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Mr. Kevin Kennedy
Assistant Executive Officer, Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Subject: ExxonMobil Comments on Point of Regulation for the Sources of Fuel Combustion Included in the Second Compliance Period in a California Cap and Trade Program

Dear Mr. Kennedy:

ExxonMobil appreciates the opportunity to provide comments to the California Air Resources Board (CARB) addressing the point of regulation for emissions from use of transportation fuels and natural gas in residential, commercial and small industrial (less than 25,000 tons per year of CO_2 equivalent emissions) sources.

ExxonMobil supports public policy that recognizes the important need for meeting the world's demands for affordable energy while reducing greenhouse gas (GHG) emissions in a cost effective manner.

Additionally, we believe that an effective GHG emissions reduction program design must:

- Ensure a uniform and predictable cost of GHG emissions across the economy
- Let market prices drive the selection of solutions
- Promote global participation
  - Recognize priorities of developing world
  - Limit consequences of differing national policies on competitiveness
- Minimize complexity to reduce administrative costs
- Maximize transparency to companies and consumers
- Adjust in the future to developments in climate science and the economic impacts of climate policies

To most effectively achieve a uniform and predictable cost of GHG emissions across the economy, minimize administrative complexity and cost, and promote broad participation, ExxonMobil believes GHG emissions reduction policy is better addressed through coordinated national and international policy, versus at the individual state or regional level, and therefore, California policies should remain flexible enough to align with emerging national policies. Further, ExxonMobil's view is that if a regulatory program is developed to assess a cost of carbon in the economy, a revenue neutral carbon tax on all emission sources is the most efficient and transparent method. A carbon tax is easy to understand, easy to collect, and easy to offset through reductions in other taxes. It provides certainty to investors, businesses and consumers so that decisions can be made on deploying new energy-saving technology, upgrading existing facilities to more energy efficient designs, and funding research for advanced technologies. Importantly, a well designed carbon tax will impact the entire energy mix throughout the economy in direct proportion to carbon emissions.

Given CARB's continued development of regulations to implement state law pursuant to AB 32, ExxonMobil believes that California's program, and state programs in general, should be designed to be flexible enough to allow easy, rapid, and cost-effective alignment with a potential future federal program. Effective and efficient alignment with a future federal program will offer California a number of advantages, including lower administrative costs for the State and lower cost to the California economy.

CARB's AB 32 scoping plan includes a broad range of control measures to reduce GHG emissions, including a cap-and-trade program for large stationary-source emitters. The scoping plan recognizes the importance of addressing a broad range of sources, including fossil transportation fuels and natural gas distribution.

ExxonMobil supports maximizing the use of markets, and including as many GHG emissions sources as is practical in order to achieve the most cost-effective GHG reductions. ***Given CARB's proposal to implement a cap-and-trade program, ExxonMobil supports addressing fossil transportation fuels through a market-determined carbon fee, rather than direct inclusion in the cap-and-trade program.*** The carbon fee would be fixed for some period of time and should be equivalent to the average cost of carbon in the cap-and-trade program for some recent period of time. The revenue from the fee should be recycled through a broad-based reduction of current taxes on labor or capital. This "linked carbon fee" approach will ensure a consistent price of carbon in the market, while minimizing market instability, price volatility and the potential for supply disruptions.

Challenge of Including Emissions from Fossil Transportation Fuels under a Cap-and-Trade

Inclusion of transport fuels directly in a cap-and-trade program will likely result in the volatility in carbon allowance prices being translated into additional volatility in the price of transport fuels. This volatility creates difficulty for consumers in managing household budgets and would unnecessarily add to consumer dissatisfaction with the efforts to reduce GHG emissions.

In addition, including transportation fuels directly in a cap-and-trade program could lead to instability in the cost of allowances. The response of consumers to the rising costs of transportation fuels created by a cap-and-trade program is difficult to predict and may be more limited in the short-term than the response from large emitters of GHGs. If a cap is creating a shortfall in allowances and a resulting increase in allowance costs, it is possible that transportation fuel consumers will respond more slowly than large emitters of GHGs, reflecting the barriers that exist to rapidly changing vehicles and adjusting consumer need for vehicle miles traveled. The burden for offsetting GHG emissions from the relatively inelastic transportation fuel demand will fall primarily on large emitters, resulting in potentially volatile and steeply rising allowance prices.

A similar need for large GHG emissions reductions from large emitters could develop if efficiencies in transportation do not develop as quickly as assumed. The pace at which more stringent CAFE standards, increased supplies of biofuels, and lower carbon fuel/vehicle systems can be introduced into the market may potentially lag expectations for reducing GHG emissions. Further and paradoxically, it is possible that efficiency improvements due to CAFE standards may be offset by higher vehicle miles traveled, when consumers experience lower fuel cost per mile.

Considering the relative GHG emissions of the transportation sector and the large emitters, a scenario could easily develop in which insufficient emissions reduction from the transportation sector overwhelms the ability of large emitters to generate GHG emissions reductions. In such circumstances, the supply of transportation fuels would have to be limited to hold GHG emissions under the cap.

Thus, including transportation fuels directly under a cap-and-trade system could result in higher instability of the market, volatility in allowance prices, and potentially unmet fuel demand, compared to a system with a cap covering only large emitters. Nevertheless, considering the amount of GHG emissions directly controlled by consumer choice, providing consumers with a GHG emissions cost to encourage efficiency and reduce vehicle miles traveled remains an important objective.

Linked Carbon Fee Option

An option to provide the GHG emissions cost signal to consumers of transportation fuels without the drawbacks of market instability, price volatility, and potential supply limitations would be to apply a fee to the fossil carbon content of transportation fuels, with that fee linked periodically through an averaging process to the cost of GHG emissions imposed in the large emitter cap-and-trade program. Such a linked carbon fee could be imposed at the same point, and collected in the same manner, as fuel excise taxes are collected today. For example, the linked carbon fee could be set quarterly, based on an average of the cap-and-trade allowance cost from the prior quarter.

The linked carbon fee has the following advantages

It avoids the risk that near-term price inelasticity of transportation fuels could create serious shortfalls and price spikes in carbon markets.

It places a known cost on vehicle tailpipe GHG emissions. This cost would remain consistent with the cost imposed on industrial sector GHG emissions, sending a consistent economic signal throughout the economy, but with lower price volatility for the consumer.

It is more transparent to the consumer (versus including the sector in the cap- and-trade program), especially if posted on the pump, reinforcing consumer behavior to seek, over time, vehicle and travel efficiencies.

It can be implemented using existing systems that collect federal and state excise taxes, thus avoiding significant additional administrative burden both to government and fuel suppliers.

Some entities may see as a disadvantage the fact that a linked carbon fee would not "cap" end-use GHG emissions from transportation. This limitation can be addressed and overcome over time by adjusting the cap in the large emitter system based on experience and forward objectives. It is important to recognize that reductions in transport GHG emissions by consumers will be determined by the cost of carbon emissions transmitted to the consumer. Whether transmitted by an economy-wide cap-and-trade system or by a linked carbon fee system, placing a cost on carbon will reduce transport emissions. If economy-wide emission reductions in a linked fee system are not meeting expectations, the cap in the large emitter system can be further reduced. This cap reduction will increase the cost of allowances and increase the linked carbon fee, sending a stronger price signal to the transport consumer.

Managing the total inventory of GHG emissions in the atmosphere is more critical to addressing the risk of long-term climate change than managing annual GHG emissions. Therefore, long term GHG emissions reduction objectives can still be met even if there are near term variations in GHG emissions rates. Hence a hard "cap" for any given year or short period is not as important in reaching long term GHG emissions reduction goals as establishing a sustainable system that encourages long term planning and investment, both by businesses and by consumers. The most effective means of encouraging long term behavior to meet GHG emissions reduction goals is to establish a system that provides a transparent, predictable price of carbon in the market.

Residential and Commercial Use of Natural Gas

The same linked carbon fee approach could be applied to local natural gas distribution companies to address residential and commercial use of natural gas in a linked manner to a cap-and-trade system. The same benefits of providing a transparent GHG emissions cost signal to final natural gas consumers could be achieved while avoiding the same potential supply, instability, and volatility issues.

Revenue Considerations

Inclusion of transportation end-use GHG emissions under either a linked carbon fee system or a cap-and-trade system where allowances are auctioned would generate substantial revenue to the government. Depending upon how this revenue is used, there is potential for significant economic distortions.

Revenue from a cap-and-trade system or a linked carbon fee should be returned to the economy with the least distortion of economic activity possible, preferably through a broad-based reduction of a current tax on labor or capital.

Thank you for considering our views. Please contact David Ligh at (916) 444-7852 if you wish to discuss further.

Sincerely,

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