



August 13, 2008

Ms. Janice Adair  
Chair  
Western Climate Initiative  
Washington Department of Ecology  
300 Desmond Drive  
Lacey, WA 98503

Mr. Steven Owens  
Co-Chair  
Western Climate Initiative  
Arizona Department of  
Environmental Quality  
1110 West Washington Street  
Phoenix, AZ 85007

Dear Ms. Adair and Mr. Owens:

**SUBJECT: ExxonMobil Comments on WCI Draft Design of the Regional Cap-and-Trade Program Associated with Reducing Greenhouse Gas Emissions from the Use of Fossil Transportation Fuels**

ExxonMobil appreciates the opportunity to provide comments to the Western Climate Initiative's document entitled Draft Design of the Regional Cap-and-Trade Program, dated July 23, 2008.

ExxonMobil supports public policy that balances 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 generally better addressed through coordinated national and international policy versus at the individual state or regional level.

The current WCI Draft Design outlines provisions for implementation of a cap-and-trade on large stationary emitters of GHGs. While the Draft Design recognizes the importance of addressing all sources, including fossil transportation fuels and natural gas distribution, it is not clear whether these sources will be included directly in the cap-and-trade or addressed through other market mechanisms.

ExxonMobil supports maximizing the use of markets and including all GHG emissions sources to the extent it is practical in order to achieve the most cost effective solutions for GHG emissions reduction. Given WCI's choice to implement a cap-and-trade on large stationary emitters of GHGs, 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 a current tax on labor or capital. The linkage could be accomplished efficiently by basing the fee on the average cost of carbon in the industrial cap-and-trade program during a recent period of time. This "linked fee" approach will ensure a consistent price of carbon in the market (unlike 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, adding 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 is likely to be more restricted 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 likely 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 the industrial/commercial sector, with potentially volatile and steeply rising allowance prices.

A similar need for large GHG emissions reductions from the industrial/commercial sector could develop if efficiencies in transportation simply 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 sizes of the transportation and industrial sectors, a scenario could easily develop in which insufficient emissions reduction from the transportation sector overwhelms the ability of the industrial sector to generate GHG emissions reductions, and 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 industrial and commercial GHG 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, and link that fee periodically through an averaging process to the cost of GHG emissions imposed in the industrial cap-and-trade program. Such a fee could be imposed at the same point, and collected in the same manner, as fuel excise taxes are collected today. For example, the 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 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 overall system based on experience and forward objectives. 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 summary, a linked carbon fee approach is expected to provide superior GHG emissions reduction performance, improved allowance price stability, and reduced fuel supply risk, compared to a cap-and-trade system which includes both large stationary emitters of GHGs and transportation fuel GHG emissions.

### **Residential and Commercial Use of Natural Gas**

The same linked carbon fee approach could be applied to local natural-gas distribution companies to cover residential and commercial use of natural gas under 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 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,

Original signed by S. K. Stuewer

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

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