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# MEMORANDUM

## RE: Oil Company Capital Spending

Oil companies are by definition in business to make a profit. Their actions are aimed at removing or preventing any barriers to achieving increased profits. Taxes are a barrier to achieving profits and when raised serve to reduce profits and when lowered serve to increase profits. Thus, oil companies are naturally predisposed to oppose any increase in taxes. With all things being equal (which they rarely are), oil companies would preferentially invest in areas with the lowest taxes, however this is not the real world calculus.

When materiality and prospectivity are added to the investment decision criteria, oil companies quite often end up investing in countries with relatively high or above average tax rates. They do so because they believe (and often realize) that investments in those countries will provide access to new reserves and will generate significant profits. Similarly, countries that offer extraordinary potential (like Angola, Russia and Kazakhstan) are able to command a greater share of the total pie while, at the other extreme areas which have extremely favorable tax regimes (like Ireland and Morocco) still do not attract significant industry interest.

The oil companies are – rationally – resisting initiatives to increase their effective tax burdens and attempting to boil down the issue of fiscal policy and its impact on their capital investment decision making to a single factor: **the effective tax rate**. But the issue is not that simple. The oil companies must, if they are to remain in existence, do a good job at profitably replacing the reserves that they are currently producing. The number of locales in the world that offer the larger oil companies the needed level of materiality to do that are limited in number. ExxonMobil, BP, Chevron and ConocoPhillips for example, together produce over 12 million barrels of oil equivalent per day – to simply replace their production they need to find a Kuparuk size accumulation every 8 to 9 months!

The oil companies have compared Alaska's tax regime to mainly other lower 48 United States tax regimes; however, such a comparison would only be valid for a small portion of their overall investment capital spending. Lehman recently published a survey of 350 companies that showed estimated total worldwide capital spending in 2007 of just over US$300 billion of which roughly one quarter or US$77 billion would be in the United States (including Alaska). Overall, 2007 numbers represented over a 20% increase for international (i.e. non-US or Canada) spending with United States spending up slightly and Canadian spending down.

Looking at just the United States, expected 2007 spending represents an increase of 4.8% over 2006. A further breakdown of the numbers by Lehman shows that smaller companies (those with annual spending under US$1 billion) were estimating increasing their spending by some 10+% for 2007 while the large oil companies were only expecting spending in the United States to increase 1.2%.

The Lehman data seem to be corroborated by data in the oil companies' annual reports. Gaffney, Cline & Associates reviewed annual reports for BP, Chevron, ConocoPhillips and ExxonMobil for 2002 through 2006. Where available, capital spending data overall and in the United States for the upstream sector were used. Where such geographic breakdown was not provided data for corporate spending were used to arrive at the numbers below. The key piece of information is not the absolute value, but the trend of where the main players in Alaska are spending the bulk of their investment dollar. For upstream spending BP's investments outside the United States represented 50% to 75% of their overall total. Similar numbers for Chevron were 67% to 71%, ConocoPhillips 63% to 75% and ExxonMobil 77% to 85%.

| | | Capital Spending ($millions) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2006 | | 2005 | | 2004 | | 2003 | | 2002 | |
| **BP:** | **US** | $6,592 | 50% | $3,870 | 38% | $3,913 | 36% | $3,906 | 26% | $3,100 | 32% |
| | **International** | $6,526 | 50% | $6,367 | 62% | $7,095 | 64% | $11,286 | 74% | $6,559 | 68% |
| | **TOTAL** | **$13,118** | | **$10,237** | | **$11,008** | | **$15,192** | | **$9,659** | |
| **Exxon:** | **US** | $2,486 | 15% | $2,142 | 15% | $1,922 | 16% | $2,125 | 18% | $2,357 | 23% |
| | **International** | $13,745 | 85% | $12,328 | 85% | $9,793 | 84% | $9,863 | 82% | $8,037 | 77% |
| | **TOTAL** | **$16,231** | | **$14,470** | | **$11,715** | | **$11,988** | | **$10,394** | |
| **Conoco:** | **Alaska** | $820 | 9% | $746 | 11% | $645 | 12% | $570 | 13% | $706 | 22% |
| | **US (Continental)** | $2,008 | 21% | $891 | 13% | $669 | 12% | $848 | 19% | $499 | 15% |
| | **International** | $6,685 | 70% | $5,047 | 76% | $3,935 | 75% | $3,090 | 68% | $2,071 | 63% |
| | **TOTAL** | **$9,513** | | **$6,684** | | **$5,249** | | **$4,508** | | **$3,276** | |
| **Chevron:** | **US** | $4,123 | 32% | $2,450 | 29% | $1,820 | 29% | $1,641 | 29% | $1,888 | 30% |
| | **International** | $8,696 | 68% | $5,939 | 71% | $4,501 | 71% | $4,034 | 71% | $4,395 | 70% |
| | **TOTAL** | **$12,819** | | **$8,389** | | **$6,321** | | **$5,675** | | **$6,283** | |

Moreover, the review of the annual reports show investment by these four companies in significant projects in jurisdictions that have average and marginal tax rates above those in place or proposed in Alaska.

In deciding where to invest, tax policy is one of the factors considered but is demonstrably not, in and of itself, the controlling factor.