Exxon Mobil Corporation
5959 Las Colinas Boulevard
Irving, Texas 75039-2298

Sherri K. Stuewer
Vice President
Safety, Health and Environment

ExxonMobil

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Ms. Mary Nichols
Chairperson
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Subject: ExxonMobil Comments on CARB's Proposed Climate Change Scoping Plan to Reduce Greenhouse Gas Emissions from the Use of Fossil Transportation Fuels

Dear Ms. Nichols:

ExxonMobil appreciates the opportunity to provide comments to the California Air Resources Board's Climate Change Proposed Scoping Plan, dated October 2008.

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.
- Maximize the use of markets.
- Minimize administrative complexity and cost.
- Maximize transparency to regulated entities and consumers.
- Promote global participation, considering the priorities of the developing world.
- Adjust to future 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. We believe that California's AB 32 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.

The CARB proposed 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, but it does not clearly specify whether these sources will be included directly in the cap-and-trade program or will be addressed through other market mechanisms.

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 should be equivalent to the cost of carbon in the cap-and-trade program, with recycle of the revenue through a broad-based reduction of current taxes on labor or capital. The linkage could be accomplished efficiently by basing the fee on the average cost of carbon in the large emitter cap-and-trade program during a recent period of time. This "linked carbon fee" approach will ensure a consistent price of carbon in the market (unlike Low Carbon Fuel Standards (LCFS) or biofuels mandates), 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.

In a cap and trade program as envisioned by CARB, ExxonMobil believes that reduction of GHG emissions from the transportation sector can be more cost effectively achieved through market mechanisms such as a linked carbon fee, compared to alternatives such as LCFS. The linked carbon fee extends a uniform cost of carbon across a large portion of GHG emissions, giving GHG reduction incentives to both consumers and fuel manufacturers. By contrast, the technology mandates inherent in a LCFS will result in uncertain and potentially much higher costs for GHG reductions, while not necessarily transmitting a consistent carbon emissions cost to the users of fossil transportation fuels. In addition, a LCFS, if not designed properly, could potentially impact fuel supply which could erode support for overall GHG reduction efforts. The linked carbon fee will promote investment in lower GHG technologies as well as reduction in vehicle miles traveled while ensuring adequate transportation fuel supply. Lastly, LCFS, with its complicated accounting and compliance mechanisms, is inherently more complex and hence by its nature less transparent than a linked carbon fee.

An aggressive federal Renewable Fuel Standard (RFS) is already in place. This federal RFS provides an aggressive, national push for increased biofuels usage, including strong volumetric mandates for advanced biofuels with threshold GHG reduction requirements. Additional state-by-state adoption of a LCFS will likely result in inconsistent fuel programs scattered around the country. A combination of the existing federal RFS and a linked carbon fee that addresses transportation fuels is more effective than placing transportation fuels in an economy-wide cap-and-trade program, with a federal RFS and possible state LCFS overlays.

In summary, a linked carbon fee approach is expected to motivate consumer GHG emission reductions, reduce volatility in fuel price, improve allowance price stability, and reduce fuel supply risk, compared to a cap-and-trade system which includes both large emitters of GHGs and transportation fuel GHG emissions. The linked carbon fee, which gives incentives for emission reductions to both fuel producers and consumers, is also a more cost effective and transparent method of addressing emissions from the transportation sector than a LCFS.

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 governments. 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.

Cost Containment

ExxonMobil appreciates CARB's recognition that cost-containment mechanisms play an important role under a cap-and-trade regime. CARB has identified unlimited banking, use of offsets, and the potential for extended compliance periods as measures to help control costs in the cap-and-trade program.

A 2008 research publication produced by the United States Congressional Budget Office (CBO) has examined the efficiency implications of a carbon tax versus a cap-and-trade program. In short, the CBO concludes that any long term emissions reduction target could be met by a tax at a fraction of the cost of a cap-and-trade program. A tax would provide firms with an incentive to undertake more emission reductions when the cost of doing so was relatively low and allow them to reduce emissions less when the cost of doing so was particularly high. Significantly reducing GHG emissions requires large investment in long-lived capital stock. The more predictable the long-term cost of GHG emissions, the lower the risk of making these long-term investments. A carbon tax provides a more predictable, lower risk, and thus more effective driver than a cap-and-trade system.

The CBO study also explores ways in which policy makers could preserve the structure of a cap-and-trade but capture some of the efficiency advantages of a tax. Specifically it concludes that policymakers could improve the efficiency of a cap-and-trade program with the following step:

- Establish a cost containment mechanism -- by setting a ceiling and a floor on the price of emission allowances. The government could maintain a ceiling by selling companies as many allowances as they would like to buy at the containment price, which might be, for example, twice the high end of the price the government has predicted for the program. The government could maintain a price floor by selling allowances in an auction and specifying a reserve price.

Experience with cap-and-trade programs, such as the EU Emissions Trading Scheme, has shown that price volatility can be a major concern when a program's design does not include provisions to adjust for unexpectedly high or low costs. High costs can be damaging to the economy as they impact energy prices, inflation rates, and the value of imports and exports. Lower costs can occur when there are temporary declines in economic activity, as seen recently in the EU. These lower costs erode the incentive to make investments that will result in long-term reductions.

Banking provisions and offsets alone, while fundamentally important in reducing the overall cost of a GHG reduction program, cannot adequately protect the market and the economy from potential spikes in the price of GHG allowances. However a cap-and-trade program that includes an effective cost-containment mechanism will mitigate price volatility concerns. Lower volatility should facilitate investment planning and protect the California economy from unintended consequences, particularly in the early years of system implementation.

ExxonMobil supports the inclusion of a strong cost-containment mechanism such as a fixed ceiling price for allowances, in addition to a robust offset program and banking provisions, to promote the efficient operation of the AB 32 GHG reduction program and to assist in reducing price volatility.

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

Sincerely,

Sherri K. Stuewer
Vice President
Safety, Health & Environment
Exxon Mobil Corporation