

Daniel Nelson
Vice President
Washington Office

February 16, 2006

The Honorable Richard G. Lugar
United States Senator
Senate Hart Office Building 306

The Honorable Tom Harkin
United States Senator
Senate Hart Office Building 731

Dear Senator Lugar and Senator Harkin:

I am writing in reply to your letter of February 2 to ExxonMobil's Chairman, Rex Tillerson. Your continuing interest in energy issues is appreciated. You have raised some important questions about the practical implications of E85, and I welcome the opportunity to give you our perspective.

Attached you will find an article on E-85 from the February 15, 2006 edition of USA Today as well as an article from Platts Oilgram News, dated today. These articles capture the essence of why E85 has not penetrated the market in significant volumes, and why transportation fuel retailers and middlemen have been hesitant to invest in facilities to be able to handle E85. Simply said, customers are extremely price sensitive and E85 cannot compete with conventional gasoline at present given the price of ethanol.

As you may be aware, ethanol has considerably less energy content per gallon than gasoline. The combination of an E85 price that is high relative to gasoline, relatively poor E85 fuel economy performance and the small number (2 to 3 percent of the US total) of vehicles that can use this fuel means that there is little viable demand.

The US motor fuels market is in the midst of a significant transition, with the introduction of lower sulfur gasoline and ultra low sulfur diesel, the phase-out of MTBE in gasoline and the implementation of the Renewable Fuels Standard. The initial offering of ethanol has largely been in gasoline blends composed of 10 percent ethanol by volume (E10). E10 is generally compatible with existing service station equipment and the majority of vehicles on the road.

ExxonMobil was one of the earliest suppliers of ethanol-blended gasoline and we have been among the leaders in volume usage. We blend almost a million gallons into our gasoline products every day -- both to meet federal and state government regulations or local demand in ethanol-producing areas. The volume of ethanol-blended gasoline we sell will increase substantially to meet the Renewable Fuels Standard required by the Energy Policy Act of 2005.

ExxonMobil operates only a small percentage of Exxon and Mobil branded sites in the US. Independent business people own and/or operate more than 93% of these retail sites. As the marketing of retail fuels continues to evolve, we, of course, will work with our independent dealers and distributors to introduce innovative products that have consumer appeal and are financially viable.

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The Honorable Richard G. Lugar

The Honorable Tom Harkin

There are presently 11 Exxon and Mobil branded sites in the Midwest selling E85, with another five installing E85 dispensing equipment. Our dealer and distributor sites are permitted to install unbranded E85 dispensers provided that such installation is reviewed and approved by ExxonMobil in advance. I am not aware of any instance where a request to install E85 dispensing equipment at a dealer or distributor site has been denied.

Retail dispensing equipment and the fuel distribution system will have to be replaced or modified to handle E85, representing potentially significant costs for the independent small businesses that make up the majority of our service station sites across the U.S. This is because certain materials - such as aluminum, a common component in gas pumps - are incompatible with E85 and may corrode, resulting in fuel contamination. New underground storage may also be needed. Similarly, terminal operators will need to add or expand dedicated storage tanks and specialized blending capabilities for E85.

As ethanol production capacity in the US and worldwide grows, ethanol pricing may become more reliably competitive with gasoline. Given the low barriers to entry in the fuels marketing business, economic incentives may then motivate any number of participants to enter into the E85 business. Indeed, given the ready availability of wholesale gasoline in the United States and the fact that E85 is 85 percent composed of something produced by non-petroleum participants in the fuels market, we will be surprised if E85 outlets are not substantially owned or franchised by companies involved in ethanol production as they seek to capture more of the profit potential from their base business.

I hope that you find these comments to be helpful.

Sincerely,

A handwritten signature in black ink, appearing to read "Dan Rostenkowski". The signature is fluid and cursive, with a long horizontal stroke at the end.

Enclosures (2)

Oilgram News

Volume 84 / Number 32 / Thursday, February 16, 2006

Amid US gasoline changes, ethanol price up

EPA announces oxygenate requirement to be dropped May 6

New York—Ethanol prices have surged on a tug of war for product after passage of a new US energy bill spiked demand and created logistical concerns.

Growing East Coast demand has sent New York spot ethanol prices to more than \$2.80/gal, the highest price since spot trading of the product began a few years ago, according to *Platts* data.

The US Energy Bill combined a repeal of the national oxygenate mandate for reformulated gasoline with a renewable fuels requirement for RFG, but did not provide an MTBE liability waiver. That prompted many refiners and pipelines to eliminate MTBE, known to

contaminate drinking water supplies.

While refiners were now free to make oxygen-free RFG, many decided not to do so, according to Michael Leister, fuels technology manager at Marathon Petroleum.

The US Environmental Protection Agency announced Feb 15 the national oxygenate requirement will be dropped May 6, with California's separately dropped in mid-April. But Leister told *Platts* those actions came too late for refiners who must switch over to summertime RFG production by April. Summertime RFG has a lower RVP formula than the wintertime formula.

Refiners already knew the national oxygenate rule would be dropped in early May. Because of the timing, most plants have been upgraded to make ethanol-blended RBOB as they try to move away from MTBE while still making an oxygenated RFG.

"Everyone's going to invest to make RBOB," said Leister. "Once you're converted for the season, it's really unlikely to change. This spring and summer the price of ethanol is going to be quite high, but everyone's locked into it."

EPA said Feb 15 it also expects ethanol to replace MTBE despite the lack of an oxygenate mandate. The agency cited "current gasoline prices and the tightness in the gasoline market, the favorable economics of ethanol blending, a continuing concern over MTBE use by refiners, the emission performance standards still in place for RFG, and the upcoming renewable fuels mandate..."

Non-oxygenated RFG, known as "clear RFG," is not easy to make, said Joanne Shore, analyst with the Energy Information Administration. "We're not expecting much of that to be made at this point," she said, explaining you must find a way to give the product the octane boost it usually gets from oxygenates like ethanol without also raising emissions. "Ethanol is clearly going to be the choice of most people at this point," said Shore.

The jump in ethanol demand is creating supplier issues. "The timing and the magnitude of this voluntary shift (to ethanol from MTBE) presents greater problems than we've

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Amid changes in US gasoline, ethanol prices surge

(continued from page one)

previously encountered," Roger Miller, CEO of big ethanol supplier Aventine Renewable Energy, told a recent Platts Gasoline Blendstock conference.

Miller's use of the term "voluntary" to describe the switch raised the hackles of some participants, who complained the lack of a liability waiver gave them no choice.

Transitions away from MTBE were said to be smooth during bans in key states such as New York, Connecticut and California. But last fall's Energy Bill passage was a "tipping point" in the evolution of the ethanol industry, Miller said.

"With the rapid MTBE removal" this year, there is "enormous market opportunity" for ethanol suppliers, he said, noting 2-bil gal of MTBE is being rapidly removed from the gasoline pool.

"Currently we have a tight (ethanol) supply condition" because MTBE was "phased out much more rapidly" than anybody thought, said Miller. He said he expects ethanol prices to remain firm; however, "once we get past this period...I would expect to see some moderation."

"There's plenty of ethanol produced in the country to meet the needs, but a lot of that ethanol is being used in the Midwest today," Leister told the conference. He said ethanol prices have to be high enough to move the product, sold mostly under contract in the Midwest, to RFG areas like the East Coast.

"The price needs to get to the point where the people in the Midwest no longer find it economic to blend," he said.

"Ethanol supplies are tight and are going to get tighter for the next few months," said Leister. He added demand has been seen in the Gulf Coast: "There are lots of people trying to line up ethanol contracts in Texas."

And more ethanol demand may be on the horizon. "You're seeing signals in all the southern states. They're talking about MTBE bans," said Leister. A Kentucky MTBE ban went into effect in January.

Current US ethanol capacity is around 4.3-bil gal/yr from 95 plants, according to the Renewable Fuels Association. There are 31 plants and nine expansions under way that will add a combined 1.5-bil gal, according to RFA.

"Certainly if we're looking at 1.3- to 1.6-bil gal (of new ethanol demand) and it takes 15 months to build plants, we're talking about 2007-2008," before "supply may begin to get ahead of what you would consider sort of a mandated transition," said Miller.

Adding to the supply issue is a logistical one, he said, citing multiple markets from the Gulf Coast to the Northeast. "In the near term, faster than anticipated MTBE withdrawal will create logistical issues that need to be managed," he said.

More unit trains, which are dedicated to the movement of a particular commodity like

ethanol, will be needed, said Miller.

"Large scale product movements will be required," he said. "We can no longer ship one-car, five-car, 10-car shipments (of ethanol). We need to be shipping 95-car unit trains." He said new tank car availability is tight and most cars are not available until January 2007 at the earliest.

"We are seeing train programs developing in some RFG areas," such as Dallas, New York Harbor, Providence, Baltimore and Norfolk, said Miller. "But the industry will rely heavily on marine delivery until the rail infrastructure is developed, both on the US Gulf Coast and on the US East Coast."

Meanwhile, EPA Feb 15 also changed current rules to allow limited commingling of ethanol-blended volatile organic compound-controlled, or summertime, RFG with VOC-controlled RFG produced using other oxygenates such as MTBE.

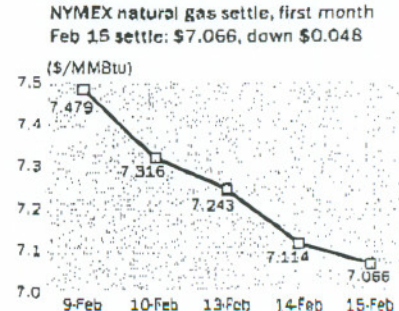
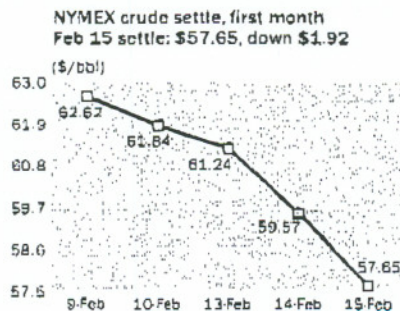
The commingling provision "will typically be used by retail outlets to change from the use of RFG containing ethanol to RFG not containing ethanol or vice versa," said EPA in its rule. "Such blending can result in additional VOC emissions," it said.

The EPA will allow retail-level commingling of summertime ethanol-blended RFG with non-oxygenated or oxygenated RFG if three conditions are met: individual certification of gasoline batches; EPA notification prior to combining the gasolines, as well as the retail outlet location and specific tank; and inspection certifications must be available accounting for all gasoline at the retail outlet.

Retailers may combine such RFG batches during two 10-day periods between May 1 and Sep 15. They are prohibited from combining VOC-controlled gasoline with non-VOC-controlled gasoline between June 1 and Sep 15, said EPA.

"EPA believes retailers and wholesale purchaser-consumers should have additional flexibility during the time that they are converting their tanks from one type of RFG to another, while minimizing the time period during which non-compliant gasoline is present in their tanks and being sold," EPA said.—Beth Evans

What crude & natural gas markets are doing...



College All-Stars

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February 15, 2006

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Cost of E85 fuel is higher than gasoline

Ethanol blend's price rises as refiners buy it in bulk

By James R. Healey
USA TODAY

The heavily promoted alcohol fuel called E85 might cut America's oil use and help support U.S. agriculture, but it's not reducing motorists' fuel bills. It's boosting them significantly.

Alternative energy The price of E85 — a fuel that's 85% ethanol made from grain and 15% conventional gasoline — is higher than that of gasoline, even though E85 has only 72% as much energy. The U.S. Department of Energy says a vehicle has to use 1.4 times as much E85 as gasoline to go the same distance.

At some Nebraska stations, E85 was \$2.19 a gallon Tuesday, while gasoline with 10% ethanol — a common substitute for unleaded regular in the Midwest — was \$2.06. "This doesn't make sense," says Wayne Davis, a division manager at fuel company Bosselman, based in Grand Island, Neb. "Our customers are saying, 'I'm not going to buy E85, which is better for the environment

and the economy, unless it's cheaper.' We're seeing E85 just sit."

President Bush, in his State of the Union speech Jan. 31, promoted ethanol as a way to help reduce Middle East oil imports 75% by 2025.

Ford Motor and General Motors are working with fuel companies to boost the number of E85 stations in the Midwest. The two automakers say they will build about 600,000 vehicles this year with the special equipment needed to use E85. About 5 million already are on the road. All that emphasis could be negated by pricing.

"Price dictates demand. Period," says Dave Lybarger, who sells E85 at one of his two Petro Plus stations in Garnett, Kan.

He was selling E85 for \$1.94 a gallon Tuesday, and conventional gasoline for \$2.19. "If you get it 40 cents under, you start attracting new business. If you get to just 10 under, you start to lose some (E85) business," he says.

Comparing fuel prices

Wholesale gasoline prices, per gallon, without ethanol and gasoline-ethanol blends at two fuel distributors on Monday:

Des Moines

Unleaded gasoline	\$1.5737
E10 (10% ethanol)	\$1.6516
E85 (85% ethanol)	\$2.2425

Omaha

Unleaded gasoline	\$1.5695
E10 (10% ethanol)	\$1.6730
E85 (85% ethanol)	\$2.2544

Note: Federal tax credit would reduce E10 price 5.1 cents and E85 price 43.4 cents per gallon if passed straight through from wholesaler.

Source: Oil Price Information Service

By Julie Snyder, USA TODAY

Nationwide average price for gasoline has sunk to \$2.286 per gallon, according to travel group AAA's daily report.

To be an even-up energy value, E85 would have to sell for 72% of that, \$1.646.

But E85 wholesale prices have jumped to more than \$2, so retailers can't afford to sell it for that.

The price of ethanol has been driven up because major oil refiners are suddenly buying in bulk. They're stocking up on ethanol as a replacement for MTBE, a petroleum-based additive suspected of causing cancer. MTBE and ethanol boost the octane of gasoline and can reduce pollution.

MTBE isn't officially banned, but oil companies are switching to avoid lawsuits.

"Gasoline with MTBE in it will become like gasoline with anthrax in it within the next 90 days," predicts Tom Kloza, veteran analyst at the Oil Price Information Service.