



April 7, 2003

Mr. Paul Knueven, Manager  
Records and Information Management Team  
Center for Excellence  
Minerals Revenue Management  
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P.O. Box 25165, MS 320B2  
Denver, CO 802250-0165

Re: FR Doc. 03-6254 Filed 3-14-03 Geothermal Resources

Dear Mr. Knueven:

This is in response to the request for comments on FR Doc. 03-6254 Filed 3-14-03, *Geothermal Resources: Proposal To Convene Discussions To Develop Consensus on Royalty Valuation Approaches*. You are at this time requesting our response to three questions which are repeated in this letter prior to each response.

**Question 1: Is there a need for new or modified geothermal royalty valuation approaches, especially for no-sales resources?**

The current primary method for valuing the resource in a no-sales situation is the federal netback method. Use of the netback in many instances led to a minimal valuation for the resource and since one half of all federal geothermal royalties are distributed to the State and County of origin, among other entities, there have been some significant political repercussions as a result of its use. The netback method seemed to work fine for valuing resources following its adoption but was essentially made for Standard Offer No. 4 and modified Standard Offer No. 2 contract arrangements in California, but the electric industry has undergone significant change since that time. While some of those contracts are still in existence, many will expire soon and most of the electricity sold today is either through bilateral contracts or in the open market.

These contract or market prices dictate the value of the electricity sold on a day-to-day basis, and to the extent electrical sales revenue was used in the netback method it did follow the "market value" approach. But the other factors that were included in the netback method distorted the resource value. In addition, the netback calculation involved a complicated accumulation of all of the expenses and capital investments associated with the project which led to very time consuming accounting practices and of course federal royalty audits that could run on for months. It can become even more complicated if a project is sold.

Since the true value of the resource when used to generate electricity is the value of the electricity, why not tie the valuation of the resource directly to the revenues received from the sales of the electricity? This is what was done at The Geysers to resolve the problems of a multi-lease, multi-power plant, complex system but the method would work just as well in simpler circumstances. The method is referred to as the "Percentage of Revenues".

**Question 2: Are you interested in and would you participate in public workshops to discuss alternative valuation procedures and develop a consensus on new or modified approaches?**

We would gladly participate in at least one of the proposed workshops. We suggest that you have no more than two workshops, preferably in California and Nevada where the majority of the U.S. geothermal resources are located.

**Question 3: What alternatives or modifications, with descriptions and examples, to the existing valuation rules do you propose?**

We propose the adoption of the Percentage of Revenues method to cover no-sales circumstances. The method works by applying a fixed percentage of the total revenues received from the sale of electricity and using the resulting amount as the value of the resource. You then simply allocate the value to each producing well based on metered production and multiply this by the leases royalty rate. You then total all so calculated wells for a given lease and this is your royalty payment for that period.

For a simple example, assume a lease with a 10% royalty rate that produces one-half of the resource to run a plant that generates \$1 million in revenue for the period and that the fixed percentage rate is equal to 30%. The calculation would run as follows:

<u>Gross Revenue</u>	<u>Fixed %</u>	<u>Steam Value</u>	<u>Allocation %</u>	<u>Royalty Rate</u>	<u>Royalty</u>
\$1 million	30%	\$300,000	50%	10%	\$15,000

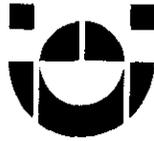
An alternative to using both the lease royalty rate and the fixed percentage is to combine the two into an electricity royalty rate, which in our example would be 3% (30% x 10%).

We don't think you will find an easier method than this. It makes the accounting work significantly easier and auditing a very simple process.

Sincerely,



Kevin Talkington  
Land Manager



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