

# **Geothermal Site Acquisition and Early Development: Key Legal Issues and Emerging Strategies**

*Presented at Geothermal Energy 2008*

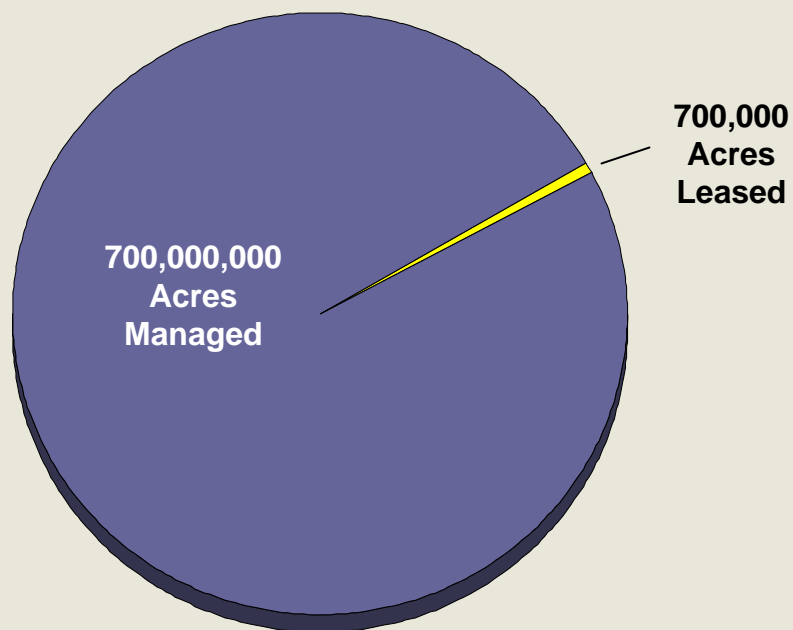
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# Agenda

- **Site Acquisition and Entitlement**
  - Federal
  - State
  - Nature and ownership of geothermal rights
  
- **Project Development Issues**
  - Joint development
  - Development finance
  - Unitization

## BLM Geothermal Leasing



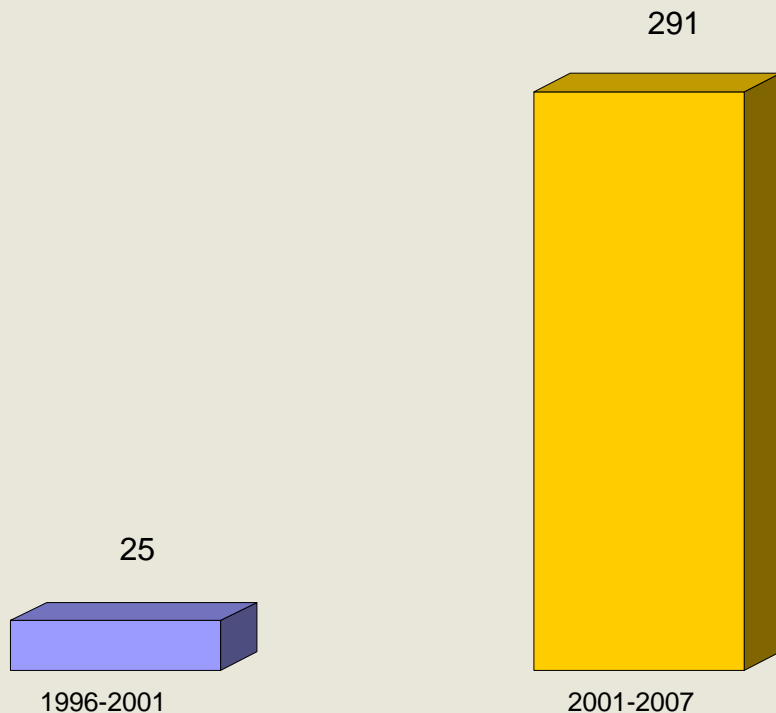
- 58 producing leases
- \$12 million/year revenues

**BLM: Acres Managed vs. Leased**

## BLM Leasing Reform

- Competitive leasing outside KGRA's by private nomination
- Additional lands opened by BLM and Forest Service
- Acreage limits relaxed
- Changes to royalty rates and structure

## BLM Lease Application Processing



- BLM must process all backlogged applications by 08/18/10

BLM Lease Application Processing

## 2006 Interior-Agriculture MOU

- Uniform administrative procedure
- Five-year program for leasing in NFS
- Reducing lease application backlog
- Joint lease/permit application tracking system

## Draft PEIS

- Expedite leasing and permitting, especially in “critical locations”
- Amend BLM/USFS LRMPs to conform
- Provide pragmatic impacts analysis so lease backlog can be cleared

## State Leasing and Permitting

- **Leasing:** rusty gears
- **Permitting:** exploration impediments
- **Example:** California (School Lands)
  - 2007: 5 Applications for Prospecting Permits, none approved.
    - ▶ 3 Complete (Geysers), but waiting for staff to examine the suitability of offering the lands for lease by competitive public bid
    - ▶ 2 Remain Incomplete (Salton Sea/Truckhaven)
  - 2006: 1 Application for Prospecting Permit approved – *First permit issued since 1984.*
    - ▶ 2 Remain Incomplete (Salton Sea/Truckhaven)
  - 2005: 1 Application for Prospecting Permit received, 2 incomplete
  - 2004: 1 New lease issued covering 1,657 acres – *First new geothermal lease since ten years.*



## Nature of Geothermal Resources: Animal, Vegetable, or Mineral?

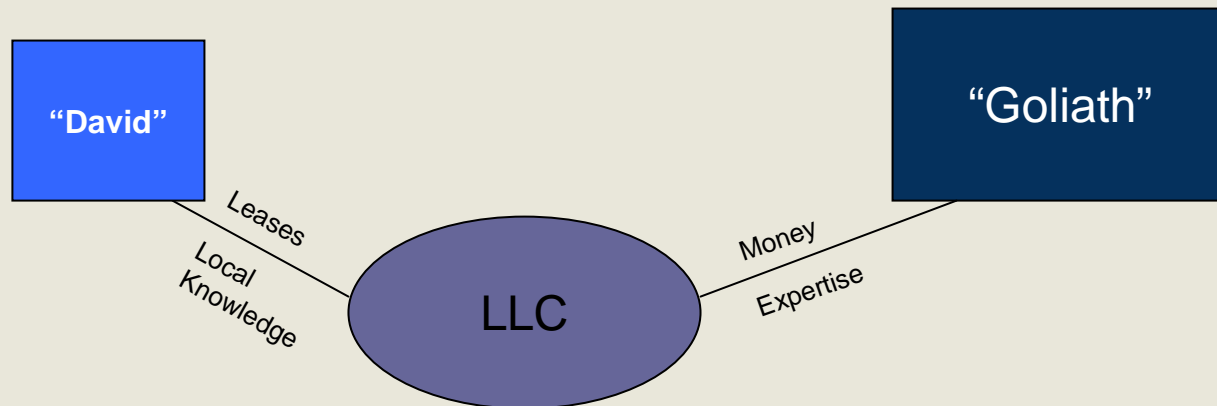
- **States treat geothermal resources differently**
  - Mineral
  - Water
  - *Sui generis*
- **Examples**
  - California (Mineral)
  - Wyoming and Utah (Water)
  - Washington (*sui generis*)

## Ownership of Geothermal Resources

- State law vests ownership of geothermal rights variously in the surface owner, mineral owner, or neither (with any clarity)
- Examples
  - Washington (surface owner)
  - California (mineral owner)
  - Utah (unclear)
- Relevance to granting clause and site diligence

## Joint Development

- **Why JV?** It sometimes is the most efficient (or the only workable) way to bring to bear required elements of project development:
  - Assets
  - Skill sets
  - Money
  - Risk Tolerance
- **Basic Structure**



## Geothermal JV Key Issues

- **Novel Challenges in Geothermal**
  - Capital intensive development process
  - Development budget/timing hard to predict
  - Development decisions complex and highly discretionary
- **Cause difficulties in agreeing on**
  - Control
  - Funding
  - Valuation
- **Result in failed JV negotiations and languishing resources**

## Closing a JV Deal: Strategies

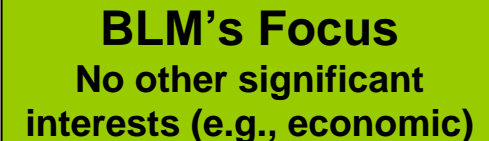
- **Mindset**
  - Pragmatic
  - Solution-oriented
  
- **Deal structure**
  - Control to Goliath; Transparency and involvement for David
    - ▶ Milestone bonuses and revenue streams to David
    - ▶ Carefully address dilution and its consequences
      - loss of effective vote after threshold passed
      - reduction/loss of milestone bonuses
      - Buy/sell mechanism triggered

## Convertible Development Loans

- **Why?** Developer has site rights and development expertise, but needs or wishes to leverage financial resources...without giving up equity
- **Structure**
  - Loan
  - Collateral
  - Default
  - Conversion rights
- **Issues**
  - Conversion triggers
  - Valuation at conversion

## Unitization of BLM Geothermal Leases

- **Source of Law:** Regulations on unitization implementing the requirements of the Energy Policy Act of 2005 were issued on May 2, 2007, and appear at 43 C.F.R. Part 3280.
- **Purpose:** To coordinate the efficient, productive development of a geothermal resource associated with multiple **\*BLM\*** geothermal leases in order to protect the public interest by:
  - preventing waste or inefficient use of the resource; and
  - Ensure maximization of revenues
- **BLM's Limited Authority:** Unitization is often voluntary, but BLM can require a BLM geothermal leaseholder to unitize "if in the public interest". BLM has no authority over geothermal leases issued by private or state lessors.



**BLM's Focus**  
No other significant  
interests (e.g., economic)

## Unitization of Geothermal Leases (Cont.)

- **Key Terms:**

- Unit Area: Area covering all lands included at any particular point in time in the Unit Agreement that are logically subject to development.
- Working Interest Owners: Those parties holding an interest in geothermal resources by virtue of a lease, operating agreement, fee title or otherwise, who is vested with the right to explore for, develop, produce and utilize such resources.
- Participating Area: That part of the Unit Area which is deemed productive or is otherwise necessary to support the development of the resource.

- **How is Unitization Achieved?**

- BLM must designate the “unit area” following analysis of information submitted by Unit Operator
  - ▶ Geological report
  - ▶ Map showing proposed unit area, all leases within the unit area, etc.
  - ▶ Certain information about all of the leases and tracts of unleased land
- Approve the Unit Agreement
  - ▶ Model Agreement (43 C.F.R. § 3286.1)



## Unitization of Geothermal Leases (Cont.)

- **Relationship Between Unit Agreement and Joint Operating Agreement (“JOA”):**
  - Unit Agreement: The Unit Agreement is merely meant to cover the basic items *between the leaseholders and the BLM*.
  - JOA: Economic and legal relationship between the *leaseholders* contained in a separate JOA.
- **Benefits of the JOA:**
  - Private document not subject to FOIA
  - Allows Working Interest Owners and investors to structure the deal to meet their specific needs
    - ▶ Different treatment of passive vs. active owners
    - ▶ Assessing different values to land (e.g., producing land, support facilities, easements or rights of way, etc.)
    - ▶ Special arrangements with the party acting as Unit Operator
  - Bind private and state leaseholders to the same obligations as Federal leaseholders.

## Unitization of Geothermal Leases (Cont.)

- **Jump Through the Hoop:**
  - Use the Model Unit Agreement to increase likelihood of BLM's quick disposition
  - Modify Art. IX so that in the event of a conflict between the JOA and the Unit Agreement, the JOA shall prevail.
    - ▶ Revenue/Cost Sharing: Section 13.2 of the Unit Agreement provides for revenue distribution and cost sharing between the Working Interest Owners on a pro rata basis based on acreage of the lease included in the Participating Area. Development structures are often more complex and the parties may have other ideas about revenue and cost distribution.
    - ▶ Minority Rights: The Unit Agreement provides certain mechanisms for protecting minority interests. Working Interest Owners may have different ideas about how to protect the interests of minorities.

## Unitization of Geothermal Leases (Cont.)

- **Other Considerations:**

- Recordation: Record evidence of the existence of a Unit Agreement and JOA on the county land records, particularly if private or state leases have joined in the Unit Agreement.
- JOA Deadline: BLM can impose a JOA if one is not entered by the parties within 180 days of entering the Unit Agreement
- JOA Provisions:
  - ▶ Cost and revenue sharing
  - ▶ Dispute resolution and buyout provisions in the event of deadlock
  - ▶ Designation, duties, and removal of Operator
  - ▶ Procedures for developing work programs and development budgets
  - ▶ Events of default (should be coordinated with Unit Agreement)
  - ▶ Method for withdrawing from the JOA and Unit Agreement
  - ▶ Clause incorporating Unit Agreement in order to bind private and state owners/leaseholders to the terms of the Unit Agreement
- Termination: BLM can terminate a unit if the Unit Operator fails to comply with any term or condition of the Unit Agreement.



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