

Testimony for the
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Committee on Transportation and Infrastructure
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on

“Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990
and Related Statutes.”

by

Kate Gordon
Vice President for Energy Policy
The Center for American Progress Action Fund
1333 H Street NW
Washington DC 20005
(202) 682-1611

Mister Chairman, Ranking Member Mica, and members of the committee, thank you for inviting me to testify before you today. The issue of oil industry liability for oil spills is critical in light of the current disaster in the gulf. I am glad to be able to share my and the Center for American Progress Action Fund’s fundamental belief that the liability cap for damages must be raised, and other measures put in place, to more realistically account for the actual costs of oil spills to the environment and economy. I look forward to your questions and comments.

The Oil Pollution Act of 1990, or OPA, was put into place after the Exxon Valdez oil spill, which focused national attention on the oil industry’s responsibility to plan for, prevent, and eventually clean up its oil spills. As everyone on this committee knows, the OPA imposes several limits on the liability of a vessel or drilling facility owner in the event of a spill. These liability limits depend, for vessels, on the size of the vessel and whether it is a single- or double-hulled vessel; for facilities, the limits depend on whether the facility is onshore or offshore. For the purposes of the current disaster, the OPA provides that the facility owner is liable for all cleanup costs, but that its liability for longer-term effects on natural resources and the economy are limited to \$75 million. Beyond this, damages are paid out of the Oil Spill Liability Trust Fund, which itself has a spending cap of \$1 billion per incident, of which no more than \$500 million may be paid for natural resource damages. Beyond that, the costs are ultimately the responsibility of the taxpayers and communities affected, sometimes for decades, after an oil spill.

These are big numbers. But they do not even come close to the likely cost of the current disaster, or in fact, to most modern oil spills. Each year, the Coast Guard submits an annual report to Congress assessing the year's oil spills and their impact on the Oil Spill Liability Trust Fund. In its August 2009 report, the Coast Guard found that 51 spills or near-spills that had occurred since the OPA's enactment had resulted in damages that exceeded statutory liability limits.¹ The overall cost of these spills to the Trust Fund, which must cover damages that exceed the liability caps, was \$1.5 billion. Not one of these spills was anywhere near the scale of Exxon Valdez or the BP Deepwater Horizon disaster; the majority were from fishing vehicles and small cargo vessels. The report concluded that for vessels containing "substantial fuel oil", the liability limits likely do not account for actual costs of cleanup and damages.²

Lessons from Exxon Valdez

For a clear example of the failure of the liability caps to come close to the actual damage caused by a severe oil spill, we need look no further than the Exxon Valdez fiasco in 1989.

On March 24, 1989, The *Exxon Valdez* tanker spilled more than 11 million gallons of crude oil into Alaska's Prince William Sound. Eventually more than 1,300 miles of shoreline were contaminated.³ The total costs of Exxon Valdez, including both cleanup and also "fines, penalties and claims settlements," ran as much as \$7 billion, with cleanup costs and related damages (the type of costs covered by the OPA liability cap) running to at least \$2.5 billion.⁴

Despite an aggressive spill response, involving more than 11,000 people and costing more than \$2 billion, coastal regions and coastlines of the Prince William Sound are still contaminated. In its 2009 status report, the Exxon Valdez Oil Spill Trustee Council found that as much as 16,000 gallons of oil remains in the sound's intertidal zones today.⁵ Similarly, the National Oceanic and Atmospheric Administration found that "a total area of approximately 20 acres of shoreline in Prince William Sound is still contaminated with oil. Oil was found at 58 percent of the 91 sites assessed and is estimated to have the linear equivalent of 5.8 km of contaminated shoreline."⁶

The continuing impact of the spill has taken its toll on the coastal towns in Prince William Sound, which rely heavily on the fishing industry. Because some fish populations, like the Pacific herring, have never fully recovered, these towns have seen a dramatic decline in income, along with more sobering consequences like increased suicide and alcoholism rates.⁷

The long-term nature of the Exxon Valdez damage is typical of major oil spills. As Dr. Jeffrey Short of Oceana testified at a hearing on the 20th anniversary of the spill, "Despite heroic efforts. . . only about eight percent of the oil was ever recovered. This recovery rate is fairly typical rate for a large oil spill. About 20 percent evaporated, 50

percent contaminated beaches, and the rest floated out to the North Pacific Ocean, where it formed tar balls that eventually stranded elsewhere or sank to the seafloor.”⁸

In short, the actual costs of both cleanup and longer-term damages of the Exxon spill were far greater than \$75 million. They will surely exceed this amount in the current BP oil disaster. First and most important, the BP disaster directly caused the deaths of eleven individuals—a cost that is impossible to put into a dollar figure on a spreadsheet. Second, at least 30 million gallons of oil have already surged into the gulf waters. Though BP is making efforts to contain the undersea volcano, it appears that at least 11,000 barrels per day are continuing to escape.⁹ Oil-covered birds and fish are already washing up on Louisiana, Mississippi, Alabama, and even Florida’s shorelines, and each day that passes brings us closer to hurricane season, with its potential to spread the oil much further afield.

Until BP finally stops its flood of oil, we have no way of knowing all the short- and long-term costs of this fiasco. But some estimates put the cleanup costs alone at over \$1 billion so far, with the potential for tens of billions of dollars more in related “social costs”—all of the private costs of the spill, minus punitive damages and fines.¹⁰

Internalizing the actual costs of deepwater drilling

Raising—or completely eliminating, as just proposed by the White House—the liability cap for oil companies, especially those engaged in undersea exploration where a disaster is less an “oil spill” than an “oil flood,” would have two key benefits: It would bring the costs paid out by the oil companies far closer to the actual costs of these disasters; and it would encourage these companies to do a more realistic cost-benefit calculation when weighing the risks and rewards of deepwater drilling.

The actual costs of large oil spills and of “oil floods” are almost guaranteed to exceed the \$75 million cap set by OPA. A company paying only immediate cleanup costs plus the \$75 million would be responsible for just a fraction of the true costs of such a disaster. Increasing the cap for large vessels and deepwater facilities would better reflect the truly staggering amount of oil these vessels and facilities can potentially release into public waters, and the enormous damage caused by that oil when released.

Raising the liability cap would force companies engaged in deepwater drilling and large-scale oil importation to better internalize the risk of an oil disaster. Right now these companies have no incentive to internalize this risk. As my fellow panelist Michael Greenstone recently wrote, the \$75 million cap actually has the perverse result of *encouraging* drilling in the most environmentally sensitive areas, using the most risky practices. As it stands, there is no additional cost to drilling near wildlife habitats and fisheries, or to using new and untested equipment without a clear idea how that

equipment will work under deepwater conditions. Therefore “[t]he cap effectively subsidizes drilling in the very locations where the damages from spills would be the greatest.”¹¹

Without an increase in the OPA liability cap, these costs will be paid out of the trust fund, but only up to \$1 billion per incident, which is the current limit set by the fund. Some legislative proposals have suggested lifting the \$1 billion per incident cap. We at the Center for American Progress Action Fund support this proposal. Unless the cap on the liability fund is raised, the fund will not be available to help those hurt by spills like the Deepwater Horizon disaster.

But it is also important to ensure that the fund is available for future spills. Oil companies currently pay an 8-cent tax on each barrel of oil imported or produced in the United States, and this tax goes directly into the fund. But this tax is set to expire in 2017 or when the trust fund hits \$2.7 billion dollars, whichever comes first. We believe Congress should eliminate the sunset from the tax to ensure the fund can replenish itself. And it should also increase the per-barrel tax so that oil companies more accurately bear the costs that their actions impose on society. The House just voted to raise this tax to 34 cents per barrel in the recent tax extender bill; we recommend the Senate follow suit and pass the bill into law.

Unless the barrel tax is extended and increased, the fund will run out of money and will no longer be available to pay the cleanup costs for the many smaller spills, such as those from fishing vessels and small cargo vessels, which occur frequently but without much media attention. These smaller spills include instances where the responsible party cannot be identified or cannot afford to pay for the costs of cleanup—clearly not the case with the BP Deepwater Horizon disaster.

Oil companies are already required to calculate the actual risk of deepwater drilling, even though they are not required to make drilling decisions on the basis of this risk. The OPA requires that deepwater facility owners calculate their worst-case oil discharge scenario, and then demonstrate the ability to cover the liability costs of this scenario. In its Initial Exploration Plan for the Macondo site, BP presented a worst-case scenario of 300,000 barrels, or about 12.6 million gallons, of oil *per day* escaping from an uncontrolled blowout. (This worst-case scenario is actually worse than reality: In fact, the current estimate is that the Deepwater Horizon was spewing between 19,000 – 25,000 barrels of oil per day before the most recent containment attempt.)¹²

This nightmare scenario would, as we know from the Exxon experience, lead to billions upon billions of dollars in cleanup costs and damages, something BP must have known when it filed the Exploration Plan. But under the OPA, companies are only required to demonstrate that they have the financial resources to cover \$150 million in potential liability costs¹³—an amount that is almost certainly less than the cleanup costs plus \$75 million in damages that would have to be paid out in the event of any serious spill. In

other words, even knowing of the potential for a 300,000 barrel per day spill, were something to go wrong at its Deepwater Horizon facility, BP had no financial incentive to change its plans to drill in this area under these conditions.

In fact, early reports point to the fact that BP might have prevented at least some of this disaster by installing a switch, known as an “acoustic blowout preventer,” to remotely shut off the flow of oil. This technology is required in other countries, such as Brazil and Norway. Installing the blowout preventer would have cost BP \$500,000, but the company had no incentive to spend extra money on extra precautions.¹⁴

The oil industry’s history of avoiding payment for spills

Unfortunately, BP’s unwillingness to spend money up front to prevent later disaster is just one example in a long history of oil companies’ reluctance to pay the true costs of drilling and transporting large quantities of oil.

Again, Exxon provides a good example. The company famously made high profits even in the aftermath of the most expensive oil spill in history: Company profits totaled \$3.8 billion profit in 1989¹⁵ and \$5 billion in 1990¹⁶. At the same time, Exxon disputed spill cleanup costs nearly every step of the way.

Exxon fought paying damages and appealed court decisions multiple times, and in fact, the company still has not paid its costs and fines in full. Years of fighting and court appeals on Exxon’s part finally concluded with a U.S. Supreme Court decision in 2008, which found that Exxon only had to pay \$507.5 million of the original 1994 court decree for \$5 billion in punitive damages.¹⁷ As of 2009, Exxon had paid only \$383 million of this reduced amount, stalling on the rest and fighting the \$500 million in interest owed to fishermen and other small businesses from more than 12 years of litigation.¹⁸

Twenty years later, some of the original plaintiffs are no longer alive to receive, or continue fighting for, their rightful compensation for damages to their livelihoods from the oil spill. An estimated 8,000 of the original Exxon Valdez plaintiffs have died since the spill while waiting for their compensation as Exxon fought them in court.¹⁹

Moreover, Exxon is allowed to take a tax deduction on any punitive damages it pays—meaning that taxpayers ultimately pay about 40 percent of these costs. As the Center for American Progress’s Sima Gandhi points out, this tax advantage is equivalent to a subsidy for polluters. “[Taxpayers] cannot afford to pay these subsidies. The nation’s current and long-range fiscal challenges demand that we get maximum value out of every taxpayer dollar spent. Oil companies are highly profitable—they don’t need these subsidies.”²⁰

Impact of raising or eliminating the liability cap for offshore facilities

Raising the liability cap for offshore facility operators from \$75 million to \$10 billion (as originally recommended by Sens. Robert Menendez, Frank Lautenberg, and Bill Nelson in the Senate and Rep. Arthur Davis in the House)—or eliminating the cap altogether, as just proposed by the White House—would begin to address this dysfunctional risk-reward calculation by changing company behavior to better internalize actual costs. We have evidence that imposing higher liability costs changes company behavior: When the OPA passed in 1990, it broadened the scope of damages for which a responsible party would be liable. For instance, it made any cleanup by a private party, not just a government agency, eligible for reimbursement. When the spill is due to gross negligence or other such circumstances, the OPA allows for unlimited liability. These new higher limits, combined with the actual costs incurred by Exxon as a result of the Valdez spill, are considered to be a major reason for the overall decline in spills throughout the 1990s.²¹

But would raising the cap ultimately lead to the demise of offshore drilling? This is highly unlikely. First of all, the companies that are large and well-financed enough to invest in offshore drilling are also well-financed enough to weather greater liability costs. BP, for example, brought in \$239 billion in revenue during 2009, a recession year. That same year, the company realized \$16.8 billion in profits from ongoing operations. In other words, even if cleanup costs and damages ultimately cost BP \$100 billion, this would still be less than BP's profits for the past five years.²²

Some observers have expressed concerns that offshore oil companies would no longer be able to get insurance to cover their operations without the liability cap. But raising the cap should not have any impact on insurance coverage. In the same section that requires responsible parties to show the ability to pay costs up to \$150 million, the OPA makes clear that no guarantor of an offshore drilling operation will be liable for damages or cleanup costs that “exceed, in the aggregate, the amount of financial responsibility which that guarantor has provided for a responsible party pursuant to this section.”²³ In other words, a guarantor—an insurance company, in most cases, or a bondholder—has no liability for the costs and damages of a spill over and above \$150 million. Raising the liability cap for damages would not affect this section and should not affect the willingness of the insurance industry to cover deepwater drilling operations.

For the same reason, raising the cap should not have a strong negative impact on the insurance industry as a whole. Furthermore, in the case of BP specifically, the company is self-insured for gulf activities through a captive insurer, Jupiter Insurance Ltd. As the Insurance Information Institute has noted, the fact that BP is self-insured means that “a large portion of [its] losses will not hit the insurance industry.”²⁴

Raising the cap should not, then, affect the ability of companies to receive insurance, or the long-term viability of the insurance industry itself. But if companies are forced to truly face the risks and potential costs of drilling, what would be the impact on the gulf economy and on U.S. oil production?

The United States imports almost 70 percent of our oil. Of the 30 percent produced domestically, about one-third comes from the Gulf of Mexico; however, oil production from the region has been in steady decline since the early 2000s.²⁵ Interestingly, the U.S. actually exports a significant percentage of gulf oil: A Center for American Progress analysis of Energy Information Administration data found that about 40 percent of the oil produced in the Gulf Coast region is actually exported to other nations in the form of finished petroleum products.²⁶

The deepwater oil supply at issue in the BP disaster represents some of the last remaining “technically recoverable” (as opposed to “economically recoverable”) oil remaining in the United States. According to the Energy Information Administration, lifting all current moratoria on drilling in the Pacific, Atlantic, and eastern gulf regions “would not have a significant impact on domestic crude oil and natural gas production or prices before 2030.”²⁷ Such a move would likely only increase domestic oil production by one or two million barrels a day within the next decade—an amount so small that many believe it really only “delays the day of reckoning,” or the day the world decides to truly focus on moving away from its dependence on oil.²⁸

The Obama administration is already preparing for that day of reckoning: The administration’s new fuel economy standards will improve vehicle efficiency by more than one-third, saving 1.8 billion barrels of oil over the lifetime of new vehicles.²⁹ The emerging market for electric vehicles will also contribute to overall oil savings, as will the new investments in electric vehicle and transit infrastructure that have been proposed as part of the next transportation bill reauthorization.

Taken together, declining supply and declining demand spell the end of an oil-dependent era. The U.S. is moving, slowly but surely, toward a more diversified and more efficient energy system. In that context, any small decreases in deepwater drilling that might theoretically be caused by higher liability caps or other regulations will not have a significant global impact.

Beyond the liability cap: Other policy recommendations

Raising the liability cap for deepwater drilling is critical so that oil companies can begin to bear some of the true risk of their actions. But raising the cap is not the only legislative or administrative fix necessary to account for these costs or to level the playing field for other, less risky technologies.

The Center for American Progress has recommended a number of policies to help internalize the cost of risky oil company decisions.³⁰ These include:

- Adopting the recommendations for offshore oil well safety in the Interior Department's "Increased Safety Measures for Energy Development on the Outer Continental Shelf" report, including better backup systems and more complete inspections
- Eliminating the tax deduction that allows companies to avoid paying about 40 percent of any court-ordered punitive damages
- Raising penalties for breaking safety regulations so there is a meaningful incentive to adopt preventive measures
- Requiring oil companies to pay a reasonable rent for extracting resources from public waters
- Eliminating nine major tax expenditures for oil companies³¹—including reforming the "foreign tax credit" to ensure that oil companies pay U.S. tax when they don't pay taxes abroad—to save \$45 billion over 10 years
- Eliminating the sunset provision from the Oil Spill Liability Trust Fund, which currently allows the 8 cent per barrel tax that populates the fund to expire in 2017 or when the fund hits \$2.7 billion (Note that this has already been proposed in the Senate by Sens. Lisa Murkowski and Mark Begich as part of the Oil Spill Liability Trust Fund Improvement Act of 2010.)

CAP has also called for BP to put \$5 billion—its first quarter 2010 profits—into an escrow fund to ensure prompt payments for cleanup and compensation for the current disaster.³² As a longer-term strategy, CAP recommends that all the major oil companies with operations in the Gulf states region invest some portion of historical profits from the region into a long-term economic development fund, with the goal of weaning this region off its dependence on oil-related industries.³³

Finally, and in many ways most important, we have been a strong voice in favor of passing a comprehensive climate and energy plan that would help create the market, financing, and infrastructure necessary to move America toward a cleaner energy future.³⁴ This plan must include strong measures to significantly reduce oil use, including new fuel economy standards and investments in electric- and natural gas-powered vehicles.³⁵

Conclusion

The BP Deepwater Horizon disaster is stark reminder of what happens when companies ignore the true risks of doing business in the search for higher profits. We cannot stand by and allow this to happen again—we must begin a real accounting of the costs and benefits of offshore oil drilling. Though this requires a comprehensive policy agenda, the first step is to raise or eliminate the cap on oil spillers' liability for damages beyond simple cleanup costs.

Thank you very much.

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