



OFFICE OF THE GOVERNOR

May 13, 2005

The Honorable Pete Domenici
Chairman, Energy and Commerce Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Jeff Bingaman
Energy and Commerce Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Senators Domenici and Bingaman,

As the Senate Energy & Natural Resources Committee begins consideration of comprehensive energy legislation, I would like to share with you my views regarding federal energy policy.

Californians know all too well the importance of reliable and affordable energy supplies. Experience has taught us that California – and the nation – must establish an energy policy that encourages investment in new infrastructure and technology, provides stable supplies of energy, protects consumers and reduces environmental impacts. Federal energy policy should promote the economic well-being of our people, improve the health of our economy in the short term and promote healthy economic growth for the longer term.

As you know California has played a leadership role in pursuing these objectives. We are proud of the leadership role in California for technology development, including technologies to produce, convert and use energy. Our environmental leadership has provided a model for the rest of the nation. California and the West enjoy a wide diversity of resources that, if appropriately utilized, could reduce the risks associated with our nation's dependence on energy imported from foreign sources. Research contributions from national labs, industry, government agencies, universities and other California organizations have improved our energy alternatives.

At the same time, there are important challenges that California must still address. The federal energy bill can play an important role in helping California and the West address these challenges. Whether it be the development of renewable energy, promotion of energy efficiency, expansion of transmission and natural gas infrastructure and encouragement of research and development in new energy technologies, the federal energy bill can make great strides in providing for our nation's economic growth and protecting our environment.

With this background I would like to outline several recommendations regarding federal energy policy.

The Honorable Pete Domenici
The Honorable Jeff Bingaman
May 13, 2005
Page two

1. Renewable Energy

The further development of cost-effective renewable energy would support our economic and environmental goals and would reduce risks by increasing the diversity of domestic energy supplies. Renewable energy should remain a research and development priority. Appropriate incentives for accelerated implementation are needed to support these emerging technologies.

I urge you to adopt four specific recommendations:

- Extend the renewable energy production tax credit (PTC) by ten years.
- Support a tax credit for distributed renewable energy such as photovoltaic solar systems.
- Treat all renewable resources equally.
- Create a tradable tax credit for electric service cooperatives, municipal power providers and others who do not derive financial benefits from a tax credit.

2. Energy Efficiency

Investments in energy efficiency can strongly support all three goals – economic performance, environmental protection, and national security enhancement. I urge you to adopt five specific recommendations:

- Permanently reauthorize Energy Savings Performance Contracts.
- Increase funding for the DOE standards program.
- Increase funding and expand coverage of the Energy Star Program.
- Create tax incentives for performance-based efficiency applications in buildings and equipment, similar to those in the Cunningham/Markey & Feinstein/Snowe Tier Act.
- Preserve the ability of States to set higher energy efficiency standards than the federal level.

3. Electricity Transmission Siting

Very importantly, the energy bill should include measures to increase the security of the electric grid, to encourage investments in new transmission lines, and to improve the utilization of existing lines. I support six specific recommendations on electricity transmission siting:

- Apply open access rules to all transmission entities.

The Honorable Pete Domenici
The Honorable Jeff Bingaman
May 13, 2005
Page three

- Amend PUHCA's "Physical Integration" requirements to allow investors already participating in the electric utility sector to more easily consider investments in areas that are not physically contiguous to their existing assets.
- If PUHCA is repealed, include language that would ensure consumer protection safeguards are in place.
- Allow WAPA and SWPA to enter into public/private partnerships and participate in the development of new transmission lines.
- Adopt the corridor designation provisions (Sec. 350 in H.R. 6). A two-year deadline for designation of corridors would expedite the designation process; a streamlined environmental review process would reduce uncertainty and encourage investment.
- Designation of a lead agency would expedite the permitting process by eliminating the possibility of multiple redundant environmental reviews. Such a designation would also require all federal agencies to work under the same one-year deadline for decisions.

4. Federal Funding/Financial Role for Interstate Transmission Projects

Interstate transmission projects are a priority for Western states. Appropriate transmission investment will enable the Western states to access competitively priced energy, will reduce congestion, permit the natural retirement of aging plants, increase access to renewable resources, increase diversity of fuel sources, increase grid reliability, and reduce economic risks from state-specific supply shortages. Both new construction and upgrades of existing transmission lines are important.

I support the House action on participant funding. By removing this language, it will allow Governors and States in the West to bolster the robustness and reliability of our region's electricity grid through upgrades and expansion of the interstate electric transmission system. The West should be afforded maximum flexibility to devise pricing mechanisms that work best for our region.

I urge you to adopt two specific recommendations:

- Eliminate the language from the 2003 Energy Title that explicitly prohibits costs from being assigned to native load customers if the utility serving them "would not have required the expansion or new interconnection absent the request for service." Such a restriction could endanger important interstate transmission projects. Given that FERC already has the authority to approve a range of transmission rate designs, this language is not necessary. It is important to allow each electric region to adopt its own approach to interstate transmission funding.

The Honorable Pete Domenici
The Honorable Jeff Bingaman
May 13, 2005
Page four

- Give Federal Power Market Agencies (PMAs) financial tools to upgrade transmission facilities. Include language authorizing the WAPA and SWPA to upgrade their transmission facilities or construct new facilities and accept third party financial contributions for such purposes.

5. Strengthening Electric Supply Reliability Standards

Effective energy risk management requires electricity suppliers to reliably provide electricity to utilities and other bulk electricity purchasers. Bulk power producers, operating in interstate commerce, and thus outside of the regulatory authority of states, require federal rule making through FERC. I urge you to adopt one specific recommendation:

- Develop and direct FERC to enforce mandatory reliability standards that are enforceable on all market participants and electric companies.

6. LNG Siting

Acquiring adequate natural gas supplies is a high priority for California and the west. One of the sources important to our future is imported natural gas in the form of LNG. Yet the unresolved issue of state vs. federal jurisdiction for LNG siting is delaying the provision of LNG. I oppose federal preemption of State siting jurisdiction of LNG terminals, and urge Congress to preserve a strong role for States in siting both onshore and offshore LNG facilities.

I urge you to adopt two specific recommendations:

- Maintain the existing State authority under the Coastal Zone Management Act for siting of LNG terminals.
- Retain the State permit review of siting, construction, expansion, or operation of facilities located onshore or in State waters.

7. Offshore Oil and Gas Drilling

Federal energy policy must not get in the way of California efforts to continue preserving and protecting our State's environment, one of our great assets. I strongly oppose any new oil and gas leasing off California's coastline and any efforts to weaken the right of California, or other states, to protect their coastlines from the adverse impacts of offshore oil and gas drilling on the Outer Continental Shelf.

The Honorable Pete Domenici
The Honorable Jeff Bingaman
May 13, 2005
Page five

Thus I urge you to adopt three recommendations:

- Strengthen the legislative moratorium language.
- Prohibit any federal funds from being spent on any lease planning activities on the Outer Continental Shelf.
- Oppose efforts to reduce the states' ability under the federal Coastal Zone Management Act to prevent inappropriate federal development of coastal areas.

8. Hydrogen

I have been a strong proponent of diversifying our energy supplies. As California and the nation witness the steady rise in oil prices, it is important that we take steps to encourage the development of new transportation fuels. In California, I have established a blueprint for the creation of a Hydrogen Highway. We aim to build the infrastructure necessary to support a growing hydrogen-based vehicle fleet. My Administration is beginning a transition from multiple, isolated demonstration projects to an integrated system of publicly accessible stations to make up the California Hydrogen Highway Network. I support the federal commitment to hydrogen technology in the 2005 Energy Policy Act. In addition, Congress should provide a tax credit for hydrogen-based infrastructure projects, as proposed in the Cox/Wyden legislation in the 108th Congress.

Our experience to date puts us in a position to work with the Department of Energy (DOE) to further our mutual goals. California would like to share that experience with DOE through membership on the Hydrogen Technical and Fuel Cell Advisory Committee to be established under section 805 of the Energy Policy Act. I encourage the DOE to work with us and to use California as a proving ground for the hydrogen economy.

9. Renewable Fuels Mandate

California has long been a leader in efforts to reduce air pollution. Our aggressive transportation fuel requirements have led to significant reductions in pollutants. To that end, I have consistently called for an end to the federal requirement that oxygen be added to reformulated gasoline. California's request to waive the oxygenate requirement is still pending before the U.S. Environmental Protection Agency.

California also recognized the benefits of developing alternative transportation fuels. Cellulosic and grain-based ethanol are renewable sources that reduce our reliance on foreign oil, significantly reduce greenhouse gas emissions and provide economic opportunities for home

The Honorable Pete Domenici
The Honorable Jeff Bingaman
May 13, 2005
Page six

grown industry. California is eager to produce and use these renewable fuels, but we must have the flexibility to use them in a way that does not adversely affect our air quality.

I urge Congress to adopt the following recommendations:

- Remove the oxygenate requirement on reformulated gasoline (RFG).
- Eliminate any requirement that ethanol be used seasonally, such as with semiannual averaging periods and exempt all RFG areas from summer ozone season ethanol use.
- Limit the renewable fuels portfolio requirement to 5 billion gallons nationwide until the infrastructure and use of E-85 is widely available.
- Credit the use of E-85 as a full gallon of ethanol, rather than 0.85 gallons.
- Provide additional incentives for cellulosic ethanol to account for its superior greenhouse gas emissions relative to gasoline and corn based ethanol. Congress could increase the tax credit for cellulosic ethanol or allow additional credits for cellulosic ethanol relative to corn based ethanol.
- U.S. EPA should develop new emissions models that use all appropriate data that more accurately reflects current fleet emissions. These models should be updated periodically.
- Eliminate the exemption that MTBE manufacturers are free from liability for damages caused by their product.

10. Fuel Efficiency

Between 1970 and 1985 on-road fuel economy of cars and light-duty trucks in California increased from 12.6 miles per gallon to 20.7 mpg as a result of federal CAFE standards. Unfortunately, fuel economy has actually decreased in recent years. Because CAFE standards have been largely unchanged since 1985, most automotive technological improvements to engines and vehicles have been used to increase performance and overcome gains in weight. To avoid the adverse environmental and economic consequences of our nation's dependence on foreign petroleum fuels, I strongly urge Congress to take advantage of these existing technologies and to establish national fuel economy standards that double the fuel efficiency of new cars, light trucks and SUVs.

11. Clean Coal

As Governor, I am committed to both a diverse fuel base and a clean air quality profile for California's electricity sector. Rising natural gas prices require us to look to the renewable and coal sectors for a secure power base. We encourage Congress to continue to support clean coal

The Honorable Pete Domenici
The Honorable Jeff Bingaman
May 13, 2005
Page seven

technology research and development, so that in the short- to mid-term (5-10 years) time frame we can economically achieve the goals of dramatically reduced emissions of pollutants such as SO₂, SOX, NOX and mercury; and continue to develop methods for capturing and storing significant amounts of CO₂, either as an integral part of the energy conversion process or in pairing with external CO₂ sequestration.

It is not possible to predict which technologies will advance to commercial maturity fastest, so a variety of technology paths must be encouraged. Furthermore, given the diversity of regional electricity markets and the wide variation in regional coal properties, effective deployment of advanced coal power systems will require a portfolio of technologies, such as Integrated Gasification Combined Cycle (IGCC) and Supercritical Circulating Fluidized-Bed Combustion (SC CFBC), as well as technologies yet to be developed, as we work towards a long term goal of zero-air-emission or near-zero-air-emission operation.

12. FERC Penalty Authority

California's electricity restructuring in the late 1990s revealed large gaps in enforcement powers and authority of federal agencies charged with monitoring interstate electricity flows. I urge Congress to equip federal agencies with the authority and staff necessary to ensure that no other State or region experiences the levels of market manipulation that California and the West suffered during the 2000-01 energy crisis. I support the provisions in 108th Congress' version of the energy bill that give the Federal Energy Regulatory Commission greater ability to issue refunds when energy sellers are found to have overcharged for power. Sufficient enforcement laws and strong market monitoring will infuse confidence in electricity markets and protect consumers from future manipulation.

Thank you for the opportunity to comment. As the energy bill proceeds through Congress, I hope you will continue to rely on the advice and experience of the nation's governors on these important issues.

Sincerely,



Arnold Schwarzenegger

cc: Senator Charles Grassley, Chair, Senate Finance Committee
Senator Max Baucus, Ranking Member, Senate Finance Committee
Congressman Joe Barton, Chair, House Energy and Commerce Committee
Congressman John Dingell, Ranking Member, House Energy and Commerce Committee
Congressman Bill Thomas, Chair, House Ways and Means Committee
Congressman Charles Rangel, Ranking Member, House Ways and Means Committee