

Chapter 1

About This Handbook

1.1 Introduction

The Office of Natural Resources Revenue (ONRR), within the Department of the Interior, is responsible for ensuring the proper collection, accounting for, and disbursement of all revenues from Federal geothermal leases to the appropriate recipients. The Bureau of Land Management (BLM) administers 245 million acres or one-tenth of America's land base and 700 million acres of subsurface mineral estate. Other Federal agencies such as the Forest Service and Fish and Wildlife Service also manage some surface lands, while the BLM manages the Federal onshore subsurface. BLM sets the lease terms such as royalties and rentals while ONRR collects these payments and disburses them to the U.S. Treasury, states, and counties.

Geothermal revenues that ONRR collects include the following:

- Rents - some Class 3 leases require rentals regardless of producing status.
- Production royalties - for producing leases.
- Credits for in kind electricity delivery to states and/or counties - may be taken against production royalties.
- Direct use fee schedule.
- Advanced royalties - for cessation of production.
- Compensatory royalties for geothermal resources that are avoidably lost, wasted, or drained (as determined by BLM).

This handbook describes the regulatory methods of valuing Federal geothermal resources to determine production royalties for Class 2 and 3 leases. These same methods determine compensatory royalties as well. Royalty is due on the value of geothermal resources (including certain byproducts) produced, processed, removed, sold, or utilized from the lease, or reasonably susceptible to sale or utilization by the lessee or designated operator.¹

1.2 Introduction to New Geothermal Rules and Handbook

On May 2, 2007, ONRR issued new regulations (Title 30, Code of Federal Regulations (CFR) Parts 1202, 1206, 1210, 1217 and 1218) to implement the geothermal provisions of the Energy Policy Act of 2005 (EPAAct) governing the payment of royalty on geothermal resources produced from Federal leases and the payment of direct-use fees in lieu of royalties. The EPAAct provisions amend the Geothermal Steam Act of 1970 (GSA). Those regulations became effective on June 1, 2007.

¹ This handbook does not apply to valuation of Indian geothermal resources unless the Indian geothermal lease otherwise provides for it.

This handbook supplements the geothermal regulations in 30 CFR Parts 1202, 1206, 1210, 1217, and 1218 (2007 forward). If there are inconsistencies between the regulations and this handbook, the regulations always take precedence. The 2007 regulations have the following new geothermal provisions from EAct 2005 which:

1. Identify when credits against royalties are and are not allowable;
2. Explain how and when to pay advanced royalties;
3. Provide royalty reduction for existing leases that qualify for near term production incentives;
4. Provide new Product Codes for reporting with the direct use fee schedule;
5. Provide new Transaction Codes for in-kind deliveries of electricity to states or counties
6. Identify allowable deductions from royalty payments and how to calculate them;
7. Amend, streamline and re-write the existing sections of the regulations, promulgated in 1991, in plain English;
8. Explain the new percent of gross proceeds royalty calculation method for electrical generation lessees and the new direct use fee schedule for direct use lessees.
9. Gave current lessees the option of staying on the current royalty calculation method (usually netback) or converting to the new percentage of gross proceeds method within 18 months of the effective date of the new regulations. (June 1, 2007)

This handbook does not replace the regulations. You are responsible for the proper valuation, for royalty purposes, of Federal geothermal production. Accordingly, you should have a working knowledge of all governing regulations.

Concurrent with the publication of the ONRR Geothermal Valuation Rule in 2007, the BLM also published a final rule revising the BLM's existing geothermal resource leasing, operations, and unit agreement regulations to implement provisions of the Energy Policy Act.

The BLM 2007 geothermal rule is found at: 43 CFR Parts 3000, 3200, and 3280. ONRR collects royalties on three types of leases. ONRR defined these names to describe BLM leases from the BLM 2007 geothermal regulations, however, BLM does not use these terms for the different leases in their geothermal regulations, only ONRR does. ONRR wanted to make clear that there were differences in lease terms between pre and post-EAct leases as follows:

Class 1 Leases

Class 1 lease means: (1) A lease that BLM issued before August 8, 2005, for which the lessee has not converted the royalty rate terms under 43 CFR 3212.25; or (2) A lease that BLM issued in response to an application that was pending on August 8, 2005, for which the lessee has not made an election under 43 CFR 3200.8(b).

Contains all the royalty provisions for existing leases: minimum royalty, rentals, byproduct royalty rates. The only new provisions that apply are the production

incentives for new or qualified expansion production and credits for in kind delivery of electricity

Class 2 Leases

Class 2 lease means: A lease that BLM issued after August 8, 2005, but also includes leases issued in response to an application that was pending on August 8, 2005, and for which the lessee does not make an election under 43 CFR 3200.8(b).

Contains all new royalty rates, direct use fees, new rental rates, rental credits to royalties, new byproduct royalty rates, credit for in-kind delivery of electricity, and advanced royalties

Class 3 Leases

Class 3 leases are broken into **Parts A and B**. These parts are based on definitions found in ONRR regulations at 30 CFR 1206.351 and two options provided for in the BLM regulations at 43 CFR 3212.25, 3200.7, and 3200.8(b).

The ONRR regulations at 30 CFR 1206.351 define a *Class 3 lease* as: A lease that BLM issued before August 8, 2005 for which the lessee has converted to the royalty rate or direct use fee terms under 43 CFR 3212.25.

Under Class 3 as defined by ONRR, BLM allows for lessees to convert lease terms using either of two options.

Part A provides for the first option: Class 1 leases may be converted to modify lease terms to accept only the royalty rate or direct use fee terms provided for by EPO Act under 43 CFR 3212.25.

Class 1 leases that only convert to the new royalty terms, i.e., royalty on electricity (% of gross proceeds, the royalty rate on electricity, which is determined on a case by case basis for existing producing leases. If not producing, then they will have the 1.75% royalty rate, direct use fees. Does NOT affect byproduct royalty rates, i.e., the old rates apply like in Class 1 leases.

Part B provides for the second option: Class 1 leases may be converted to modify lease terms by electing to accept all terms provided for at 43 CFR 3200.7 and 3200.8.

In effect, these are identical to Class 2 leases except for the royalty rate on electricity, which is determined on a case by case basis for existing producing leases. If not producing, then they will have the 1.75% royalty rate. See BLM regulations at 43 CFR 3212.25 and 3200.7(a)(2).

This handbook covers Class 2 and 3 leases. Class 1 leases are covered in the Geothermal Payor Handbook for Class 1 leases.

NOTE

Report geothermal royalties to ONRR using the monthly Report of Sales and Royalty Remittance (Form ONRR-2014). Once a geothermal lease begins commercial production, you must submit a Form ONRR-2014 for each month that your lease produces. Do not submit a Form ONRR-2014 for those months that your lease does not produce. You must, however, submit production and facility reports to BLM, which will verify your production volumes and forward them to ONRR.

For detailed geothermal royalty and other lease obligation payments reporting instructions and examples, see ONRR's *Mineral Revenue Reporter Handbook, Chapter 7-Geothermal*.

1.3 Using the Geothermal Payor Handbook, Class 2 and 3 Leases

We divided this handbook into the following chapters:

- **Chapter 2: Valuation Overview**
This chapter identifies geothermal resources that are subject to royalty and addresses minimum royalty requirements. It describes measurement standards for royalty reporting, reviews general valuation principles, defines terms crucial to valuation, and discusses housekeeping subjects that we could not easily accommodate in other chapters.
- **Chapter 3: Valuation Standards for Electrical Generation**
This chapter describes the requirements for valuing geothermal resources used to generate electricity.
- **Chapter 4: Valuation Standards for Direct Use**
This chapter describes the requirements for valuing geothermal resources used in direct-use processes.
- **Chapter 5: Byproduct Valuation**
This chapter describes the requirements for valuing byproducts and for determining byproduct transportation allowances.
- **Appendix A: Definition of Terms**
- **Appendix B: Important Addresses**
This section contains important ONRR addresses.

The first two chapters cover general concepts and are designed to be used in conjunction with the other chapters of the handbook. For example, if you are using gross proceeds less applicable deductions to value your production, you need to be familiar with the information in Chapters 1, 2, 3, and 4. If you are valuing direct use, you need to be familiar with Chapters 1, 2, and 5. If you are valuing byproducts, you need to be familiar with Chapters 1, 2, and 5.

We cite pertinent regulations and authorizing statutes throughout the text for legal

cross-reference. For example, “30 CFR 1206.352 (b)(1)(i)” refers to the regulation in Title 30 of the Code of Federal Regulations, Part 1206, section 352, paragraph (b)(1)(i) that governs the valuation of electrical generation resources sold under arm’s-length contracts; likewise “30 U.S.C. 1001 et seq.” refers to the codification of the Geothermal Steam Act in Title 30 of the United States Code, section 1001 and following.

1.4 Nomenclature and Terminology

We use the following conventions throughout this handbook:

- **You:** The geothermal lessee, operator, royalty payor, or affiliate. Although a royalty payor may not be the lessee for a particular lease, a royalty payor has the same reporting and valuation obligations as the lessee (see the definition of lessee at 30 CFR 1206.351). The lessee is ultimately responsible for ensuring the proper reporting and paying of royalties.
- **We:** The Office of Natural Resources Revenue.

We use several specialized terms throughout this handbook; for example, *Arm’s-length Contract*, *Gross Proceeds*, *Byproduct*, and *Direct use*. In the new regulations, terms have been changed to reflect current valuation methods. For example, “net back” and “gross proceeds less deductions” are interchangeable in Chapter 4. You must be familiar with the definitions of all these types of terms in order to fully understand and properly use the valuation principles presented here. Definitions can be found in Appendix A or 30 CFR 1206.351.

1.5 Supplementary Payor Handbooks

The *Geothermal Payor Handbook—Product Valuation Class 1* and *The Geothermal Payor Handbook Class 2 and 3* are part of a series of ONRR handbooks containing information on Federal and Indian mineral valuation and royalty reporting requirements. Follow the instructions in the *Minerals Revenue Reporter Handbook*, Chapter 7, in order to establish your account with ONRR. Chapter 7 also contains detailed instructions for completing Form ONRR-2014 to report your geothermal royalties. As previously mentioned, you must submit a Form ONRR-2014, together with your royalty payment, each month, by the end of the month following production that you have commercial geothermal production.

1.6 Handbook Distribution

This handbook is available on the web at

<http://www.onrr.gov/ReportPay/PDFdocs/geopayor.pdf>.