

**GEA--MMS MEETING
DECEMBER 7, 1999
LAKEWOOD, COLORADO**

MINUTES

The purpose of this meeting was for members of the Geothermal Energy Association (GEA) to give further comment on Minerals Management Service's Advance Notice of Proposed Rulemaking regarding geothermal royalty valuation regulations (Advance Notice; 64 FR 45213, August 19, 1999). Attending the meeting were:

Karl Gawell, GEA
Bob McCutchen, Coso Operating/
Caithness
Frank Misseldine, Oxbow
Stu Johnson, Oxbow
Steve Ponder, FPL Energy
Guy Martin, Perkins Coie
Joe Ronan, Calpine

Charles Brook, MMS
Debbie Gibbs Tschudy, MMS
Vincent Donnelly, MMS
Rich Estabrook, BLM
Sean Hagerty, BLM
Miyoshi Stith, BLM

Karl Gawell and Guy Martin opened industry's comments by questioning the underlying issues driving MMS to consider changing the current valuation rules, particularly the netback procedure. A common thread in their comments was that MMS has not offered any substantive rationale to develop new valuation rules; the only reason appears to be to increase royalty revenue. If increasing royalties is MMS's sole reason to change the rules, then it is unfair to industry.

They remarked that MMS's actions appear to be a political response to the concerns raised by Lake County, California, about that county's declining royalty share, but they perceived the causal issues could be more complex. MMS later responded that the Advance Notice was an opportunity to explore the possibility of developing valuation procedures that were simpler to use than the netback.

GEA recognized that Lake County was an important issue but it was an isolated situation, essentially involving only one company (NCPA, which does not belong to GEA). They indicated that industry did not wish to become involved in an adversarial rulemaking and therefore wanted to support changes that would be responsive to concerns of other constituents. These changes might include making the rules more flexible to accommodate particular situations where the netback doesn't work as it should or instituting nonregulatory changes that would accomplish the same goal. However, they indicated that industry would fight any changes that would substantially effect their current royalty obligation.

With regard to declining royalties under netback valuation, industry noted that much of the decline is caused by the expiration of incentive electricity prices under SO4 contracts and the shift to market-based prices in California's deregulated power market, not the operation of the

netback procedure as implied in the Advance Notice. The netback appears less satisfactory now only because of low energy prices.

Various company representatives with geothermal projects outside The Geysers then commented on their particular operations. They noted that they were employers and tax payers in their respective counties of operation. They also characterized their projects as marginal. With respect to FPL Energy's binary Ormesa project, Steve Ponder thought that the rate-of-return method would yield a value much greater than that for The Geysers because of the Ormesa field's pumping costs. Bob McCutchen remarked that while DOE wants to increase domestic geothermal activity, the instability of a rulemaking makes financing of future project uncertain. Frank Misseldine noted that royalty (Federal and fee) comprises 17 percent of Oxbow's operating costs and any change to increase royalties would be detrimental to their operations.

Guy Martin summed up that while geothermal companies might not like the netback, they were accustomed to working with it and had grown to accept it. Other valuation methods could certainly be used where netback doesn't work. However, it is unfair to increase royalties to companies when electricity prices are down.

In response to a question on how MMS intends to proceed, Debbie Gibbs Tschudy reviewed MMS's three pronged approach to the declining royalty issue: (1) conduct audits to assure proper royalty payments under the current rules, (2) initiate the rulemaking process, and (3) negotiate with Federal geothermal producers in Lake County to use a valuation method different from netback. She indicated that MMS had tentatively reached verbal agreement with Calpine and was still working with NCPA. In response to a question about how these agreements might effect the rulemaking, she indicated that they might be a factor in determining the need to proceed with a rulemaking, but that this decision would be made at the Washington level.

Charles Brook and Vince Donnelly reviewed the audit schedule for NCPA, Calpine, and FPL Energy. A question arose regarding whether the rulemaking would be based on the audit findings. Charlie clarified that the audits are solely to ensure compliance with current rules.

Guy Martin then returned the question of a need for a rule change, asking what is wrong with the netback: Is it inefficient? (The audits may answer this question.) Does it not give local governments enough revenue? (This is not a rational reason for change.) Does it not yield a fair return on the public's resources? (This question needs further analysis, as MMS has not demonstrated that the public is not getting a fair return.) Guy summed up that if it's not broke, don't fix it and reiterated that if the sole reason to change the rules is to increase royalty, then industry would fight the rulemaking.

Rich Estabrook asked whether the historic steam sales at The Geysers contracts reflected a fair value. Joe Ronan responded that they did not in today's market because the steam prices were greater than the electricity prices (i.e., costs more to purchase steam than companies could sell electricity for). He indicated that there is no universal steam sales agreement or price for the geothermal industry.

In view of the changing economics of the geothermal industry, Guy Martin remarked that we need a clear public policy to support and encourage domestic geothermal development; initiating a rulemaking at this time is not conducive to encouraging future projects.

Charles Brook asked whether industry would accept simpler rules that might increase royalties but reduce industry's cost of compliance. Industry thought that because of their diverse interests, they could not positively respond at this time.

The meeting ended on that note.