface of the lands for wildlife protection and management and favors development of the geothermal resources from surface facilities located outside boundaries of its Imperial Wildlife Management Area;
- (2) The State owns a fractional interest in certain of the lands to be covered by the two leases, specifically a 50 percent (50%) interest in 160 acres, and a 35 percent (35%) interest in 80 acres;
- (3) Lessee and its affiliates own or have under lease the remaining mineral interests in the fractional-interest lands, and control available offsite surface locations from which exploration and development of the State lands may be conducted; and
- (4) Consolidated management and operation, through the formation of one or more geothermal units that will include the leased lands, promotes the orderly development and conservation of the resources.

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Negotiated leases are therefore considered to be in the best interests of the State.

CONSENT OF DEPARTMENT OF FISH AND GAME:

Public Resources Code section 6924 provides that where the surface of State-owned lands is under the jurisdiction of another State agency, leases may be issued by the Commission only with the consent of and subject to reasonable terms and conditions as may be prescribed by that other agency. When a lease was first proposed in 1992, Commission staff met with and discussed all relevant issues with CDFG staff to ensure that the Lease provided adequate protection to the wildlife management activities associated with the Hazard Unit of the Imperial Wildlife Management Area. The CDFG provided its consent to the Lease by formal letter prior to consideration by the Commission. Similarly, Commission staff obtained letters of consent from the CDFG for the First Restatement in 2001 and the subsequent amendment in 2008.

Commission staff has discussed the terms of this Second Restatement of the Lease, and the new lease that will include the land removed from the Lease, with CDFG staff and has obtained a letter of consent, which is on file in the Long Beach office of the California State Lands Commission.

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. The Salton Sea Anomaly (SSA) Master Environmental Impact Report (MEIR, SCH #80102409) was prepared by Imperial County as lead agency and certified in December 1981. The area designated within the MEIR encompasses 111,000 acres within the Geothermal Overlay Zone of Imperial County's General Plan. The lands covered by Lease PRC 7621.0, including Hazard Tract, are included in that acreage. California State Lands Commission staff has reviewed such document certified by the lead agency.
2. The project description within the MEIR projected the development of 1,400 MW of generating capacity within the SSA, and the MEIR included mitigation measures for each potentially significant environmental impact identified for such capacity. Generating capacity from geothermal production within the SSA is currently about 340 MW, well below the environmental thresholds discussed in the MEIR. Such would remain the case with the addition of the potential 195 MW of new generating capacity

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that could be developed by Lessee. Other development activities, including directional drilling onto the proposed lease, would require the issuance of Conditional Use Permit(s) from Imperial County. Such consideration will require the preparation of additional environmental documentation under the provisions of CEQA. The functional equivalent to a CEQA analysis is a requirement of the California Energy Commission's licensing of any thermal power generating facility of 50 MW or larger. The State Lands Commission and the California Department of Fish and Game would have the opportunity to participate in such environmental processes and in subsequent permit considerations by Imperial County and the California Energy Commission.

3. Imperial County, by letter dated January 22, 2010, stated that the MEIR "will continue to be the baseline document for review of future geothermal plants in that area due to its extensive environmental analysis of 1,400 MW with only about 340 MW having been developed to date."
4. Findings made by Imperial County in conformance with the State CEQA Guidelines (Title 14, California Code of Regulations, sections 15091 and 15096) are contained on file in the Sacramento office of the California State Lands Commission.
5. A Statement of Overriding Considerations was adopted by Imperial County in conformance with the State CEQA Guidelines (Title 14, California Code of Regulations, section 15093) and is contained on file in the Sacramento office of the California State Lands Commission.
6. 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 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

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RECOMMENDED ACTION:

It is recommended that the Commission:

CEQA FINDINGS:

1. Find that the Salton Sea Anomaly Master Environmental Impact Report (MEIR) was prepared for this Project by Imperial County (SCH #80102409) and certified in December 1981, and that the Commission has reviewed and considered the information contained therein.
2. Adopt the findings made by Imperial County in conformance with Title 14, California Code of Regulations, sections 15091 and 15096 (h), as contained on file in the Sacramento office of the California State Lands Commission.
3. Adopt the Statement of Overriding Considerations made by Imperial County in conformance with Title 14, California Code of Regulations, section 15093, as contained on file in the Sacramento office of the California State Lands Commission.

OTHER FINDING:

1. Find that negotiated leases pursuant to Public Resources Code section 6919 are warranted and are in the best interests of the State for the reasons discussed above.

AUTHORIZATION:

1. Authorize the amendment and restatement of State Geothermal Resources Lease No. PRC 7621.0 upon the terms and conditions outlined in this calendar item and insubstantially the form on file in the Long Beach office of the California State Lands Commission, including removal of a portion of the leased land.
2. Authorize the issuance of a new, separate State Geothermal Resources Lease for the removed land upon the terms and conditions outlined in this calendar item and insubstantially the form on file in the Long Beach office of the California State Lands Commission.
3. Authorize the Executive Officer or his designee to execute any documents necessary to implement the Commission's actions.