

in the netback procedure during the reporting period, the lessee shall be required to pay additional royalties retroactive to the first month of the reporting period, plus interest computed pursuant to 30 CFR 218.302. If the actual transmission deduction is greater than the amount applied in the netback calculation, the lessee shall be entitled to a credit.

(2) Lessees must submit corrected Forms MMS-2014 to reflect adjustments to royalty payments in accordance with MMS instructions.

(e)(1) All transmission deductions are subject to review, audit, and adjustment. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual transmission deduction and adjust royalty values accordingly.

(2) Pursuant to subpart H of 30 CFR part 212, the lessee must maintain all data and records supporting its transmission deduction, including wheeling and other transmission-related agreements. These data and records must be made available to MMS and other authorized personnel upon request, and shall be maintained in a confidential manner in accordance with applicable laws and regulations pursuant to § 206.352 of this subpart.

(f) A one-time refund of royalties equal to the royalty amount of actual dismantlement costs attributable to the transmission line that are in excess of actual income attributable to the salvage of the transmission line will be allowed at the completion of the dismantlement and salvage operations.

§ 206.354 Determination of generating deductions.

(a) Where the value of geothermal energy is determined by the geothermal netback procedure pursuant to paragraphs (c)(1)(ii) and (d)(1)(ii) of § 206.352 of this subpart, that value shall be determined by deducting the lessee's reasonable actual costs incurred to generate electricity from the plant tailgate value of the electricity (usually the transmission-reduced value of the delivered electricity). Generating deductions are subject to the limitation prescribed in paragraph (c) of this section.

(b)(1) Generating costs shall be based on the lessee's actual annual costs associated with the construction and operation of a geothermal powerplant. The monthly generating deduction is determined by multiplying the annual generating cost rate (in dollars per kilowatthour) by the amount of plant tailgate electricity measured (or computed) for the reporting month. The generating cost rate is determined from the annual amount of plant tailgate electricity and must be redetermined annually at the beginning of the same month of the year in which the powerplant was placed into service or, at the lessee's option, at a time concurrent with the beginning of the lessee's annual corporate accounting period; *Provided*, however, the period selected must coincide with the same period chosen for the transmission deduction pursuant to § 206.353(b)(1). After a deduction period is chosen, the lessee may not later elect to use a different deduction period without MMS approval.

(2) Allowable generating costs include operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the capital investment in the powerplant multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those costs for depreciable assets, including costs of delivery and installation of capital equipment, that are an integral part of the powerplant or are required by the design specifications of the power conversion cycle. A return on capital invested in the purchase of real estate for a powerplant site may be allowed provided that the lessee demonstrates the necessity for such purchase, the purchased land is not on a Federal geothermal lease, and MMS approves the deduction; the rate of return shall be the same rate determined in paragraph (b)(2)(v) of this section. The costs of gathering systems and other production-related facilities are not allowed.

(i) Allowable operating expenses include operations supervision and engineering, operations labor, materials, ad

valorem property taxes, rent, supplies, auxiliary fuel and/or utilities used to operate the powerplant during down time, and any other directly allocable and attributable operating expense that the lessee can document.

(ii) Allowable maintenance expenses include maintenance of the powerplant, maintenance of equipment, maintenance labor, and other directly allocable and attributable maintenance expenses that the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the powerplant is an allowable expense. State and Federal income taxes and severance taxes, including royalties, are not allowable expenses.

(iv) To compute costs associated with capital investment, a lessee may use either depreciation with a return on undepreciated capital investment, or a return on capital investment. After a lessee has elected to use either method, the lessee may not later elect to change to the other alternative without MMS approval.

(A) To compute depreciation, the lessee must use a straight-line depreciation method based on the life of the geothermal project, usually the term of the electricity sales contract or other depreciation period acceptable to MMS. A change in ownership of a powerplant shall not alter the depreciation schedule established by the original lessee-owner for computing the generating costs. With or without a change in ownership, a powerplant shall be depreciated only once. The rate of return used to compute the return on undepreciated capital investment shall be determined pursuant to paragraph (b)(2)(v) of this section.

(B) To compute a return on capital investment, the allowed cost shall be the amount equal to the allowable capital investment in the powerplant multiplied by the rate of return determined pursuant to paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to powerplants first placed into service on or after March 1, 1988.

(v) The rate of return shall be 2 times Standard and Poor's industrial BBB bond rate. The rate of return shall be 2

times the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the annual deduction period and shall be effective during the following deduction period. The rate shall be redetermined annually at the beginning of the same month beginning the annual deduction period chosen pursuant to paragraph (b)(1) of this section.

(3) Generating cost rates, determined annually, shall be computed by dividing the sum of the operating, maintenance, overhead, and capital costs by the annual amount of plant tailgate electricity.

(4) For new powerplants, the lessee's generating costs for the first deduction period shall be based on estimated expenses (including overhead) for operating and maintaining the powerplant. For subsequent deduction periods, the generating costs shall be estimated based on the lessee's actual operating and maintenance expenses for the previous period adjusted for decreases or increases that the lessee knows will affect the deduction in the current period.

(c) Under no circumstances shall the generating deduction plus the transmission deduction determined pursuant to §206.353 of this subpart reduce the royalty value of the geothermal resource to zero.

(d)(1) If the actual generating deduction determined at the end of the annual reporting period is less than the amount the lessee estimated and used in the netback procedure during the reporting period, the lessee shall be required to pay additional royalties retroactive to the first month of the reporting period, plus interest computed pursuant to 30 CFR 218.302. If the actual generating deduction is greater than the amount applied in the netback calculation, the lessee shall be entitled to a credit.

(2) Lessees must submit corrected Forms MMS-2014 to reflect adjustments to royalty payments in accordance with MMS instructions.

(e)(1) All generating deductions are subject to review, audit, and adjustment. When necessary or appropriate, MMS may direct a lessee to modify its

estimated or actual generating deduction and adjust royalty values accordingly.

(2) Pursuant to subpart H of 30 CFR part 212, the lessee must maintain all data and records supporting its generating deduction. These data and records must be made available to MMS and other authorized personnel upon request, and shall be maintained in a confidential manner in accordance with applicable laws and regulations pursuant to § 206.352 of this subpart.

(f) A one-time refund of royalties equal to the royalty amount of actual dismantlement costs attributable to the powerplant that are in excess of actual income attributable to the salvage of the powerplant will be allowed at the completion of the dismantlement and salvage operations.

§ 206.355 Valuation standards for direct utilization.

(a) The value of geothermal resources produced for leases subject to this subpart and used in direct utilization processes shall be determined pursuant to this section.

(b)(1)(i) The value of geothermal resources that are sold pursuant to an arm's-length contract shall be the gross proceeds accruing to the lessee, except as provided in paragraphs (b)(1)(ii) and (b)(1)(iii) of this section. The lessee shall have the burden of demonstrating that its contract is arm's-length. The value that the lessee reports for royalty purposes is subject to monitoring, review, and audit.

(ii) In conducting these reviews and audits, MMS will examine whether or not the contract reflects the total consideration actually transferred either directly or indirectly from the buyer to the seller for the geothermal resource. If the contract does not reflect the total consideration, MMS may require that the geothermal resource sold pursuant to that contract be valued in accordance with paragraph (d) of this section. Value shall not be less than the gross proceeds accruing to the lessee, including any additional consideration received.

(iii) If MMS determines that the gross proceeds accruing to the lessee pursuant to an arm's-length contract do not reflect the reasonable value of

the geothermal resource because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, MMS shall require the geothermal resource to be valued pursuant to paragraph (d) of this section and in accordance with the notification requirements of paragraph (e) of this section. When MMS determines that the value may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's value.

(2) The MMS may require a lessee to certify that its arm's-length contract provisions include all of the consideration to be paid by the buyer, either directly or indirectly, for the geothermal resource.

(c)(1) The value of geothermal resources subject to this section that are sold under a non-arm's-length contract shall be determined in accordance with the first applicable of the following paragraphs:

(i) The gross proceeds accruing to the lessee pursuant to a sale under its non-arm's-length contract provided that those gross proceeds are not less than the gross proceeds derived from or paid under the lowest-priced available comparable arm's-length contract for sales of geothermal resources to the lessee-affiliate's same direct utilization facility (the "minimum value"). If the gross proceeds under the lessee's non-arm's-length contract are less than the "minimum value" under available comparable arm's-length contracts, or if there are no available comparable arm's-length contracts, value will be determined by the weighted average of the gross proceeds established under arm's-length contracts for the sale of significant quantities of geothermal resources to the same direct utilization facility. Available contracts will mean contracts in the possession of the lessee, the lessee's affiliate, or MMS. In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors shall be considered: Time of execution, duration, terms, quality of the geothermal resource, volume, dedication to the same direct utilization facility,