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LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES

(111–117)

HEARING

BEFORE THE

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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June 8, 2010

SUMMARY OF SUBJECT MATTER

TO: Members of the Committee on Transportation and Infrastructure

FROM: Subcommittee on Coast Guard and Maritime Transportation Staff and Subcommittee on Water Resources Staff

SUBJECT: Hearing on "Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes"

PURPOSE OF THE HEARING

The Committee on Transportation and Infrastructure will convene on Wednesday, June 9, 2010, at 10:30 a.m., in room 2167 of the Rayburn House Office Building to receive testimony regarding the liability requirements for oil spills imposed by the Oil Pollution Act of 1990 (OPA) (P.L. 101-380) and related statutes on offshore facilities and vessels operating in U.S. waters. The Committee will also consider the potential impact of the liability claims arising from the loss of the *Deepwater Horizon* mobile offshore drilling unit (MODU) in the Gulf of Mexico and the subsequent oil spill from the Macondo well site on the offshore industry.

Given the complexity of the *Deepwater Horizon*/Macondo incident and the size of the potential damages arising from this spill (which far exceed current liability limits applied to offshore facilities), the Committee will assess whether the current liability limits for offshore facilities and vessels should be raised and whether the amount of financial responsibility offshore facilities and vessels are required to demonstrate for liabilities associated with oil spills should also be raised (and, if so, to what levels). An important related question is whether increases in the liability limits can and should be applied retroactively to the *Deepwater Horizon* incident.

EXECUTIVE SUMMARY

OPA holds the owners or operators of vessels and facilities engaged in the exploration, development, or shipment of oil strictly liable for any oil that is discharged or that poses a significant threat of discharge into or upon the navigable waters, adjoining shoreline, or exclusive economic zone of the United States. Generally, an owner or operator of a vessel or facility is liable for the removal costs and the damages that result from an oil spill.

OPA imposes several limits on the liability of an owner or operator of a vessel or facility; however, OPA statutory limits do not apply if a facility or vessel responsible party has been grossly negligent or has violated an applicable Federal regulation.

OPA imposes different liability limits and different requirements for demonstrating insurance coverage for facilities involved in the drilling of oil, and vessels that carry oil.

For facilities, the statutory limits vary depending on whether the facility is onshore, offshore, or a deepwater port. There is no limit on the responsible party for removal and cleanup costs. For offshore facilities, the liability is limited to $75 million for impacts to natural resources, services, and other eligible damages outlined in the statute.

OPA also requires each owner or operator of a facility to establish and maintain evidence of financial responsibility up to certain thresholds. The owner of a facility is required to show its ability to cover damages up to $150 million. The required level is based on a formula for a worst-case scenario and may be less than $150 million (if the amount of oil that can be spilled from the facility in a worst-case scenario is less than 105,000 barrels). This cap also limits the financial responsibility of the guarantor (which is typically, but not always, a private insurance company or a firm's satisfactory demonstration of self-insurance), but does not affect the overall liability of the owner or operator for a spill. Guarantors are also subject under OPA to direct action for damages related to a spill.

For vessels, vessel owners' liability covers all types of liability (damages and cleanup costs). It is important to recognize that there is a wide range in the size of vessels carrying oil, ranging from large supertankers to small tug and barge units carrying home heating oil. Under OPA, all vessels over 300 gross tons are required to demonstrate financial responsibility for their liabilities.

Calculations of total liability for vessels are based on a vessel's gross tonnage and, for tank vessels, whether the vessel is double-hulled or single-hulled (e.g., current limits are calculated at $3,200 per gross ton for a single-hulled tank vessel with a minimum limit of $23,496,000 and $2,000 per gross ton for a double-hulled tank vessel with a minimum limit of $17,088,000). The largest calculated liability limit for any vessel currently in operation is $510,134,000, which is the amount of financial responsibility calculated for the largest single-hulled tank vessel currently in operation. For smaller, non-tank vessels, liability is usually calculated at $1,000 per gross ton, with a minimum liability limit of $854,400.

Vessel owners are required to show financial responsibility for the full extent of their potential liability. Many of these vessels are independently owned and operated and significant increases in these vessels' financial liability (and thus in the financial responsibility they would be required to demonstrate) may affect their ability to participate in these ventures.

OPA authorized the funding and use of the Oil Spill Liability Trust Fund (OSLTF). The OSLTF is currently funded by a tax of eight cents per barrel of oil, and has a fund balance of approximately $1.6 billion. OPA authorizes payment from the OSLTF for those removal costs and damages that result from an oil spill that are not covered by a responsible party. Currently, there is a per incident cap of $1 billion (including $500 million for natural resource damages) for expenditures from the OSLTF. However, the House of Representatives has passed legislation to raise the per incident cap from the OSLTF to $5 billion (including $2.5 billion for natural resource damages) and to raise to 34 cents the tax on barrels of oil. These taxes would be directed into the OSLTF.

BP p.l.c. (BP) self-insured its operations at the *Deepwater Horizon*/Macondo well site in the Gulf of Mexico, and therefore its losses and liabilities will likely not impact the private insurance market. However, current estimates suggest that losses associated with this incident currently covered by private insurance (e.g., the loss of the *Deepwater Horizon* rig itself (which is a property loss), potential liability claims related to equipment utilized on the rig (such as the blowout preventer (BOP), business interruption claims, extensive reinsurance claims, and other potential claims) could yield between $1 billion and $3.5 billion in total claims. Damages resulting from the *Deepwater Horizon*/Macondo oil spill will far exceed the current liability cap applied to offshore facilities for damages resulting from an oil spill as well as the current per incident expenditure limit from the OSLTF.

The issues for possible legislation include raising or eliminating the cap on liability for facilities and vessels, and raising the levels required for demonstration of financial responsibility. An important subsidiary issue is whether any changes should be applied retroactively to the *Deepwater Horizon* spill. In analyzing the constitutional issues that may arise from retroactive application of an increased liability cap, the Congressional Research Service found that, "[constitutional] claims based on . . . – the Takings Clause, Substantive Due Process, and Bill of Attainder Clause – appear to have at best a modest chance of success, while claims under two others – the Impairment of Contracts Clause and Ex Post Facto Clause – seem to have almost no chance of success." [1]

BACKGROUND

The *Deepwater Horizon* is a fifth generation MODU; it is owned by Transocean Ltd. Due to causes and in circumstances still under investigation, the *Deepwater Horizon* suffered an explosion on April 20, 2010, apparently resulting from a blowout in the well it was drilling at the Macondo exploration site in an area of the Gulf of Mexico known as the Mississippi Canyon Block 252 (MC 252). At the time of the explosion, the *Deepwater Horizon* was leased by BP, which owns a majority stake in the MC 252 site and had contracted the rig to drill a prospect well. Following the explosion, the MODU sank on April 22. Eleven individuals who had been working on the *Deepwater Horizon* were killed in this accident.

[1] *See* attachment A, Congressional Research Service, *Constitutional Issues Raised by Pending Bills to Increase Retroactively a Liability Limit in the Oil Pollution Act* (May 12, 2010).

Federal officials estimate that between 12,000 and 19,000 barrels of oil are leaking each day from the Macondo well site.[2] In response to the *Deepwater Horizon*/Macondo oil spill, BP has made numerous attempts to stop or contain the flow of oil while simultaneously drilling two relief wells to permanently cap the well (a process that could take until August to complete). In the days immediately following the spill, BP unsuccessfully attempted to activate the BOP located on the ocean floor at the well head using a remotely operated underwater vehicle (ROV). On May 7, BP tried to contain the leaking oil and pump it to surface vessels by placing a large containment dome over the leaking riser pipe still attached to the BOP. This operation failed to stem the flow of oil into the Gulf due to the collection of hydrates (a type of ice crystal that can occur in deep waters) in the containment dome. On May 16, BP successfully inserted a tube into the riser pipe and was able to direct a portion of the leaking oil to surface vessels. On May 26, BP attempted the "top kill" strategy under which heavy drilling mud was pumped into the BOP to suppress the flow of oil. Implementation of the "top kill" plan apparently resulted in the development of dangerously high pressure within the BOP and did not suppress the flow of oil, and was therefore abandoned on May 29. The most recent response strategy, begun June 2, involves removing the leaking portion of the riser pipe from the BOP using the ROVs and placing a re-engineered containment dome over the BOP, with the intent of capturing the majority of the oil and pumping it to surface vessels until relief wells successfully seal off the well.[3]

According to the International Union of Marine Insurance (IUMI), in 2009, there were more than 700 MODUs in the world fleet and approximately 550 rigs were under contract; this utilization rate is below the rate observed in 2008 and is attributed to the global economic crisis and reduced demand for oil and natural gas.[4] IUMI notes that the "most dramatic drop in rig utilization is in the Gulf of Mexico" due to the "severe drop in the price for North American natural gas" as well as the impact of Hurricanes Katrina and Rita and of storms that occurred in that region in 2008.[5] IUMI's Spring Energy Statistics report shows that the size of the MODU fleet in the Gulf of Mexico dropped from a high of more than 200 rigs in 2001 to more than 100 rigs in 2009.[6] The chart below details current drilling and production activities in the Gulf of Mexico region (note that facilities on the Outer Continental Shelf that operate in water depths greater than 400 meters are required to submit a Deepwater Operations Plan in addition to all other plans and studies required by the Minerals Management Service (MMS) for offshore production and drilling operations).[7]

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[2] Deepwater Horizon Incident Joint Information Group, *Flow Rate Group Provides Best Estimate of Oil Flowing from BP Oil Well* (June 2, 2010).

[3] David Cutler, Reuters news service, *Timeline – Gulf of Mexico Oil Spill* (June 3, 2010), http://www.reuters.com/article/idUSN0322326220100603?type=marketsNews.

[4] IUMI, *IUMI 2009 Mobile Offshore Drilling Unit Statistics – Analysis*, http://www.iumi.com/index.cfm?id=7297.

[5] *Id.*

[6] IUMI, 2009 Energy Statistics, *World Mobile Drilling Fleet Statistics*, http://www.iumi.com/index.cfm?id=7297.

[7] Curry L. Hagerty and Jonathan L. Ramseur, Congressional Research Service, *Deepwater Horizon Oil Spill: Selected Issues for Congress* (May 27, 2010), at 12.

Drilling and Production Activities in the Gulf of Mexico

Water Depth in Meters	Active Leases	Approved Applications to Drill	Active Platforms
0 – 200	2,279	33,590	3,492
201 – 400	143	1,099	21
401 – 800	330	835	9
801 – 1,000	412	506	7
1,000 and Above	3,454	1,634	25
Total	6,618	37,664	3,554

Source: MMS, current as of June 1, 2010

I. Federal Government Reponses to Oil Spills in U.S. Waters

The Federal Government has a number of statutory and regulatory authorities that govern oil spills from vessels and other entities. These authorities include section 311 of the Clean Water Act (P.L. 92-500), the Shipowner's Limitation of Liability Act of 1851 (LLA), and OPA. The Coast Guard Authorization Act of 1996 (P.L. 104-324) and the Coast Guard and Maritime Transportation Act of 2006 (P.L. 109-241) also authorized regulatory changes that impact liability conditions.

Under the Clean Water Act, when an oil spill occurs, the Federal Government is tasked with ensuring the "effective and immediate removal of a discharge, and mitigation or prevention of a substantial threat of a discharge, of oil or a hazardous substance" into navigable waters or their adjoining shorelines, into the waters of the exclusive economic zone (EEZ) (water extending 200 miles seaward of the coast line), or in areas that may affect the natural resources of the United States. (33 U.S.C. § 1321(c)). To carry out this responsibility, the Federal Government is authorized to:

- remove or arrange for the removal of a discharge, and mitigate or prevent a substantial threat of a discharge, at any time;
- direct or monitor all Federal, State, and private actions to remove a discharge; and
- remove and, if necessary, destroy a vessel discharging, or threatening to discharge, by whatever means are available.

The Federal Government is responsible for making determinations regarding the extent of clean up required to be conducted after an oil spill occurs. The Federal Government also manages the OSLTF. OPA authorized the use of the OSLTF for the payment of:

- costs associated with cleaning up a spill, including costs incurred by the Federal Government or by a State;
- costs incurred by a Federal, State, or Indian tribe entity to assess damages and to develop and implement restoration and related plans;
- removal and damage costs associated with a spill from a foreign offshore unit;

- uncompensated removal costs; and
- Federal administrative, operational, and personnel costs and expenses necessary for and incidental to the implementation and enforcement of OPA and the Federal Water Pollution Control Act, albeit limits are set on the amounts that are to be available to cover the Coast Guard's operating expenses.

OPA authorized funding of the OSLTF through the imposition of a five cent tax on barrels of oil; however, that tax expired at the end of 1994. The Energy Policy Act of 2005 (P.L. 109-58) reinstated the five cent tax on oil barrels and the tax was increased to eight cents per barrel by the Emergency Economic Stabilization Act of 2008 (P.L. 110-343); this Act also specifies that the tax will rise to nine cents in 2017 and then expire at the end of that year. The OSLTF also receives revenues from amounts recovered from responsible parties for damages resulting from oil spills, from penalties paid for violations of section 311 of the Clean Water Act and for violations of the Deepwater Port Act (P.L. 93-627) and the Trans-Alaska Pipeline Authorization Act, and from certain other sources.

Pursuant to 26 U.S.C. § 9509, the OSLTF may not pay more than $1 billion for any single incident,[8] and natural resource damage assessments and claims arising from any single incident may not exceed $500 million. Further, the OSLTF pays claims arising only from the spill of oil and related products (petroleum, sludge, oily wastes etc.); it does not cover any claims arising from the spill of other substances, including hazardous materials listed under the Comprehensive Environmental Response, Compensation, and Liability Act (P.L. 96-510) (costs associated with such spills are paid for out of the Superfund).

The costs incurred by the Federal Government to respond to the spill are paid out of the OSLTF, which will then bill the responsible party for the amounts paid from the Trust Fund. This will be the case with the ongoing *Deepwater Horizon*/Macondo spill in the Gulf of Mexico. The OSLTF is administered by the National Pollution Funds Center maintained by the U.S. Coast Guard. OPA provides direct spending authority for Federal agencies of up to $100 million; funds above that amount are subject to appropriation.

II. Shipowner's Limitation of Liability Act of 1851

Before there was access to an insurance market for vessels, the concept of limitation of liability developed so that a ship owner could limit his/her exposure to claims associated with the vessel to the value of the owner's investment – i.e., to the value of the ship. Limitations on liability extended to a variety of potential claims, including claims for personal injuries, death, and cargo loss, and limited the amount of recoverable damages to the value of the ship and any earned freight or receivables that were unpaid at the end of the voyage or at the time the vessel was lost. In the case of a ship that is sunk or otherwise becomes a total loss, the value of the ship may be reduced to its salvage value or even to zero. The LLA was intended to place U.S. vessel owners on a competitive

[8] H.R. 4213, the *American Jobs and Closing Tax Loopholes Act*, passed by the House on May 28, includes provisions that would raise the per barrel tax used to fund the OSLTF to 34 cents and increased the per incident payment cap to $5 billion, including up to $2.5 billion in natural resource damage claims.

footing with foreign owners and to encourage investment in shipping.[9] Pursuant to the LLA, as currently codified at 46 U.S.C. § 30505 *et. seq.*, a vessel owner may seek to limit liability only if the loss occurred without the privity or knowledge of the owner.

For such claims, the LLA specifies that, "the liability of the owner of a vessel . . . shall not exceed the value of the vessel and pending freight." For personal injury or death claims, the LLA contains additional provisions for limitation of liability, which specify that if "[the value of the vessel and pending freight] is insufficient to pay all losses in full, and the portion available to pay claims for personal injury or death is less than $420 times the tonnage of the vessel, that portion shall be increased to $420 times the tonnage of the vessel. That portion may be used only to pay claims for personal injury or death." If the liability limits calculated under the LLA are insufficient to pay all claims, the LLA specifies that the claimants are to receive a proportional share of the limited damages calculated under the LLA. Upon a vessel owner's filing of a civil action in a United States District Court, which must be brought within six months of a claimant providing the owner with written notice of a claim, and compliance with procedural requirements to provide notice and secure the value of the vessel as calculated under the LLA, "all claims and proceedings against the owner related to the matter in question shall cease."

On May 13, 2010, Transocean filed a petition under the LLA in Federal court in Houston. The petition seeks to limit Transocean's liability related to the *Deepwater Horizon* accident to approximately $26.7 million.[10] [11] On June 1, the U.S. Department of Justice filed a motion opposing Transocean's petition.

III. Oil Pollution Act of 1990 (OPA)

OPA was enacted in response to the *Exxon Valdez* oil spill in 1989.[12] OPA consolidated existing laws and enacted new provisions to create a comprehensive Federal legal framework to govern liability and bolster the national response to oil spills.

To implement the responsibilities assigned by OPA, and section 311 of the Clean Water Act as amended by OPA, President George H. W. Bush issued Executive Order (EO) No. 12777 on October 18, 1991. The EO delegates responsibility to the Department of the Interior (DOI) for

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[9] Norwich Co. v. Wright, 80 U.S. 104 (1871). See Christopher S. Morin, The 1851 Shipowners' Limitation of Liability Act: A Recent State Court Trend to Exercise Jurisdiction Over Limitation Rights, 28 Stetson L. Rev. 419, 420-424 (1998).

[10] Complaint and Petition for Exoneration From or Limitation of Liability, *In re: Triton Asset Leasing GmbH et al.*, S.D.Tex., docket 4:10-cv-01721 (May 13, 2010).

[11] It should be noted that Gilmore and Black, authors of *The Law of Admiralty*, remarked on the "cryptic language" and other shortcomings in the Act of 1851 by stating "[t]here is no reason to believe that the courts will pump new life in the Section 189 [the section that limits the owner's liability]. Nevertheless, as in the case of any statute, there is always a danger that language, judicially done to death, may be judicially restored to life. The only safe thing to do with such a statute is to repeal it ..."[11] Similarly, in the case of Maryland Casualty Co. v. Cushing (347 U.S. 409, 427 (1954)), Justice Black, dissenting, wrote "the 1851 Act was passed to help shipowners by limiting the damages they must pay on account of wrongs inflicted by their agents. I see no possible reason for making insurance companies the beneficiaries of this shipowners' relief act."

[12] The *Exxon Valdez*, a large tank vessel, grounded on Bligh Reef, in Alaska's Prince William Sound, near Valdez, Alaska, on March 24, 1989, resulting in the discharge of approximately 258,000 barrels of crude oil and catastrophic environmental damage. *See* NTSB Final Report No. MAR-90-04 (adopted July 31, 1990).

establishing measures to prevent and contain oil discharges from offshore facilities; issuing regulations governing the preparation and submission to DOI of offshore facility response plans; and periodically inspecting containment booms and equipment intended to be used to manage oil discharges at offshore facilities.[13] The DOI, through the MMS, is also required to manage the financial responsibility provisions for offshore facilities. The EO assigns to the Coast Guard the responsibility for conducting periodic drills testing removal capability under the relevant response plans for offshore facilities located in the coastal zone, and publishing annual reports on such drills.

IV. Liability for Oil Spills Under OPA

Under OPA, the owners or operators of facilities or ships that spill oil are known as "responsible parties". Section 1002 of OPA specifies that each "responsible party for a vessel or a facility from which oil is discharged, or which poses the substantial threat of a discharge of oil, into or upon the navigable waters or adjoining shorelines or the exclusive economic zone is liable for removal costs and damages . . . that result from such incident. " Removal costs include all costs incurred by the United States, a State, or an Indian tribe under federal law or State law as well as all acts taken by any person consistent with the National Contingency Plan (NCP).[14] Damages include injury to, destruction of, loss of, or loss of use of natural resources; injury to or economic losses resulting from destruction of real or personal property (including the loss of taxes, royalties, rents, or fees recoverable by the United States, a State, or a political subdivision and the loss of earning capacity recoverable by any claimant); loss of the subsistence use of natural resources, which is recoverable by any claimant who uses the natural resources without regard to ownership or management; and damages for the net costs of providing increased or additional public services. Importantly, OPA expressly does not pre-empt or limit the liabilities of responsible parties under State law.[15]

In establishing liability limits, OPA built upon the liability schemes for oil spills that already existed under Federal law at the time OPA was enacted – principally the Clean Water Act, but also provisions in the Outer Continental Shelf Lands Act, the Deepwater Ports Act, and the Trans-Alaska Pipeline Authorization Act. Prior to OPA, the liability standards, scope of covered response costs, and recoverable damages were not synchronized among these diverse oil spill-related statutes; OPA intended to remedy this. Moreover, OPA built upon existing provisions; thus, although strict liability requirements, as well as specific statutory limits for such liability, already existed, OPA raised the liability limits and required that third party damages be covered by responsible parties. OPA

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[13] *See generally*, 33 U.S.C. § 1321(j).

[14] The Federal response to an oil spill is conducted in accordance with the NCP. This is intended to guide an effective, multi-tiered, and well-coordinated national response strategy for minimizing the adverse impacts of releases of oil or other hazardous materials into the environment. As required by OPA, and EO 12777, the Environmental Protection Agency (EPA) published an updated NCP in 1994. The NCP has not been updated since 1994. *See* 59 Fed. Reg. 47384 et seq. (September 15, 1994).

[15] *See* OPA section 1018(a)(1) ("Nothing in this Act … shall … affect, or be construed or interpreted as preempting, the authority of any State … from imposing any additional liability or requirements with respect to … the discharge of oil or other pollution by oil within such State … [or] any removal activities in connection with such a discharge[.]"); *see also Askew v. American Waterway Operators, Inc.*, 411 U.S. 325 (1973) (holding that a comprehensive pre-OPA Florida statute establishing strict liability and state recovery of oil pollution cleanup costs was not, per se, preempted by the Federal Water Quality Improvement Act of 1970).

similarly extended the requirement that owners and operators of vessels and offshore facilities must demonstrate financial responsibility to meet costs incurred as the result of an oil spill.

Under 33 U.S.C. § 2704, OPA does not provide any limits on liability if a spill was "proximately caused by" a responsible party's "gross negligence or willful misconduct" or by the "violation of an applicable Federal safety, construction, or operating regulation" on the part of the responsible party or the party's agent or employee or by any person acting pursuant to a contractual relationship with the responsible party. Assuming that the responsible party is not grossly negligent or has not violated a Federal requirement, OPA does not authorize the collection of any punitive damages from a responsible party.

For those responsible parties that are not grossly negligent and that have not violated Federal laws, OPA provides limits on total liability; such limits vary by type of vessel or offshore facility. Since 2005, section 1004(d) of OPA requires the President to adjust the limits of liability based on the change in the Consumer Price Index (CPI) at least every three years. Again, Federal liability limits do not affect liabilities that may be owed under State statutes.

Prior to the enactment of OPA, the liability of offshore facilities on the outer Continental Shelf (OCS) was $35 million plus cleanup and removal costs. Under OPA, all offshore facilities except deepwater ports (which have separate liability responsibilities) are liable for all removal costs plus a total of $75 million for all damages arising from an oil spill. Responsibility for raising liability limits for offshore facilities rests with MMS; MMS has not adjusted such limits since OPA was enacted in 1990, despite being statutorily required to do so.

OPA specifies liability limits for tank vessels depending on whether they are single-hulled or double-hulled. Responsibility for raising liability limits for vessels rests with the Coast Guard. The Coast Guard and Maritime Transportation Act of 2006 raised the liability limits for both single-hulled and double-hulled vessels; the Coast Guard subsequently adjusted the limits in 2009. A tank vessel's liability is currently calculated at $2,000 per gross ton for double-hulled vessels and $3,200 per gross ton for single-hulled vessels (and minimum liability requirements apply).[16] The limits yielded by these calculations cover the combined total of damage and removal costs. OPA specifies that a MODU that is "being used as an offshore facility" is deemed to be a tank vessel with respect to the discharge of oil; if the removal and damage costs associated with the spill of oil from the MODU exceed the amount of liability it would bear as a tank vessel, it is then deemed to be an offshore facility for purposes of assigning liability responsibilities.

The Coast Guard and Maritime Transportation Act of 2006 also required the Coast Guard to submit annual reports to Congress assessing both the extent to which oil spills are likely to result in removal or damage costs for which no defense to liability limits exists and the impact of claims against the OSLTF that exceed liability limits. In its report submitted in August 2009, the Coast Guard reported that "[s]ince the enactment of OPA, 51 oil discharges or substantial threats of discharge . . . all originating from vessels, have reportedly resulted or are likely to result in removal costs and damages that exceed the liability limits amended in 2006."[17] These include all spills that likely exceeded vessel liability limits, including spills that accessed the OSLTF and spills that did not

[16] A MODU is not required to have a double-hull unless it is "constructed or adapted to carry, or carries, oil in bulk as cargo or cargo residue" (46 U.S.C.A. § 3703a).
[17] U.S. Coast Guard, *Oil Pollution Act (OPA) Liability Limits – Annual Report to Congress Fiscal Year 2009*, at ii.

seek funding from the OSLTF. The Coast Guard further reported that "[t]he estimated removal costs and damages from incidents taking place since the enactment of OPA total approximately $1.5 billion in 2009 dollars" and of those costs, "approximately $1.0 billion, or an annual average of $56.3 million, would be in excess of liability limits as amended by the CG&MT Act [the 2006 Act]." The report concludes that the "the overall trend continues to be toward an increasing average annual potential Fund liability despite the amended limits" and that "available data continues to suggest that existing liability limits for certain vessel types, notably tank barges and cargo vessels with substantial fuel oil, may not sufficiently account for the historic costs incurred as a result of oil discharges from these vessel types [sic]."[18]

The Coast Guard reports that oil spills in U.S. waters originating from 47 offshore facilities, including five production or drilling rigs, have accessed the OSLTF, though no spills originating from offshore facilities have exceeded their liability limits in the history of the OSLTF.

In the absence of a finding of gross negligence, in the case of the current *Deepwater Horizon*/Macondo oil spill, BP will be responsible for all clean-up costs. Pursuant to OPA, BP will also be responsible for a maximum of $75 million in economic damages. BP has indicated, however, that it will provide payments for all "legitimate claims" – even if such claims total a sum greater than $75 million. To the Committee's knowledge, BP has not, however, defined what "legitimate claims" will consist of, or what criteria it will use to determine whether a claim is legitimate or not.

As of June 5, 2010, BP had made $48 million in claim payments.[19] According to BP, the total estimated costs associated with the *Deepwater Horizon*/Macondo oil spill as of June 5, 2010 are in excess of $1 billion. These costs include the cost of the spill response, containment, relief well drilling, grants to the Gulf States, claims paid, and Federal costs. In addition, BP states that "no person asserting a claim or receiving payment for interim benefits will be asked or required to sign a release or waive any rights to assert additional claims, to file an individual legal action, or to participate in other legal actions associated with the Deepwater Horizon incident."

V. Evidence of Financial Responsibility for Oil Spills

Prior to the enactment of OPA, offshore facilities on the OCS were required to demonstrate $35 million in financial responsibility. OPA as enacted established a blanket requirement that all offshore facilities establish and maintain evidence of financial responsibility for $150 million to meet potential liabilities for oil spills.[20]

The Coast Guard Authorization Act of 1996 altered provisions related to the financial responsibility required to be demonstrated by an offshore facility. Under the 1996 amendment, a responsible party for a facility located "seaward of the line of ordinary low water along that portion of the coast that is in direct contact with the open sea and the line marking the seaward limit of inland waters" and that is "used for exploring for, drilling for, producing, or transporting oil from facilities engaged in oil exploration, drilling, or production" and "has a worst-case oil spill discharge

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[18] *Id.*

[19] *See* BP Press Release, *Gulf of Mexico Oil Spill Responses Update* (June 5, 2010).

[20] *See generally*, S. Rep. 101-94, at 725-738; *see also* DOI Memorandum M-36981, *Implementation of the Oil Pollution Act of 1990 by the Minerals Management Service* (November 29, 1994), at 3.

potential of more than 1,000 barrels of oil" is required to "establish and maintain evidence of financial responsibility" *See* 33 U.S.C. §2716. Further, the 1996 amendment stated that offshore facilities located seaward of the seaward boundary of a State must demonstrate $35 million in financial responsibility while offshore facilities located landward of the seaward boundary of a State must demonstrate $10 million in financial responsibility. However, the 1996 amendment provided that if "the President determines that an amount of financial responsibility for a responsible party greater than [$35,000,000] is justified based on the relative operational, environmental human health, and other risks posed by the quantity or quality of oil that is explored for, drilled for, produced, or transported by the responsibility party," the amount of liability determined by the President shall not exceed $150 million.

Commenting on the conference report on the Coast Guard Authorization Act of 1996, Senator Chaffee stated in part, "[t]he conference report brings the amount of financial responsibility required of offshore facilities under OPA more into line with common sense and the original intent of Congress." [21] He further stated:

> OPA currently directs the promulgation of regulations that would require all offshore facilities to meet financial responsibility requirements at a $150 million level. The conference report, however, calls for use of the current $35 million requirement in the Outer Continental Shelf Lands Act for facilities in Federal waters while giving the President discretion to increase the requirement on the basis of risk. A similar approach is taken for offshore facilities in State waters, except that the minimum financial responsibility requirement is $10 million, given that many coastal States impose their own such requirements. These changes should remove the potential for unnecessary and inefficient economic burdens yet preserve OPA's fundamental purpose of ensuring that oil-spill polluters pay for their pollution.[22]

Thus, under Federal law, while an offshore facility is liable in the event of an oil spill for all clean up costs and up to $75 million in damages, such a facility is not required to demonstrate financial capabilities exceeding $150 million – even though total liability under a worst case scenario blow out may (and in the case of the *Deepwater Horizon* will) far exceed $150 million. Further, 33 U.S.C. § 2716 states that "[i]n a case in which a person is a responsible party for more than one facility subject to this subsection, evidence of financial responsibility need be established only to meet the amount applicable to the facility having the greatest financial responsibility requirement under this subsection."

By contrast, 33 U.S.C. § 2716 states that for deepwater ports, "[e]ach responsible party with respect to a deepwater port shall establish and maintain evidence of financial responsibility sufficient to meet the maximum amount of liability to which the responsible party could be subjected under 2704(a) of this title in a case where the responsible party would be entitled to limit liability under that

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[21] *See* 142 Cong. Rec. at S11796 (Senator Chafee commenting on the conference report accompanying S1004, which was agreed to by unanimous consent of the Senate on September 28, 1996, and subsequently signed into law on October 19, 1996 as the Coast Guard Authorization Act of 1996); *see also* H. Rep. 104-854.
[22] *Id.*

section." However, the Secretary of the Department of in which the Coast Guard is operating has the authority to lower the limit of liability for deepwater ports, but if that authority is exercised, "the responsible party shall establish and maintain evidence of financial responsibility sufficient to meet the maximum amount of liability so established."

Regarding the guarantors that provide evidence of financial responsibility, 33 U.S.C. § 2716 states that "a claim for which liability may be established under . . . this title may be asserted directly against any guarantor providing evidence of financial responsibility for a responsible party liable under that section for removal costs and damages to which the claim pertains." Typically, insurance companies reimburse their insured parties for covered claims and are not liable to direct action by parties that have claims against an insured entity. However, guarantors may be liable for claims only if:

- the responsible party for whom evidence of financial responsibility has been provided has denied or failed to pay a claim under this Act on the basis of being insolvent, as defined under section 101(32) of title 11, and applying generally accepted accounting principles;

- the responsible party for whom evidence of financial responsibility has been provided has filed a petition for bankruptcy under title 11; or

- the claim is asserted by the United States for removal costs and damages or for compensation paid by the Fund under this Act, including costs incurred by the Fund for processing compensation claims.

To defend itself against a claim under OPA, a guarantor may invoke: all rights and defenses that would be available to the responsible party under this act; a defense incorporated into the financial instrument approved by the government; and the defense that the incident was caused by the willful misconduct of the responsible party. However, the guarantor may not invoke any other defense that might be available in proceedings brought by the responsible party against the guarantor.

Finally, 33 U.S.C. § 2714 specifies that "[n]othing in this Act shall impose liability with respect to an incident on any guarantor for damages or removal costs which exceed, in the aggregate, the amount of financial responsibility which that guarantor has provided for a responsible party pursuant to this section. The total liability of the guarantor on direct action for claims brought under this Act with respect to an incident shall be limited to that amount."

VI. Demonstration of Financial Responsibility by Offshore Facilities

Regulations applying 33 U.S.C. § 2714 to offshore facilities are provided at 30 C.F.R. part 253. Under these regulations, the responsible party must calculate the worst case oil-spill discharge volume that could flow from an offshore facility and then demonstrate the corresponding amount of financial responsibility, up to $150 million. The regulations require the responsible party for facilities located seaward of the coast line to calculate the worst case oil spill discharge scenario that is four times the uncontrolled flow volume estimated for the first 24 hours. The chart below shows

the amount of financial responsibility that must be demonstrated for the corresponding worst-case oil spill discharge volume for facilities located wholly or partially on the OCS.

Oil Spill Financial Responsibility of Facilities Located Wholly or Partially on the Outer Continental Shelf

Worst Case Oil Spill Discharge Volume	Applicable Amount of Oil Spill Financial Responsibility
More than **1,000** barrels up to **35,000** barrels	$35,000,000
More than **35,000** barrels but not more than **70,000** barrels	$70,000,000
More than **70,000** barrels but not more than **105,000** barrels	$105,000,000
More than **105,000** barrels	$150,000,000

Source: 30 C.F.R. § 253.13

In its Initial Exploration Plan for the Macondo site, BP noted that "[a] scenario for a potential blowout of the well from which BP would expect to have the highest volume of liquid hydrocarbons is not required for the operations proposed in this EP."[23] The Initial Exploration Plan does, however, present a "comparison of the appropriate worst-case scenario from BP's approved regional OSRP [Oil Spill Response Plan] with the worst-case scenario from the proposed activities in this Exploration Plan." The comparison shows that the worst-case scenario leak from wells covered in the Exploration Plan is a release of 162,000 barrels of oil per day from an uncontrolled blowout while the worst-case scenario covered in the BP Regional OSRP for Exploration is a release of 300,000 barrels per day from an uncontrolled blowout.[24] Any facility with a worst case scenario discharge in excess of 105,000 barrels – as was the case with the Macondo site – is required to demonstrate financial responsibility only up to $150 million regardless of the actual worst case scenario discharge volume.

Pursuant to 30 C.F.R. part 253, responsible parties are required to maintain continuous oil spill financial responsibility coverage for all leases, permits, and right-of-use easements associated with covered facilities. Coverage can be demonstrated through any of the following methods: self-insurance; insurance; an indemnity; a surety bond; or an alternative coverage method approved by the Director of the MMS.

Specific regulations govern the use of each coverage method. Any responsible party that fails to demonstrate financial responsibility may be liable for a civil penalty of up to $25,000 per offshore facility per day of violation.

According to a report developed by the Insurance Information Institute (III), BP, which held a 65 percent interest in the Macondo drill site, self-insures its activities in the Gulf of Mexico. BP maintains a captive insurer called Jupiter Insurance Ltd. which "has $6 billion in capital, but does

[23] BP Exploration & Production Inc., *Initial Exploration Plan, Mississippi Canyon Block 252, OCS-G 32306 Public Information* (February 2009), at 2-1.
[24] *Id.* at 7-1.

not purchase outside reinsurance protection."[25] According to III, "Jupiter's per occurrence limit on physical damage and business interruption is $700 million and is not expected to cover environmental clean-up costs or third party liability."[26] III notes that because BP self-insures, much of the expense associated with the clean-up of the oil spill resulting from the blowout at the Macondo site, "a large portion of the losses ***will not*** hit the insurance industry" (emphasis in original).[27]

Additionally, III reports that BP Shipping has bought $1 billion in marine liability pollution insurance from the Protection and Indemnity Clubs (P&I clubs), "but it is unclear if this coverage will respond."[28] The other parties with interests in the Macondo site, including Anadarko and Mitsui Oil Exploration, each hold owner's extra expense insurance coverage; Anadarko's coverage is reported to be $100 million and Mitsui's coverage is reported to be $45 million.[29]

VII. Demonstration of Financial Responsibility by Vessels

Similar to offshore facilities, vessels that carry oil must demonstrate their ability to meet their financial obligations under OPA. Regulations under 33 C.F.R. part 138 describe the procedures that vessel operators must follow to demonstrate their financial responsibility. The regulations state that the "owner, operator, and demise charterer are strictly, jointly, and severally liable for the costs and damages resulting from an incident or a release or a threatened release, but together they need only establish and maintain an amount of financial responsibility equal to the single limit of liability per incident, release or threatened release."

A vessel operator can demonstrate its ability to meet its financial responsibility under OPA through the following methods: insurance; a surety bond; self-insurance; financial guaranty; or an alternative self-insurance method approved by the Director of the National Pollution Funds Center.

After a vessel satisfactorily demonstrates financial responsibility (and pays all applicable fees), the Director of the National Pollution Funds Center will issue a Vessel Certificate of Financial Responsibility (COFR) to the vessel, which is required to be carried aboard the covered vessels operating in U.S. waters. The Coast Guard has indicated that there are approximately 19,000 current COFRs; of these, just under 9,300 COFRs are for tank vessels. Currently, 3,394 vessels self-insure. The largest current COFR is for the single-hulled tank vessel *Gemini Star*, which has a calculated liability limit of $510,134,000.

Any vessel operator that fails to comply with these regulatory requirements may be subject to a civil penalty, and the Attorney General "may secure such relief as may be necessary to compel compliance" with these requirements. Further, the Coast Guard "may deny entry to any port or place in the United States or the navigable waters of the United States, and may detain at a port or place in the United States in which it is located, any vessel subject to this part, which, upon request,

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[25] P. Hartwig, Ph.D., CPCU, President and Economist, III, *Deepwater Horizon Gulf Oil Spill and Insurance Market Impacts*, Robert (June 3, 2010), at 9, www.iii.org/presentations.
[26] *Id.*
[27] *Id.* at 10.
[28] *Id.* at 9.
[29] *Id.*

does not produce evidence of financial responsibility;" in addition, any vessel "which is found in the navigable waters without the necessary evidence of financial responsibility is subject to seizure by and forfeiture to the United States."

Most vessels obtain marine insurance from what are known as P&I Clubs. There are 13 such clubs that together form a non-for-profit mutual insurance association; according to information provided by the P&I Clubs, they insure more than 95 percent of the world's ocean-going tank vessel fleet and the vast majority of the world's ocean-going tonnage. The P&I Clubs report that they share excess exposure above $8 million; figures below that sum are insured by the individual Club with which a vessel contracts. P&I Clubs provide insurance for pollution liability up to $1 billion per insured vessel; however, the Clubs refuse to provide the evidence of coverage necessary to enable a vessel to obtain a COFR. Therefore, vessels typically obtain COFRs from firms that are predominantly located in Bermuda; these firms provide insurance only up to the level of liability calculated based on a vessel's gross tonnage. Typically, however, if a vessel releases oil, the vessel will file its claim with the insurance provided by the P&I Clubs.

VIII. Potential Impact of the *Deepwater Horizon* Incident on the Offshore Energy Insurance Industry

Companies operating rigs offshore can buy many types of insurance, including property damage insurance and third party liability insurance. Such insurance can include windstorm insurance (to cover losses arising from hurricanes).

Transocean insured the *Deepwater Horizon* rig with Lloyd's of London and other insurers; Lloyd's of London has reportedly paid at least part of a $560 million insurance claim for the rig.[30] Transocean claims that BP indemnified it and media reports indicate that Transocean's excess insurers, including Lloyd's of London, are suing BP, claiming that "BP had agreed in its contract with Transocean that the rig's owners would not be responsible for any pollution that originated below the surface of the land or water from spills, leaks or discharges;" these insurers claim that Transocean's coverage for excess liability is approximately $700 million.[31]

In addition to the Transocean coverage already reported, Cameron (the firm that manufactured the BOP used with the *Deepwater Horizon* MODU) and Halliburton (the firm involved in the failed attempt to seal the well dug at the Macondo site by the *Deepwater Horizon*) each hold liability insurance policies.

III has indicated that the estimate of insured losses resulting from the *Deepwater Horizon* incident could total between $1 billion and $3.5 billion,"[32] while another source has indicated that "total claims could surpass the $2.2 billion to $2.5 billion generally believed to represent the annual

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[30] Kevin Crowley, Bloomberg, *Lloyd's Sees Deepwater Horizon Claims at $600 Million* (May 26, 2010), http://www.businessweek.com/news/2010-05-26/lloyd-s-sees-deepwater-horizon-claims-at-600-million-update1-.html.
[31] Laurel Brubaker Calkins and Margaret Cronin Fisk, "BP Sued by Transocean's Excess Insurers Over Spill," *Bloomberg Businessweek* (May 24, 2010).
[32] Robert P. Hartwig, Ph.D., CPCU, President and Economist, III, *Deepwater Horizon Gulf Oil Spill and Insurance Market Impacts*" (June 3, 2010), at 10, www.iii.org/presentations.

premiums that insurers collect globally from companies involved in oil and gas exploration."[33] III reports that 20 firms have announced losses associated with the *Deepwater Horizon* incident, ranging from the losses reported by Lloyd's of London to the $5 million in losses reported by W.R. Berkley and including losses by numerous reinsurance firms[34] including Swiss Re and Munich Re.[35] In early May, shortly after the *Deepwater Horizon* collapsed, the reinsurance firm Swiss Re "estimated in its earnings release that insurers would incur $1.5 billion to $3.5 billion in total claims."[36]

According to one source, prior to the *Deepwater Horizon* accident, "the cost of insuring a physical rig itself ranged from $3 million to $9 million a year."[37] One firm that provided property insurance to Transocean for the *Deepwater Horizon*, W.R. Berkley Corp., has reportedly already raised its rates by 40 percent; this firm paid out only $25 million in association with the loss of the *Deepwater Horizon* but recouped $20 million through reinsurance.[38]

Surveying the insurance market specifically for MODUs, IUMI notes that in 2009, the "number of attritional claims over $1MM dropped" but "total costs spiked significantly, due to the large loss attributable to the West Atlas incident in the Timor Sea"[39] and that even excluding that incident, the "average claim cost . . . was slightly higher in 2009 and continues a trend upward since 2005."[40]

While the full potential impact of the loss of the *Deepwater Horizon* – and of the regulatory uncertainty surrounding the offshore energy industry in the wake of that incident – are unknown at this time, III notes that the insured risks (beyond those self-insured by BP) associated with the *Deepwater Horizon* incident "are well-syndicated, with the insured loss spread across a broad range of insurers and reinsurers on a global scale."[41] However, it is unclear if, or to what extent, this insurance market is already changing given insurers concern after the Deepwater spill or if the market will change if OPA or other Federal laws are amended to raise the cap on liability for

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[33] Erik Holm, "Insurance Premiums for Offshore Drilling Soar 15%-50%," *The Wall Street Journal* (May 25, 2010).

[34] According to the Reinsurance Association of America, firms that issue insurance can, in simple terms, seek insurance for the policies they write; such backing is known as "reinsurance" and is intended to protect an insurance company against the claims filed by those the company insures. The original insurer is known as the *ceding insurer* while the company that sells reinsurance is called the *assuming insurer* or the *reinsurer*. The main reasons that insurers purchase reinsurance are to 1) limit loss exposure to defined risks; 2) stabilize financial results; 3) reduce losses from catastrophic events; and 4) expand capacity. In general, reinsurance is characterized by a low frequency of claims but by severe losses when claims are made. Once the ceding insurer has paid claims up to its retention level, reinsurers remain exposed to "long tail lines," which are claims that may take many years to develop. Therefore, reinsurers must collect premiums in the present for losses that will be adjudicated under the legal, social, economic, and political environment that exists in the future. When considering a reinsurance contract, ceding insurers take into account their capacity to pay claims based upon their financial strength, determine how much of a loss they can absorb (the level of risk they should retain), then purchase reinsurance for remainder.

[35] Robert P. Hartwig, Ph.D., CPCU, President and Economist, III, *Deepwater Horizon Gulf Oil Spill and Insurance Market Impacts*" (June 3, 2010), at 10, www.iii.org/presentations.

[36] Erik Holm, "Insurance Premiums for Offshore Drilling Soar 15%-50%," *The Wall Street Journal* (May 25, 2010

[37] *Id.*

[38] Dan Wilchins, "Oil Rig Insurance Premiums Rise 40 Percent-Berkley," *Reuters Newservice* (May 26, 2010).

[39] The West Atlas incident involved an oil rig located approximately 125 miles off Australia's western coast that suffered a blowout, resulting in a large oil spill that flowed from mid-August 2009 until early November 2009. See Sophie Tedmanson, "Oil Rig Bursts Into Flames After Massive Spill," *Times Online* (November 2, 2009).

[40] IUMI, *IUMI 2009 Mobile Offshore Drilling Unit Statistics – Analysis*, http://www.iumi.com/index.cfm?id=7297.

[41] Robert P. Hartwig, Ph.D., CPCU, President and Economist, III, *Deepwater Horizon Gulf Oil Spill and Insurance Market Impacts*" (June 3, 2010), at 10, www.iii.org/presentations.

offshore drilling operations and vessels carrying oil products. For instance, insurers may already be planning on making changes to future insurance policies, given the exposure anticipated from a worst-case scenario like the *Deepwater Horizon* spill.

On the other hand, OPA statutorily limits the liability of insurance companies to $150 million. The insured companies are liable for any costs above and beyond that for clean-up costs. Additionally, in the case of gross negligence, or violation of Federal laws, the responsible party would be liable for the full costs of clean-up and economic damages. Therefore, changes to the cap on liability may not matter from the perspective of the insurance companies, as long as their liability exposure remains the same.[42]

In the case of the Deepwater spill, while the cause of the accident is still under investigation, BP may lose its protection under the $75 million cap for damages if it is found to have been negligent or to have violated any Federal laws or statutes. If that is the case, BP would be responsible for all clean-up costs and would be liable for all claims for economic damages.

PROPOSED LEGISLATION

Since the BP *Deepwater Horizon* disaster, several bills have been introduced to amend OPA to address issues related to liability and financial responsibility for oil spills. The Committee on Transportation and Infrastructure is the primary committee of jurisdiction in the House of Representatives for proposed amendments to OPA. Below is a summary of bills introduced as of the date of this memorandum.

On May 5, 2010, Representative Rush Holt introduced H.R. 5214, the "Big Oil Bailout Prevention Act of 2010". This legislation raises the current limits on liability for non-removal costs (e.g., damages to the natural resources and related services) for offshore facilities from the current cap of $75 million to $10 billion. In addition, H.R. 5214 provides the President with authority to advance payments from the OSLTF to States and political subdivisions of a State for actions taken to prepare for and mitigate substantial threats from the discharge of oil. The legislation also strikes the per incident cap on expenditures from the OSLTF related to oil spill removal costs and costs related to natural resource damage assessments and claims. This legislation includes language that makes the change to liability limits retroactive to April 15, 2010, prior to the *Deepwater Horizon* spill. H.R. 5214 was referred to the Committee on Transportation and Infrastructure.

On May 6, 2010, Representative Lois Capps introduced H.R. 5241, the "BP Deepwater Horizon Disaster Inquiry Commission Act of 2010". This legislation creates an independent commission within the Executive branch to investigate the causes of the BP *Deepwater Horizon* disaster, to evaluate the current and future impact of the disaster on the environment, economy, and public health, and to evaluate the adequacy of the response to the disaster by BP as well as by Federal, State, and local agencies. The commission would be required to report to the President and Congress on its findings and recommendations within nine months of the date of enactment of the legislation. H.R. 5241 was referred to the Committee on Natural Resources and the Committee on Transportation and Infrastructure.

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[42] For more discussion on the potential impact of the *Deepwater Horizon* oil spill on the offshore energy insurance market, see attachment B.

On May 13, 2010, Representative Aaron Schock introduced H.R. 5313, the "Offshore Safety and Response Improvement Act". This legislation requires the: (1) Secretary of the Interior to study the effectiveness of acoustic control systems and to promulgate regulations for the implementation of such systems on offshore oil rigs; (2) President, acting through the Administrator of the EPA, to revise the NCP to include specific response procedures related to future discharges of oil; and (3) Administrator and the Secretary to review current and future technologies and methods for the removal of an oil spill, and report to Congress. H.R. 5313 was referred to the Committee on Natural Resources and the Committee on Transportation and Infrastructure.

On May 20, 2010, Representative Raul Grijalva introduced H.R. 5355, to amend OPA to repeal the limitation of liability for a responsible party for a discharge or substantial threat of discharge of oil from an offshore facility. H.R. 5355 includes language that would make the change to liability limits retroactive to April 15, 2010, prior to the *Deepwater Horizon* spill. H.R. 5355 was referred to the Committee on Transportation and Infrastructure.

On May 20, 2010, Representative Roy Blunt introduced H.R. 5356, the "Oil Spill Response and Assistance Act". This legislation requires the Secretary of Homeland Security to promulgate a Federal rule to require the development and deployment of new technologies for use in the event of a breach or explosion at, or a significant discharge of oil from, a deepwater port, offshore facility, or tank vessel. In addition, H.R. 5356 revises upward the existing liability caps for vessels and offshore facilities contained in OPA, and to index the liability caps for inflation. H.R. 5356 includes language that makes the change to liability limits retroactive to April 15, 2010, prior to the *Deepwater Horizon* spill. Finally, this legislation requires the Federal Government to undertake a study of the effectiveness of the coordination of Federal actions related to the *Deepwater Horizon* disaster and to report to Congress on its findings. H.R. 5356 was referred to the Committee on Transportation and Infrastructure.

WITNESSES

PANEL I

The Honorable Rush D. Holt
New Jersey's Twelfth District
Member of Congress

The Honorable Kathy Castor
Florida's Eleventh District
Member of Congress

The Honorable Sheila Jackson Lee
Texas's Eighteenth District
Member of Congress

PANEL II

Mr. Jack Gerard
President and CEO
American Petroleum Institute

Mr. Charles B. Anderson, Esquire
Senior Vice President and Head of Office
Skuld North America, Inc (P&I Club)

Mr. Brian Buckley McAllister
Vice President & General Counsel
McAllister Towing

Mr. Robert P. Hartwig, PhD, CPCU
President and Economist
Insurance Information Institute

Dr. Michael Greenstone
Massachusetts Institute of Technology
Department of Economics
And
Director
The Hamilton Project
And
Senior Fellow Economic Studies Program
The Brookings Institution

Ms. Kate Gordon
Vice President of Energy Policy
Center for American Progress

Panel III

Mr. Tom Perrelli
Associate Attorney General
U.S. Department of Justice

Mr. Bob Abbey
Acting Director
Minerals Management Service

Mr. Craig A. Bennett
Director
National Pollution Funds Center

LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL PETROLEUM ACT OF 1990 AND RELATED STATUTES

Wednesday, June 9, 2010

HOUSE OF REPRESENTATIVES,
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,
WASHINGTON, DC.

The Committee met, pursuant to call, at 10:35 p.m., in room 2167, Rayburn House Office Building, Hon. James Oberstar [Chairman of the Committee] presiding.

Mr. OBERSTAR. The Committee on Transportation and Infrastructure will come to order. Today in our continuing review of the underlying causes, conditions, and factors involved in the spill of oil in the gulf, we will examine the issue of liability and financial responsibility of the Oil Pollution Act of 1990.

I would add parenthetically I have had the privilege of being associated with oil spill liability and technical issues since my first term in Congress in 1975–76, shortly after the Tory Canyon disaster in the English Channel, and Mr. Young, then-member of the Merchant Marine and Fisheries Committee, and I participated in much of that legislation, all the way through the oil spill liability of 1989 and OPA 90.

The liability, financial responsibility, and insurance issue surrounding the Deepwater Horizon are complex. There are estimates that suggest losses associated could result in between 1 billion and $3–1/2 billion in claims. Those will far exceed the liability caps that apply to offshore facilities with a limit of $75 million.

If the predictions prove accurate, total damages will exceed the amount available in the Liability Trust Fund. This tragedy shows the need for a comprehensive review of liability concepts in the law now in effect. When you look at the body of law, it goes back at least 150-plus years. Existing laws were developed from centuries of maritime history. As I learned back in my first term in Congress, maritime is one of the oldest, most encrusted bodies of law in existence.

The purpose then was to deal with damages to persons and property involved in accidents involving sea-going vessels. A vessel carries a known quantity of oil or other cargo. There is a reasonable basis for estimating the worst possible case of damages for release of all of the oil in the cargo of that vessel. This in turn establishes a basis for a liability cap and for setting levels of required insurance.

One of the lessons of Tory Canyon of Amoco Cadiz and other smaller spills, that there had to be—the insurance industry insisted on a known amount against which they could insure.

In contrast, Deepwater Horizon shows that when we are dealing with a facility for drilling, rather than a merchant vessel, the amount of oil is unpredictable, unknown, and could be astronomical.

Deepwater Horizon also demonstrates that the technology for drilling in deep waters and deeper regions below the sea floor is riskier and more uncertain than merchant vessel technology. It shows us that we need a financial and liability program based on the technological complexities and realities of deepwater drilling, rather than simply adapting and adjusting concepts that were originally developed for surface vessels.

In addition to the liability issues, the Deepwater Horizon tragedy shows that deepwater drilling's complete reliance on industry does not provide the safety margin nor the safety regime that we need. The Federal Government has allowed the drilling industry to self-police, self-certify, self-engineer and design, and it is time that we set new standards and exert authority over safety issues associated with deep sea oil drilling, as we do with high-level aviation operations.

The issues for consideration in this hearing include raising or eliminating the cap on liability for both facilities and vessels, raising the levels required for demonstration of financial responsibility. A subsidiary issue of importance is whether any changes should be applied retroactively. I make no judgment on those. I want to hear the testimony that comes out of this hearing on whether caps and insurance requirements that exist and are incorporated into existing leases, whether the government would likely be in breach of contract, liable for damages, if liability or insurance requirements were raised under existing leases.

With regard to the liability caps for facilities, one option is to remove the caps altogether. A major argument against liability caps is that they reduce the incentives for operators to take steps necessary to ensure safety. In addition, liability caps that are well below the level of damages from the spill will mean persons who suffer damages will have to be reimbursed exclusively from the oil spill Liability Trust Fund, and if there is not enough money in the trust fund the injured persons either will not receive compensation or may be compensated by taxpayers from general revenues.

The argument in support of liability caps is that without caps, only the largest companies will be willing to drill in the deepwater, only the largest companies will be able to run the risk of huge damages, and this could lead to less competition for drilling leases and lower proceeds to the Federal Government in selling the rights. Limiting drilling to the largest companies could result in less drilling and a reduced supply of oil.

Somewhat different factors are involved when considering raising or eliminating caps for vessels, for smaller vessels. Tug barges carrying home heating oil are subject to a major increase in expense for insurance. There may be loss of shipping capacity that could have a detrimental effect on consumers. The potential damages from a spill from a vessel are more predictable than losses from an

uncontained well. The amount of oil carried by a vessel is known. The amount of oil released by a spill such as Deepwater Horizon is speculative, scientific guesswork.

The caps for facilities have not been adjusted since the Oil Pollution Act was enacted, and the caps for vessels have been raised by law and administrative action to adjust for inflation, so facilities have stayed unadjusted and vessel liability caps have increased. The Deepwater Horizon tragedy shows a need for a change in the trust fund that backs up the individual responsibility for damage. If the cost of cleaning up an oil spill and the cost of claims for damages from the spill exceed the limits in the Oil Pollution Act, the trust fund is available to cover the costs.

The trust fund is funded predominantly by an 8-cent per barrel tax on crude oil at U.S. refineries, and the tax is paid by refinery operators. It now has a balance of about $1.6 billion, with a cap on expenditures of a billion, and 500 million for natural resource damages. We have passed legislation to raise the tax on crude oil to 34 cents a barrel and raised the caps on trust fund expenditures to $5 billion. Still, the Coast Guard tells us that they will run out of money to fight this disaster possibly next week, because they will have exhausted the authority for the $100 million advance out of the trust fund.

On May 13, 2010, just prior to our previous hearing, Transocean, a Swiss company, filed a complaint in Federal Court in Houston to limit its liability to $26.7 million under a little-known statute, the Limitation of Liability Act of 1851. The Department of Justice has since filed a motion opposing Transocean. The 1851 act was put into place before shipowners had access to insurance, to encourage American shipowners to invest in shipping and put the American shipping industry on an even footing of competition with its European competitors. It allows shipowners to limit their liability to the value of the vessel and the value of her cargo.

Claims for personal injury and for death and economic losses that are coming forward or will come forward will far exceed the value of the rig in the gulf and whatever was owed to Transocean by BP and others. In researching the 1851 act, which I recall from my earlier days on the Merchant Marine and Fisheries Committee, we found that in The Law of Admiralty book, Gilmore and Black observation on that 1851 act: "No doubt when more obscure statutes are drafted, the Congress will draft them. But it is difficult to believe that any future body of lawmakers will ever surpass this extraordinary effort. The only safe thing to do with such a statute is to repeal it." And maybe that is what we will wind up doing.

As we examine the existing liability laws, we have to consider revisions to the Death on High Seas Act, the Jones Act, both enacted in the 1920's, to prevent persons injured on vessels from recovering noneconomic damages generally available under tort law.

Now that is the broad scope of what I expect to cover in this hearing. A lot of questions and answers yet to be found.

Mr. OBERSTAR. I look forward to the testimony and yield now to the gentleman from Florida, my good friend, Mr. Mica.

Mr. MICA. Thank you, Mr. Oberstar, and I look forward to working with you.

And one of our responsibilities is to learn from tragedies, to learn from disasters, and to make certain that we put positive measures in place to make certain they don't happen again. Now, we can't bring back the loss of 11 lives, but people who have lost lives or property or their business, their opportunity to earn a living in this country or in the areas affected, need our assistance and we may need to make certain that we have measures in place to assist those folks that are hurting now.

Let me just say we will be doing legislation. I am told that the leadership has made a decision to have legislation before the Fourth of July recess. I look forward to cooperating in a bipartisan effort to make certain that we have, again, in place, measures that will assist folks.

And this Committee does have jurisdiction, checked it over all liability questions dealing with this matter and the legislation Mr. Oberstar outlined, including a National Response Plan, in addition to the liability question. And I think that Mr. Oberstar has also brought some things forth that he didn't talk about a great deal in public today, but I think I concur with him and we need to look at eliminating some of the self-certifying that the industry has done and we will talk about that in a second.

I didn't know too much about how the fund worked. I knew we had one in place. Mr. Oberstar is correct.

If you want to put the oil spill Liability Trust Fund slide up there, if we have got that, the trust fund is between $1.5 and $1.6 billion. This was set up some time ago as you heard the history of, I think, back in 1990. It was adjusted in 2006, and it is about 1.5 to $1.6 billion balance in the fund.

The thing that is interesting: I said, well, what about people who are hurting; are they getting getting compensation, the ones that have economic damages? And the answer to me was, the response to me was, No. I said, well what about this emergency fund of $150 million? And I was told that that is being used right now. In fact, this 150 million emergency fund they told me was just about expired.

So my question is, Where did the money go? Well, it is being spent to pay for operational funds, for some cleanup costs, and for some other items. None of it goes to economic damages at this point.

Now, the poor son-of-a-gun that has been hurt by this has to put an application into BP first, I guess, and get refused before they are eligible. Now, the fund, I am told, is already expired. So I said, I will introduce legislation to expand it because we need to have funds available immediately. And I will support that, Mr. Oberstar.

Mr. OBERSTAR. Will the gentleman yield?

Mr. MICA. Yes.

Mr. OBERSTAR. The fund—and it is not an emergency fund. It is limiting the oil spill liability to $100 million per incident, and the Coast Guard has drawn up to that so we need to change that cap and give them more authority.

Mr. MICA. Exactly and I have no problem with that. But listen to this. That money is all the responsibility of BP. Is there anybody here who doesn't know who is responsible for this spill? Raise your hand if you don't know who is responsible for the spill. The govern-

ment and the taxpayer and the people who have been paying the 8 cents on the barrel have put the money into this fund, and we are front-financing BP's responsibility.

So I am fine with opening this up. But the first thing the government needs to do is get some payments from BP and responsible parties so that we are just doing this to front-finance their responsibility. In this, we should never let BP off the hook, or responsible parties off the hook. But in the process of changing things, you don't want to do damage or you don't want to reward offenders and penalize people who have done the responsible thing. So that is the first item.

Now, of course, on the other side of the aisle, the first thing they do is, we have to raise taxes or fees. It is not the 8-cents-per-barrel fee that got us to this 1.6 billion, 1.5 billion. There are some other fines and penalties in there, but for the most part it is that 8 cents. So what did the other side propose? In fact, they passed it in legislation last week that we increase this to 34 cents. Now, I don't mind increasing it, but I will tell you one thing: I am not going to pay BP's expenses up front from this fund. They should be held responsible, or responsible parties pay for that. So we may need to adjust this upwards, and I have no problem with that.

The Senate has a proposal for 41 cents per barrel. But what we have got to do is get the right figure and keep—and still hold people responsible, not use this fund to let people off the hook.

The other thing, too, is we need to find some way to allow those who are affected by economic damage—the business closed down, their job lost, their resort activity or tourist income killed by this disaster—that they get some immediate relief, not going through some bureaucratic things. So don't think, folks, that those people are being helped in this situation right off. So that is the first caveat that I have.

Economic damages. We now have the $75 million cap, and I say it is fine to raise that. But what we have to do is be careful that we don't raise it and have unintended consequences. When you raise the cap too high, what happens? Small business people, small operators, cannot get the insurance. They cannot meet the liability limits. So what do you do? You reward the big companies.

Put the second slide up there, the one on the number of spills. The number of wells. I am sorry—the number of wells.

This is interesting, and this is actually put by the majority staff into the report that they provided. And I tell them, the majority staff, you did a very good job. It was 29 pages. It was one of the most thorough reports I have read that the Committee produced, Mr. Chairman.

Mr. OBERSTAR. Thank you.

Mr. MICA. But this is interesting, and what we want to do if we raise again the liability and the economic front, we don't want to put everybody out of business. We don't want to make only the big operators protected and put everybody else out of business, because I come from a business background. If you can't get insurance, if you can't meet these liability caps, as a small business person I wouldn't be able to compete.

Now, we don't have that many that we have to worry about in deepwater if you look at the chart. And most of the wells and the

activity, the drilling, is done under 600 feet. Look at that. It is almost 3,500. So what we want to do is target and keep responsible those people who are posing the biggest risk and also would have the biggest resources, and should be held on the liability issue responsible financially.

One other point I want to make on this, Mr. Chairman, as we do this. Last week the administration had three different positions on moratoriums on drilling. Did you watch that? And it threw everybody into a panic. Actually, some people are out of business as a result of just a few days of uncertainty in this market.

And what we have got to do is make certain that we don't have the same kind of havoc when we go forward with these liability proposals; again, not letting anyone off the hook, making certain they are held responsible.

Finally, let me just say that Thad Allen who is in charge, he was recently quoted—we will put this in the record, May 24—when he asked, Why doesn't the government take this cleanup over—he was very frank, Thad Allen is a great guy and we are fortunate to have him in charge—he said, "because the government doesn't have any capability."

Now, probably the worst thing the administration could have done, as on June 1, they sent the Attorney General, Eric Holder, down there and Eric Holder said he is going to launch a criminal investigation. I submit that what he did is he probably put the biggest damper on the cleanup you could possibly do. If you are a small business or one in business, and you are needed or going to be contracted to be involved in the cleanup, and the first thing they do is send in the attorneys and the Attorney General to start threatening people as if they are looking at criminal activity there, that is going to get people out of that business of cleaning up an activity.

I think where they need to start—and there may be a time for that, and I want people held criminally responsible—but right now we need to get that cleaned up.

Finally, there is one other point I think we should do in cleaning that up now. This is a report that we had. It is in Newsweek, June 7. We need to start with the Minerals Management Office in the Department of Interior. Let me just read this, and if Eric Holder wants to investigate, it says the MMS appears to have had a coziness, sometimes creepy corruption activities, and we saw three criminal investigations in that department, which I submitted evidence to under the Bush administration. It says oil companies filled out inspection forms in pencil, and then the Department of the Interior official, the inspector, traced over their writings in ink.

Now, there is a place to start investigating, start looking at criminal activity, is our own Department of the Interior that issued the permits, that set the parameters for drilling, and then penciled in their opinion on what was done in inspections. Something is rotten in Denmark and also in oil drilling in the Department of the Interior, and that is a good place for Eric Holder to start.

I yield back the balance of my time.

Mr. OBERSTAR. I want to thank the gentleman for his comments and for his reference to our Committee staff preparation memo. I appreciate your acknowledgment. These are all very thorough, very

factual, documented pieces that I personally review, and I appreciate.

I would like to just supplement the gentleman's comments. Under the OPA 1990 law, BP must reimburse the Federal Government to the oil spill Liability Trust Fund. Last week, the Obama administration sent BP a $69 million bill for reimbursement to the trust fund for expenditures from that fund. And under the act, there will be no taxpayer expenditures; all that, for compensation for losses and damages resulting from the spill, that all must come out of the fund.

Mr. MICA. Will the gentleman yield?

Mr. OBERSTAR. Yes, I will yield.

Mr. MICA. Again, I was asked why this fund is depleted. And they said, basically, We are covering those costs now, waiting for reimbursement.

So I will send a letter if you want to join me or whatever. I want BP to be paying now, rather than depleting this fund. I don't mind changing it, increasing it, and we need to adjust it. But I will be damned if I am going to have that fund depleted by front-forwarding the financing of BP's responsibility. And if they have got a $69 million bill, they sure as hell need to pay it sooner rather than later.

Mr. OBERSTAR. Exactly. And there are other costs that BP is paying, as they must do when bills are submitted. But the OPA 90 established this trust fund so that the Coast Guard could act promptly, and not wait for oil companies to come forward with money, and then come back to them and demand funds and do these concurrently. But the law itself, we are going to change that law, and we will of course discuss this with the gentleman when we proceed, following this hearing, to draft legislation.

But the Oil Pollution Act of 1990 limits the Coast Guard to $100 million expenditure out of the oil spill Liability Trust Fund per incident. It is not that the fund has run out. It is that they are limited by law to spending $100 million out of that fund. We need to raise that amount and change other factors within the oil spill Liability Trust Fund.

And further, I would note that the 8-cent contribution into the trust fund expired at the end of 1994 and, unfortunately, the previous management of the Ways and Means Committee didn't reinstate it until 2006. We had 12 years when the funds were not going into the trust fund.

I know other members have statements they would like to make. I would ask them to withhold until our congressional panel makes their statements, and then before the second panel comes, I will recognize members for individual statements. And we will begin with Mr. Holt.

TESTIMONY OF THE HON. RUSH D. HOLT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. HOLT. Thank you, Chairman Oberstar and Ranking Member Mica and Members of the Committee. I appreciate the opportunity to testify about oil spill liability.

As we speak, the oil continues to gush into the gulf at an unprecedented rate. We can watch it instantaneously any time of the day

or night. The environmental effects are already evident along hundreds of miles of coastline from Louisiana to Florida; and, despite a variety of efforts, top hat, top kill, junk shot, the recent modified top hat or sombrero, we are still not containing the leak. There are signs that the spill won't be stopped anytime soon.

Our concern must be simultaneously stopping the leak, limiting the damage to natural resources in the Gulf States and addressing the loss of people's jobs and dislocations resulting from the incident. This goes beyond the important questions of just liability that you are considering today.

I will restrict myself to the liability.

Since the catastrophe began, we have all been concerned about the long-term economic livelihood of the 200,000 people employed by Gulf Coast fishing, 2.8 million people employed in Florida in the tourism industry and so forth, and all Americans who rely on the Gulf of Mexico for economic livelihood. BP should be liable for every last cent of the natural resources and economic damage it caused; not the small business owner, not the restaurateur, not the vacation home renter, not the fishermen, not the American taxpayer.

Revisiting the liability issue is long overdue. As the Chairman said, it has been two decades since the Oil Pollution Act was enacted in response to the Exxon Valdez spill. Under this act, oil companies are required to cover the full cost of "removal." However, the law set a $75 million cap for liability for other losses such as economic losses and the cost of providing extra public services for the response.

For a catastrophe of the magnitude that we see now, $75 million is laughable. Initially BP said it would cover "all necessary appropriate cleanup costs ." More recently it said it would pay for all legitimate claims, including those above $75 million.

If you look at the last decade of BP's operations in the U.S., you see a decade of BP's management repeatedly disregarding safety and environmental rules in ways that are deadly and dangerous. The current spill in the gulf, the explosion of the Texas City refinery in 2005 that resulted in the deaths of 15 people and injuries to more than 150, the four explosions along the Alaskan pipeline due to corrosion in 2008 and 2009, the 200,000-gallon spill in Prudhoe Bay pipeline in 2006, the falsification of compliance reports in the Carson refinery in California over a period of years, why should the American public trust BP?

And history shows, this history and the rest of the history shows that mild sanctions and lower liability limits do not provide adequate care, prudence, and preparation. It is fair to ask if BP's word is enough. It is nice that BP says it will cover claims over the legal limit of $75 million. It sounds good. But it doesn't satisfy me, and it shouldn't satisfy you. I don't think it should satisfy any Member of Congress.

I disagree with the administration that BP's word is sufficient. The liability cap needs to be raised to ensure BP is legally responsible, and it needs to be raised retroactively. The law allows that.

Therefore, I have introduced the Big Oil Bailout Prevention Act, which would raise the liability cap for offshore well spills from $75 million to $10 billion. Those provisions would be made retroactive,

as permitted by environmental law precedent, so that the Deepwater Horizon incident would be covered under the bill. The bill has nearly 70 cosponsors, including a dozen or so members of this Committee.

I am glad that the Transportation and Infrastructure Committee is holding this hearing today, and I am sure that other members and witnesses who are testifying today will help us figure out what is the proper level of liability. If $10 billion is too low, then we should set it at a level that will ensure that those responsible are fully liable and the people affected do not have to spend the rest of their lives fighting with BP and other companies in court.

Limits should be set not by the size of the company, for example, so as not to disadvantage smaller companies; rather, limits should be set by the possible expense of harm, injury, and damage.

The Deepwater Horizon is the most catastrophic spill that we have experienced. In a fair and just world, companies like BP, which made over $16.9 billion last year, should pay for every cent of the mess it made, not taxpayers.

Our bill is clear. The buck stops with the oil companies. It shouldn't spill over to taxpayers.

The American people clearly want to see Congress holding BP accountable. And it is fair for them to ask why Congress, nearly 7 weeks later, is only now getting around to acting. I urge the Committee to act quickly to reassure the American people that we will hold BP accountable and bring the Big Oil Bailout Prevention Act to the floor of the House expeditiously.

I thank you for the opportunity to testify. I look forward to working with you on this legislation.

Mr. OBERSTAR. Thank you, Professor, for your very thorough presentation and your very scientific manner.

Mr. OBERSTAR. Ms. Castor.

TESTIMONY OF THE HON. KATHY CASTOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Ms. CASTOR. Thank you, Chairman Oberstar and Ranking Member Mica and all of my colleagues on the committee. We must act swiftly to update this outdated Oil Pollution Act of 1990. That says it all, doesn't it?

Mr. OBERSTAR. Or 1851.

Ms. CASTOR. We have learned a lot from this, from BP's oil disaster in the Gulf of Mexico. This isn't just affecting all Gulf States, this is America's economy. Just when we have fought to come out of this recession, BP wreaks havoc on our economic recovery. But I am confident, especially, Mr. Chairman, with your depth and breadth of knowledge on these issues, we will be able to bring legislation to the floor swiftly to address this outdated law.

It is very difficult to characterize liability in this case when we are talking about the worst environmental disaster in our Nation's history.

And those of us living on the Gulf Coast, we are going to be living with the impact of this disaster for years and years to come.

I met last week with tourism officials, fishermen, environmentalists on Saint Pete Beach—and you know the oil isn't washing up in the Tampa Bay area yet and we hope and pray it will not. But

there are still very significant economic impacts that we are dealing with: cancellations of hotels and vacations. And they are able to chronicle this. Fishermen are beside themselves because they will go off the west coast 100 miles to where the fishing grounds are, and the Commerce Department has said, don't go there because it is not safe.

We have got to make sure that this, when we update the act, that we are really looking at the true economic impacts. And you have very talented staff, professional staff here. And I look around, and they are very thoughtful and knowledgeable members, and we have got to ensure that when we update the act they are delving into the legal terminology that is used. And when you look at the terminology that is used, "responsible parties," are we really able to capture everyone in this scenario, or a future scenario, that is a responsible party?

"Removal costs," removal costs include the cost of removing spilled oil from water and shorelines or taking of other actions that may be necessary to minimize or mitigate the damage to public health or welfare. Is that broad enough?

"Recoverable damages" cover, among other things, injuries to natural resources, destruction of property, loss of subsistence, use of natural resources, public services. But I am concerned that that doesn't go far enough.

We had an economist from the University of Central Florida yesterday that said the potential impact on our economy is over $10 billion—that is his early estimate—and that the State of Florida alone could lose 195,000 jobs, like I said Mr. Chairman, just when we are coming out of this economic disaster.

So you have got to put all of your talented folks to work, and I ask all of the Committee members to get into the terminology of this legislation. It is not a complicated act, the Oil Prevention Act. But if we take Mr. Holt's bill, which I am a cosponsor of—and I am heartened to know that so many of you are cosponsoring—we take that, we have got to update it so that we prevent these, that we are able to compensate folks and our economy in addressing the environmental impact.

And one other thing that the Ranking Member has raised, if an oil company that is drilling cannot get insurance because they can't cover the risk, the potential damages, should they be drilling at all? If we cannot insure that we can mitigate the harm and damages, and they can't get insurance, should that operation be going on in America's waters?

These are not the waters of big oil companies. These are the resources of the people of the United States of America. And they deserve all the protection that we can bring.

So I thank the Committee very much for your attention and all of your ongoing efforts to address this horrendous disaster that is not just the Gulf Coast disaster but it is is all of ours. Thank you, Mr. Chairman.

Mr. OBERSTAR. Thank you very much, Ms. Castor, for your very thoughtful presentation. Just a footnote to your last comment about insurance. In aviation, if an airline cannot get insurance, it cannot fly.

Mr. OBERSTAR. Representative Jackson Lee.

TESTIMONY OF THE HON. SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Ms. JACKSON LEE. Mr. Chairman, thank you so very much for the invitation to provide testimony this morning, and to the Ranking Member. To all of the members that are here, let me thank the T&I Committee for the important jurisdiction and leadership that you give to so many of these issues.

Publicly, again, I want to acknowledge the lost lives of those who have lost their lives. My sympathy to the family of the 11 workers who lost their lives in the Deepwater Horizon, but also to the many impacted employees whose stories are now being told, who are suffering from post-traumatic stress disorder. And we know that this is not only catastrophic as it continues, but it is catastrophic in the lives of so many Americans.

I believe America is crying out for action now. And therefore, I believe Congress would be excused for looking at all of the legislative initiatives and amending them and reforming them retroactively. That always poses a lot of sticky questions and concerns because Congress wants to do the right thing. But I don't believe America wants to wait around and pat us on the back for legislation that will be enacted for operation after this tragic incident.

I recently had the opportunity to join my colleague and friend, Chairman of the Subcommittee on the Coast Guard, Elijah Cummings, and my friend Corinne Brown, the Chairwoman of the Rail Committee, as we went out over the gulf last week to look at the operations that were clearly mind-boggling.

First, the fireboats were spewing water on fires to burn. Then you could see the oil lines going through the pristine waters. Then, of course, you could see the enterprise which is trying to draw up the oil spill. My friends, this is catastrophic, it is overwhelming, it is going to continue. And I come from oil country in the city of Houston.

And so I would suggest that we look at this in the way that we have talked about—a seamless energy policy or green energy. It has all been on the basis of trying not to hand our destiny over to terrorists. That is important. And therefore, I think as we become thoughtful in this process, I think we need to have that as part of our consideration. But we also need to raise this beyond the level of an individual company and say that this is the oil industry problem; that as they proceed for permits in shallow water and deepwater, one of the legislative aspects of our work should be the reforming of how permits should be issued. And therefore, I believe no permit should be issued without insurance, obviously, at a certain level, but also recovery plans.

I can tell you for sure that deepwater drilling is like a surgeon who knows how to do heart surgery, to open the patient, perform the surgery, but with no idea how to close on the surgery. That patient dies. And even though I come from this industry and represent thousands who are now frightened about their jobs, I believe for their safety and security, and those that I have spoken to, they want increased liability, they want safety for their jobs to be protected long range.

So I believe that we need, first of all, to raise the cap, and then I think we need to look at, as the Chairman so articulately men-

tioned, the various legislative initiatives, the Oil Pollution Act, the Death on the High Seas Act, but also the Jones Act, Mr. Chairman.

And let me just briefly go through these. As relates to collateral damage, after I left the overview of the deepwater drilling rig, I want into Plaquemines Parish and visited with those at Pointe la Hache: the oystermen, the fishermen, and the shrimpers. The claims process is broken. And I thought, Well, let's give this process a chance. They are taking paperwork, they are filing, and maybe the processes is working.

Well, let me tell you this: First of all, the offices are closed by the company. They are here today, they are closed the next day.

The second thing is, fishermen, oystermen, and shrimpers don't necessarily have the paperwork that an accountant has. They have their boats, they go out, water may impact, and BP is asking them to provide the kind of documentation that you would think the greatest accountant would have.

They are not trying to cheat. When I sat down with these folk they said, We simply need to get our money. The last payment they got was in May, $5,000. Therefore, they asked whether they could get a 6-month lump sum. We thought that was something they were responding to because the claims process is so erratic.

Well, lo and behold, they had a meeting on Monday, and that meeting resulted in a zero response. "We don't know what you are talking about. We have to keep doing what we are doing." And right now, the shrimpers, the fishermen, and the oystermen are literally dying because they have no way of providing for their families.

I think they want Congress to act now, whether we demand that there be a claims process that is set independently, away from BP, and whether or not you then ask that process to address to the particular industry, such as tourism, such as the restaurants, that are likewise being impacted in my own community.

As relates to the Oil Pollution Act, I would suggest that the cap be raised, and I join Mr. Holt on that. I think we need to be deliberative on how that process is calculated. I also think it is important that we independently assess how many gallons are going out of the deepwater spill at this point, so that any funding payment is not based on industry assessment but our assessment.

I do believe it is important to act now, immediately, to provide for the Coast Guard to draw down on that fund beyond the $100 million. The Coast Guard says it is absolutely imperative.

Mr. Chairman, there is something called the multidistrict courts claims process, and I would suggest—and this is overlapping jurisdiction that, as the attorney general Jim Hood said, the multidistrict is to form all these cases into one court and not allow these cases to be filed in State court.

I would suggest that the Anti-Injunction Act be amended to specify that no Federal court may enjoin parallel litigation pursued by a State in its own courts. That will allow Florida and other particular States to have cases if necessary.

Also as I indicated, the lifting of the cap should be done immediately. And I would suggest that we engage, as you are doing today, the oil industry collectively on providing for answers to how you put in a recovery plan if you are trying to get a permit.

The Death on the High Seas Act I think is extremely important and only allows for pecuniary damages to be collected. This of course, Mr. Chairman, is what you said. It is because when this industry was formulated,, this legislation was 1920, all they could think of was ships and captains. They couldn't think of offshore drilling to the level that we have now, and they didn't want to say that a bad weather storm was going to be the fault of that captain.

I am going to be introducing legislation that will add punitive damages as well to the issue of the Death on the High Seas.

In addition, the Jones Act, Mr. Chairman, only allows or refers to seamen. Many of those who died were engineers. One of the witnesses that came before the Judiciary Committee was the father of Gordon Jones, I believe. He was an engineer and spoke of the fact that his widow could only receive pecuniary damages and not punitive damages for what may have been or may become the most horrific tragedy that we can experience. I believe that there should be an immediate correction of that right now, so that those who have lost their lives, their families, will not suffer.

Might I just conclude by adding this point and a story about Linda Smith, who had a restaurant or has a restaurant, with all of her savings in it, called the Alligator Cafe. But it is in Houston, Texas where most people would assume that she relies on the Louisiana crop, if you will, of oysters and shrimp and fish. And I might tell you, Mr. Chairman, it is darn good. Well, her business is literally almost shut down; one, because people are asking whether the product is contaminated; two, because she cannot get product.

When I spent time in New Orleans, there were restaurants that were closed because they indicated that they could not get product. We have seen a number of stories that are now part of the collateral damage.

So I would suggest that in addition to the lifting of the cap, that there needs to be an immediate assessment of whether or not a recovery plan needs to be part of the permitting process, legitimate permitting process, of the MMS. Lifting, of course, the cap, amending the Death on the High Seas, and amending the Jones Act is required now, and then allowing States to be able to file their own lawsuits in spite of the multidistrict litigation that I believe came after the Valdez. The Valdez, of course, was a tanker spill. This is an oil spill of large proportions never seen before.

And I would just close by saying I represent roughnecks. They are frightened for their jobs. These are hardworking Americans. And I want to protect them, too. What I hope most of all is that Congress will be deliberative in their response, that they will move quickly, that the oil industry will see that it is in their advantage to collaboratively work to make sure that this never ever happens again.

A heart surgeon would not operate on a patient and not know how to save them. That is what happened with the Deepwater Horizon drill. And I think it is imperative that we act now. Thank you Mr. Chairman.

Mr. OBERSTAR. Thank you very much for your testimony, for your firsthand experience with those in the gulf. And I would say that on the matter of safety of operations, we don't let airplanes leave the ground unless they have all the redundancy needed to get

that aircraft safely back on the ground. At 7 miles in the air, there is no curb to pull over, look under the hood and see what is wrong. You get it right before you leave. And when the aircraft returns, there are redundant systems, safety, that aircraft is approaching the runway at 165 miles per hour. It has flaps that deploy automatically to slow the aircraft down. When it hits the ground, the thrust reversers kick in and then the brakes apply. Any one of those is supposed to stop that aircraft. But under certain conditions, even that isn't enough. But we ensure in aviation.

But if at a mile below the ocean surface, at a depth below that which our Los Angeles class nuclear submarines can operate, we don't have sufficient redundancy and protection and backup, and we have to end the industry self-certification.

One question I have: Should your bill be retroactive for the incident in the gulf?

Mr. HOLT. I want to make clear, Mr. Chairman, that it should be. It can be. It is written that way. And I think that is what the American people want, and we have research to say that the law allows that.

Mr. OBERSTAR. If the permits include the limitation on liability, is there a cause—have you researched whether there is a cause of action by the oil company under that lease?

Mr. HOLT. I am not the best person to testify on that, I think.

Mr. OBERSTAR. We will get a lawyer, not a physicist.

Mr. Mica, do you have any questions?

Mr. MICA. First, let me make one thing clear; that I don't think there should be any limits on economic liability. And also if there is negligence, these people need to be held accountable.

Mr. OBERSTAR. If there is negligence, if the gentleman would yield, the law sets no limits.

Mr. MICA. Exactly. That is the first thing. I think my point, too, is when you set terms of—blanket terms for again increasing some of the liability responsibility, what we don't want to do is end up with only the BPs and the Royal Dutch Shells and the others as the only ones that can play in this game. And what you don't want to do is accidentally put tens of thousands of people in the industry out of business because you created a very limited playing field in which very few can participate. There are many subcontractors and small businesses people in this business who, just by the action last week for a few days, some of those people have been put out of business. So we are talking about creating stability and responsibility.

And then I point again to the staff's chart. Mr. Holt, you saw the staff's chart, and you saw how limited, actually, the deepwater wells and the deepwater drilling activity is. Would you have a problem with again focusing on where the potential risk is in making certain that those that are actually taking on that risk or that additional liability, we could limit that scope so we aren't putting the small guys out of business.

Mr. HOLT. Thank you, Mr. Mica.

As I tried to make clear in my testimony, the judgment, the operative thinking, should be not whether a small company can afford the insurance. The consideration should be how much damage might possibly be done. And just as the Chairman said, a plane

doesn't take off if it doesn't have insurance. You don't first ask is it owned by a small company or a large company; you ask, does it have the insurance?

Mr. MICA. But there are different levels of insurance. And people who are in the industry—and, yes, first I want no limits on economic responsibility, and if there is negligence, and I have no problem increasing the cap. But I think you just said what I was saying; as those that incur that type of risk should be covered and held responsible, and people with lesser risk should—for example, a small operator cannot get $10 billion worth of liability coverage. But that may not be the person that is drilling. That is a person that is a subcontractor or a small business person in the industry.

Mr. HOLT. There is developed law about how liability is passed through subsequent participants, and that is not the subject of this legislation. The responsible parties should not be able to hide under a liability cap that is so small that it allows them to engage in imprudent behavior.

Mr. MICA. I agree with that. But, again, you want those with a higher liability have a higher responsibility of making certain that they are insured or covered or can meet that liability. Otherwise——

Mr. HOLT. And I think Ms. Castor has made my point, that same point, very well.

Mr. MICA. Thank you Mr. Chair.

Mr. OBERSTAR. Do other members have questions of our panel?

Mr. Nadler.

Mr. NADLER. Yes, thank you.

Let me just ask, Representative Holt, in light of what you were just saying, it seems to me—and I would ask if you would agree that if a company undertakes an activity, the result of which may lead to billions and billions of dollars worth of damage, in the end result, either that company is going to pay for that damage or the people who are damaged are going to be unrecompensed or the taxpayers are going to pay for the damage. There are no other alternatives. Can you think of any other alternatives? OK.

That being the case, then, someone who says that, Well, eliminating the liability cap for that would say small companies can't do that business. Why shouldn't we say small companies can't do business that puts millions of people at risk of billions of dollars unless they can cover the risks that they set up?

Mr. HOLT. Let me repeat—thank you Mr. Nadler.

The Chairman said, Well, with regard to aviation, if you are not insured, you don't fly. You don't ask whether it is a large company or a small company or a mom-and-pop airline or not. If you can't cover the damages, then you shouldn't be engaging in the activity. And I think that——

Mr. NADLER. I think that is the end of the statement. Which is another way of saying that if a company—that either a very large company that can cover the damages should do it, or government should do it, or nobody should do it.

Mr. HOLT. Maybe Ms. Castor wants to add a word to that.

Ms. CASTOR. I think it is obvious. It is obvious and the devil would be in the details of any insurance negotiation between the insurer and the insured. It is ultimately, how do you quantify the

risk? In this disaster where they downplayed the risk, I think now has demonstrated what the true risks are. And it is enormous and it is probably not $10 billion.

Mr. NADLER. A lot more.

Ms. CASTOR. We should probably look at something significantly more in liability caps for this kind of activity.

Mr. NADLER. I agree with you. I think it is obvious. I just want to make the point that someone who says you have to wipe out liability caps because it will inhibit smaller companies from doing it, is really saying that either the people who are damaged should not be recompensed, that the environment should be at risk, or that the taxpayers should pay for it.

Ms. JACKSON LEE. Mr. Nadler, may I respond?

Mr. NADLER. Certainly.

Ms. JACKSON LEE. Let me try to answer that question coming from a community that has what we call independent oil producers.

I think there is a distinction between the insurance that major airlines have versus the mom-and-pop airplane that the family takes out on a Sunday afternoon joy ride. Certainly the death and disaster that may come about is devastating no matter what you say.

But I do think there is something to the concept of a tiered review. When you look at the graph, there are about 3,000 applications for zero to 200 feet in drilling. That is called shallow-water drilling. There are only about 1,000 permits.

What I have indicated is that I believe whatever permit you seek, you should have a defined, vetted recovery plan. What happened with Deepwater Horizon is they were in the highest levels of technology in terms of drilling, but they had a poor response in terms of recovery. When you are talking about companies that are in the top five in terms of wealth, and certainly, unfortunately, this tragedy, the sky is the limit; but when you look at the independents, you can tier the recovery and tier the cost.

Mr. NADLER. Reclaiming my time, let me just say in the few seconds left that I would agree, obviously, if the risk is limited, then the liability can be limited, and it may be that there are tiers. I am not familiar with technology, but where the risk is really limited, then the liability can be limited. But where the risk is very, very large, you cannot limit that liability unless you are willing to have the taxpayers or the public eat that liability, and if the liability potential is so large that it is uninsurable, then that is the market telling you you should not engage in that kind of activity, and we should heed the market in that kind of situation.

Mr. OBERSTAR. We will have plenty of time to engage with our colleagues as we progress with this bill over the next couple of weeks. I appreciate the enthusiasm of Members of the Committee and those on the panel. I thank you for your contributions. I know each of you have Committee responsibilities as well.

Mr. OBERSTAR. We will conclude this panel and continue with our second panel.

Mr. Gerard, president and CEO of America Petroleum Institute; Mr. Charles Anderson, senior vice president and head of Skuld North America, P&I Club; Mr. Brian McAllister, vice president and general counsel of McAllister Towing; Mr. Robert Hartwig, presi-

dent and economist, Insurance Information Institute; Mr. Michael Greenstone, MIT Department of Economics; and Kate Gordon, vice president of energy policy, Center for American Progress.

While they are taking their seats, I will now go to Members on the Democratic side who may want to make opening statements.

Mr. Nadler.

Mr. NADLER. Thank you, Mr. Chairman.

Let me begin by thanking you for holding this hearing on the liability issues under the Oil Pollution Act as it relates to the Gulf Coast oil spill. I obviously support efforts to greatly raise or eliminate the liability cap in the act. I have heard the argument that if the cap is raised or eliminated, then drilling companies will not be able to get insurance, but that would be the market telling us that we shouldn't be doing this kind of drilling, or not in this way, without greater safety requirements and oversight. The government should not be in the business of shielding companies from the check of the free market and providing cover for bad or overly risky behavior.

I have also heard it said that we don't need to raise the cap because BP will ignore the cap and cover all damages. If BP can afford to do that, why do they need a cap in the first place? Frankly, I am very concerned that despite BP's statements, they ultimately won't pay for all the damages caused by this disaster. BP says it will pay "all legitimate claims." But who makes the determination what is legitimate and on what basis if they are not statutorily required to pay the claim? So far BP has refused to answer that question. And there are certain types of damages not covered under the OPA; namely, personal injury and punitive damages.

I have tried to get BP to accept responsibility, for example, for health problems caused by this disaster, and so far they have refused to do so. BP is trying to look like a good actor that will cover all of the damages, but the fact that BP refuses to acknowledge liability for health problems tells me that they have no intention of paying such claims. And if BP doesn't pay, that means it will fall upon the taxpayers and the victims themselves.

Making matters worse is BP's use of toxic chemical dispersants. The only thing that the toxic chemical dispersants have accomplished, as far as I can, see is to hide the true nature, the true extent of the damages by getting the stuff off the surface of the water where it can be picked up more cheaply but where it is visible, and causing these huge underwater plumes to form, the plumes which BP denies exist. We are basically air-dropping this toxic stuff all over the gulf, as we did Agent Orange in Vietnam.

I have a deep personal concern about this because it reminds me of the World Trade Center disaster in my district. The government authorized use of these dispersants and is saying everything is safe; there is no need for respirators. Yet everyone knows that defies logic. And in the meantime, people are getting sick. BP's CEO had the nerve to insinuate that people got sick from food poisoning, while OSHA seems to think it is probably just from the heat. So sick workers are filing injunctions against BP to try to enforce respirator use on their own. This is crazy. Chairman Oberstar and I wrote to the EPA and OSHA asking that respiratory protection be

enforced, but based on some of the statements in the press so far, I am not optimistic.

I cannot believe we are repeating the same mistake again, the same mistake we made in weeks after 9/11 when the United States Government caused thousands of people to get sick by denying that the air was toxic. And we are doing it again, only this time BP is doing it, and having thousands of workers working in what amounts to unsafe conditions. They are going to get sick; some of them are getting sick, and BP is going to deny liability.

I cannot believe we are repeating the same mistake again and personally causing even more harm to the people of the Gulf Coast while BP could get off the hook. I urge everybody here to start asking these questions.

Chairman Oberstar, I know you share these concerns, and I thank you for aggressively pursuing these issues on behalf of the people of the Gulf Coast and of the entire Gulf Coast region, because I believe that all of the harm we are now seeing in some of the States bordering the Gulf Coast we are going to see in all of the countries bordering the gulf, and this is going to become an international crisis.

Mr. Chairman, I yield back.

Mr. OBERSTAR. I now recognize Mr. LoBiondo and then two others, and then we have to go our witnesses.

Mr. LOBIONDO. Thank you, Mr. Chairman.

I think it is great that you are holding this hearing to examine the proposed changes to the liability limits established under the Oil Pollution Act. As we know, several Members on both sides of the Capitol have proposed to dramatically raise or even eliminate statutory caps on liability. I want to ensure our Committee reviews these proposals closely to determine their impact on operations in the maritime industry which could be very far reaching. I hope today's hearing will be the first step in a process that resets liability in a way that is commensurate with the risk and potential damages associated with activities on board the vessel or facility.

I strongly believe we should raise the liability limits. In 2006, I was the lead sponsor of a bipartisan bill that restructured and raised these limits for the first time since Congress originally passed OPA in 1990. We were forced to do this because three successive administrations failed to follow the law's requirement to periodically adjust the law's limits according to inflation. While they have finally done that for vessels, the current administration has still not done so for offshore facilities. If the administration had followed the law and adjusted limits for offshore facilities like the Deepwater Horizon, the cap on damages for this incident would be more than $50 million higher than the current $75 million cap. This adjustment could be made immediately, and I urge the administration to do so as soon as possible. The administrative action would be a good first step, but I agree we must raise liability standards to account for the significant changes that have occurred in the offshore drilling industry since 1990.

I look forward to working with the Chairman of the Full Committee and the Chairman of the Subcommittee to develop legislation that adjusts liability limits to come in line with the risk; however, as we undertake this process, we must not fall into the trap

of treating all vessels and facilities in the same manner. I think it is important, the risk for a major oil spill from a small, nontank vessel is not the same as the risk associated with an oil-laden tanker vessel or an offshore drilling operation. The current spill in the Gulf of Mexico has presented the Federal Government with a new set of challenges not foreseen during the development of OPA.

I hope our witnesses share their suggestions on new or amended authorities necessary to respond to the current and future spills. And I want to thank all of the witnesses for participating in the hearing and look forward to working with them and Members of the Committee as we move forward on this legislation to protect our waters.

Thank you, Mr. Chairman.

Mr. OBERSTAR. Thank you.

Mr. OBERSTAR. Ms. Johnson, Chair of the Water Resource Subcommittee.

Ms. JOHNSON OF TEXAS. Thank you, Mr. Chairman.

To put this hearing in context, today marks the 51st day of the ongoing BP oil spill disaster in the Gulf of Mexico. One of the reasons why I think that it was nearer to Louisiana than Texas, because Texas has no cap on liability.

While this committee's last meeting focused on what went wrong and how we have gotten to where we are today, today's hearing will focus on what needs to be done and to make sure similar disasters do not happen again. Today's witnesses, I hope, will focus on liability and financial responsibility for oil spills and the resulting damages. This issue is becoming increasingly important as the impact of the gulf spill is currently unknown, but is still under assessment, and as questions arise on who will ultimately bear the responsibility for cleanup costs and economic damages.

Today this Committee will investigate how the Oil Pollution Act of 1990 and other statutes should be amended to increase or lift the cap on liability for companies or individuals responsible for oil spills. BP testified under oath that it will pay all legitimate claims and will not be bound by the $75 million liability cap under the Oil Pollution Act. However, as Congress continues its investigation of the BP oil spill disaster, this Committee should rightly question whether or not the current $75 million—and obviously we think it is worth more than that—should be just eliminated.

The President and Members of Congress have called for significant changes to the liability cap or for the cap to be eliminated altogether. In light of these proposals, today's hearing compels us to ask important questions about how much liability we should expect oil companies to maintain and how much financial responsibility we should expect them to have when accidents of this nature happen.

According to reports in the Washington Post earlier this week, BP is currently capturing as much as 15,000 barrels a day with its latest effort. This is in sharp contrast to the amount that BP has reported is leaking. It seems to me that we have to rely on BP for data and information, and we have no way of confirming it. Given that we may not know the full extent of the oil spill for years to come, it might not make sense for us to cap any amount of finan-

cial responsibility for BP and other companies, and this is what we are here to discuss today.

While the entire story of this disaster might not be told for decades, we have an obligation to see those responsible for this spill held accountable for their actions not only to the people of the Gulf Coast, but to the American people. We also have an obligation to learn from this disaster and make necessary changes to our laws and update our laws to ensure companies are held accountable in the future.

Mr. Chairman, I thank you, and I look forward to hearing the witnesses today.

Mr. OBERSTAR. I thank you for your statement, despite limitations on your voice. It is getting better, and it is good to hear that.

Mr. Cao, and then two more, and then we will go to our panel.

Mr. CAO. Thank you, Mr. Chairman, for holding this very important meeting, and I thank the Ranking Member for all of his support following the oil spill. And as we speak today, oil continues to flow in the Gulf of Mexico, affecting thousands of businesses, fishermen; destroying our ecosystem; as well as impacting people's physical and mental health issues.

I represent a district that is directly impacted by the Deepwater Horizon disaster, and I feel the pain and the suffering of my people, and want to do everything that I can to address their needs. Therefore, I support the raising of the liability cap. But, Mr. Chairman, we must do it in a very deliberate way that will prevent the loss of thousands of jobs in Louisiana.

Another decision that might have unintended consequences is the administration's decision to impose a 6-month moratorium of deepwater drilling. Again, the primary issue we have is the issue of safety and how to prevent the same disaster from happening in the future, but at the same time, Louisiana is very much dependent on the oil and gas industry, and to impose a 6-month moratorium will cost Louisiana approximately 40,000 jobs.

I do believe we need a time period in order to inspect all of the rigs that are in the deepwater portion of the gulf and to ensure that they have the plans and the procedures necessary to prevent a disaster from happening; but at the same time, I hope that we move, at least the administration moves, in a very responsive way as to limit the potential job loss to the State of Louisiana.

Again, the Deepwater Horizon disaster is a disaster of grave magnitude, and it is impacting and destroying the lives of thousands of my constituents. We must do everything that we can as a Federal Government to help those who are in need, to provide a long-term recovery plan for the district, as well as to rebuild the coast and the wetlands of Louisiana that are being destroyed by the disaster.

With that, Mr. Chairman, thank you for this important hearing. I yield back.

Mr. OBERSTAR. Thank you very much.

Ms. Brown has an introduction to make.

Ms. BROWN OF FLORIDA. Yes, Mr. Oberstar. Thank you for your leadership on this matter.

They will be leaving, but we have 20 SCUBAnauts from Florida who are here. They are very interested in the environment; not just

in diving, but the whole marine biology. They are here visiting us from Florida.

Mr. OBERSTAR. We welcome them. Thank you very much for your enterprise and work. With the experience learned, you will be helping us prevent future disasters in the gulf and elsewhere.

Thank you for the introduction.

Mr. Cummings, a brief opening statement.

Mr. CUMMINGS. Thank you, Mr. Chairman. As Chairman of the Subcommittee on the Coast Guard and Maritime Transportation, I am pleased that we are here today holding our second hearing on the Deepwater Horizon incident. Today's hearing will enable us to examine whether liability limits for offshore facilities and vessels under the OPA of 1990 should be changed, and if so, how.

I have now made two trips to the gulf. Most recently I have traveled with Congresswoman Brown, Chairwoman of the Rail Subcommittee, and Congresswoman Jackson Lee, who testified earlier, and have had an opportunity to see firsthand the astounding devastation that has resulted from the blowout at the Macondo well site.

BP has said that regardless of their current legal liability, they will pay all costs associated with the spill. The government must be aggressively vigilant in holding BP to its commitment.

I have been deeply concerned about the reports that BP may be nickel-and-diming Gulf Coast residents and businesses. Many thousands in the gulf are facing the loss of their livelihoods for what may be a long time to come, and, by extension, they are facing the risk of losing their homes, businesses, and the futures for which they have worked their entire lives.

Based on my discussions as recently as this Monday with the Federal officials in the gulf, I am confident that the government is working diligently to require that BP processes claims as expeditiously as possible; but this must continue to be a top priority, and I question whether it has been.

As with so many aspects of this disaster, BP urgently needs to improve its performance. As late as this morning, Mr. Chairman, Thad Allen was saying that they will be meeting with—that is, the Coast Guard will be meeting with BP officials to speed up the process of addressing those claims. That said, although facilities are legally liable for all costs associated with cleaning up the oil-based spill, the cap of $75 million in liability for the damages that a spill from an offshore facility might cause is unrealistically low given what we are now seeing, and it is obvious when we see all of the problems associated with this bill. It is imperative that this cap be raised to a level that reflects the extent of the potential consequences associated with spills from offshore facilities.

Further, under current statutes, facilities are not required to demonstrate more than $150 million in financial responsibility, although it is apparent their potential liabilities may be many times that figure. As we consider, Mr. Chairman, the appropriate liability level for offshore facilities, we must also assess the appropriate level of financial responsibility they should be required to demonstrate. The current threshold of $150 million is unrealistically below the extent of the potential liability in light of what has happened in the gulf.

We will also consider the adequacy of current liability caps for vessels. Unlike facilities, vessels are currently required to demonstrate financial responsibility for the full amount of their liability. And we must consider what impact a liability increase would have on the smaller vessels that are critical particularly to our domestic maritime commerce.

That said, over the longer term it is also imperative that we move away from our dependence on oil. Simply ceasing all offshore drilling is not the answer, particularly if that means we just import increasing amounts of oil from nations that seek to use those payments to destroy us. Reducing our demand and creating reliable alternative energy sources are essential steps we must take now to ensure our future security and prosperity.

I thank you, Mr. Chairman, and I yield back.

Mr. OBERSTAR. Thank you for your work as Chairman of the Subcommittee on the issue at hand.

Now we begin with Mr. Gerard, American Petroleum Institute. Thank you for being with us. You have heard concerns expressed by colleagues on the first panel and Members of this Committee, and we look forward to your presentation.

TESTIMONY OF JACK GERARD, PRESIDENT AND CEO, AMERICAN PETROLEUM INSTITUTE; CHARLES B. ANDERSON, ESQUIRE, SENIOR VICE PRESIDENT AND HEAD OF OFFICE, SKULD NORTH AMERICA, INC. (P&I CLUB); BRIAN BUCKLEY McALLISTER, VICE PRESIDENT AND GENERAL COUNSEL, McALLISTER TOWING; ROBERT P. HARTWIG, PH.D., CPCU, PRESIDENT AND ECONOMIST, INSURANCE INFORMATION INSTITUTE; MICHAEL GREENSTONE, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, DEPARTMENT OF ECONOMICS, AND DIRECTOR, THE HAMILTON PROJECT, AND SENIOR FELLOW, ECONOMIC STUDIES PROGRAM, THE BROOKINGS INSTITUTION; AND KATE GORDON, VICE PRESIDENT OF ENERGY POLICY, CENTER FOR AMERICAN PROGRESS

Mr. GERARD. Thank you very much, Mr. Chairman and Mr. Mica, Ranking Member, and Members of the Committee. I am Jack Gerard of the American Petroleum Institute. API's 400 member companies represent all sectors of America's oil and natural gas industry. Our industry supports 9.2 million jobs, including many in the offshore development business, and provides most of the energy the Nation needs to power the economy and our way of life.

The tragic and heartbreaking accident in the gulf was unprecedented, and our thoughts and prayers go out to the families who lost loved ones, to the workers who were injured, and to all of our neighbors in the gulf who were affected. The people of the oil and gas industry understand our responsibility to find what happened and why, and work in cooperation with government to come up with recommendations for improving this process across the board.

We have already assembled the world's leading experts to conduct a top-to-bottom review of offshore drilling procedures from operations to emergency response. And our industry is providing data and expertise to the Federal Government to stop the flow of oil, clean up the environment, and understand the causes and correct them.

As Congress considers legislative changes that impact domestic oil and natural gas production from our offshore resources, it is critical that proposals both protect the taxpayers and advance our country's energy and economic interests. This Nation's energy and economic security demands must be met by increased domestic oil and natural gas production now and for several decades to come. We want to work with the Congress and the administration as we consider the best ways to protect taxpayers and to provide our country its energy needs.

The Oil Pollution Act of 1990 established the Oil Spill Liability Trust Fund as an important insurance policy to cover the cost of potential economic damages from oil releases from exploration, production or transportation accidents. It is funded by a per-barrel tax on the oil industry that has been mentioned earlier, not by the taxpayers. We accept that responsibility to ensure the support and safety net is adequately funded well into the future.

Some are proposing to increase liability limits for economic damages from $75 million up to $10 billion, or even to remove the limit altogether. We recognize that changes are needed, but believe that some proposals to arbitrarily raise or remove the fund's cap would threaten the viability of offshore operations and could significantly reduce U.S. domestic oil and natural gas production, cost jobs, and harm U.S. energy security.

We are not alone in this assessment, as independent insurers and analysts have reached similar conclusions. Preliminary analysis indicates the following are some anticipated results of increasing the liability amounts for economic damages from $75 million to $10 billion. Let me share just a few.

Some of the leading insurance companies in the oil and gas market have told Congress that they would be unable to offer adequate insurance protection for offshore operations, making the economic risk of conducting offshore operations too great for small-, mid- and even large-sized companies. Estimates indicate that aside from national oil companies owned by foreign governments, only a few of the very largest oil and natural gas companies could meet a potential $10 billion financial assurance test for self-insurance. Lack of insurance created by a $10 billion cap would, in effect, push all small, medium and even most of the major integrated companies out of the gulf.

An estimated 170,000 direct and indirect jobs are supported by the oil and natural gas industry in the Gulf of Mexico. As the companies that could meet the self-insurance threshold account for about 15 percent of the total gulf production, raising the liability cap would place about 145,000 jobs at risk. Even the largest companies would see premiums for additional insurance skyrocket, raising overall cost for offshore operations by as much as 25 percent. The impacts could be devastating. For example, Wood Mackenzie estimates that just a 10 percent increase in development costs could render seven current discoveries subeconomic, reducing production jobs, and putting $7.6 billion in future government revenue at risk.

In conclusion, Mr. Chairman, as Congress considers this issue, thoughtful consideration must be given to harmonize the need to provide necessary resources to this important industry-funded safe-

ty net to protect our environment, while allowing us to safely and reliably provide the energy our Nation relies on for our economic and energy security. To help achieve these critical objectives, the API has initiated an effort with our member companies to quickly develop and provide to you and the administration our recommendations on how to effectively address liability limits and financial responsibility for offshore exploration activities. We are committed to providing quick and constructive input to this important policy debate, and will provide our recommendations to you soon.

That concludes my statement. Thank you, Mr. Chairman.

Mr. OBERSTAR. Thank you.

Mr. OBERSTAR. We certainly look forward to receiving that set of recommendations, and I would urge you to get it in within a week. We don't have much time. We have a goal of getting a package of bills from several committees ready for introduction before the July 4 recess.

Mr. OBERSTAR. Mr. Anderson, welcome and thank you for participating today. Your testimony is of particular interest.

Mr. ANDERSON. Thank you very much, Mr. Chairman. I am honored to be here before the committee. My name is Charles Anderson. I am a senior vice president with Skuld North America, which is the U.S. and North American representative for the Skuld Protection and Indemnity Association. Skuld is 1 of 13 not-for-profit mutual marine underwriting associations which make up the international group of P&I clubs, which in turn collectively insure over 90 percent of the world's oceangoing tonnage and 95 percent of the world's oceangoing tankers.

Just a few words about what protection and indemnity associations are. They are commonly referred to as "clubs" for historical reasons, because ship owners, going back as far as the mid-19th century, recognized the need for new forms of insurance to cover compensation to third parties, such as injuries to crew and passengers, damage to cargo interests and collision. These liabilities were insured on a mutual basis. The ship owners pooled their resources in mutual associations. And most recently, as pollution has become a concern in ship operations, P&I cover is now available to cover removal costs and damages resulting from pollution incidents up to $1 billion.

Again, cover is provided on a mutual basis, and it is important to note that cover is available worldwide for virtually all types of vessels arising from liabilities in many, many different jurisdictions. Cover is provided for liabilities that arise directly in connection with the operation of a ship. It is important to note that P&I cover is not available on a mutual basis for offshore oil exploration and production facilities, although there is limited cover available on a fixed-premium basis.

The clubs operate on a very unique claim-sharing pool. For claims that exceed the individual club's retention, which is currently $8 million, the pool is reinsured by commercial reinsurers worldwide, including virtually all major reinsurers in the U.S. market. Through these pooling arrangements, the group member clubs are able to offer the highest levels and broadest range of cover for the benefit of victims of marine casualties.

Mr. Chairman, you have already pointed out, I think very eloquently, the difference between the carriage of cargo aboard seagoing vessels from one port to another and that this represents a very different risk from deep-ocean drilling and exploration of undersea oil fields, such as the Deepwater Horizon incident, and also, back in the 1980's, the Piper Alpha incident in the North Sea.

Vessels have a limited capacity for oil and fuel. Coast Guard regulations require tank and nontank vessels to insure by contract the availability of resources to respond to a worst-case discharge, which is defined as the discharge of the vessel's entire cargo- or fuel-carrying capacity in adverse weather conditions.

Another important distinction between vessels and offshore facilities is that the enforcement and oversight of vessel safety and environmental protection has been delegated to the U.S. Coast Guard. Mr. Chairman, I work with the U.S. Coast Guard on an almost daily basis on compliance issues, and I don't need to tell this panel that the Coast Guard does not rely on industry self-certification or self assessment. The Coast Guard personnel are motivated, dedicated, highly trained individuals who carry out systematic and vigorous on-site inspections of all vessels entering U.S. Ports to verify compliance with Federal law and regulations and international conventions. And statistics compiled by the Pollution Fund Center show that the Coast Guard Port State Control Program, in partnership with the shipping industry, has led to significant decreases in the number of ship-source oil pollution incidents in the U.S.

Since my time is limited, I wanted to particularly emphasize the importance of vessel certification, or the COFRs. COFRs are essentially what makes ships able to trade in the United States. COFRs, however, are supplied by independent, dedicated companies, and they are not provided by the P&I companies. These COFR providers rely on the same system of reinsurance as the P&I clubs; 85 percent of all ship owners trading to the U.S. use one of these dedicated COFR providers.

It is important to realize, as I said, that these providers are reliant on the same system of reinsurance as the P&I clubs. Current proposals to remove caps on liability, or to have a one-size-fits-all limit regardless of vessel capacity or type, would require an enormous increase in reinsurance capacity at a time when it is questionable whether this capacity would be available. The reinsurance market is very broad in the sense that it must respond to a great variety of casualties, such as floods, earthquakes, and other disasters, and in any given year that capacity may be very limited. So the reinsurance capacity is finite and dependent on the risk perception of the reinsurance market and on essentially the experience of the reinsurance market in any given year with respect to these other claims.

The current proposals, which would essentially strike out any limit for removal costs and replace the current vessel limits, which are a tonnage-based system, with an as yet unquantified damages limit, would lead to an uninsurable ship owner liability, and it would bring to an end the current system of certification of financial responsibility, which would in turn mean that ships would have to cease trading to the United States, or that job would be relegated to substandard ship owners who were willing to take risks

and bet the company assets essentially on delivery of oil cargoes to our country.

Mr. Chairman, that concludes my remarks. Thank you very much for your time, and I am happy to answer any questions the Committee may have.

Mr. OBERSTAR. Thank you very much.

Mr. OBERSTAR. The distinctions you have drawn are very important, and we will come back to those. The administration's proposal is going in one direction, and we are looking at bifurcation of the responsibilities; those of vessels where there is a quantifiable amount of oil, and from rigs and sea-bottom wells where there is both an unquantifiable and perhaps unknowable amount of oil.

Mr. OBERSTAR. Now Mr. McAllister.

Mr. MCALLISTER. Thank you. I am Bucky McAllister. I am the vice president and general counsel of McAllister Towing, a company that was founded in 1864. It is a fifth-generation, family-owned company with a fleet of U.S.-flagged tugboats, barges and ferries on the east coast of the United States. I am testifying this morning on behalf of the American Waterways Operators, the national trade association for the inland and coastal tugboat, towboat, and barge industry. Our company and other AWO members are in the business of marine transportation, not oil exploration or production.

McAllister Towing and AWO's 350 member companies share a deep commitment to marine safety and environmental stewardship. Our thoughts and prayers go with the deceased and all those who were impacted.

We understand that no spill is acceptable. They damage the natural environment, and they jeopardize our ability to stay in business. We did not come to this realization this April. Our industry woke up long ago. Two decades ago Congress passed the Oil Pollution Act of 1990. Our fundamental message today is this: With respect to vessel spills, OPA 90 is working.

Let me cite a few examples. Tank barge oil spill volumes have plummeted 99.6 percent since you passed OPA 90, with a record low of 4,347 gallons spilled in all of 2009. To put that in perspective, that is about the same amount of oil that is estimated to be escaping from the ocean floor in the gulf every 10 minutes. With nearly 69 billion gallons of oil transported by barge on U.S. waterways, this means that 99.99 percent of the oil moved by tank barges is being moved safely. More than 90 percent of the U.S. tank barges are double hulled, 5 years ahead of the schedule you set in OPA 90.

Since OPA 90, our industry has been challenged to lead improvements in safety and stewardship above and beyond the requirements of law and regulation, and we have done so. Developed in 1994, the AWO Responsible Carrier Program, which is a safety management system for tugboat and barge operators, has long been a condition of membership in AWO. All AWO members must undergo an independent, third-party audit every 3 years. Companies that fail their audit forfeit their membership.

In 2004, AWO joined the Coast Guard in supporting legislation to bring towing vessels under a Coast Guard inspection regime and require all towing vessels to have a safety management system.

Mr. Chairman, we join you in urging the Department of Homeland Security to publish its Notice of Proposed Rulemaking.

The liability and financial responsibility provisions of OPA 90 have been an important contributor to this record. Vessel owners must demonstrate financial responsibility up to the limits that were raised by Congress in 2006 and by the Coast Guard in 2009 to keep up with inflation. Those limits can be breached in events of gross negligence, willful misconduct or violation of regulation. Today, liability limits for vessels are two or three times higher than they were in 1990, and a mechanism is in place to continue increasing the limits over time.

In exercising its oversight mission, we urge the Committee to be mindful of this history and the potentially severe consequences of changes in the liability and financial responsibility regime for vessel owners. The current statutory and regulatory framework reflects a careful balance. It ensures that vessel owners have access to appropriate levels of insurance cover, typically $1 billion for companies that obtain their coverage through the P&I clubs. If the costs of a spill exceed those limits, claims are then paid by the Oil Spill Liability Trust Fund you have been discussing. This fund is not drawn from the General Treasury to shift the cost of the spill to U.S. taxpayers; rather, it is essentially a supplemental insurance pool that is funded by the oil industry itself.

We are troubled by proposals to further increase liability limits for vessel owners as a reaction to the current disaster. Tank vessels are not oil-production facilities. A worst-case discharge from a vessel is a quantifiable amount, as you have pointed out. The liability limits for vessels, unlike limits for offshore facilities, have already been increased by Congress and the Coast Guard. For a vessel owner, unlimited liability is not insurable. However, it is not only unlimited liability that places vessel owners at risk; proposals to raise liability limits also threaten to raise the cost of insurance to a level where responsible small- and medium-sized companies could not afford it.

We urge the Committee to be sensitive to the impact of its changes on responsible, tax-paying American companies that provide family-wage jobs for tens of thousands of Americans citizens. We urge you to recognize the differences between a tank barge or a towing vessel and an oil rig, and we urge you to be thoughtful and judicious as you exercise your very important oversight responsibility. Thank you.

Mr. OBERSTAR. Thank you very much. You referenced my concern in my opening remarks, and I will come back to that theme during the questioning period.

Mr. OBERSTAR. Dr. Hartwig.

Mr. HARTWIG. Thank you, Chairman Oberstar and Ranking Member Mica and Members of the Committee, for inviting me to testify here today. My name is Robert Hartwig, and I am president and economist for the Insurance Information Institute, an international property casualty insurance trade association based in New York.

I have been asked by the Committee to testify on the insurance implications of the Deepwater Horizon accident; and specifically I will address the following three issues: the insurance arrangements

in place at the time of the Deepwater Horizon accident; the immediate and current insurance market reaction to the accident; and the potential market reaction to proposed changes by Congress to various acts governing the limits of liability associated with offshore drilling activity.

Since April 20, when a fire and explosion on the Deepwater Horizon tragically claimed the lives of 11 workers, we have seen an estimated 800,000 barrels of oil spill into the Gulf of Mexico through June 1, and this is shown in figure 1 at the back of my testimony. This makes the Deepwater Horizon event the second largest oil well blowout in world history, and the largest ever in the U.S., approximately eight times larger than the magnitude of the largest prior event. And by way of reference, it is also three to four times larger than the 1989 Exxon Valdez event.

Given these sobering statistics, and from an insurance perspective, offshore oil platforms are among the most difficult and complex commercial risks to insure in the world. They feature a number of risk-financing components such as: self-insurance; high retentions and deductibles; traditional insurance; reinsurance, which is insurance for insurance companies; participation in mutual insurers; the use of captives; and even accessing the capital markets.

Many of the largest offshore energy operators, like BP, are self-insured. In terms of discussing some of the key coverages that are in place, I have a page-long list of these in my testimony. I will not go through what is in the written testimony there. But basically these coverages provide these offshore operators with protection for physical loss, for instance the rigs and the pipes, but also the liability losses they might have obviously to workers, but also in terms of pollution and other sorts of liabilities they may incur.

Specifically with respect to the operators involved in the Deepwater Horizon disaster, BP had a number of partners. The partners outside of BP all had private insurance protection in place. As I mentioned, however, BP, which was the lead in this particular endeavor with a 65 percent interest in the project, was self-insured. BP did self-insure in part through the use of a captive known as Jupiter Insurance, which had $6 billion of capital on the day the event occurred. This protected it mostly against property losses; but, in effect, BP's prodigious earnings power are, in fact, its insurance policy.

Now, ultimately in terms of when we add together the private-insurance-sector losses that we are seeing from the other parties, again it is still too soon to tell ultimately where we will wind up, but estimates today range from private insurance that will be contributed to recovery from this event to be in the range of $1.4 billion to $3.5 billion.

In terms of the immediate market response to the event, the global energy market response to the Deepwater Horizon loss has, in fact, been quite orderly. Capacity has not fled the market. Prices have indeed risen, but commensurate with the rapidly changing outlook in demand for liability coverages and mounting uncertainty over government action related to both future and potential retroactive liability, estimates are that the cost of insurance for drillers operating in the Gulf of Mexico has increased from 15 to 50 percent, depending on the nature of the operation.

In terms of capacity, the typical third-party limit for liability coverage that can be purchased on the market is approximately $1 billion, and that has not changed in the wake of the Deepwater Horizon event. At the same time, as I mentioned, prices have risen, but those increases in prices do not appear to have attracted significant additional capital.

Contributing to the skittishness of new capital is the fact that the Deepwater Horizon event could, in fact, unleash one of the largest tort actions in United States history. As displayed in figure 2 at the back of my testimony, a total of 126 Deepwater Horizon lawsuits have been filed through May 24 against just the four primary companies involved.

In terms of potential market impacts associated with changes in the Oil Pollution Act of 1990, since the Deepwater Horizon incident, there has been a great deal of discussion in Congress and at this hearing about changing the limits of liability from those that existed originally under the act from $75 million to a number in the vicinity of perhaps $10 billion. Now, currently the OPA features a compulsory liability insurance structure combined with strict liability rules for oil pollution damages associated with offshore energy facilities. These parties are responsible for offshore facilities. They must establish and maintain oil spill financial responsibility capability to meet their liability for removal costs and damages associated with oil discharges. That capability is demonstrated in a variety of ways, but most importantly through insurance.

Now, in the wake of the Deepwater Horizon spill, as we have mentioned, Congress has proposed raising the limit under OPA to $10 billion from the current $75 million. As discussed already, the typical maximum available third-party liability coverage is somewhere between 1- and perhaps, if you stretch it, 1.2- and perhaps even $1.5 billion. But as a practical matter, energy insurers and reinsurers simply cannot at the current point in time provide $10 billion in capacity.

There are a number of reasons for this: The entire global energy insurance market currently consists of no more than $3 billion in premiums annually. Higher limits of liability will increase the demand for coverage, perhaps greatly, potentially, exhausting available capacity. Underwriting for very low-probability, extremely high-severity events is very challenging for insurers and reinsurers, and the higher cost of coverage, of course, as we have already heard, could disadvantage smaller offshore operators that do not have the resources to self-insure.

The current tort liability environment increases uncertainty as to the frequency and severity of future events. As I mentioned, if Congress retroactively raises the limits of liability under OPA, it may well do so in the future, raising potential future payouts unexpectedly, thereby increasing the uncertainty in costs associated with offering such coverage in the near future.

So in conclusion, while the availability of liability coverage in offshore energy insurance markets remains at pre-Deepwater Horizon levels, it is unlikely that the insurers at the current point in time could provide limits sufficient to meet a proposed $10 billion limit

in terms of what is being discussed today under the context of a revised Oil Pollution Act.

Thank you for the opportunity to testify before the Committee today. I will be happy to respond to any questions that you have.

Mr. OBERSTAR. Thank you very much for a thoughtful and very comprehensive statement.

We now turn to Dr. Michael Greenstone, MIT Department of Economics, and a lot of other titles that you wear.

Mr. GREENSTONE. Thank you for the kind introduction. I thank Chairman Oberstar, Ranking Member Mica, and Members of the Committee for inviting me here today.

The Deepwater Horizon disaster is the worst spill that our country has experienced in both economic and environmental terms. A key purpose of my testimony today is to use economic theory and evidence to take a critical look at the economic incentives around drilling decisions that impact the chances of future oil spills.

As I see it, we have two objectives related to oil drilling. The first is to support energy security through increased energy production in the United States. The second objective is to protect the environment by making sure that energy producers put the appropriate safeguards in place against oil spills and other environmental damages. These two objectives are often in conflict with each other.

The American people depend on the government to determine the appropriate level, type and location for drilling. In trying to set safety standards and conduct inspections, the government faces an information disadvantage relative to industry. With that information disadvantage, it is crucial that drillers face the proper economic incentives to prevent spills. However, this is not the case under the current law. As has been pointed out today, the 1990 Oil Pollution Act capped firms' liability for economic damages from oil spills at $75 million, and this cap effectively shields companies from responsibility for their decisions. This misalignment of incentives is a classic case of what economists like to call moral hazard. Firms just behave differently when they are protected from the consequences of their decisions.

My primary argument here today is that the removal or substantial increase of the liability cap on economic damages is the most effective way to align oil companies' incentives with the American people's interests.

I want to take a minute to explain why caps are so troubling in aligning oil company incentives with the interests of the American people. Consider what an oil company does. The oil company makes decisions about where to drill and which safety equipment to use based on benefit-cost analyses of the impact on their bottom line. However, the cap distorts a company's decisionmaking because it protects them from the full cost of any spills. The result is that the cap effectively subsidizes drilling and substandard safety investments, like blowout preventers, in the very locations where the damages from spills would be the greatest.

In the case of the Deepwater Horizon venture, BP and its partners made drilling decisions with the legal guarantee of a $75 million cap on economic damages. Just to put that in perspective, many estimates place the economic damages from the spill at more than 100 times the cap that BP was making decisions under. The

point is that the cap provides economic incentives for companies to cut corners. These incentives will remain as long as the cap is set at such a low level relative to the potential risk.

In my written testimony, I evaluate several of the arguments from an economic perspective against lifting the cap. And here, I am going to try to provide a brief summary of some of those conclusions.

Number one, lifting the cap will not have a meaningful impact on gasoline prices. The U.S. is a small producer. In total, the U.S. is a small producer in a very large, worldwide petroleum market.

Two, job losses that may result from lifting the cap would be concentrated at risky drilling sites. And what I want to underscore is these sites are economically viable only because of the protection from the liability cap.

Three, lifting the cap does not target small firms; rather, it will raise the cost of production for firms of all sizes that do not take adequate safety precautions.

Number four, the economic case for lifting the cap on damages for shipping companies is as strong as it is for raising the cap on drillers, in my opinion.

If the cap on liabilities is removed or raised, there are a number of important implementation issues, and I discuss them in greater detail in my statement, and I want to summarize them here.

Number one, the economic case for a higher cap is equally strong for all well types. That includes shallow water, deepwater, productive wells and exploratory wells.

Number two, an increase in the cap must be accompanied by a requirement for proof of liability insurance, a certificate of financial responsibility, or the posting of a bond to cover potential damages. Without those requirements, increasing the cap could allow for changes in corporate organizations that undermine the purpose of a higher cap.

Number three, there is a very strong economic case for raising the cap on new drilling.

Number four, the economic case for raising the cap on existing drilling sites is less clear-cut. One possibility with some intuitive appeal is a transitional strategy that raises the liability cap on existing operations slowly over the course of several years.

Mr. GREENSTONE. The $75 million limit on liabilities for economic damages distorts oil companies' decisions and actually provides economic incentives for spills to take place.

Number 2, the removal or substantial increase of the liability cap is the most effective way to align oil companies' incentives with the interests of the American people.

Number 3, it is possible that a higher liability cap would reduce the domestic production of oil. If this is the case, a higher cap could be paired with targeted policies that promote domestic production and/or reduce domestic oil consumption. Such a pairing would allow us to keep both our energy security and environmental goals.

Thank you once again for the invitation to participate in this discussion. I would gladly respond to any questions.

Mr. OBERSTAR. Very fine statement. Thank you for addressing several of the key issues that we are exploring in the course of this hearing.

And, Kate Gordon, Vice President of Energy Policy, Center for American Progress.

Ms. GORDON. Thank you, Mr. Chairman. Mr. Chairman Ranking Member Mica and Members of the Committee, thank you so much for inviting me to testify before you today. I am glad to be able to share the Center for American Progress Action Fund's fundamental belief that the liability cap for damages must be changed and other policies put in place to more realistically account for the actual cost of oil spills to the environment and the economy.

As you know well by now, the OPA of 1990 currently limits BP's liability to this disaster's impact on natural resources and the economy to $75 million— which sounds like a big number, especially to many Americans in this recession, but it does not come even close to the likely cost of the current disaster. The proof is in the last major oil spill in U.S. waters. The Exxon Valdez in 1989 spilled more than 11 million gallons in crude oil into Alaska's Prince William Sound. Cleanup costs and immediate damages ran to at least 2.5 billion, but these were the early and only immediately quantifiable in cleanup and damage costs. In fact, the damage was much greater, as we have heard especially lately, and continues to this day.

More than 16,000 gallons of oil remain on the shoreline 21 years later and some fish populations, for instance the Pacific herring, have never fully recovered. Fishing communities in that region have seen a decline in income as well as higher suicide and alcoholism rates, damages that are hard to quantify but are very real.

Under the OPA liability cap currently in place, Exxon would have had to pay only its immediate cleanup costs for the 1989 spill, which it ended up paying about $121 million in cleanup costs plus $75 million in damages. That means essentially that Exxon would have paid just under $200 million per spill, where the most conservative cost estimates were more than 10 times that amount; like a fire sale for oil spills, 90 percent off the actual price of a catastrophic disaster.

The BP disaster is already more expensive than the Exxon spill. Here we have the tragic loss of 11 human lives. Here we have three times the amount of oil as from Exxon already in the water, with more flowing every day. Here the Obama administration authorities spent more on direct cleanup than Exxon did in 1989, and we are not fully even in cleanup mode until BP figures out how to stop the disaster from happening. Costs could go as high—as you have heard—as $1 billion per direct cleanup and between—I have heard estimates between 8 and 14 billion for damages.

How did this happen and what does it have to do with the liability cap? Here is how it happened. Over the years, oil companies bike BP, as my fellow panelist Michael Greenstone has testified, have had no incentive to base their business decisions, including decisions about environmental and human health and safety, on the true cost of these decisions. With every decision BP made, it knew its liability would ultimately be limited to $75 million under the OPA. As Mr. Greenstone has said, this cap has a perverse result of actually encouraging risky practices, such as drilling in the most environmentally sensitive areas with cheaper equipment and fewer safety standards.

Take the current disaster. BP could have installed, as we have heard, a switch to remotely shut off the flow of oil. This technology is actually required in other countries like Brazil and Norway. Installing the switch would have cost BP $500,000 but the company had no incentive to spend extra money on such precautions. BP also has a long history of disregarding safety and environmental rules at its pipelines and facilities and of ignoring workers or intimidating workers who raise these safety concerns.

BP has made these choices throughout with the comfortable knowledge that whatever happened, its liability for damages would be limited to $75 million. It took a calculated risk, one that will affect the gulf region for decades and one that in fact killed 11 people.

We need to take away the incentive to trade American lives and livelihoods for oil company profits. Raising or eliminating the liability cap is one step toward changing that calculation. But we also must begin accounting for the other true costs of our oil addiction. Oil companies receive subsidies, including some tax deductions for damage payments under oil spills, that cost taxpayers billions of dollars per year. They operate in an environment where carbon pollution is not capped and has no real business cost.

Taken together with liability limits, these policies, or, in the case of carbon caps, lack of policies, create a situation where polluters don't pay, pollution pays.

Thank you so much for allowing me to testify and I look forward to questions.

Mr. OBERSTAR. Thank you very much for your splendid presentation and comments from all of the panelists.

I will begin with Mr. Gerard. We expect, based on daily reports and observations and comments from Admiral Allen, the incident manager, that it will be August before relief wells begin to reach their goal, relieve the pressure. Some countries require relief wells to be drilled at the same time as the main well. Should we have a similar requirement?

Mr. GERARD. I am not aware, Mr. Chairman, of any particular nation right now that requires a relief well at the same time. But I am happy to go back and review that and to determine. As you know, there are risks associated every time you drill a well; and what we do is we manage those risks each and every time. We are happy to take a look at that, Mr. Chairman. If you have got a particular reference I am not aware of it.

I have had that conversation with others. Others have made that suggestion and I am not aware that there is any significant producing nation that does that now. But I will look into it and I will get back to you on it.

Mr. OBERSTAR. We will provide that information to you Mr. Gerard.

Mr. GERARD. Thank you, Mr. Chairman.

Mr. OBERSTAR. The American Petroleum Institute has developed the standards for construction of blowout preventers, including the one used by Deepwater Horizon. There is a great deal of concern that there is little oversight by government of industry and little capacity by the Coast Guard to undertake such regulatory action because they don't have in-house capacity. We are going to have

legislation that will direct the Coast Guard to establish that capacity, to understand the industry much better, much better than the Minerals Management Agency has done. And we are also considering directing the Coast Guard to develop the standards, much as the FAA establishes standards for aircraft and engines.

What would be your view, that of the American Petroleum Institute, in response to such a requirement?

Mr. GERARD. We would welcome working with you on that.

Let me make a couple of other comments if I can, Mr. Chairman, related to that. Secretary Salazar said most recently it would be a mistake to assume that the U.S. oil and gas industry is not highly regulated. We are highly regulated. As he commented in a public hearing, we are one of the most highly regulated industries in the country.

With that in mind, when we talk about standards setting, one of the original reasons for establishing the American Petroleum Institute in the early part of the last century, in 1924, we began a standard setting process. This process is accredited by an outside group, the American National Standards Institute, that is the same group that accredits, for example, our national laboratories, our governmental labs, that do a lot of research and development.

Within that standard setting process, we work to develop best proven technologies and best practices, and then we promote those across the entire industry, not only here in the United States but globally. We audit those practices constantly and we review those standards at least once every 5 years.

The standard setting process as is accredited to us, as the API requires that we have open forums and invite all relevant or other parties to participate in determining what those standards should be. So on many occasions we have governmental officials who sit in these panels, academics, industry experts, et cetera, to develop the standards. Our standards today, we have over 500 of them. There are 240 or so of them that relate to offshore development, another 78 of them that have been adopted by governmental entities as part of their regulatory regimes.

I believe it was in 1995 when the Congress passed the National Technology Act and required governmental entities to look at these independent accredited standard setting processes and use them as part of the regulatory system. That is what we do. We put the best minds together. It is audited by outside third parties. And our real purpose is to drive to the best highest performance in the area of safety, technology as it continues to evolve, and best practices, and, like I say, to promote that across the entire industry.

Mr. OBERSTAR. Thank you for those observations.

We have looked at some of those 500 standards established, and some are certainly very well thought through. Others do not account, in my judgment, for human error. And that is the direction of aviation safety. The redundancy that is built into aviation does not appear to be present in the petroleum sector. And you will admit that there is a significant difference between tanker standards and facilities, drilling facilities' standards, and the apparent—it is obvious—lack of redundancy with the blowout preventer on this particular tragedy in the gulf.

Those are the kinds of issues, the categories of concern that we have. And I will come back to those later.

I will restrict myself at this point and recognize Mr. LoBiondo.

Mr. LOBIONDO. Thank you, Mr. Chairman. For Mr.Anderson or Mr. McAllister, does the current tonnage-based system adequately assess liability in accordance with the risk of a major oil spill?

Mr. ANDERSON. I think it does adequately address the risk from certain vessel types. There will almost certainly have to be review of these tonnage-based limitations over time. But I think, as the Committee has already recognized with respect to vessels, those limits have already been increased twice; once in 2006, and again in 2009.

In certain industry segments it may be necessary to look at those industries more carefully, but I think on balance the existing limits are adequate. And one demonstration of that fact is that we have had very, very few incidents, in fact I believe only two incidents, since the inception of OPA 1990 involving ocean-going tankers where the limits have been exceeded.

One was the Athos I spill in the Delaware River. In that case, you will recall a tanker was proceeding into berth and hit an underwater anchor, an obstruction that was not detectable by the vessel.

Mr. LOBIONDO. Have the cost for response efforts and damages changed since the Oil Pollution Act was passed in 1990? Does anyone have an opinion?

Mr. ANDERSON. I am not sure I understand the question, Mr. LoBiondo.

Mr. LOBIONDO. The cost for response efforts. I assume costs for everything go up, so has this dramatically gone up; a little bit; what is your assessment?

Mr. ANDERSON. It has dramatically gone up, given certain recent incidents. I think in part those may be driven, quite frankly, by media and political concerns rather than the actual extent of the environmental damage caused by those incidents. But there is no doubt that the per-barrel cost in some cases has significantly risen in recent years.

Mr. OBERSTAR. Thank you Mr. LoBiondo.

Mr. DeFazio, you are deep in thought and reviewing the testimony, as I observed.

Mr. DEFAZIO. Thank you, Mr. Chairman. I always look at this job sometimes as an extended and ever-unfolding opportunity for graduate education.

Mr. OBERSTAR. My view exactly.

Mr. DEFAZIO. So one question I will throw out to whoever can answer it: What sort of limits are imposed on liability in the North Sea and what sort of certificates of financial responsibility do they require? Can anybody answer that question, all these experts here? Dr. Hartwig?

Mr. HARTWIG. Very quickly, in terms of other parts of the world for the large operators, it is my understanding that these limits are typical not just in the gulf but in other places as well. The North Sea, of course, was the site of the Piper Alpha disaster more than 20 years ago. That produced about $3.6 billion in insured losses, and that was the largest in history for an offshore event.

Mr. DEFAZIO. How is it that they had $3.6 billion of insurance on that?

Mr. HARTWIG. There were a number of parties involved, when you add up all the parties involved.

Mr. DEFAZIO. In this case, we line them up all up, we don't get to that amount.

Mr. HARTWIG. We don't get to that amount.

Mr. DEFAZIO. We don't get to that amount; right.

Yes?

Ms. GORDON. Just a quick addendum to that. The international liability scheme that covers about 104 countries including Norway, does have liability limits as you just heard. It does have liability limits that are in line.

One thing that is interesting is that those are taken off, the limits are removed, if there is an act of omission from the responsible party; for instance, not implementing required safety standards. And it is interesting to note that, for instance, the blowout preventer that BP did not put in in this case would have been required if this had been a Norway incident. So in that case, likely the liability cap would have been taken off.

Mr. DEFAZIO. Right. I was here in 1990 and we had very vigorous debate over negligence versus gross negligence, which essentially would be more along the lines of omission, and we lost that debate. But I think in this case we will probably find that that is not going to be a problem from all the testimony.

Mr. HARTWIG. I have one addendum to that. In the Piper Alpha event, we had 167 workers died, I believe, in that event, compared to 11. So a much higher contribution came from the liability with the deaths of the workers as opposed to the spill.

Mr. DEFAZIO. Very unfortunate.

On the argument that if we had unlimited natural resources damages that no one would operate or couldn't get insurance, I am confused on two levels. One is I observed that Louisiana has no limit on natural resource damages. But I assume there are quite a few rigs operating within, in—fact, I think I visited one within 3 miles within their State territorial waters.

Can anybody explain how it is that they can do that, but, if we had unlimited liability further out, that companies couldn't operate?

It doesn't seem to be a barrier. Aren't there a number of rigs operating within 3 miles of the Louisiana coast? Yeah. OK. So no one can answer that question, but I think that kind of begs the question.

And then the second part would be, we haven't thus far, and none of the legislation proposed is to change the certificate of financial responsibility. So you lift the cap but the COFR limits the exposure of the guarantors or insurers. The company or the operator, responsible party, would have the excess over and above the COFR.

So let's say we left the COFR where it is, or perhaps we raise the COFR to a quarter of a billion, why would that provide a disincentive and a lack of insurability out there because the liability is incurring to the company, not to the insurer? It would be the same as today; there are limits on their losses.

Mr. ANDERSON. May I address that? The problem with that scenario is that I don't know of any reputable shipping company whose board of directors would make a decision to call the United States, facing unlimited liability or liability that exceeds whatever the guarantor's cap is.

Mr. DEFAZIO. Right. But you are back to—you are talking shipping again versus rigs.

Mr. ANDERSON. Yes, sir. I am here entirely to talk about vessels as opposed to offshore oil rigs.

Mr. DEFAZIO. Although this was technically considered a vessel was it not, this rig?

Mr. ANDERSON. It is only considered to be a vessel if it is in navigation between, say, a supply depot and the drill site. Once it is affixed to the ocean bed, or if the platform is stabilized and has an umbilical cord into the ocean bed, then it is an offshore facility.

Mr. DEFAZIO. So we made clear we feel we should continue to distinguish between vessels and offshore facilities. I mean, I think he has made that point a number of times. And so if we were to lift the cap on offshore facilities, the operators, since we already—we would still have a COFR—I assume they could get insurance up to that amount; and beyond that, it will be the responsibility of the company.

Dr. Greenstone, I am very concerned about your testimony. I think it is excellent testimony but it raises to me a question that I am very worried about. And you were talking about moral hazard, and at one point you reference the potential of spinning off liabilities. And I am very worried in this case that at some point BP is going to decide to create an entity which relates to this accident and this well, and, perhaps through a bankruptcy proceeding and otherwise, try to protect the rest of their assets. Have you considered that? Are you concerned about that?

Mr. GREENSTONE. Yes, Congressman. I am quite concerned about that as well. I am concerned about that going forward with future legislation. And so the one point I tried to emphasize in my testimony is that if you raise the liability cap but don't raise the requirement of having proven insurance at the same level as the liability cap or a COFR at the same level, what you have effectively done is create a loophole that you can drive a truck through.

And so the consequence, what would happen, I suspect, is that major oil companies would then segregate themselves into smaller units and/or limited partnerships, and the result would be that they could use bankruptcy laws to get around the higher cap that Congress would have tried to impose.

Mr. OBERSTAR. Would the gentleman yield?

Mr. DEFAZIO. Yes, certainly.

Mr. OBERSTAR. Just quickly, would the same rationale apply if there were no cap? You said "raising the cap," but if there were no cap?

Mr. GREENSTONE. If you had no cap it is a little bit more complicated. I think, I don't know that one could get a COFR, this is outside of my expertise, but I don't know if one could get an unlimited COFR or an unlimited insurance policy. But you would want to try and get the COFR or the insurance policy or the bonds that you are having the company post as high as possible, because effec-

tively the cap is not going to bind after you reach that limit. What these companies will be able to do is to segregate the risk and use bankruptcy to avoid damages beyond whatever the COFR or the insurance requirement is.

Mr. DEFAZIO. If I could—thank you, Mr. Chairman—pursuing that line of thought, if in this case with BP, could we—it is very problematic to modify a contract or go back and retroactively change a statute—but could we ask at this point as a responsible party, would we have to have proved gross negligence in order to get them to put up a large bond now? I am just wondering what insurance can we get beyond their president saying, Oh, we will meet all legitimate claims. Every time they use the word "legitimate," I wonder what that means.

And secondly, I worry about the scenario where their stock goes low enough that someone will try to take them over. Or they will say, The heck with this, we will go bankrupt and get rid of this albatross we have created. And there will be no assets to pay for it.

Is there some way we can segregate the money or assets now out of that corporation?

Mr. GREENSTONE. Mr. Congressman, I wondered the same thing about what "legitimate" claims means, but you are asking a finely tuned legal question and that is outside of my area of expertise.

Mr. DEFAZIO. Does anybody else have ideas on that? And with that, my time will have been expired.

OK. Thank you, Mr. Chairman.

Mr. OBERSTAR. Mr. Mica.

Mr. MICA. Thank you.

I think I heard some from Mr. Gerard about the economic impact of, I guess—did you say a $10 billion—increase to $10 billion; that would be pretty devastating if it wasn't crafted properly. Who could comply with that? As I said earlier, you might limit it to the biggest of the big players if that was imposed.

Mr. GERARD. When you say the "biggest" and the "big players," let me just clarify that a little bit. Obviously it would have to be those that have the financial wherewithal to assume that.

Mr. MICA. Exactly. The BP, the Shell, Royal Dutch Shell. I don't know all the people who are in.

Mr. GERARD. Some of the insurers, the underwriters and others that we have spoken to—and I am not in the insurance business—they have indicated, at least those that currently operate in U.S. waters, it would be less than a handful that would be able to qualify. But then they go on to remind us, and let me pull my list here, the only other ones that would likely qualify would be what we call the national oil companies, which are foreign governments, and that includes Venezuela Petrobras, PetroChina, and others. Those would be the only ones with sufficient financial wherewithal around the world to qualify to——

Mr. MICA. And I would imagine PetroChina, they are probably salivating at the opportunity to drill off of Cuba, and with everything we impose——

Mr. GERARD. They are there now.

Mr. MICA. With everything we impose, there are consequences. And I think what we want to do is well-intended. Now the fund,

too, was set up to put some cap on economic damages. It is unlimited liability for the spill right now, and that is taking place.

What concerns me is the drawdown of the energy portion of the fund; that to me it is clear responsibility that BP needs to be paying us back in some sequence in order to keep that from being depleted. I have no problem raising the cap and we are probably going to have to do that, that emergency cap that is in the current legislation. But, I am not front-financing people who are responsible and should be held responsible.

The other question is, too, this fund was set up to cover the liability above where something happened—say, an orphan spill where you can't identify the perpetrator or go after them or to cover the amounts larger than specified.

Now when you create the fund and you get it, we increase the—again, the first thing everybody around here does is increase the taxes. So they go from 8 cents or the fee, whatever you want to call it, to 41 cents or 34 cents. Somebody is paying that. The consumer is paying that. It is sort of front-end loading an emergency backup fund; is that correct?

Mr. GERARD. Yes.

Mr. MICA. And what concerns me then, now, with what is proposed, there is somewhere between 12 and maybe 15 billion in the fund. And this gentleman over here, Mr. Greenstone, just said, These aren't dummies that are operating these activities so now they will figure out a legal mechanism to limit their exposures.

So what concerns me is we are using that fund to assume some of that responsibility that should be inherent. The fund was set up; if there wasn't some, I thought primarily if there wasn't somebody that could be held responsible, say an orphan spill, or someone who their resources ran out to cover us over and above that, is that simple explanation correct?

Mr. GERARD. I think you raised a lot of issues, Mr. Mica. Let me raise a couple if I can. The first is, obviously, the fund is paid into currently by the oil industry at the refinery at 8 cents.

Mr. MICA. But that is passed on in the costs. If it goes from 8 to 34——

Mr. GERARD. Traditional cost.

Mr. MICA. They are going to be paying big dividends and making big profits. That is what they are in business—and they stay in business, because they have a positive bottom line.

Mr. GERARD. The point I was going to make, Congressman, is I think there is a combination here that needs to be looked at. We need to look at this from a broad policy perspective.

To your point, if we create a significant fund in this trust fund, how does that play, then, into the risk equation? If the industry is paying for that fund, then how do we use that to set it up to balance, if you will, the potential impacts by an unlimited cap, or a $10 billion cap, so that we don't have unintended consequences in the economic realm? I think it is important for consideration.

Mr. MICA. Two final things here. This is the plan BP submitted. I got criticized for—well, when we had the last hearing, I went over the Bush administration, they gave the lease, the Bush administration, the Minerals Management Agency, had three criminal investigations we submitted to the record went on there. We looked at

when this was submitted under the Obama administration. And it is interesting. Everybody should read what they approved and didn't approve, but the lady here said there was no acoustical shutoff valve, no acoustical shutoff valve, which is common in deepwater off of Scandinavia. That is the only place I am familiar with. But then we saw the staff, the Committee staff, prepare that there is only three, maybe four dozen at the most, of really the deepwater permits that have been issued, and that is where we have had the problem.

Does anyone know of instances where we have had the either onshore or at the lesser depths most of, I guess, 600 feet, which was 200 meters, and is what 3,500 of the wells are—does anyone know of a problem that we have had similar that they could cite, or protections that we didn't have?

So what you want to do is focus where we have the risk is my point. Someone should pay the premium and be held responsible for economic damages. Again, I am not sure what the magic figure, the number, is. But we don't want to let anyone off the hook. Mr. Gerard?

Mr. GERARD. Congressman, I just had one other contextual comment there. We have been drilling in the Gulf of Mexico for over 65 years and we have drilled 42,000 wells out there. And this incident, this tragic incident is unprecedented. And when you look across the spectrum of what has been going on, the protection of the environment, et cetera, I just put that in the context we are talking about.

Mr. MICA. Two things, Mr. Chairman and others here. In addition to this liability issue which we must address and should address in legislation, I think it is important that we look at some backup; because if you look at the two biggest spills, and I went back and researched some of them, 1979, the biggest spill in the gulf district was not off of the United States, it was off of Mexico, and it went for 9 months.

And then the gentleman just testified they are drilling now or testing—are the Chinese off of Cuba?

Mr. GERARD. There are a number of interests that are off of Cuba right now exploring.

Mr. MICA. But they are not getting permits from us. But we should have some backup system in place. I don't know if the Coast Guard should contract it or we should get the oil companies, so that we are not developing a bell after the effect, or a top hat or whatever—so that we have a backup system.

Here is the thing. If you go look at what was required, there is no backup system here. Now, I want it for the ones that are issued here. But I think in the interest of preserving our environment in the future—Florida, we are going to get the brunt of whatever happens, particularly off of Cuba—that we should have a backup system ready to go with tested technology to stop this in its track.

We are learning a lot about this because I understand this is sort of a new venture, closing one of these down with that kind of a break at that depth. But maybe we can look at a requirement in that area for a backup system. Thank you.

Mr. OBERSTAR. We are indeed. And as I mentioned, between us, with all the testimony that is going on, I have directed staff and

am working with them to develop a number of redundancy provisions as well as requirements for skills development by the Coast Guard to get up to speed and get ahead of this.

Minerals Management Service clearly had no such capability, no understanding, and that is completely unacceptable. So we have to bring Coast Guard up to a level of understanding of all the skills. Mr. Cummings has already explored that matter through hearings and work in his Subcommittee.

We have to address this issue of categorical exclusions. The previous administration extended the process for categoric exclusion from NEPA requirements for offshore leases. That was continued. And then the Minerals Management Service issued a multistate environmental impact statement for a proposed 5-year lease in the Outer Continental Shelf that estimated a likelihood of three spills from platform drilling that would produce 1,500 barrels for each spill. Completely missed the target, totally missed the reality of what has happened. And the assessed impacts from oil spills under the 5-year lease were described as minimal.

And we have heard that from BP, which has a terrible record, to say the least. They were convicted in Federal court of a misdemeanor action and given an 18-month suspended sentence and a $12 million fine of criminal penalties for their actions on the—and failures on the North Slope.

Now we will recognize the Chair of our Hazardous Materials and Railroad Subcommittee, Ms. Brown.

Ms. BROWN OF FLORIDA. Thank you, Mr. Chairman, and thank you very much for holding this hearing.

Let me just say, last week I traveled to the gulf with Mr. Cummings, and I really learned a lot while I was there. And this is not just the worst spill in U.S. history, this is the worst spill in the world. The world.

You had scientists, you had agencies there, over 20 different agencies were there, working together along with the different—not just BP but other of the oil companies were all there. Everybody had boots on the ground. But it is kind of afterthought.

We have called up over, I think, 15,000 National Guards from four States—Florida, Mississippi, Alabama, and Louisiana—and the Coast Guard has spent over $100 million to date, and they are coming back to Congress this week to authorize another $100 million. And so it is the concern that there is a cap at $1 billion, with a 500 million cap on environmental damage.

And I guess I got a couple of quick questions. In the briefing that we had, one of them, I asked the question about the 500,000 technology, why did BP not have this in place as another backup, because they said they had five, none of them was working. And so they said that it works on shallow drilling but not to this depth. And when I listened to television and the—I was under the impression that the depth was like 5,000 feet. It is not 5,000. It is about 15,000 feet, a lot like 3 miles deep. So there is no technology available for this problem.

But can you respond to that first?

Ms. GORDON. The specific technology is outside my expertise, but I do know that offshore, deep offshore drilling rigs in Norway and Brazil, for instance, are required to have backup technology such

as the acoustic backup preventer that BP did not install in this case. So my assumption is it works at those depths, but it is not my area of expertise.

Ms. BROWN OF FLORIDA. OK, BP has stated—and this is for whoever wants to take it—that they would cover all legal claims. And I know there has been some discussion. But I am not clear on what their definition of legal claims would be.

What recourses do States like my State of Florida have if they decide to declare bankruptcy or something like that? What are we doing to ensure that the taxpayers will not be left on the hook for this problem?

Ms. GORDON. Something that we at the Center for American Progress have recommended is putting, and I believe it is being followed up on by Members of Congress, is putting some amount of money into an escrow fund now from the BP revenues so that we don't run into this situation. Going back to Mr. DeFazio's comments as well, there is a real concern among a lot of people that we are going to—BP will either find a way to not pay the claims that are currently being paid by the Federal Government that will run up against the limits in the trust fund. There is a real need to see the money right now put aside and kept safe.

And I think we have recommended that that happen both for short-term recovery costs—and going to an earlier point on this side, those may include things like a conservation corps to do some of this cleanup, actually creating jobs, not just paying claims.

But the second thing is we need to look at the long term, and we have recommended potentially not just BP, but all of the oil companies involved in drilling in the region, putting some portion of funds into some kind of a new gulf recovery fund that would look at long-term consequences of drilling in the region, like the erosion of the wetlands that has happened over the last 80 years. So there is a real need to do something immediately in order to protect those moneys. We agree to that.

Ms. BROWN OF FLORIDA. Mr. Greenstone, would you like to respond to that?

Mr. GREENSTONE. No, it is outside of my area. The only point I will make about the extra half million dollar device, as long as those caps exist, it will always be the case that the drillers or the shippers don't bear the full costs of whatever their actions are. And as long as that is the case, the interests of the oil companies and the interests of the shippers will diverge from the interests of the American people.

So I don't know anything about the specific device, but as long as that diversion occurs, we are increasing the chances of spills going forward.

Ms. BROWN OF FLORIDA. I was asking about the economic portions of it. Someone else wanted to respond? Yes, sir.

Mr. MCALLISTER. When you ask what are we doing, the Oil Spill Liability Trust Fund does exist to help fund spills where the responsible party is either unavailable or the liability limits have been reached. So I think OPA 90 is already achieving what you are asking about: What are we doing to set aside?

Granted, this bill is a very significant one, but I think that as you review this legislation and you look at alternatives for how you

may wish to amend it, you need to be careful with what you do; because right now you have a balanced system that is encouraging responsible entities to engage in maritime commerce in an economic environment where they have adequate insurance to fulfill their liabilities. And granted, those liabilities are limited, but you have responsible entities there.

As you increase those limits or you maybe even make liability unlimited, you are creating an economic environment where some companies, perhaps my company, at some point is not going to be able to get the insurance that you may ask us for. And either we would have to get out of the business or we would have to roll the dice and continue to function in a liability scheme where we did not have adequate insurance. I think over time what you could see is a marketplace which is divided between very large corporations or corporations that are really being set up on a gamble.

Just to answer your question, I think OPA 90 is doing its job.

Ms. BROWN OF FLORIDA. My time is limited. And let me just say that the Transocean claim liability is capped at 26.7 million based on a maritime statute from 1851.

Do you think that needs to be updated?

And you said something that I find appalling. I don't feel, not your company, but I do not feel that BP, an example, have been a responsible party. We have a history of them not following their own procedures or violating the law. We had deaths just last summer, 27 people got killed. So we got a culture here that if you don't have strong incentive, and we talking about financial incentives, then the companies are not doing what they are supposed to do.

Mr. MCALLISTER. I can only acknowledge what you are saying about the current situation in the Gulf of Mexico, and I don't know the facts of what is going to happen there legally. It is a complex situation and I can't disagree with you either. But I can tell you as for our company and the thousands of other companies that are operating under this OPA 90 law, there is a balance there that has been struck 20 years ago. It has been amended several times over the last 20 years. And to radically change the balance of that law is going to have consequences on many, many, many businesses other than British Petroleum.

Ms. BROWN OF FLORIDA. Let me just say as I close, the situation in the gulf is radically changing how we do business. And so we have got to take a hard look at what we are doing and how we can protect the environment and how we can protect the public. And that is our responsibility to hold everybody accountable, and not hold the taxpayers paying this bill. I yield back.

Mr. OBERSTAR. I greatly appreciate the gentlewoman's passion and concern. She represents a district on the water, derives much of its economic activity from the water, and I appreciate her passion.

Mr. Taylor also represents the water and the waters and those who ply the waters.

Mr. TAYLOR. Thank you, Mr. Chairman, and thank you very much for holding this hearing. I want to thank all of our panelists.

Mr. Gerard, this is—really you are the wrong guy to get this. I should have asked this a week ago to the representative from BP and Transocean, and I will admit by my mistake. But you are here

today. What I haven't heard from the industry, going back to Mr. McAllister talking about OPA 90, what I haven't heard from the industry is we have been 20 years without a major catastrophe, that we have learned our lesson and there will be a new generation of blowout preventers, there will be a new generation of skimmers, there will be a new generation of booms, there will be a new generation of technology so that this doesn't happen again.

It is fair to say boom technology hasn't improved one iota in 40 years. And I realize we are a market-based economy and for 20 years there really hasn't been a market for improvements because we haven't had a disaster. But I am not hearing any reassurance from the industry that you guys got the message and you are going to do better.

Let me take it a step further. Behind you is a Coast Guard admiral, Admiral Schultz. What I don't have a clear delineation of, and, Mr. Chairman, I think we need to know, is who is going to determine if this new generation of things work? Is the Coast Guard going to be responsible?

We tried letting the private sector come up with all the solutions. We put all of our faith in them that they would have blowout preventers that work, that they would have skimmers that work, that they would have booms that work. It didn't.

So the first thing that—Mr. Gerard, again, you are the guy that happens to be here, I should have asked this of the guys last week—who in your industry is going to reassure the American public you got the message and you are going to fix this?

Second thing, Mr. Chairman, since we have limited time, is the term "gross negligence," "willful misconduct." We are going back to what everyone else is saying. We are basically waiting for a judge somewhere to say that BP was guilty of gross negligence or willful misconduct and therefore has unlimited liability. I don't know if anywhere in the law that term is defined.

So, again, I think if you ask the American people if after 40 days a company has not capped its leak in the bottom of the ocean, is that gross negligence and willful misconduct? Should we as the Congress determine, give them a certain finite amount of time or a finite amount of volume to be spilled and say, If you cross this threshold you are automatically guilty of it? Because in my opinion, in the absence of clear and precise laws, we are leaving some judge, we are giving him a free hand to come to a bad judgment. And I don't think the American people want that.

So I would hope that one of the things that we try to do is at least set a legal threshold of what constitutes gross negligence or willful misconduct.

And last thing, Mr. Chairman, we spoke about this and I want to have Mr. McAllister possibly talk about it. I, as someone who represents shipbuilders and mariners and shrimpers and oystermen and people in the tourism business, all of which have been affected, I take personal offense that the vessel that did this was built in Korea. I take personal offense that it was chartered in the Marshall Islands. I take personal offense that the profits went to Switzerland. I take personal offense that the shipbuilders who didn't get the contract to build it won't get to run their shrimp boats this summer to make a little extra money, won't get to take

their kids fishing on the weekend because the sound is polluted, probably can't go swimming on the beach.

For those folks, this is just injustice after injustice after injustice. Oh, and by the way, the profits went to Switzerland because that is where the corporation is headquartered.

If someone is going to have the privilege of pulling minerals off the American sea bottom, that ought to be a U.S.-built, U.S.-flagged, U.S.-owned vessel. And if we are going to chase somebody down to pay the bill at the end of the day, I can tell you if the people of south Mississippi couldn't get the folks in Springfield, Illinois to pay claims after Hurricane Katrina, you are going to have a heck of a time chasing somebody down in the Marshall Islands or Switzerland to pay these bills should they determine not to pay.

But again let me start with you, Mr. Gerard. And I have not heard everything your industry has had to say, but has your industry at any time in the past 40-something days said, Do you know what, we got caught flat-footed, we are going to come up with better devices to keep this from happening and to respond should it ever happen again.

Mr. GERARD. Thank you for the question, Congressman Taylor. And let me just reassure you here on behalf of the broader industry, we get it. And we understand what you are saying and we take this as a sober reminder that we have to look, we have to reexamine everything we do, how we do it, and how we can do it better.

Let me just give you a couple quick anecdotes of what we are doing today. When this thing first happened, we were called by Secretary Salazar. We sat down with him at the highest levels of industry across the board. We immediately sat down and created a task force of the best minds and put together ideas where we felt we could improve practices and increase some of the regulatory processes. A lot of that was reflected in the President's announcement and the Secretary's announcement, because we understand our commitment not only to our employees and their safety and to the environment but to the country as a whole.

We recognize these are U.S. waters. We also recognize we have a key role to play to provide the energy for this economy. We are 60 percent of all the energy consumed in the United States. So we recognize that role.

The other thing we are working on right now is we have three other task forces. One of them is focused on liability, as I mentioned to the Chairman earlier, and we want to be very responsive to figure out a way to make some exchanges in OPA without destroying the underlying activities, either the vessel traffic, be it in deepwater, et cetera, and also to preserve the potential opportunities for others in the business community, be they mid-sized, small, and others.

And that is why I say through the Liability Trust Fund to use that potentially as pooling the risk where we can make sure this doesn't come back on taxpayers. We recognize our obligation as an industry.

The two others we focused on are task forces once again, and we do these in collaboration with the best minds, with government, individuals, is on control at the seabed floor, the very issue that has

been raised here today about technologies and other things. And the last one is on response.

While there has been some improvements in the booms and others, clearly we need to look harder at that. We need to spend more money on research and development. This spill is unprecedented. We have lessons to learn. We understand, and we will learn those lessons.

We want to work with this committee, the Congress, and the administration, though, to make sure as we come through this very difficult time that the public policy that is developed in this highly charged environment is such that we can continue to do what we do well for many years to provide the energy the country needs to fuel our economy, not only for those of you down the coastal States but across this land and elsewhere, so we can enjoy the high standard of living we do today.

So I will convey your comments and sentiments back to the industry and give you my commitment in the roles—that as head of their trade association, we understand and we are going to do our part.

Mr. TAYLOR. Anyone else? Thank you very much. Thank you, Mr. Chairman.

Mr. OBERSTAR. I very much appreciate your observations that for 20 years had no major spills, but similarly no significant dramatic improvements in blowout preventers, in boom caliber and quality, in vessel operation. And that led to complacency. Complacency then lead to categorical exclusions from NEPA and to rulings of the MMS that produced an estimate of the likelihood of three spills from platform drilling in deepwater that would produce 1,500 barrels for each spill. That is so categorically wrong on the face of it, so lacking in perception of the risks involved in drilling at those depths, that it is unspeakable.

And then they extrapolated that or expanded it to impacts on spills under a 5-year lease with no understanding of or expectation of an uncontrolled failure.

Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

And, Mr. Chairman, as I listen to Mr. Taylor, I just could not help but feel what he is feeling. It is very frustrating.

And, Mr. Gerard, I think what Mr. Taylor is saying is that it is one thing for a business to go out and make money, that is important we all want that; but I think going along with that is certain responsibilities. And it does appear, and as I went down there and I saw what I saw, that there is a disconnect here in some kind of way. And I think that I know your industry is doing a whole lot of wonderful things, but—and I have said in it in the Coast Guard Subcommittee over and over and over again, that I do not want us operating in a culture of mediocrity. Because when we do that, what happens is this kind of thing happens.

What I am saying is I think—I tell my kids, I tell them you have two tracks that you have to go down in life. One is your destiny, the other one is your development. And I said they have to be—you have to do both.

And I wonder sometimes whether—when I see what happened here with BP, it seems like the destiny they were shooting off and

doing real fine and going way down below the sea. And the development part, and when I say development and the ability to control the situation, I wonder whether that kept up. Do you follow what I am saying? Because that is part of the development. It makes sense.

I think it is kind of—and I am not beating up on you, I wasn't even going to say this, but I am sitting here and I am thinking that is part of the problem. And then the Chairman, and I am so happy that the Chairman has taken this on, trying to make sure that we have the expertise that we need in the Coast Guard and the MMS.

If we don't have the expertise, we can talk all this stuff we want. If we don't have the people that can properly inspect the rigs—we keep talking about when the rubber meets the road, everything is going to be fine. Well, guess what? Bulletin is coming over the wire; when the rubber meets the road we discover there is no road. And that is part of the problem we saw happening in Katrina. We are seeing it happening in a lot of ways. So I just wanted to throw that out for whatever it is worth.

But let me go to you, Mr. Hartwig. Do you believe that the estimated $1 billion to around $3.5 billion in liabilities owed by insurance firms in association with the Deepwater Horizon incident could exceed oil premiums paid for insurance for offshore facilities in the past year? And what does this mean for potential impact for this event, from this event on the industry in offshore facilities? To be frank with you, I believe that it will exceed 3.5 billion. I think it will be much higher than that. But I am just wondering what you, how do—what happens then?

Mr. HARTWIG. Well, what will happen here is, as I mentioned in my testimony, somewhere between 2–1/2 and $3 billion are earned annually globally by energy insurers, it is possible that the high end——

Mr. CUMMINGS. That is their earnings?

Mr. HARTWIG. Sorry, that is the premiums they earned on their annual—not their net income or profits, it is the premiums that they generate from this business.

Mr. CUMMINGS. That is the gross.

Mr. HARTWIG. That is correct. That is the gross.

Mr. CUMMINGS. So in other words these insurance companies get 2—how much?

Mr. HARTWIG. Two and a half to $3 billion a year in premiums that they earn from this business.

Mr. CUMMINGS. Period. Now——

Mr. HARTWIG. Now the expectation is you aren't going to see events along the lines of a Deepwater Horizon every year. They are very, very rare. So, just as in any type of insurance there are years when your bottom line can be larger than your top line. That is the nature of the insurance business.

What will also happen in this instance is while some of the losses have already been paid, such as for the value of the craft itself, the Deepwater Horizon is a total loss. Some of the losses will emerge over time. Liability losses don't all emerge instantaneously, they emerge over a period of years. Soinsurers will be paying that out out of cash flow of the next couple of years. And obviously, this impacts the capacity in the marketplace. And the cost of insurance,

as I mentioned, is rising in the gulf area 15 to 50 percent, the 50 percent being among the deepwater rigs and 15 in the shallow-water rigs.

So the market has been orderly. As I mentioned, insurers are accustomed to large-scale losses, although not typically this large, but it is something that the industry contemplates and plans for.

Mr. CUMMINGS. And so the larger certificate of financial responsibility for a vessel appears to total just over $500 million; is that correct?

Mr. HARTWIG. Well, the larger drillers can obtain $1 billion or so, or even more in terms of third-party liability coverage, so it is larger than that. They are not going to obtain all of that from one individual insurer. It is a program that gets put together.

Mr. CUMMINGS. What is your biggest—and then I will yield back, Mr. Chairman—what is your biggest concern with regard to all of this? As I see it, it seems as if there is going to be unlimited—when I think about all of the folks that are affected by this incident, and then I think about the fact that you can be, we can be in a position where the liability is so great that some folks—I think it has been mentioned here by you, Mr. McAllister I think—folks won't even be able to get insurance. Is that, that was your concern, Mr. McAllister?

Mr. MCALLISTER. Certainly.

Mr. CUMMINGS. And the question I guess, what is the reasonable, the way you—in other words, we all want to address the problem but we want to address it in a way that makes sense. And we don't want to be in a situation, I think it was you, Mr. Hartwig, that talked about loopholes—and maybe it was Greenstone—and so we don't want to have a Swiss cheese resolution where folks can kind of get around what we are trying to do, because then we just fall right back to the rubber-meets-the-road kind of situation with regard to payments. That is, paying for these problems. And we don't want it to fall back to the American people.

So what is the most reasonable way to do it so that we cover all of the folks that we want to cover and so the American people don't get stuck with these kinds of situations, assuming something like this would happen again, God forbid?

Mr. MCALLISTER. I think when we think about cutting-edge technologies, and Deepwater Horizon and ultra deepwater drilling is an example of one of those, when we look at the history of this over the past century or so, what we see is extraordinary new technologies being rolled out. When you think about aviation, when you think about space flight, when you think about satellites, when you think about even marine navigation, when you think about the Internet, what happens? All of these encounter very substantial problems. And the way that you solve these in the end is not through insurance, it is not through limits or higher limits of liability. Ultimately what winds up happening is there has to be a dedication towards better risk management practices here. Part of the answer is of course regulation, and, throughout the entire process, financial responsibility has had to be proven in each and every one of these industries.

But at the end of the day, what do we have? We have sound risk management. What causes an airplane to crash? And now it is

safer than ever to fly around the world. What used to cause large ships to crash at sea? And that doesn't really happen anymore. These are the sorts of things we don't have to worry about too much. In the days of the Titanic you worried about hitting an iceberg or another ship.

So what we wound up with is having technological innovations which allowed us to improve the risk management practices, a variety of them that come together. And I think I have been impressed in the course of American history as to how this has reduced losses. And this has even occurred in the offshore petroleum business.

This is a terrible event that has happened, but if you look at over the past 40 years the number of events, both large and small, as well as the total leakage or spillage, whether we are talking about offshore platforms or whether we are talking about events involving tankers, all of these processes have gotten safer over time. Are we going to have setbacks? Yes. Can we learn from those? Absolutely.

And I think that is what is going to happen here. It is going to be risk management, the best practices, that in the end are what is going to make the biggest difference.

Mr. OBERSTAR. Thank you Mr. Cummings, and thank you again for your splendid work as Chair of the Coast Guard Subcommittee and following up on these numerous issues that you have done with great skill.

The comments, though, Dr. Hartwig, about safety in aviation should be accompanied with an observation that the FAA has the skills equal to those of the industry to know the capabilities of engines and of airframes. We have, in addition, an investigative agency, the National Transportation Safety Board, that also has those skills. And we have a rigorous regime of oversight and a periodic issuance of notices to airlines, to their maintenance operations, of failures, and notices sent to the manufacturers, Boeing and Airbus, of responsibilities they must undertake in inspection or upgrading of equipment and operating parts on the aircraft.

That doesn't exist in the Minerals Management Service or in the Coast Guard because we have so relied on the industry for so many years. That must end. There has to be backup oversight.

Mr. Teague, who has had greatly experience in this industry, New Mexico, good to have you.

Mr. TEAGUE. Thank you, Mr. Chairman and Ranking Member. I also want to thank all of the panel for being here today. It has been interesting to listen to this question-and-answer. And I really do look forward to working with the Chairman and leaders on both sides of the aisle to craft legislation that responds to this disaster in a focused and responsible way. But as one of the only Members, if not the only Member, of Congress with direct experience in drilling oil and gas wells, I think I am in a unique position to understand the facts and hold BP accountable for the Deepwater Horizon disaster.

There are some things that we have to do. First, we have to clean up the mess and compensate the victims of the disaster. We must hold the responsible parties accountable to make sure this never happens again. And we have to understand that some of the

responsible parties are ours, Minerals Management Service, but this is primarily a BP problem.

You know, as we do this and pass the legislation that we pass, we need to be sure that we don't act in haste, that we don't legislate out of anger or out of fear. As we work real hard to ensure that the safety and update the laws that we need to from the liability statutes, we need to take care not to negatively impact the ability of smaller companies to compete both offshore and across America. Let us not let BP effectively put the smaller companies out of business by us painting with too broad a brush when we need to be painting BP and deepwater drilling and not everything else.

As we investigate this accident and get all of the facts, I think we are going to be pretty pleased with the safety and technology that are available. We might not be happy with what was utilized, but we will be happy with what is available.

Just like small businesses all across this country is the backbone of our economy and the backbone of America, the small oil and gas companies are the backbone of the oil and gas industry. We need to keep that in mind, that we don't put penalties on the industry that hurt the smaller companies that the larger companies can work around. We need to hold the responsible people responsible at this time and take whatever measures we need to to make the people who make a living from the Gulf Coast, whether it be through fishing or restaurants or whatever.

I think there are some responsibilities that BP needs to accept that they have and they need to stand up to. Their first responsibility is to their employees. They need to provide them with a good, safe workplace, all of the things that everybody needs to ensure that they get to come home. And they owe it to the industry. So many people in the industry work hard and abide by the rules and don't try to take shortcuts. And then they owe it to the citizens of the United States and of the Gulf Coast to clean the mess up. They made the mess, and they need to clean it up.

I guess that gets me to something that we need to be careful about as we move forward, and that is how we structure—and I will let any of you all comment—how do we structure the liability limits to ensure that independent oil and gas producers can still buy insurance and participate in the gulf, while at the same time ensuring the citizens of the gulf that the financial stability is there to take care of a problem they may have?

Mr. HARTWIG. I think I did hear a suggestion earlier that they could be staggered or staged in a particular way. It is clear that many of the small operators that you are talking about simply don't have the ability to create an economic or an environmental disaster along the lines of what we have seen with respect to British Petroleum. Clearly a tiered approach where some formula is developed in terms of output and is also sensitive to location of where the drillers are.

Certainly when an insurer evaluates the risk associated with providing an insurance, it is looking at what the possible maximum loss is with every one of these. It is something that we would take a look at, and we certainly don't expect many of the small drillers that are in your district to have anywhere near the same capability

of a BP in terms of the environmental damage. So this kind of tiered approach, I think, might make some kind of sense.

Mr. TEAGUE. So we need to be sure that the requirements that we ask for differ as the water gets deeper, and that we don't try to, with just one sweep of the brush, paint everything on land and offshore both. Thank you.

Thank you, Mr. Chairman.

Mr. OBERSTAR. Thank you, Mr. Teague.

And a very patient Ms. Edwards, thank you for staying here and waiting so long for your turn at bat.

Ms. EDWARDS. Thank you, Mr. Chairman. This may be a case where everything has been said, but I haven't said it yet.

Mr. OBERSTAR. No, not everything has been said. There are still a lot of questions that I have. But you go ahead.

Ms. EDWARDS. Thank you.

You know, obviously decisions that we have today going forward are related to when, where, how, and to whom to attach liability and where to strike the balance of risk.

Dr. Hartwig, you spoke about risk management. I want to focus on that, because obviously there must be an environment where small and large companies can operate, can be competitive and efficient. But the problem with that formulation alone is when push comes to shove, under the current statutory framework, the taxpayer really bears the real risk. And as Dr. Greenstone pointed out, when that happens, companies can operate in a way that doesn't effectively take into consideration what the real risk is, or the insurance industry in terms of its insuring that risk. So that is my concern, that the liability limit that we have under current day's dollars, especially in these deepwater accidents, that the risk, in fact, doesn't allow for the real allocation of responsibility.

And so I am wondering, for example, when I think about some of the smaller spills—I think earlier was referenced a spill in the Gulf of Mexico. There was another one in the Timor Sea which was only 253 feet, but it took a couple of months before it could be retained, and then with a relief well. And my understanding, Mr. Gerard, is Canada required relief wells until BP pitched such a fit that they began to loosen those regulations for relief wells even this last December.

We are in a circumstance, I think, where the allocation of risk is not full enough to allow for that competitiveness in terms of determining and investigating new technologies, but also place enough of a burden on the industry so it operates a little more safely and with greater concern.

I mean, we saw this, for example, in the financial sector, where you had total lack of regulation, bad products, risky behavior, and at the end, in that game, too, the taxpayer bore the burden.

Here I think a BP representative sat where Mr. Anderson is just a couple of weeks ago and said at that time they had revised their estimates, 1,000 barrels a day to 5,000 barrels a day, and estimating that the worst-case scenario was 250,000 barrels a day, but they weren't insured for 250,000 barrels a day. And now today, just a couple of hours ago, it looks like the independent sort of group of scientists is estimating this to be about 28,000 barrels a day and perhaps more than that. So what that is saying to me is so BP

could say, well, if we are going to suffer fines in addition to our liability limit, then we will take on the possibility of only having to pay out $20 million or so in those kind of fines. Or if it is a 28,000-barrel-a-day spill, as we are now beginning to believe, or perhaps more, it is more like $600 million for that spill.

So I wonder what the relationship—and perhaps, Dr. Greenstone, you can answer this—the relationship between the gross negligence provisions rather than simple negligence, combined with the $75 million liability limitation, and what that does, in fact, to depress the proper allocation of risk among the entities. So could we consider from a statutory standpoint changing that gross negligence to absolve oneself of risk, and also look at shifting at some level or other that can be determined the liability limits?

Mr. GREENSTONE. Thank you for the question, Congresswoman. I confess I am not a lawyer, so I can't talk in great detail about gross negligence, but let me make a few points about the point related to the cap.

From an economic perspective, there is no reason to have differentiated caps, depending on where the oil is being drilled or depending on the type of company. The reason which I tried to emphasize today is you then put a wedge between the oil companies' interests and the American people's interests. That has showed up in the Deepwater Horizon case.

I think there is a more subtle way in which that affects the industry in the long run. It effectively removes incentives for developing the technologies that can reduce risks in the long run, because there is no price for it. There is no market for developing new technologies, new and better blowout preventers. There is a subtle, longer-running impact.

Finally, one other thing which has come up several times here, and I thought it was worth discussing for a minute. Several people have said it would be very difficult, maybe impossible, for some companies to get insurance if the cap was raised. I want to make the point that I am very confident that oil companies that are taking adequate safety protections will have no problem getting insurance. The only companies that would have a hard time are the ones where insurers would find it not a good bet and would want to raise prices to the point where no one would buy it.

There is another point about the rise in premiums that is related to all of this, which is if oil companies are already taking adequate safety provisions, then there will be no rise in premiums. So this claim about the rise of premiums, I think it all—I think it bears closer scrutiny.

Ms. EDWARDS. Thank you.

If I can just finish, we have heard suggested a couple of times that we should look at small, medium and large companies differently. So I take it that you would share the view that we shouldn't attach different kinds of liability limits based on the size or scope of those companies or the depths at which they are drilling?

Mr. GREENSTONE. Again, there is no economic case for doing that. Any differentiation will put a wedge, will allow the relevant oil companies not to take full responsibility or consider the full po-

tential of their actions, and that creates this incentive for not taking proper precautions.

Ms. EDWARDS. Lastly, back to this point of gross negligence, because I would like to know if there is a way to capture the economic impact when you have sitting out there you can only lose your limit if there is an action of gross negligence, and what that does to affect the economics of your making a decision as a business person about where to allocate your risk or what risk to take? I am concerned about that high a bar being set out there so that a company could internally to its own operation say, well, you know what, the liability limit applies unless it is gross negligence. Anything in between that, all bets are off.

Mr. Anderson.

Mr. ANDERSON. May I may make a comment? First of all, gross negligence and willful misconduct are not the only grounds for breaking limitation under OPA 90. In fact, it is rather difficult to hold limitation under OPA 90 unless you have a pretty stringent operation with respect to safety.

One of the grounds, for example, for breaking limitation would be violation of an applicable Federal safety or operating regulation which is the proximate cause of the incident; failure to cooperate with Federal officials in the spill response; failure to report a spill; failure to lend assistance consistence with the National Contingency Plan. There are a number of other grounds for breaking through the limits of liability under OPA, particularly this safety and operating regulation requirement. So that is one thing.

I just want to go back to your concern, and also, Mr. Cummings, I am hearing your concern about what I think is really confined to the offshore oil industry, and I think there is a little bit of confusion about the differentiation between the risks here in terms of insurance cover. Right now in terms of vessel liability for oil spills, there is very little risk to the U.S. taxpayers because historically we have seen, since OPA 90 came into effect, almost no situation where the fund has been called upon to respond in damages to a spill.

With vessels you have many layers of private risk absorption, including the COFR system, which I talked about before. The system depends very much upon gradation of risk. That is the point I wanted to get across. If you are considering raising limits of liability, and certainly removing caps on liability, you have to look at the specific risks in that industry, and there is a great difference between international shipping, which really involves navigational risks of moving cargo from point to point, and drilling in a deep-ocean environment in an untapped oil field. So if you are considering changes, what the international group and I think the ship owners association would ask you to do is look very carefully at the gradation of risk within each industry segment before you start adjusting those limits.

Ms. EDWARDS. Thank you. I do understand those differences. I was speaking here principally about the offshore risk both in shallow water and deep water.

Thank you, Mr. Chairman.

Mr. OBERSTAR. I appreciate that very thoughtful line of questioning and the responses.

I yield to Mr. Olson in just a moment, but, Mr. Gerard, the pressure at the 18,000-foot level, below mud line where the oil reservoir has been located, is by various estimates in the range of 2,300 to 12,000 pounds per square inch, or psi. Was the blowout preventer tested at those pressures?

Mr. GERARD. I assume it was, but let me go back and inquire about that. I don't want to speak for BP. But I am assuming through their typical practices, they are testing for the expectation of what they might encounter as they go into reservoir. And that is the way the system should be designed.

Mr. OBERSTAR. I want to have that response in writing because API sets the standards for blowout preventer infractions. The manufacture is done by another industry representative or organization, but it is an API standard. And the standard was not set by MMS or the Coast Guard, and it is vitally important to know was it designed and tested to operate against those pressures from oil at that depth and against the thicker casings of steel for the pipe at that level, which is different from the thickness of steel for a 300- to 600-foot well, correct?

Mr. GERARD. I will have to inquire of BP to get the answer. We will do what we can to get the answer.

Mr. OBERSTAR. Supply both the API standard and the response from BP; but it was Transocean, the driller, that actually acquired the blowout preventer and installed it with the confidence that it would operate at those levels.

If it is not, if it was not capable of withstanding pressures of that—of those numbers that I just cited, then even if the sheer had worked and had been able to cut through the steel and shut off the flow, it might nonetheless have exploded at that level. We don't know that because it hasn't been tested.

Mr. GERARD. That is right. But we haven't pulled it up to see what the situation is.

Mr. Chairman, I have a couple of smart people with me. We have a whole group of individuals. We probably should come up and sit down with staff, and we can walk you through the details of the standards-setting program.

One clarification, in our certification process on these standards in a blowout preventer, we certify the manufacturer to make sure that they have the quality control and capability to build such products. We don't certify the products. I think that is an important distinction for the record. But we can have folks that spend their lifetimes, engineers and others, and they can sit down and show you this process.

Mr. OBERSTAR. There are a great many comparisons here between aviation safety and maritime safety. We have passed a Coast Guard authorization bill that substantially, dramatically changes the way in which Coast Guard will conduct marine safety, and I won't go into all of those specifics, but it addresses this. The Senate has passed a similar bill, it doesn't have our provisions in it, and we are working those differences out before conference, but the human factor in drilling operations, the master of the vessel is licensed by the Coast Guard, meaning that that person has to meet certain standards. But to the best of my knowledge, the drill master is not licensed by anyone, by any government organization, that

is, hired by the company and certified by the company to be capable, but there is no government standard, no Federal Government standard that the drill master must meet; is that correct?

Mr. GERARD. I will get you the details on it. But they are trained in the processes and the procedures, and they are part of the inspections as people come out to see what is going on.

Mr. OBERSTAR. But every mechanic who works on an aircraft, every carman in the railroad industry has to meet standards that the government has set. You are a licensed avionics and power plant—airframe and power plant technician, and if that technician does not sign off the ticket on that aircraft, it doesn't move. That is the kind of standard I am looking for in this industry.

Mr. GERARD. I understand. These individuals are highly trained in what they do, and we can go back and answer the question as to what certification processes aside from standard training. We provide a lot of that training through the API in certifying training schools and others. And we can go back and talk with your staff.

Mr. OBERSTAR. We will engage you.

Mr. Olson.

Mr. OLSON. Thank you, Mr. Chairman, for having this hearing today. And I thank the witnesses for providing their insights on this incredibly important matter for our country going forward in the future with our offshore exploration.

I want to talk to Mr. Gerard first, and I want to get to the issue of the limit on the insurance liability, the current $75 million that was part of the Oil Pollution Act of 1990. As you know, there are proposals from the administration and from Congress to up that to $10 billion. And there are even some indefinite proposals.

I represent the 22nd Congressional District of Texas, and we have a significant petrochemical industry throughout the greater Houston area. At home last week I cannot tell you how afraid the operators were in the offshore industry if this provision would somehow become law. Again, many of them can't afford—a lot of these are small businesses, smaller operators. They cannot afford and they cannot purchase a $10 billion or indefinite liability for some sort of spill. I want to get your thoughts. Is that what you are hearing from your members? What can we do to help them?

Mr. GERARD. What we are hearing, the insurance industry has indicated to us, and there have been a number of letters sent to the Hill, there are not sufficient capacity within the industry to meet those limits. Therefore, you would reduce down to only a handful of the largest companies in the world to be able to operate because they would self-insure, clearly having an impact.

One estimate done by a third party suggests that of the 170,000 people employed in the Gulf of Mexico, with such a limit you put at risk 145,000 of those jobs just merely by raising that cap on liability. So as an industry we think it is an important part to have a conversation about what that should be and what this system should be, if you will, to make sure that the taxpayer doesn't bear the burden of any particular spill. But we do think there has to be balance in this to make sure that at the end of the public policymaking process, we still have the ability to generate and produce the energy our economy requires moving forward.

So we share your concerns and think that is a very legitimate consideration that should be looked at as you develop this policy.

Mr. OLSON. The people in my district, this is what I heard over and over and over, and then concerns about the moratorium.

Mr. Greenstone and Dr. Hartwig, any comments?

Mr. GREENSTONE. Yes. This point keeps coming up, and I think it is one that merits a lot of consideration about will small and medium-sized companies be able to get insurance policies going forward if the cap is raised to $10 billion or some indefinite limit.

One thing I just want to point out is insurance rates are based on the risk; they are not based on the size of the company. So as long as the company is undertaking adequate safety provisions, it is a little hard for me to understand why they would have a hard time getting a policy.

I also want to talk to a related point, which is that the current size of the insurance market is not very big, and so would not be able to insure such large risk, and only big companies would be able to do it, and they would have to self-insure.

If we think back to this last decade, it is not hard to see that Wall Street is quite capable of shifting money around to new markets in the last few years. That was obviously the housing market, but shifting around to new markets where there are opportunities. So to the extent there was a higher cap, that would create a new market, and I have great confidence that Wall Street would find a way to shift capital to this sector and be able to write insurance policies with much higher limits than are currently being written.

Mr. HARTWIG. Just a comment or two on this. I agree absolutely that insurance rates at the end of the day are going to be based on risk, and they are going to be based on the track record of the individual company involved.

But at the same time, if a company is going to be obliged to demonstrate a very, very high threshold of ultimate potential responsibility beyond what the insurer would have potentially offered in terms of coverage, the insurer itself caps its own risk. It sets a limit to the coverage. If there is another standard set by the government whereby instead of $1 billion it is going to be $10 billion, that particular driller, even if they have never had a claim, is going to wind up paying more because the insurer has more dollars ultimately at risk, it has to tie up more dollars in order to hold that in reserve if it winds up having to pay that claim.

Outside of the world of the offshore insurance industry, I can only think of one particular major type of coverage where there is unlimited liability, and it is a market that is completely falling apart. It is Michigan's no-fault automobile system. It has nothing to do with offshore drilling, but that is where I am spending a lot of my time recently. I testified recently there in that State, and a quote from me is with unlimited benefits come unlimited costs, and that is exactly what is happening in that particular State.

Mr. ANDERSON. I just wanted to reemphasize the role of reinsurance in this industry. It is not the question of a single insurer being responsible for damages, but also whether the capacity exists in the reinsurance market. The experience, I think, in the international group is there is not infinite capacity in that market. That has been demonstrated. It was demonstrated by the Exxon Valdez

where the group could not complete its reinsurance contract because of the magnitude of the damages.

It would be compounded now by an order of magnitude by removing liability caps and by imposing a one-size-fits-all damages cap on all responsible parties under the act.

As I said before, if you have major events in the world such as earthquakes, floods, storm damages as we had with Hurricanes Katrina and Rita, that is going to put incredible strains on the reinsurance market, and the capacity is not there.

I would very much disagree that the insurance industry is comparable to Wall Street in coming up with different financial instruments. That market that we are talking about is much more limited, and covers a very, very broad range of risks besides simply offshore drilling and exploration.

Mr. OLSON. Thank you very much for that perspective. That jibes basically with what I am hearing back at home. People feel if they are required to purchase, they won't have the capital to purchase the insurance, particularly the smaller and middle-sized guys which do the bulk of the work out there.

Mr. OBERSTAR. Mr. Cao.

Mr. CAO. Thank you, Mr. Chairman.

My question to the panel will focus on the moratorium. Based on the knowledge of anyone on the panel, how can we address at the same time the issue of safety, preventing another disaster from happening in the future, but at the same time trying to limit the economic impact of the moratorium? Right now there is a 6-month moratorium imposed. Is there any way for us to do the review work we have to do without extending it all of the way up to the 6-month period without compromising safety issues?

Mr. GERARD. We think there is, Congressman. As you probably heard from our statements, the key to where we are now in the moratorium, as you know, there were 33 operations under way that were just stopped and told to cease. Each one of those drilling operations had attached to it about 1,400 jobs. That totals 46,000 jobs that were put in limbo as a result of the moratorium. We think it is very appropriate to take a pause and scrutinize and look closely at what is going on in the gulf from a safety standpoint and for protection of the environment, but we think there may have been better ways to do that without having such severe economic disruption take place.

We believe one of the ways they could have done it is move quickly for increased inspection and oversight. Of those 33 operations, in the first week they had inspected 29 of them. And as an industry we recognize and welcome that additional scrutiny to come out and look closely and make sure that the testing and inspections and other things are taking place. Like you, we are very concerned that we are compounding the economic challenge in the gulf. This tragic incident has caused severe distress, and now we are going to compound that if we continue to pull back on the other economic activities that have provided for strength in the gulf all these years.

Mr. GREENSTONE. I think the moratorium obviously has severe economic consequences, and obviously a lot of them are concentrated in your district.

Just speaking off the top of my head, one solution would be instead of having a moratorium for a 6-month period of time, you could have a higher cap. It could be a trial run to see how businesses operate with a higher cap on liability damages.

Mr. CAO. Anyone else who has any ideas or comments on the question posed?

My next question, I guess to Mr. Gerard, you basically conveyed an idea that I am pretty sure many Members, a lot of people in my district would support, is to look at an increase in liability, but doing it in a way that would be very responsible and to limit job loss. And I believe earlier in the session you conveyed to the Chairman that you have certain ideas and proposals which you want to submit. I would also ask that you submit to my office a copy of that proposal, if you don't mind.

Mr. OBERSTAR. Mr. Cao, if you would yield, any information submitted in requests to witnesses to the Committee will be distributed to all Members. That is our standard practice. We will be sure you receive it.

Mr. CAO. Thank you, Mr. Chairman. With that, I yield back the balance of my time.

Mr. OBERSTAR. Mr. Gerard, you said or you suggest that the proposal to go to $10 billion is too severe. What is the number between $75 million and no limit that the industry would support?

Mr. GERARD. We haven't yet decided what we think a fair number would be. However, we have looked closely at, for example, some of the letters we have received from some in the insurance industry who typically underwrite these policies. They are down closer—I think some of the comments that were made by the gentlemen on the panel today, they said the capacity in this area is 1.2-, 1.5- at most.

I am not in the insurance business, and I don't fully appreciate all of the nuances of that, but I think it is important, Mr. Chairman, we take that in consideration and we look at that from spreading that risk and decide what the best policy should be. I realize this isn't the Energy Committee, but we have also got to take into that equation the role and the impact it has on the energy production in our society. Today 30 percent of all of our oil comes out of the gulf; 70 percent of all of that comes out of the deep water. Actually 80 percent of that, I am sorry. And of the 11 percent of our natural gas that comes out of the gulf, 45 percent of that is in deep water. So there is a very serious economic energy dynamic that we think needs to be considered, as well as talking about what the right level of the cap might be. We will get you some feedback on that.

Mr. OBERSTAR. Very true, but there is also another economic factor: Fifty percent of the fish and shellfish of the Nation come from the gulf.

Mr. GERARD. We understand that.

Mr. OBERSTAR. There are 300,000 jobs in the recreational fishery industry.

I think the advantage of having long service in the Congress is to have been present when this body of law was created. I remember very well in the aftermath of the Torrey Canyon and the Amoco Cadiz the hearings we held in the Marine and Fisheries Sub-

committee on the extent of liability that should be imposed upon the industry, and the repeated claims that you had to have a number against which the industry could insure. That became the standard for oil pollution liability in the1978 act andthe 1988–1989 act and the OPA 90. Those were measures aimed at known quantities. We know how much oil there was onboard the Exxon Valdez and the Amoco Cadiz and Torrey Canyon and the big supertankers. That is a definable, measurable amount.

But when a well breaks at 5,000 feet from a reservoir that is another 18,000 feet further, and the amount of oil in that reservoir is only an estimate, you have an unknown or unknowable quantity of oil coming out against which it is very difficult to insure. I understand that. So if the damages are in excess of a billion, $5 billion, or $10 billion, whose responsibility is it then?

Mr. GERARD. Well, I think the other consideration we should talk about, we are talking about the liability cap, but we are also talking about the trust fund. That is paid into by industry. As you know, the House passed provisions recently to add $10 billion to that trust fund, and the Senate is considering legislation to add $15 billion to that. We think that is another piece of the equation that should be considered as we try to manage that risk. As it has been talked about, that is really what we are doing is trying to manage that risk.

Mr. OBERSTAR. That is a fund to which all of the industry contributes. It is not just a company responsibility.

Mr. GERARD. It is assessed at the refinery with the intent to pick up both the imported and the domestically produced crude. So it is paid for by the refinery sector.

Mr. OBERSTAR. I think you have to do some serious soul searching about the very fundamental principle of this liability and cleanup, which is the basic principle of the Superfund Act, which goes back to what I said in this Committee room 25 years ago. I spilled something; my mother said, clean it up. I was responsible. And so when industry spills, as in the case of the Arrowhead refinery in Duluth, all manner of stuff was just dumped because it was a convenient location. We came back, and you had gasoline, waste motor oil, you had wastes from grease from automobile maintenance. They collected it all, and we said, you just dumped it all, and you are all responsible. They had to have a share and a cost in cleaning up that mess.

So we are dealing with something that is really of unimagined magnitude compared to what we were considering in1978 and1988 and1989, and 1990 thinking only about surface vessels.

Mr. Anderson, there are 13 of these nonprofit, not-for-profit mutual insurance associations, the P&I clubs, which I have had some experience with over a period of many years. They will provide up to a billion dollars in coverage for pollution liability for vessels, but they do not issue documents necessary to enable a vessel to obtain a certificate of financial responsibility, COFR, to operate in U.S. waters. Backing for those certificates comes from other insurance firms, some of which are in Bermuda. It is like the BP vessel built in Korea, registered in the Marshall Islands, with a registry maintained in Reston, Virginia. Oversight is limited to the laws or the regulations of the IMO. To what extent does imposition of direction

action against firms providing backing for COFRs factor into the P&I club decisions not to provide such backing?

Mr. ANDERSON. I feel I am preaching to the converted, Mr. Chairman, because I know you were present for the hearings for the original OPA 90. As you know, the problem for the clubs was the direct action provision in OPA 90 and the principle that P&I insurance is basically a contract between the ship owner member and the individual club wherein the member undertakes to keep his vessels in a very seaworthy condition and pay premiums in exchange for payment of claims. And the direct action provision would essentially mean that the club's assets are at risk even though the ship owner may not be operating in accordance with club rules.

Again, we deal with the principle of mutuality, that the clubs cannot put assets at risk simply because one jurisdiction imposes a very stringent requirement as opposed to worldwide trading and jurisdictions.

The mechanics of the COFR system have operated in a very excellent manner because in my experience I don't know many cases, if any, where the guarantor company, the Bermuda corporation, has actually been called upon to respond. In the vast majority of cases, the P&I club is on the front line of payment of pollution claims. The COFR basically is there as a backup in the rare case that the clubs, for reasons of perhaps individual members were not complying with rules, would not be paying. But the guarantor is basically there, as the industry and the trade would say, as a ticket to trade in the United States. It is a requirement to have the guarantee; but as a practical matter, at least with respect to the shipping sector, it is not in the first line of response to an oil pollution incident either in terms of payment of cleanup costs or third-party damages.

Mr. OBERSTAR. Well stated, but following up on a question Mr. Olson asked about reinsurance, do you think— perhaps you also, Mr. Gerard—do you think the reinsurance market can issue coverage for $1 billion to a $1.2 billion COFR?

Mr. ANDERSON. The capacity for a COFR in that amount is probably there, between $1 billion and $1.5 billion. One of the problems with that is that, again, because of the market capacity, if you are increasing limits, as some of the administration bills are proposing, that will have an overspill effect on all of the market so that the costs for every operator, whether it be a vessel operator or a rig operator or a small driller, is going to be increased astronomically because reinsurance costs will be increased.

Mr. OBERSTAR. The Bermuda operators will provide insurance only up to the level of liability based on the vessel's gross tonnage.

Mr. ANDERSON. That is correct, or the limits specified in OPA 90 or the relevant law.

Mr. OBERSTAR. But if there is a spill, the vessel spills and it has to file a claim, does it file first with the reinsurance firm in Bermuda and then file with the P&I club?

Mr. ANDERSON. The way it typically works is the guarantor corporation in Bermuda will receive a notice from the fund center of the claim, and that is passed on to the P&I club, or in practice the P&I club will already have been involved in the response because

it is involved from day one. When we get a report of an oil spill, we will have correspondents on scene dealing with financial response of that spill. So once again, the guarantor corporations—and keep in mind that these are not simply paper corporations; they have the same reinsurance contracts essentially that the club has. So they are backed up by first-quality insurance on both the European and U.S. markets.

This is not simply a paper operation that is necessary to get the ticket to trade. They can respond through reinsurance again in the event of a spill. But again, going back to the basic operation of OPA 90 with respect to vessels has operated very, very efficiently for 20 years. We have not had to call upon the guarantors to respond, because the P&I clubs are there in the forefront of a response. Whether it comes to removal costs that the government incurs, or damages to natural resources that NOAA has, or third-party claimants who are claiming economic loss or property damage, P&I clubs will respond to those kinds of damages.

Mr. OBERSTAR. In fact, there is a relationship between the P&I clubs and the reinsurers, whether Bermuda or elsewhere, and you do have a relationship and you communicate with each other?

Mr. ANDERSON. Absolutely. We would deal with the guarantors. Obviously they are going to be very concerned to know that the responsible party and the P&I club are responding, and so we have a dialogue with them whenever there is a spill incident which might involve a guarantor.

Mr. OBERSTAR. If the limits were raised or eliminated, as occurred in those deliberations back in 1990, or 1989 and 1990, on OPA 90, your testimony refers back to the lack of any workable substitute to the international group's insurance program threatened to cause withdrawal of the majority of the world's commercial shipping from the U.S. trade. But if liability limits were raised or eliminated, would that same circumstance occur today?

Mr. ANDERSON. If they were raised or unlimited?

Mr. OBERSTAR. Or eliminated.

Mr. ANDERSON. It certainly would. If some of the proposals were to come into effect, I think, quite frankly, we would be facing a similar train wreck to the scenario that we faced back in 1990. Mr. Oberstar, you know probably better than anyone else there are simply very few ship owners, and I am talking only about the international shipping sector, not the offshore—there were very few ship owners who could possibly meet those kinds of financial responsibility and liability requirements by using their own assets. They have to rely on P&I insurance to do that, and on the reinsurance scheme. So we would be faced with the same situation as we had back in 1990 where basically the wheels of commerce would come to a grinding halt if we had unlimited liability or if we had a one-size-fits-all liability limit to third-party damages. Those risks really would not be insurable or would be insurable at an astronomical cost to the industry, and that would cause smaller operators, as Mr. McAllister has already said, probably to cease their operations.

Mr. OBERSTAR. That really raises the question of the capacity in the reinsurance sector. Dr. Hartwig and Dr. Greenstone, do you have comments on the ability of the first-line insurance and the reinsurance sector to back up a $10 billion spill liability?

Mr. GREENSTONE. Yes. I am not an expert on the first line of reinsurance markets, but I think one thing is clear: As they are currently constructed, it sounds like they would have a difficult time responding to higher limits. But if we have learned—when you watch the massive flows of capital fly from sector to sector, from country to country, what would happen, the lesson from that is when there are opportunities—so the notion that the wheels of commerce were going to come to a grinding halt is false—what would happen is that is a tremendous opportunity for some new firm to enter that market, or a series of new firms to enter that market, and the result is that it might not be the same people providing the insurance, but there would be new providers of that insurance because people would be willing to pay for it.

Mr. OBERSTAR. Why would they be willing to pay for it, because the industry until up to now has had so few massive spills?

Mr. GREENSTONE. Well——

Mr. OBERSTAR. Because they are out there evaluating risk. That is what they are doing. And in evaluating risk, they look at the record of the industry to some degree.

Mr. GREENSTONE. I think they are evaluating risk, and they are evaluating what the cap is, because the companies are only asking to be insured up to the cap. If I understand the concern that is being raised, if you raise the cap, the current insurance companies would not be able to write policies for the entire level. The point I am trying to make is I think that would create a tremendous incentive for new firms to enter and provide insurance to the higher levels.

Mr. OBERSTAR. Dr. Hartwig.

Mr. HARTWIG. If I could on that, insurance is very different from the banking industry, and that is why during the financial crisis precisely zero property casualty insurers failed, and so far 300 banks did.

The reality is capital doesn't go flying around the insurance industry at the touch of a mouse. Just because there is an opportunity to write $10 billion in limits, I would be very wary of a company that came in tomorrow and said they knew how to do that, because not even companies that have been around 400 years are doing that today. If anyone could do it, they could do it, and they are not. That might tell you something.

So the reality is that while some additional capacity can potentially be brought into the markets, we are talking about orders of magnitude greater than what currently exists, idle capital having to stand by which is going to need to earn a risk-appropriate rate of return just for that 1-in-50-year type of event. It is very, very expensive to do. Can some be attracted in on the margins? Absolutely. The billion, billion and a half number we are talking about right now includes a share of loss that would be paid by the reinsurers. It is really spread around the globe. It is already a global marketplace. But I can't see a situation where for such massive limits that would require extraordinary underwriting expertise, that a new company would come and write limits like that. I think it is impossible.

Mr. OBERSTAR. We are looking for some way to insure, as Mr. Mica said earlier, so the public doesn't pay for this spill.

Mr. ANDERSON. If I can comment on Dr. Hartwig's comment, what would happen, I am afraid the analogy to Wall Street is a dangerous one. I think it is important to understand that the reinsurance that is available for the P&I clubs is first-class security. It has never failed in response to an oil pollution incident.

If you were to open this up to other underwriters with more questionable securities, you may find yourself in a Wall Street scenario where the insurance industry is not able to respond to damages. That has not been a problem up to now because of the quality of the reinsurance the clubs are able to procure under their contracts of insurance.

Mr. OBERSTAR. Mr. Garamendi was here earlier and had to leave for another committee. He has experience as the insurance commissioner for California, and I am going to recognize him at this point.

Mr. GARAMENDI. Thank you, Mr. Chairman. I do have some experience. I ran a multibillion-dollar insurance program and oversaw even more over an 8-year period of time.

It is entirely possible for the insurance industry, working together, to create an insurance program of $10 billion. It is possible. And the way it can be done is, for example, in the Skuld program, you have the first tranche. I don't know what it is; maybe it is 100 million, maybe more than that. Then there is a second tranche that may come through with the trust fund that already exists, whatever that number may be, and then the reinsurers take tranches above that. Let us say you want $10 billion, it is not just one company; it is multiple companies, each one assessing the risk.

The thing that is critically important here is that you now have the insurance companies themselves involved in assessing the risk. You are not totally dependent upon the government regulators assessing the risk, the risk of a blowout or the risk of a particular piece of equipment doing the job. You now have multiple insurance companies, reinsurance companies involved in taking an assessment because they have money at risk.

The other point I want to make is one brought up by Mr. Greenstone. You could not be more right about the economics. We have seen this over and over again. We have seen it in flood insurance. It is much discussed in earthquake insurance. As long as you put a cap on the potential liability, you then have incentivized risky behavior. If we want to incentivize risky behavior, leave the cap where it is today, and you will continue to have risky behavior because it is financially in the interest of the operator to run the risk. You know what the maximum potential liability is. It is $75 million. Big deal. I can make $700 million by drilling this well, and I am going to drill the well.

By superimposing on the risk a limitation, you have incentivized bad behavior. We see it over and over again in flood insurance. We see it in earthquake insurance. I saw it in California over and over again. In fact, it modified the way in which earthquake insurance is sold to take account of the risk of the building, the nearness to earthquake faults and the rest. The same thing applies here.

The shipping industry, I am not focused on that, but certainly with regard to drilling, whether it is shallow water or deepwater, you need to build the cost—the risk potential into the cost of the activity. If you don't, we are just going to continue to have prob-

lems. You will also, by the way, have problems even if you do build it in, but you will guarantee—by eliminating the cap or setting a very high cap, you will guarantee that the operator is keenly interested in doing it safely. That is the critical point here.

Thank you, Mr. Chairman. If you want more about reinsurance, we can have a great debate here about it.

Mr. OBERSTAR. That was a very good textbook discussion.

Mr. McAllister, I have one question. We have four votes, 6 minutes remaining. Should there be two standards for insurance, one for these very big operations and one for smaller operations?

And in the case of your organization, your tugboat operators, where you are delivering home heating oil, there is also a provision in OPA 90 that eventually was dropped but that would make the owner of the product liable also. And the purpose in previous legislation, it was dropped in OPA 90, was to engage the owners of the oil in forcing the vessel owners to move to double-hull operations. If the owner of the oil was liable for the spill, then they would take care that the vessel in which their product was carried was the safest as could be. That would have had a devastating effect on home heating oil operators, because the owner might be a little filling station or home heating oil operator somewhere in the hinterland of the United States who have no ability to provide financial backup for a spill, so that provision was dropped.

But should there be two standards for your organization, smaller operators and those several-hundred-thousand-ton tankers on the high seas?

Mr. MCALLISTER. Well, I think that is a good point. And, the fact of the matter is if you look at OPA 90 right now, it already does make that differentiation. There are various different liability limits in OPA 90, and OPA 90 even differentiates between single-skin vessels and double-skin vessels.

I think there is a lot of talk about whether this differentiation or these liability limits somehow incentivize reckless behavior, but I think it is worthwhile to look back at how the existing differentiation between types of operations and types of vessels has incentivized responsible behavior, and I think it is a success story. There has been a lot of focus on the P&I clubs, but the OPA 90 law that you are talking about also affects fishing vessels, ferryboats, nontank vessels of all sorts. Not all of those vessels are in the P&I clubs. Not all of those vessels carry $1 billion worth of insurance. They carry insurance that is appropriate for the limits of liability that have been set up for them.

If everybody is required to jump up to those high levels of insurance, I think you may see that some modes of transportation are going to become unaffordable.

I would like to highlight here that maritime transportation is the most efficient and, in my view, environmentally responsible mode of transportation for lots of cargo in America. We produce fewer emissions than you would produce by rail or truck. We get trucks off the road, and I think it is important to keep in mind what is going to happen with the cargo that is being carried on America's waterways if a large expense for required insurance is placed there.

There is no question insurance is based on risk. So if you require—if you impose a larger liability cap and more risk, you are

going to require more money to go out the door to pay for the insurance for that risk.

Mr. OBERSTAR. I am going to have to stop at that point. You have all been wonderful. You have been on the stand for 4 hours. It is a long time without relief. I will have a number of other questions that I will submit or have staff submit for your response for the record.

Any supplemental comments that you have or observations and material that Mr. Gerard has already committed to providing for us, do that within a week. We will be developing legislation on a wide range of issues: liability and COFR vessel liability; cap per incident; limit on borrowing from the trust fund; Americanizing the U.S. Economic zone; the 1851 Limitation of Liability Act; and seven other items that are in my agenda to address, have legislation developed, and for an overall oil spill response package that the Speaker is going to put together by the end of this month.

The Committee will stand in recess, and panel three will resume in roughly 40 minutes.

Mr. OBERSTAR. The Committee on Transportation infrastructure will resume its sitting with Panel III, including Mr. Tom Perrelli, Associate Attorney General for the U.S. Department of Justice; Mr. Bob Abbey, Acting Director, Minerals Management Service; and Craig Bennett, Director of National Pollution Funds Center.

I think some of you or your associates sat through the morning and afternoon session and heard a good deal of the testimony given and give-and-take with members, so I expect you are ready with not only that information but what you had already prepared.

TESTIMONY OF TOM PERRELLI, ASSOCIATE ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE; BOB ABBEY, ACTING DIRECTOR, MINERALS MANAGEMENT SERVICE; AND CRAIG A. BENNETT, DIRECTOR, NATIONAL POLLUTION FUNDS CENTER

Mr. OBERSTAR. So we will begin with Mr. Perrelli.

Mr. PERRELLI. Thank you, Mr. Chairman, Ranking Member, Members of the Committee, thank you for the opportunity to testify today about issues related to liability and financial responsibility in the offshore oil production area. Before I begin I would like to take a moment to express my condolences to the families of those who lost their lives and those who were injured in the explosion and sinking of the Deepwater Horizon.

The explosion and fire that took place aboard the Deepwater Horizon and the spill of oil that followed have created an unprecedented environmental disaster for the people and fragile ecosystems of the Gulf Coast. This disaster has been met with a massive and coordinated response from the Federal Government, led by President Obama. The activities have been focused, as they must be, on stopping the oil spill and preventing and mitigating its effects. While Admiral Allen and the unified command have directed these efforts, the Department of Justice is looking ahead to issues of financial responsibility and liability.

Our mandate is to make sure that we recover every dime of taxpayer funds that the United States spends on all of the removal efforts or damages caused by this catastrophe. We have been working

tirelessly and will continue to do so to carry out this mandate and ensure that the American public does not pay for damages for which others are responsible.

At the direction of the Attorney General we have been monitoring the situation on the ground, coordinating our efforts with the State attorneys general, and working with our Federal partner agencies and natural resources trustees to make sure we measure and track every bit of cost incurred in damage to the United States, the States and the environment.

Those responsible for these events must be held accountable. To this end we will enforce the appropriate civil, and, if warranted, criminal authorities to the full extent of the law. This administration will explore all legal avenues to make sure that those responsible for this disaster pay for all of the devastation that they have caused.

Some of these avenues arise under the Oil Pollution Act, or OPA, which is the subject of my testimony today. As you know, OPA was passed in the wake of the Exxon Valdez disaster to provide specific legal authority for dealing with the consequences of oil spills. OPA designates responsible parties who first and foremost are required to clean up oil spills and then pay removal costs and damages.

In its current form OPA contains conditional caps that in some instances limit the liability of responsible parties, caps which are based on the size and nature of the vessel or the type of facility that is the source of the spill.

BP has already stated in several fora, including before this Committee on May 19th, that it will not seek to limit its payments under an OPA cap. It has also said that it will not look to the Federal Government for reimbursement for the claims that it pays in excess of a cap. We expect BP to uphold these commitments. Rest assured, however, that the United States is committed to making sure that all responsible parties are held fully accountable for the costs and damages they have imposed on our people, our communities, and our natural resources.

With respect to OPA itself, the liability provisions of OPA have not been updated in some time and it is clear that the liability caps must be adjusted and in some cases lifted altogether. We are convinced that the old liability framework is simply inadequate to deal with the potentially catastrophic consequences of oil spills. For the future, the liability provisions for activities covered by OPA should be reviewed and increased, as appropriate, to reflect the inherent risks associated with those activities. In particular, we support removing caps on liability for oil companies engaged in offshore drilling. We want to ensure that those companies have every incentive to maximize safety to avoid spills before they happen. And if for some reason a spill still occurs, those companies must bear full responsibility for all of the damages their actions impose.

Arbitrary caps on the liability of offshore drilling implicitly subsidize drilling procedures that may not maximize safety, and we must remove those caps to decrease the risk of future spills and to ensure that if spills happen, the polluter pays. We will work with Congress to develop appropriate proposal and transition rules.

Thank you, Mr. Chairman.

Mr. OBERSTAR. Excellent, thank you very much.

We will go now to Mr. Abbey.

Mr. ABBEY. Thank you, Mr. Chairman and Members of the Committee, for the opportunity to testify about the Minerals Management Service's authority for oil spill financial responsibility pursuant to the Oil Pollution Act of 1990. I have worked with many Members of this Committee in my role as the director of the Bureau of Land Management. On May 28th Interior Secretary Salazar appointed me as the acting director of the Minerals Management Service. I appreciate the opportunity to be part of the Minerals Management Service organization for as long as Secretary Salazar needs me.

Our focus at MMS has been and continues to be dealing with the Deepwater Horizon incident, but other important work continues to be performed. The enactment of the Oil Pollution Act in 1990 and its implementing regulation superseded the Outer Continental Shelf Land Act requirements. And today the Coast Guard and MMS jointly administer the offshore oil spill financial responsibility program. Under this program the Coast Guard has authority over vessels and MMS has authority over offshore facilities and associated pipelines located seaward of the coastline that handles store of transport oil, except for deepwater ports.

This act gave the Secretary of the Interior, among other things, the authority to ensure that the designated applicant has the financial resources necessary to pay for the cleanup caused by oil discharges from covered offshore facilities such as the Deepwater Horizon.

Pursuant to the regulations, each covered offshore facility must have a single designated applicant that must demonstrate the ability to pay a specified amount ranging from 35 million to 150 million, depending upon the worst-case oil spill discharge volume. These regulations also prescribe methods for demonstrating oil spill financial responsibility and the requirements were submitted related information.

OPA 90 set lower and upper limits for financial responsibility coverage; the lower limit of $10 million for State waters and $35 million for OCS waters; and the upper limit of 150 million. An applicant can demonstrate their financial capability to meet their oil spill responsibility requirement by self-insurance, commercial insurance, third-party indemnification, surety bonds or alternative methods at the MMS director's approval. For example, under the oil spill financial responsibility, BP Corporation chose the maximum coverage of $150 million. BP subsidiary, BP Exploration and Production, was the designated applicant for Deepwater Horizon and was indemnified by BP Corporation, its parent company.

In the case of an oil spill from an offshore facility, the liability of responsible party is not limited to the level of their oil spill financial responsibility. The responsible party is liable for all removal costs of the spilled oil and also liable for damages from the spill.

It is important to note that under the Oil Pollution Act, oil spill financial responsibility programs attempts to balance the need for the responsible party to have sufficient financial resources available for adequate cleanup in the unfortunate event of an oil spill against financial obligations that are so burdensome that they re-

sult in a chilling effect on the ability of smaller companies to operate and do business on the Outer Continental Shelf.

Because there is no cap on a responsible party's liability for removal costs, the limits also take into consideration additional layers of protections established by OPA 90, such as the oil spill Liability Trust Fund which covers costs for which the responsible party is unable to provide. The Administration supports a significant increase in the liability for operators of offshore oil and gas facilities and welcomes the opportunity to engage with Members of Congress to figure out where appropriate limits should be set.

Mr. Chairman, this concludes my remarks and I will be happy to respond to questions from you or Members of the Committee.

Mr. OBERSTAR. Thank you very much, Mr. Abbey, we appreciate it. We will have a number of questions for you and Mr. Perrelli.

And Mr. Bennett next.

Mr. BENNETT. Good afternoon, Chairman Oberstar and distinguished Members of the Committee. I am grateful for the opportunity to testify today about the Oil Pollution Act of 1990 limits of liability and financial responsibility.

My role as director of the National Pollution Funds Center, or NPFC, in this response covers four areas:

First, I fund the Federal response, using amounts Congress made available from the oil spill Liability Trust Fund, the so-called emergency fund.

Second, I ensure the responsible party is advertising its availability to pay claims for removal costs and damages. If the claimants are not fully compensated by a responsible party, they may present their claims to the NPFC for payment from the fund.

Third, I recover Federal response costs and claims paid by the fund from any and all responsible parties.

Finally, I administer the vessel certificate of financial responsibility program, which ensures the vessels operating in U.S. waters have demonstrated that they are financially able to pay their obligations under OPA.

With respect to limits of liability, the responsible parties in this case are liable under OPA for all oil removal costs. OPA does provide for a $75 million cap on damage liability under its offshore facility provisions, but that OPA limit, as with all vessel and facility limits under the OPA, may not apply under certain circumstances, including gross negligence, willful misconduct, or violation of Federal regulations.

Whether there is any effective cap on liability for damages under OPA in respect to Deepwater Horizon has not been determined and pends further investigation and coordination with the Department of Justice.

I can't comment further on how costs or damages may eventually be shared or apportioned or how liability for costs and damages may ultimately be enforced against responsible parties or against any other person under the law. I will note that BP has stated it does not intend to assert a limit and that it intends to pay all legitimate response costs and damages.

The NPFC has provided Federal funding through the OSLTF to 11,000 spills from all sources over the last 19 years. Since OPA was enacted there has not been a spill from either an onshore or off-

shore facility that tested OPA limits provisions. Limits are believed to have been exceeded only 51 times, and in all cases those have been oil pollution from a vessel. The NPFC submits an annual report to Congress on the limits of liability and the adequacy of those limits and we can make that available to anybody who hasn't seen it.

With respect to financial responsibility, the NPFC issued certificates of responsibility to over 22,000 vessels that are required to demonstrate that they can pay if they cause an oil spill in U.S. waters. Certificates of financial responsibility are not required for vessels under 300 gross tons unless those smaller vessels are transhipping or lightering petroleum products in the EEZ.

It is important to note, however, that these smaller vessels are still liable under OPA. They are simply not required to carry a certificate of financial responsibility. This would apply, for example, to smaller fishing vessels as well as most pleasure craft. Vessel operators can demonstrate that they meet the financial responsibility requirements through insurance, self-insurance or a financial guarantor.

OPA liability limits were amended by the Delaware River Protection Act of 2006 which increased vessel limits by approximately 40 to 50 percent and created different limits for single-hulled and double-hulled tank vessels. NPFC has since implemented consumer price index adjustments to vessel limits with an interim rule that was published in April 2009 and final rule adopted in January of 2010.

In conclusion, individuals, communities, and businesses have suffered as a result of this spill. The OPA regime is working to ensure a robust Federal response that those damaged from this spill are compensated and the polluter pays. The Department supports the administration's review of the existing liability regime and we would look forward to working with Congress to set liability limits and caps that properly reflect the risk associated with oil spills.

Thank you for the opportunity to testify today and I look forward to your questions.

Mr. OBERSTAR. Well, excellent.

Thank you, Mr. Bennett and all members of the panel.

Mr. Perrelli, much of the testimony this morning from our congressional panel and a great deal of conversation about oil spill liability and its limits involves one raising the $75 million to some number above that. As you heard in the previous panel, Mr. Gerard was not prepared to respond to what number it should be between 75 million and no limit whatever. But also we didn't hear a response to the retroactivity. Should they increase the limit, whatever we agree upon, above that $75 million number apply to leases already issued? And in that connection, we requested from legal sources that would not—there would not be a constitutional prohibition, but there might be other real legal implications. Could you address that issue?

Mr. PERRELLI. Certainly, Mr. Chairman. And let me state at the outset I think the Administration supports review of all of the OPA liability limitations. And in particular, our view is that caps should be removed for offshore drilling, because we think that will create the best incentives for ongoing activities to invest in the safe tech-

nologies that will ensure that a spill of this magnitude never occurs again.

With respect to other activities, onshore activities and transport by vessels, we think that those liability provisions need review, and we would like to work with Congress on deciding what is the most appropriate level at which to set caps, if at all.

With respect to this question of retroactivity, our focus is on going forward with the idea that we would like a new liability regime to apply to all activities going forward, recognizing that there may need to be a reasonable transition period to allow orderly transition in the industry.

Let me take on the last set of questions which relate to constitutional or other issues related to making changes in the liability structure retroactive. I think we think there are very strong arguments that Congress could enact legislation that would have a retroactive effect, and indeed Congress enacts legislation all the time that has retroactive impacts. Here Congress would be enacting broadly to address problems related to compensation and cleanup of the oil spills and it would certainly have a rational legislative purpose in doing so. So we think there are strong arguments with respect to constitutional defense.

More likely these issues may arise in the context of a breach of contract action, where I think we also think that there are good arguments and there would be substantial defenses to breach-of-contract claims. There is no question there would be litigation about it, no question there is some litigation risk.

I would note that OPA itself says that Congress is reserving its authority to increase liability in this area, and so anyone who is going to operate in a context of, for example, offshore water drilling, knows that Congress has said explicitly in statute that it has the authority to increase liability. And so I think that it is difficult for a contractee to make the argument that it relied that the law would stay the same.

Mr. OBERSTAR. Very good, thank you.

In the administration's May 12th proposal the administration recommended—on the matter of standard of judicial review for determination or assessments of natural resource damages, they recommended change. It appears the proposal would change the standard of review from rebuttable presumption to arbitrary and capricious test based on review of the operating record.

Why are you proposing this change and what would be the significance of moving from rebuttable presumption to arbitrary and capricious?

Mr. PERRELLI. In proposing that change, Mr. Chairman, we were trying to bring the litigation related to natural resource damages more in line with the way litigation on a record created by the government normally is done, which is under the APA and the arbitrary and capricious standard.

The development of the record on natural resource damages is going to be done by Natural Resource trustees and the Federal Government, States, and Indian tribal governments over a number of years, and they will compile an enormous record documenting the damage here. Our view is that, again in line with the way most litigation over a government administrative record is conducted,

the APA standard of review is preferable. We think it will streamline litigation, and again we think it is consistent with the way most agencies build records and litigate over those records.

Mr. OBERSTAR. Mr. Taylor was here a moment ago. I know he had constituents outside. If he returns he may ask this question, but I will ask it on his behalf. Oh, he is here.

Legitimate claims, how and where is the term "legitimate" defined? I ask that for Mr. Taylor and for myself.

Mr. PERRELLI. The term "legitimate," at least as I have heard it, has been used by BP. It is not a statutory term. There is no term——

Mr. OBERSTAR. No statutory definition. The law is quite specific about the various factors: removal costs, natural resources, real or personal property, subsistence use, revenues, profits and earning capacity, public services. Within all of those categories I listed, there are very specific references for natural resources damage—to injury of, loss of or loss of use of natural resources, including reasonable cost of assessing the damage, recoverable by U.S. Estate trustee, Indian tribe trustee, or foreign trustee. That is very, very specific. Real or personal. The law says damages for injury to or economic losses resulting from destruction of real or personal property recoverable by a claimant who owns or leases that property. But it doesn't say whether if you are living in—if you are a travel agent in Michigan and your clients drop their plans to travel to one of the Gulf States because of their concern of the oil spill, whether that person or agency has a claim and whether it is legitimate. How would "legitimate" be determined in that circumstance?

Mr. PERRELLI. As I indicated, "legitimate" is not a statutory term. Our view is that the scope of damages that are available under OPA is quite broad. And we certainly recognize that this tragedy is going to raise—is going to cause the expenditure of funds in many ways that may not have come into play in prior implementation of OPA. But I think our view is that the definition of damages is quite broad and we anticipate pursuing BP and other responsible parties for a wide range of damages.

Mr. OBERSTAR. And there is a significant body of case law on this subject as well that attorneys regularly turn to.

Mr. PERRELLI. There is. Mr. Bennett and his office and the Coast Guard are charged with the fund and they have a tremendous amount of experience in this area.

Mr. OBERSTAR. Mr. Abbey, how many of the firms that conduct drilling or production operations in the Gulf of Mexico self-insure their risks?

Mr. ABBEY. I don't have the specific numbers, but that certainly is something that we can share with you for the record, if that is fine with you, Mr. Chairman. I will say that BP, which you have heard from earlier testimony, was self-insured.

Mr. OBERSTAR. Yes. But in supplying that information, give us the size, the value of those operations, and your assessment of whether they could or would ensure unlimited liability for the facilities. And I asked the previous panel, the reinsurance market, is it capable of handling an amount in excess of 75 million, beyond 10 billion, or unlimited. They didn't have a very concise answer to that question.

Mr. ABBEY. We will get you the information you requested, Mr. Chairman.

Mr. OBERSTAR. Thank you.

I now yield to Mr. Buchanan.

Mr. BUCHANAN. Thank you, Mr. Chairman.

Gentleman, I represent a district in Florida. We have 50–60 miles of pristine beaches and our environment—the environmental environment in terms of clean water and beaches is critical, not only to future generations but obviously to our economic viability in our region. And you take into account coastal waters and inland waters and everything along there, it is probably 150 miles.

But Mr. Abbey, I guess I want to get your thoughts. I think it was wrong that the MMS granted BP exemptions from environmental review. From what has happened this has obviously been a mistake reported in the Washington Post and other things.

I have got three questions that relate to this category. Are these exemptions still being granted, number 1?

Number 2, can you please tell us why Deepwater Horizon was granted these exemptions? And are these exemptions common practice or an exception to the rule? Again, I bring this up because, you know, I was told for a long time— because I am one member, at least in Florida, that has been against offshore drilling as it relates to our beaches anyway. I was told what happened in terms of the implosion in the gulf could not happen.

We had the deepwater technology and the capability, so it is shocking to me. And we had people who wanted to drill 3 miles off our beach, and I have been consistently against that. So that is why this is so important, because I think the agency you are representing is someone that is looking out for the American public. And so when I see things like that, and your special exemptions, I want to know why that is.

Mr. ABBEY. Well, Congressman Buchanan, first and foremost let me say that I grew up in Mississippi, so I am quite familiar with the beaches of the gulf out there in the State of Florida and what wonderful resources they are. I have spent a lot of time down there enjoying the opportunities to swim in the gulf and take advantage of other resources in that part of your State.

Let me say that a spill of this magnitude certainly is unprecedented and we are learning an awful lot of lessons as a result of events that we are currently dealing with in the Gulf of Mexico today.

I don't have the specific numbers of how many exemptions have been granted. I would really need a little more specificity relative to the exemptions you are talking about. I will say this, though. As we go forward we are looking at all safety requirements that we have applied in the past. We are making changes. We made changes as late as yesterday afternoon regarding the issuance of notices to lessees for operations both in deepwater as well as shallow waters in the Gulf of Mexico. Those requirements for those operators in the shallow waters require them to certify that they are meeting many of the safety requirements that came out of the 30-day safety report that was issued to both Secretary Salazar and the President of the United States a couple of weeks ago.

We are also requiring the CEOs of the companies who are operating to actually verify and to sign their names to the fact that they are complying with all those new requirements. We are taking actions to move forward, based upon the lessons that we have learned from this event.

I am not here to defend past practices for Minerals Management Service, but I would also say that there are a number of investigations underway, as well as the Presidential commission, that are looking into the facts of matter and we will let those facts speak for themselves.

In the meantime there is a lot of business that needs to be done. We are looking at the opportunities to improve our overall performance so that the safety that you are looking for relative to any future drilling is assured.

Mr. BUCHANAN. Since the implosion in the gulf, have we been giving consistently—or giving exemptions since that implosion? Let's not talk about the past too much, but just in terms of what has happened in the last, say, 2 months? It is my understanding we are still giving environmental exemptions, and I can't imagine why we would give any consideration to that.

Mr. ABBEY. Congressman, you are probably talking about the categorical exclusion.

Mr. BUCHANAN. Right.

Mr. ABBEY. That are allowed under NEPA. Categorical exclusions are used when there has been previous environmental analysis performed that has been deemed sufficient to cover the proposed action from an applicant. We are certainly reviewing the environmental requirements that we have placed upon the operators in the past. We are looking at making some adjustments over the course of the next couple of weeks. We have not reached final determination of how we will move forward, but I can assure you that that issue is being addressed not only within the Department of the Interior, but we are working in close partnership with the Council of Environmental Quality to determine how best to move forward. Do I have more time?

Mr. OBERSTAR. Yeah.

Mr. BUCHANAN. Thank you, Mr. Chairman.

The AP reported that since 2005, Deepwater Horizon has missed 16 monthly inspections. I guess I want to know how can MMS let this happen? Is it common for these inspections to be missed? What are you doing to make sure that our rigs are not missing their monthly inspections? And are there consequences for missing these inspections?

Mr. ABBEY. Congressman, it is my understanding that the Minerals Management Service strives to perform inspections once a month. That is the goal, that is the target that is incorporated into the annual work plans. There are some months that are missed as a result of weather that won't allow the helicopters to get out in some of the deepwater facilities. There may be some other reasons why a particular platform was not inspected each month. But it is a goal.

It is my understanding based upon the records that I have read that Minerals Management Service has done quite well in meeting that target, not 100 percent by any means, but they have done

quite well in meeting the targets of trying to perform inspections on the platforms that they manage on a monthly basis.

Mr. BUCHANAN. They are saying they have missed 16 monthly inspections. I can understand missing a couple or being pushed off. How can you miss 16 in 4 years? That is almost half of the inspections.

Mr. ABBEY. Is that just for BP or Deepwater Horizon?

Mr. BUCHANAN. Deepwater Horizon. They are saying this in the AP report, that they missed 16 monthly inspections, which is concerning to me and I think the American people.

Mr. ABBEY. Well, it should be a concern. And I will respond back to you in writing if that is OK with you.

Mr. BUCHANAN. I would appreciate that.

With that I yield back, Mr. Chairman.

Mr. OBERSTAR. Thank you, and I will recognize Mr. DeFazio.

Mr. DEFAZIO. Mr. Perrelli, I am not certain whether you were here earlier, but we are pursuing a line of questioning that related—one was, how can we secure or could we in some way secure some indemnification or assets from BP? I mean there have been numerous news accounts that BP may try and shed itself of these obligations by going into bankruptcy and forming one company over here with everything else that is performing well, and another company over there where it failed. Do you have any thoughts on that?

Mr. PERRELLI. Congressman, this is an issue—we have obviously seen similar reports. It is an issue of real concern because we want to make sure that the responsible parties truly have the wherewithal to compensate the American people for the damage done. So this is something that we have been focused on. We are reviewing our options and hope to be able to report back to you soon about the action we will take.

Mr. DEFAZIO. Then if we look to the future, if we were to significantly raise or eliminate liability caps, how in the future—what device might we use to segregate assets ahead of time, bonding? Are there things you could think of if we wanted to significantly increase the cap to be sure that there were assets there that couldn't be removed?

Mr. PERRELLI. Certainly I think in addition to looking at the liability caps, I think it is appropriate to reconsider the certificates of financial responsibility which provide on the front end a surety that payments will be available to be made in the event of a disaster such as this. So I think the administration also believes that we should, one, take another look at those and think about whether they need to be adjusted, as well as developing additional regulatory authority to allow them to be adjusted or modified over time as we learn about new or different risks. I think that is certainly a component of this.

Mr. DEFAZIO. If you can have those thoughts quickly because I expect we may act very soon on these issues, we want to do things that make sense and provide more security and assurance to the American public.

I would just observe, I am particularly concerned about that first one. And I will give you an example right in that neighborhood. There was a company, I believe it was called Entergy, that both

generated and distributed electricity in Louisiana. After all their lines blew down in the hurricane, they went to the PUC which happened to be captive to their interests, and said, we would like to split the company. We would like to put our distribution system over here and put our energy generation over there. And PUC said, Oh, it is a great idea. That would be really efficient.

So they ended up with a totally bankrupt, destroyed distribution system which very much delayed the recovery of Louisiana, and, over here, a very profitable and ongoing energy producing company. And I worry that BP could do the same thing.

I hope you have your best and most rigorous people looking at how to prevent them from scamming us that way and ducking out on what is their problem which they need to pay for in its entirety. So, thank you.

Mr. Abbey, I know you are new to MMS. We usually talk trees and forestry issues, but on these I have raised concerns in a couple of hearings about the blowout preventers. And there were reports and evaluations done by MMS's own employees, in cooperation with some engineers from BP and other companies, saying there were significant concerns about the capabilities of these blowout preventers to sever the pipe and seal off the well even if it was in functioning condition—and apparently this one was not, at least not optimally—and that with the well casings used at those depths and those pressures, that these blowup preventers which were designed for much shallower depths and thinner gauge pipe just couldn't do the job certain percentage of the time.

Are we going to take steps to require that all of the existing wells, let alone new ones, have blowup preventers that have proven capabilities to actually work, in addition to looking at their maintenance records?

Mr. ABBEY. Congressman DeFazio, we took steps yesterday to do just that. We issued a notice to lessees requiring them to perform certain checks and tests and to certify by a reliability third-party independent reviewer that such tests—the operations pass those tests and require the CEOs of those companies to verify that they are in compliance with all of our safety requirements as well as the law.

Mr. DEFAZIO. And if they sign that verification, could we attach some special sanctions to anyone who might certify that inappropriately?

Mr. ABBEY. I would look to Mr. Perrelli to respond to that question.

Mr. PERRELLI. I think that the full panoply of possible civil and criminal violations for making a false statement to the government would be available.

Mr. DEFAZIO. Thank you. Thank you, Mr. Chairman.

Mr. OBERSTAR. I have raised that question earlier with the American Petroleum Institute. They set the standards for the blowup preventer. And I asked whether their standards had been tested against the pressure of the oil reservoir at 18,000 feet below the mud floor and pressures of 2,300 psi to 13,000 psi, and the answer was, I don't know. And I asked whether at that depth when thicker pipe casing—as you have just referenced—had been tested in the blowup preventer and whether the shear could cut through that

thickness of pipe and they said, "I don't know. We will get back to you." But they are the ones who should know.

Mr. DEFAZIO. Right.

Mr. OBERSTAR. Mr. Cummings.

Mr. DEFAZIO. Could I ask what is the time line on having that testing done?

Mr. ABBEY. Before any new wells are drilled.

Mr. DEFAZIO. Right. But I am concerned about—there are some—as I understand, the blowup preventers are used in both the exploratory initial drilling and they are used until the well becomes operational.

Mr. ABBEY. Yes.

Mr. DEFAZIO. So are there any deepwater wells out there where the blowup preventers are in place now?

Mr. ABBEY. Of course there is a moratorium on any new deepwater drilling. There are some maintenance actions being allowed. They will be required to comply with the notices to lessees that we issued yesterday for all those actions.

Mr. DEFAZIO. Thank you.

Mr. OBERSTAR. Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr Abbey, just following up on that, who does this certifying? When you say an "independent party," and you know there would have been a time I would never even think of asking this question. But the integrity of these systems are so upsetting, and I see that we just seem to have these gaps where people are not doing what they are supposed to do. I am not knocking you, I am just talking about in general. I am trying to figure out who the certifiers are.

The Chairman talked about the standard, so who are the certifiers and how do we know that we have got the right people doing the certification? Do you follow me?

Mr. ABBEY. I do, Congressman Cummings. We are looking to engineers, professional engineers, as well as consultants. We are also seeking from the documentation that we are requesting from the operators to provide us a full listing of the qualifications of that third party who they were using to verify that such equipment can meet the standards. We will be reviewing the qualifications of those consultants for professional engineers to make sure that they are the best available, at least to the companies, and to have the credibility and integrity that they need to provide us as well as the American public greater assurance that the actions that are going to take place will be done in the safest manner.

Mr. CUMMINGS. Because one of the things that happens in the law is that when somebody goes to a lawyer and asks for advice on certain things and the lawyer gives advice, in some instances they can go back and say, A lawyer gave me the advice and that is why I acted the way I acted. And in some instances it can get some consideration from a judge or—in other words, if they got into some trouble.

I just want to make sure, Mr. Perrelli, that if—I don't want a situation where we go to a "certifier" and then the certifier is not legit and doesn't have the qualifications that we need. And then, say, BP would say, "Well, wait a minute now, you told me to go to a cer-

tifier. I did it and the certifier said I am fine." And the next thing you know we have problems.

Mr. DEFAZIO. Would the gentleman yield for just 1 second. Excuse me. I have worked together with the gentleman a lot on this as relates to the banking and financial services crisis, and this brings to mind the ratings agencies. You pay them for a rating and they would then ratings shop. We are worried about the same thing here, as opposed to perhaps the government designating and they are being——

Mr. CUMMINGS. That is exactly right.

Mr. ABBEY. If I could respond to that concern because it is a valid concern. This certification does not take away the government's responsibility to do our own routine checks and the verification. We intend to continue the inspections that we have been performing to make sure that the equipment that are being used will also pass our own inspections. But in lieu of our own inspectors going out and making a determination in every case, we are asking the operators themselves to also provide us that third-party independent verification.

Mr. CUMMINGS. Now, the Chairman may have asked you about this because I know it is one of his major pet peeves. But let me ask you. How are we and MMS, with regard to people who are qualified to even do the inspections, because what we see here, it seems like we have got the industry that is speeding along, but again as I said a little earlier, they have created a monster that they can't control. And so some folks tell us the only way it really gets this expertise so far is to be in the industry. That is kind of an expensive way, probably, to get it.

So I am trying to figure out what mechanisms are in place to make sure that we have the people in place, and government doesn't pay what some folks pay, private industry pays. I am just trying to figure out what is the plan there. I think after this incident I am sure antennas are going up to be even more careful with regard to inspections and whatever. But I want to make sure and the Chairman wants to make sure that we have got people in place to do the inspections.

We have seen some problems in certain inspections with regard to the Coast Guard and some automatic safety matters. And we have had people come in and testify to say that they had personnel in the Coast Guard that were looking at their equipment and giving inspections and that they weren't totally equipped to do that. That is a sad commentary.

But this is where the rubber does meet the road. I am just trying to figure out, what do you see with regard to that issue?

Mr. ABBEY. Well, the Minerals Management Service administers thousands of leases in offshore. We have 61 inspectors, 11 engineers, devoted to doing those type of inspections. Of that 61 inspectors I believe, if I remember the numbers right, there are about 50 inspectors within the Gulf of Mexico where most of the operations are occurring. As you have read and as I have, some of these inspectors have worked previously in the industry themselves. They gain experience working within the industry. We hire them based upon that experience, based upon their abilities to know what to look for, how to document any deficiencies that they have noted on

these platforms, and to report back so that we can take appropriate actions to address any deficiencies.

Mr. CUMMINGS. Just one last thing. Do you know of an instance where you sent inspectors out who were not fully qualified to do the inspections that we needed done to the degree that they needed to be done?

Mr. ABBEY. Congressman Cummings, again I have very limited experience with the Minerals Management Service. I am not aware of any inspector that is not qualified to do the job that we are asking.

Mr. CUMMINGS. All I am asking, can you give us documents? I mean, if you can go back in your files and provide us with information, because this is something that the Chairman has been really—we sat in a meeting with him yesterday with the Speaker. We are all concerned about this. Because we cannot have cultures of mediocrity; we just can't. Because there is too much at stake. We want to make sure we have a pipeline so that we can have the people, if we don't have them in place, have them in place so that they can do what needs to be done; because we can do all of this stuff, we can have all the standards in the world. If we don't have people who are competent and people with integrity doing this stuff, we might as well be out playing golf or flying a kite.

Mr. ABBEY. We have common goals in that regard.

Mr. CUMMINGS. Thank you.

Mr. OBERSTAR. Mr. Taylor. Excuse me. Mr. Taylor, you are next.

Mr. TAYLOR. Thank you, Mr. Chairman. Can any of you tell me the legal definition of "gross negligence" or "willful misconduct" as it would apply to this instance?

Mr. PERRELLI. Congressman, gross negligence and willful misconduct are not specifically defined in the statute. Gross negligence——

Mr. TAYLOR. OK to that point, Mr. Perrelli. So then it really is up to the judgment of a judge?

Mr. PERRELLI. Ultimately——

Mr. TAYLOR. Some judge could say 40-something days of pushing oil out into the Gulf of Mexico, ruining thousands of people lives, 11 deaths, some judge could make an arbitrary decision that this is not gross negligence or willful misconduct; is that correct?

Mr. PERRELLI. Certainly the interpretation of both those terms would be up to a judge. I will say that both gross negligence and willful misconduct are interpreted under many different Federal statutes. So I think there is an established case law, but they are not specifically defined in this statute.

Mr. TAYLOR. Again, Mr. Chairman, with this point I would certainly hope the legislation be drafted, we try to establish at least a legal threshold of what would constitute this. We don't need—I will leave it at that.

Secondly, Mr. Chairman, I had asked in last week's hearing for a side-by-side comparison of Coast Guard inspections versus foreign-flag inspections that were allowed in the case of the Deepwater Horizon. It has just in the past few minutes been supplied to me by the Coast Guard, and I would ask that that be submitted for the record.

Mr. OBERSTAR. Without objection, so ordered.
[The information follows:]

QUESTION: Please provide a document with a side-by-side detailed comparison of the various inspections that are performed on U.S. vs. Foreign Flagged ships. If there are additional or different inspections performed on oil rigs, please note those inspections as well.

ANSWER: The primary difference between Coast Guard inspections of a U.S. flagged vessel versus a foreign flagged vessel (including Mobile Offshore Drilling Units (MODU)) is that: for U.S flagged vessels, the Coast Guard is responsible for carrying out the inspections, tests and surveys required to issue the statutory certificate; and for foreign vessels, the flag State or Recognized Organization, working on behalf of the flag State is responsible for carrying out the inspections, tests and surveys required to issue the statutory certificates.

As authorized by 46 U.S.C. 3316, the Coast Guard may accept certain flag State statutory certificates issued to vessels by authorized classification societies or Recognized Organizations (RO), like the American Bureau of Shipping. The Coast Guard reserves the responsibility for issuing the Certificate of Inspection (COI). However, a RO may participate in the plan review and inspections necessary for issuance of this certificate. Whenever the Coast Guard allows a RO to perform any flag State duties on its behalf, the Coast Guard involvement consists primarily of liaison with the RO, policy determinations and oversight with respect to work the Coast Guard delegates to class societies pursuant to 46 U.S.C. 3316, and work that the Coast Guard accepts pursuant to its authority under the Outer Continental Shelf (OCS) Lands Act, 43 U.S.C. 1331 *et. seq.*

Statutory certificates are issued by the flag State to document that the vessel meets the requirements of domestic and international standards pertaining to the relevant convention. Statutory certificates, such as the Coast Guard issued COI, allow a U.S. vessel to operate. International statutory certificates like the Mobile Offshore Drilling Unit (MODU) Safety Certificate, demonstrates that the MODU meets the statutory requirements of the IMO MODU Code.

The Coast Guard does not perform flag State level inspections on foreign flagged vessels if the vessel's flag State has an inspection and certification program approximating that of the United States, or if the flag State performs the necessary work to issue all of the applicable IMO Convention certificates to the vessel. The United States is signatory to these IMO Conventions and recognizes the flag State involvement through port State control (PSC); this is written in law (see 46 U.S. Code Sections 3303, 3505 and 3711 and 43 U.S. Code Section 1348). In these instances, the Coast Guard will conduct Port State Control (PSC) examinations on the foreign freight vessel, foreign passenger vessel, foreign tank vessel, and/or foreign MODU to verify compliance with domestic laws, regulations and International Conventions. PSC examinations satisfy these statutory examination requirements. PSC is not intended to be analogous to an inspection for certification of a U.S. vessel. Rather, it provides an examination of sufficient breadth and depth to indicate that a vessel's major systems are in compliance with applicable international standards and domestic requirements, and the crew training and performance, such as lifesaving and firefighting drills, meet the relevant standards.

The scope of Coast Guard PSC exams for all of these vessels exceeds current international guidelines for PSC. Coast Guard PSC exams include inspection and equipment tests and emergency drill requirements far beyond those required by other PSC regimes. The Coast Guard never delegates PSC responsibilities to an RO.

When a PSC exam reveals questionable equipment, systems, or crew competency issues, the Coast Guard expands the exam as necessary to determine whether a deficiency exists. The scope of the expanded exam is not limited, and the inspector may require additional tests, inspections, or crew drills to the extent deemed necessary to determine whether or not a deficiency exists. When deficiencies exist, the Coast Guard documents these deficiencies on a "PSC Report of Inspections and/or Deficiencies" (Form CG-5437 A/B), and mandates correction of the deficiencies. Depending on the severity of the deficiencies, the Coast Guard may detain a vessel or curtail vessel operations as appropriate until the deficiencies are corrected.

In addition to the "PSC Report of Inspections and/or Deficiencies," the Coast Guard issues a Certificate of Compliance (COC) to Gas and Chemical Carriers, Oil Tankers, Passenger Ships, and MODUs after a satisfactory PSC exam. A COC documents that a foreign vessel has been examined by the Coast Guard and it meets the regulatory requirements to operate in U.S. waters, including the U.S. Outer Continental Shelf.

PSC exams are also conducted on Foreign Freight vessels, but the Coast Guard does not issue a COC upon completion of a satisfactory exam as this certificate is not applicable to freight vessels (as mandated by the aforementioned regulations). The "PSC Report of Inspection and/or Deficiencies" is issued to document a PSC exam was completed on a Foreign Freight vessel.

"Side-By-Side Coast Guard Inspection/Exam Matrix"

System	Flag State US Vessel Inspection	Port State Foreign Vessel Exam
		Note: non-convention vessels are held to US standards or equivalent.
Vessel Manning & Crew Competency -Licenses, Documents, Certificates	-CG determines officer/crew complement w/US law/SOLAS/STCW -Verify Safe Manning per Certificate of Inspection -CG issues Merchant Mariner Credentials -Evaluate competency thru review of logs, training, drills, interviews, material conditions	-Verify officer/crew complement & Safe Manning Document meets SOLAS/STCW -Evaluate competency thru review of licenses, logs, training, drills, interviews, material conditions.
Certificates/Manuals/Plans -Certificate of Inspection (US vessels) -SOLAS Safety Equipment Safety Construction SMC/DOC (SMS), ISSC (ISPS/MTSA) Security Plan -Pollution Prevention MARPOL IOPP Certificate SOPEP Oil Record book US regs VRP/NTVRP COFR -Loadline Certificate	-CG is responsible for reviewing and approving Security and Response Plans. -CG witnesses security drills/exercises. -Manuals & plans are checked for accuracy & crew familiarization. -CG issues/endorses statutory certificates based on review/approval of plans, procedures and onsite inspection. -CG may delegate issuance of statutory certificates to Authorized Class Societies (ACS) (Recognized Organizations) -CG conducts oversight of ACS activities conducted on their behalf. -Compliance with each certificate is determined by completing an inspection of the vessel as outlined below. ACS issues Loadline Certificate on CG's behalf.	-Verify all required certificates/manuals & plans are on board, not expired and properly endorsed. -The validity of each certificate is determined by completing an exam of the vessel as outlined below. -Manuals & plans are spot checked for accuracy & crew familiarization. -verify ISPS/MTSA compliance. **CG reviews and approves MTSA security plans for non-SOLAS vessels (< 500 GT)
Navigation Equipment -SOLAS Safety Radio Certificate -Navigation publications, charts -Radars -Depth -Gyro compass -GMDSS -AIS/LRIT -List is not all inclusive	-Inspect/test Navigation Safety Equipment (installation/electrical, etc). -verify compliance w/ SOLAS and/or CG applicable standards. -verify up to date publications/charts. -review logs for required tests/entries. -test operation all equipment. -ensure properly installed.	-Verify installed Nav Safety equipment aligns w/applicable Certificates. -verify up to date pubs/charts. -review logs for required tests/entries. -test operation of selected equipment. -examine overall condition. -Radio watch personnel speak English.
Structure, Stability & Loading -Safety Construction Certificate -International Loadline Certificate -Stability & Loading Booklet	-Inspect doors, cargo hatches, vents, railings, coamings, ladders, hull markings. CG approves Trim & Stability booklet (loading manual). -verify vessel operates in accordance with booklet. -review cargo record book. -Conduct comprehensive Hull Inspections: Drydock, Internal Structural, and Cargo Tank Internals for structural/watertight integrity/adequacy.	Verify drydock exam completed and recorded by RO Spot check condition of doors, cargo hatches, vents, railings, coamings, ladders, hull markings. Spot check Trim & Stability booklet (loading manual) & verify approved by admin or RO. -verify vessel operating per booklet. -review cargo record book. -General exam of accessible spaces checking structural/watertight integrity/adequacy.
Fire Safety -Fire Control Plan -Structural Fire Protection -Fire detection	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans per SOLAS and/or CG standards.	Systems/equipment approved by Flag State or RO. -review logs for required tests/entries. - test operation of selected systems/

-Fire pumps/piping/equipment -Fixed Fire Fighting Foam CO2/Flooding Inert Gas System (IGS) -Other associated equipment (SCBAs, PPE, monitors, hoses, nozzles etc)	-review logs for required tests/entries. - test operation of all systems/equipment for compliance w/applicable standards (alarms/shutdowns). -witness third party maintenance/inspections. -inspect material condition of fire safety systems/equipment. -witness fire drills.	equipment (fire detection, fire pumps, IGS) for compliance w/applicable standards in SOLAS (alarms/shutdowns). -review certificates of third party maintenance/inspections. -examine overall condition of fire safety systems/equipment. -witness fire drills. **Structural Fire Protection is CG reviewed and completely inspected during a cruise ship's initial COC exam.
Lifesaving Appliances/Equipment -Life boats -Life rafts -Life jackets/immersion suits -Other associated equipment	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans. -review logs for required tests/entries. - test operation of all systems/equipment for compliance w/applicable SOLAS and/or CG standards. -inspect material condition/expiration dates -witness third party maintenance/inspections (lifeboats/rafts). -witness abandon ship drills.	Systems/equipment approved by Flag State or RO. -review logs for required tests/entries. - test operation of selected equipment (lifeboats) for compliance w/applicable standards in SOLAS. -examine overall material condition/ expiration dates. -witness abandon ship drills.
Electrical Systems -Generators/emergency generators -Motors/controllers -Batter installations -Emergency lighting -Wiring -Alarms	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans. -review logs for required tests/entries. - test operation of all systems/equipment for compliance w/applicable SOLAS and/or CG standards. -test emergency fuel shut-offs. -inspect material conditions of electrical systems.	Systems/equipment approved by Flag State or RO. -review logs for required tests/entries. - test operation of emergency generator for compliance w/applicable standards in SOLAS. -examine emergency fuel shut-offs. -examine overall material conditions electrical systems.
Machinery Systems -Steering -Propulsion -Dewatering/Bilge -Automation/alarms	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans. -review logs for required tests/entries. - test operation of all systems/equipment for compliance w/applicable SOLAS and/or CG standards. -witness engine room automation tests. -inspect material condition of machinery systems.	Systems/equipment approved by Flag State or RO. -review logs for required tests/entries. - test operation of steering system for compliance w/applicable standards in SOLAS. -examine overall material condition of machinery systems.
Auxiliary Systems -Boilers -Air systems -Potable water -HVAC Pollution Prevention -Sewage -Oil/Hazardous materials (OWS), ODME) -Garbage	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans. -review logs for required tests/entries. -test operation all systems/equipment for compliance w/applicable SOLAS, MARPOL and/or CG standards. -inspect material condition of auxiliary systems.	Systems/equipment approved by Flag State or RO. - review logs for required entries. - test operation of OWS for compliance w/applicable standards in MARPOL & CG policy. -examine overall material condition of auxiliary systems.

Cargo Systems/Stowage -Stowage Plan Dangerous cargo manifest (DCM) Cargo compatibility -Cargo Securing Manual -Pumps -Piping -Alarms -Fixed/portable atmospheric monitoring	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans. -review logs for required tests/entries. -verify DCM & cargo compatibility compliance. - test operation for compliance w/applicable SOLAS and/or CG standards. -inspect material condition of cargo systems/equipment.	Systems/equipment approved by Flag State or RO. -review logs for required tests/entries. -verify DCM & cargo compatibility compliance. - test operation of cargo pump emergency shutdowns for compliance w/applicable standards in US regulations, SOLAS. -examine overall material condition of cargo systems/equipment.
Miscellaneous Equipment -Anchor -Windlass -Mooring winches/capstans -Mooring lines	Systems/equipment reviewed & approved by CG or ACS on CG's behalf. - inspect for proper installation w/approved plans. -test operation of anchor handling equipment. -inspect mooring arrangement.	Systems/equipment approved by Flag State or RO. -examine overall material condition of anchor handling and mooring equipment.

Acronym List for
"Side-By-Side Coast Guard Inspection/Exam Matrix"
For ease in use acronyms listed in Alphabetical Order

ACS-	Authorized Classification Society
AIS-	Automatic Identification System (for ships)
CG-	Coast Guard
COFR-	Certificate of Financial Responsibility
DOC-	Document of Compliance (associated w/Safety Management System)
GMDSS-	Global Maritime Distress Safety System
HVAC-	Heating, Ventilation and Air Conditioning System
IOPP-	International Oil Pollution Prevention Certificate
ISPS-	International Ship and Port Facility Security Code
ISSC-	International Ship Security Certificate
LRIT-	Long Range Identification and Tracking System (for ships)
MARPOL-	International Convention for the Prevention of Pollution from Ships
MTSA-	Maritime Transportation Security Act
ODME-	Oil Discharge Monitoring and Control System
OWS-	Oily Water Separator System
PPE-	Personal Protective Equipment
RO-	Recognized Organization
SCBA-	Self-contained Breathing Apparatus
SMC-	Safety Management Certificate (associated w/Safety Management System)
SMS-	Safety Management System
SOLAS-	International Convention for the Safety of Life at Sea
SOPEP-	Shipboard Oil Pollution Emergency Plan
STCW-	Standards of Training, Certification and Watchkeeping Convention
VRP/ NTVRP-	Vessel Response Plan and/or Nontank-Vessel Response Plan

Mr. TAYLOR. Mr. Perrelli, again I have only had about 2 minutes to look at this, so please forgive me if I read it to you.

We will start with structure, stability and loading. If that vessel had been U.S.-flagged, the United States Coast Guard would have had to conduct a comprehensive holding section, a drydock inspection, an internal structural and cargo tank inspection, a structural watertight integrity and inadequacy.

Contrast that with a foreign-flag vessel where they do a spot check for the condition of doors, cargo hatches, vents, railings, ladders, a spot check of stability and—but it gets better. When it came to fire safety, had it been a U.S.-flagged vessel the Coast Guard would have done a systems equipment reviewed and approved plan just to build it. They would have inspected for proper installation, they would have tested operation of all systems and equipment for compliance, and they would witness third-party maintenance inspections, and inspect the material condition of fire safety equipment.

I would contrast that with what did occur, where the Coast Guard in this instance, because it is a foreign-flag vessel, review certificates of third-party maintenance inspections. So basically if the folks in the Marshall Islands, for a fee or for whatever reason, chose to just issue a certificate saying that these guys are living by the rules, that was good enough.

Now, Mr. Perrelli, a lot of things will come out of these hearings. I would hope one of the things the U.S. Justice Department would be insisting for those vessels operating in United States territorial waters, they have to live by our rules. They can't get a pass from some Third World country that says this is good enough. And we as a Nation shouldn't be expecting the word of some Third World country that this is good enough.

Obviously there are 11 dead mariners and thousands of people whose lives have been affected by this. And Mr. Chairman, again, U.S. Territorial waters, we should not relying on somebody else's self-checkoff list if they are living by the rules.

Going back to the question of who defines "gross negligence," has there been any effort on the part of any of your agencies to come up with what you think is a fair definition of that in this instance?

Mr. PERRELLI. Congressman, we have not focused on writing a definition, but we would certainly be happy to work with the Committee if you were looking at drafting a new definition for that.

Mr. OBERSTAR. If the gentleman would yield. We will ask—following your earlier question, I discussed with counsel a request to Justice Department for drafting assistance in formulating the principles that you enunciated.

Mr. TAYLOR. Mr. Abbey, under the Federal response plan, we are both from Mississippi, just this week I inspected the contractors that BP hired as far as their land cleanup. I visited one of their vessel-of-opportunity operations. And, again, they are trying. What I don't see is a comprehensive plan to try to keep the oil from getting Mississippi's barrier islands and Mississippi's beaches.

Is your agency, is the Coast Guard, is anybody within our Nation the lead agency to look over what should be a comprehensive plan? And in the absence of a comprehensive plan, is anyone stepping forward to say this is what it ought to look like?

Mr. ABBEY. Congressman Taylor, are you talking about after the spill or before the spill?

Mr. TAYLOR. Yes, sir. I am talking about right now, what I don't see—and, again, I am asking this in the form of a question——

Mr. ABBEY. Yes.

Mr. TAYLOR. Are you, is the Coast Guard, is any—is the Department of Homeland Security, does anyone have the legal authority to turn to BP and say, "This is what your response plan ought to look like. We gave you 40-something days to come up with one and we are not satisfied with what you got."

Mr. BENNETT. Congressman, I can answer that, in that the national incident commander, Admiral Allen, and the FOSC are senior, running the response, so they do have the authority to direct BP and any response efforts—and that can be pretty broad—that they deem are required to respond to this incident.

Mr. TAYLOR. Sir, that is my whole point. Is anyone giving them a specific list of things to do based on the mistakes that were made in Louisiana and apparently the mistakes that are being made where water washed up on the Florida panhandle? Is anyone giving them a list saying, You need more skimmers out there, you need a greater presence, don't wait for it to hit the beach? I am asking this in the form of a question because I don't know the answer. I am not so certain this is an answer coming from our Nation.

Mr. ABBEY. Let me address that. I spent 3 weeks down in Robert, Louisiana at the Joint Command Center. There are reports and requests received each day by that joint command indicating what supplies are needed in order to accomplish the goals that are being laid out to protect the resources along the Gulf Coast. Based upon those requests there are decisions that are being made by the incident commanders to move forward and to provide the supplies and the actions that are necessary in order to meet those goals.

So, as already alluded to by Mr. Bennett, there is an incident commander that is in charge, who has full authority to move forward with any actions deemed necessary in order to address your concerns.

Mr. TAYLOR. Lastly, I know I am over my time Mr. Chairman, but for the record, are any of your agencies stepping forward to propose a new generation—since we all got caught flat-footed on this one—are any of your agencies stepping forward to propose a new generation of blowout preventers, skimmers, containment booms, collection booms? Because it is just a sad fact that this technology has not really progressed one iota in the past 20 years. And we sat back and hoped that the private sector would do it. They didn't.

Are any of your agencies making recommendations of what those things ought to look like now?

Mr. BENNETT. Congressman, I can speak for the Coast Guard, and probably everybody, that this event is of such magnitude, the answer is yes, everything is on the table, and everything is being looked at, and no stone will be left unturned as to where we go to make it right for the future and that all risks are taken account.

Mr. TAYLOR. Thank you, sir.

Mr. OBERSTAR. And further to the gentleman's question, and I have discussed this with him and with Mr. Cummings, we are going to—in the crafting of legislation we are going to set standards for the Coast Guard and regime under which the Coast Guard and Minerals Management Service both can acquire the skills, the know-how, the understanding and technology of this industry to be able to do the certification and do the oversight that is necessary and to do it with knowledge of the industry. We have got to get closer to the airline sector than we are today in maritime safety.

This regime that exists where the Coast Guard is limited to inspecting foreign-flagged vessels to the standards of the International Maritime Organization, which allow only a 6- to 8-hour review compared to 2- to 3-week review of a U.S.-flagged vessel operating in our territorial waters—these are two widely different standards and unacceptable. But more important is the reality that the Coast Guard doesn't have the personnel, the skills, the training, the equipment to do the certification that is necessary. Anyway, we are going to follow-up on those points.

Mr. Garamendi.

Mr. GARAMENDI. Mr. Chairman, thank you for putting this hearing together. It is an extraordinary hearing and it is setting the stage for some very, very important legislation.

Earlier we talked about the financial liability issue. I just came from an interview and I was asked a question—I guess this goes to the Attorney General—I was just asked a question that BP has accepted responsibility; what if they turn around and say, Well, but there are limits to the liability? What action and what opportunities are available to us to hold them to their earlier and present acceptance of full responsibility and full payment?

Mr. PERRELLI. Mr. Congressman, we will unquestionably pursue them to require them to fulfill their promise. I would note that there are many legal avenues that we can pursue to ensure that they pay the full measure of damages here, whether it's BP and Transocean or other potential responsible parties.

We talk often about a liability cap. As I mentioned in my opening statement, it is conditional. It does not exist if there is gross negligence or violation of any safety, operational, or construction regulation that could be deemed to have proximately caused the explosion.

I would note that my colleagues at the Minerals Management Service have many, many regulations. And so we anticipate that whether or not BP intends to fulfill its commitments, we will pursue BP, Transocean, whoever are the responsible parties, to the fullest extent we can.

Mr. GARAMENDI. Exactly so. But, however, that pushes the responsibility to the government to prove negligence or the other factors that you just described. Nevertheless, I am pleased to hear your response.

The second point I want to raise is that let us assume BP really is going to wind up in financial trouble as a result of this. There are rumors circulating that BP is interested in providing some $10 billion of dividend going out to their shareholders. If that is, in fact, what they intend to do, do you have the ability to issue an injunc-

tion to tell them to hang on to that money, that it might actually be needed for cleanup?

Mr. PERRELLI. We are concerned. We have seen reports with respect to BP. We have also seen reports about Transocean and a planned dividend. And we are concernedthat—well, we want to ensure that these companies have funds available to compensate the taxpayers, the individuals harmed throughout the gulf, the families of the individuals who were killed or injured. So we are looking very closely at this, and we are planning to take action. As I indicated previously, we will report back to you once we have decided on what steps to take.

Mr. GARAMENDI. I will tell you what an insurance commissioner in California did when faced with the situation where an insurance company that was in trouble decided that they would take the assets and run. I went to court the next moment, got what amounted to an injunction, hung on to the money so that it was available to the policyholders. I would highly suggest that the Justice Department take whatever action is necessary to make sure that none of these companies in this particular moment during this period of time is allowed to issue any dividends, to move any of their assets away from the company to the shareholders or to anyone else. If you don't do that, I am going to be all over you in a way that you will not like.

Mr. PERRELLI. We share your concern.

Mr. GARAMENDI. Because I have been there, and I have done it, and I know it can be done.

Mr. OBERSTAR. Thank you, Mr. Garamendi, and for adding your expertise in this insurance area, which is very, very valuable for us.

Mr. Cummings, you had a few more questions.

Mr. CUMMINGS. Mr. Chairman, just two questions.

I want to go to you, Mr. Abbey. I was just reading this report by the Department of Interior, and it is talking about the problems that they had at MMS. And I am trying to figure out what are we doing to turn around that culture where people are—a confidential source said MMS is expected to allow oil and gas production company personnel located on the platform to fill out inspection forms. So, in other words, the company was self-certifying and basically committing fraud, Mr. Perrelli. Fraud. That is what I consider this.

When I think about the accepting of gifts and things of that nature, I am trying to figure out, first of all, have there been people who have been fired? What have we done to begin to straighten this mess out now, because MMS is still conducting business. And I want to make sure that people who are basically—who we think are guarding us and taking care of us are not stabbing us in the back. And that is exactly what this is.

So the question is—I know you have only been there a short time, but what is being done to turn that culture around? Because I am assuming some of those people are still there, and that is a major problem. Major.

Let me tell you another reason why it is a major problem. One of the things about leadership is people, if they trust you, they will submit and say, OK, I know you have got everything under control, and it will work out. This report basically says we can't trust the

very people that we are supposed to trust and that we pay to guard us.

So what is being done to turn that culture around? I am not blaming you because you are new, but I want to know what is going on.

Mr. ABBEY. That is fine. I appreciate you asking the question.

First and foremost, it is my understanding, Congressman Cummings, that the allegation that industry employees were filling out those forms in pencil and sending them in to the inspectors, and all the inspectors were doing was writing—or using their pens to write over the pencil——

Mr. CUMMINGS. Traced over them.

Mr. ABBEY. It is my understanding based upon the documents that I have read is that that is unfounded. That did not occur. I have seen those same reports that you just alluded to, but it is my understanding, based upon follow-up reviews, that did not take the case.

As far as other deficiencies or other allegations of misconduct, Secretary Salazar has been very adamant from his very first day as Secretary of the Interior to implement a very high standard of conduct based upon our own ethical values that we have within the Department of Interior to make sure that all of our employees understand what the expectations are and that they are going to be held accountable.

Let me also say that even though I have a short period of time with the Minerals Management Service as the Acting Director, I have had the pleasure of working with MMS employees for many years in many different roles. I have found everyone I have ever associated with or worked with to be professional and ethical. And even though there are some findings based on the reviews that have been conducted, and I am sure there may be some other deficiencies noted in the ongoing investigations, it is our intent to look at every deficiency that may come about from these reviews, and we are going to deal with those deficiencies in the appropriate manner.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. I just want to make sure that when these kinds of reports come out, I am hoping—and I know you are there, and those are the people you work with, but if we have reports like that, I can't believe they just fell out of the sky. So we need to—and I would hate for us to have this kind of information and then just sort of dust it up under the rug and say, oh, that doesn't exist; everybody is the greatest employee that ever lived. I am sure 99.9 percent of them are. But at the same time, I think we need to be very careful with that.

Mr. ABBEY. No one is more irritated about the conduct of some of those employees than the employees of the Minerals Management Service because it does bring this scrutiny, this allegations of inabilities, incompetence to the table, and no one is very happy with that.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr. OBERSTAR. Thank you for raising that issue.

Mr. Abbey, it is in your interest and that of the administration to be squeaky clean. So you have made a statement absolving those implicated of having engaged in illegal activity, falsifying records.

We need independent verification of that. You have an inspector general in the Department, and that IG office should take this issue under review and submit a written report with his findings and be specific about it. We do that with the U.S. Department of Transportation. I know Interior is not directly under the jurisdiction of this committee, but I think that is in your interest and the administration's best interest.

Mr. Taylor.

Mr. TAYLOR. Thank you, Mr. Chairman.

Mr. Perrelli, I happen to represent the district where Katrina hit. A lot of homes were destroyed outright. A lot of homes were damaged by wind. A lot of homes were damaged by water. Those homes that were damaged by water, I have repeated questions from homeowners saying, what if that water that did all that damage last time; what if this time it has got crude mixed in with it?

Now, it is my understanding that the refinery in Chalmette, Louisiana, when the dam burst there flooded approximately 1,800 homes, and it took them several years of litigation for the refineries to pay those 1,800 homeowners what they were due. Now that there has been a legal precedent set in that case and other cases, I am making a request of you. I think you can give a great many Gulf Coast residents or coastal residents around this country—if your Department would step forward and say the precedent has been set, even if it is an act of God, that that company is responsible.

I would like you to respond to that.

Mr. PERRELLI. I can't speak to the prior incident, but if we are talking about the Deepwater Horizon incident, I think it is pretty clear that there is damage to property arising out of oily water that has come from the Deepwater Horizon. I don't think there is any question that falls within the category of damages that should be compensated. Those individuals should be able to bring a claim to BP, and if BP doesn't satisfy it, they would then be able to bring it to Mr. Bennett at the fund.

Mr. TAYLOR. I have heard you say it verbally. You have just said it on television. For the sake of the coastal America, I would like to see that in writing. The reason being, people shouldn't have to go to court. You shouldn't have to hire a lawyer. You shouldn't have to wait years to get paid. And I think if BP knew what the ground rules were from the Justice Department, they would be more likely to settle those claims a lot quicker.

Mr. PERRELLI. I think the whole idea behind OPA was so that people wouldn't have to go to court and wouldn't have to spend years waiting when their property was damaged as a result of an oil spill.

Mr. TAYLOR. Thank you, Mr. Chairman.

Mr. OBERSTAR. You have heard it very clearly. This is from the front line of those in harm's way from this tragedy.

I have a question for the panel, perhaps more for Mr. Bennett. We talked just in this exchange about next-generation technology and certification and bringing Coast Guard personnel skills to a new level and to a new reality, that is of dealing with deepwater drilling. How should the development of those skills be funded?

Could it come out of the trust fund without having to go to a direct appropriation?

I draw a comparison with the Aviation Trust Fund.Airline passengers pay on their airline ticket tax into the Aviation Trust Fund, which finances construction of runways and taxiways, which pays for the facilities and equipment that is the air traffic control technology that guides aircraft safely. It pays for 80 percent of the operations of our air traffic control system, meaning the controllers. Is it fair to draw a parallel between these two?

Mr. BENNETT. Mr. Chairman, I think it would be fair. In fact, as you probably know, in addition to paying for response costs and claims, the trust fund is already available to fund implementation and capacity of implementing OPA 90 to several Federal agencies. So I don't think it would be unreasonable to look at the trust fund as a potential source of funding to—if needed, to do more support to any agencies that need extra resources.

Mr. OBERSTAR. Thank you for that.

The categorical exclusions that are listed in the Code of Federal Regulations were first adopted in 1986, and then reaffirmed in 2004 by the previous administration. There is a list of a dozen such categorical activities that qualify for categorical exclusion. I am really surprised when I read number 10, approval of an offshore lease or unit exploration development production plan in the central or western Gulf of Mexico in areas of high seismic risk or seismicity, relatively untested deep water.

That qualifies for a categorical exclusion, Mr. Abbey?

Mr. ABBEY. Well, I am not familiar with the article or——

Mr. OBERSTAR. Don't they have to go through the NEPA process to drill.

Mr. ABBEY. Mr. Chairman, there is NEPA that you have to adhere to. And many of the actions that are being approved through categorical exclusion are being addressed in some manner with previous NEPA documentation or environmental analysis. Whether or not the Minerals Management Service has utilized categorical exclusions appropriately is one of those areas that we have under review right now in cooperation with the Council for Environmental Quality. We are looking at how this bureau or this agency has been using categorical exclusions to authorize some of those specific actions, and based upon that joint review, we will make a determination what we might need to do differently.

Mr. OBERSTAR. Well, my review of these 15 categorical exclusions looks to me—I have done a fair amount of this kind of work over the years—was written by the industry, for the industry, for its own benefit. You need to take a broom and sweep through this whole listing and clean it up. Clean house with this. This is shocking. We would never see anything like this in aviation. We have never seen anything like this in the Motor Carrier Safety Administration. This is appalling, and it needs a house cleaning.

Mr. ABBEY. I cannot disagree with you as far as the use of categorical exclusions and the appropriateness of categorical exclusions.

Mr. OBERSTAR. We look forward to the receipt of the information requested in the course of this afternoon's hearing within 10 days, because we expect to draft legislative language in cooperation with

the Minority on the Committee and to be part of a package of legislation to be introduced at the Speaker's request before the July 4 recess. So that gives us about 3 weeks to get all this work completed. We look forward to hearing from you.

Thank you very much for your testimony and for your dedication to public service. The Committee is adjourned.

[Whereupon, at 4:47 p.m., the committee was adjourned.]

MEMORANDUM May 12, 2010

Subject Constitutional Issues Raised by Pending Bills to Increase Retroactively a Liability Limit in the Oil Pollution Act

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This memorandum was prepared to enable distribution to more than one congressional office.

This memorandum looks at the constitutional issues implicated by two recently introduced bills -- S. 3305, titled the "Big Oil Bailout Prevention Liability Act of 2010," and H.R. 5214, titled the "Big Oil Bailout Prevention Act of 2010." The constitutional issues are raised by the retroactive increase each of these bills would effect in the oil spill liability limit now in section 1004(a)(3) of the Oil Pollution Act (OPA).[1] That limit applies to each responsible party, per oil spill incident, at an offshore facility and covers damages (not including "removal costs") resulting from the incident. Section 1004(a)(3) currently sets this limit at $75 million,[2] though the limit is lifted (liability is unlimited) if any of several exceptions apply.[3] The bills, in identical language, would simply strike the $75 million figure and replace it with $10 billion, thus preserving the exceptions.

S. 3305 and H.R. 5214, introduced May 4 and May 5, 2010 respectively, state that they take effect on April 15, 2010. Thus, they are plainly retroactive; even if, under the bills, a responsible party's payments over the current $75 million cap all go toward damages incurred after the bill is enacted, those damages stem from a pre-enactment incident and thus satisfy a common definition of retroactivity. The intent of making the increased liability limit retroactive to April 15, 2010 is presumably to displace the existing $75 million liability limit on damages that would otherwise apply to any responsible party in connection with the Deepwater Horizon blowout in the Gulf of Mexico on April 20, 2010. Even in the absence of this pre-enactment effective date, however, the bills could be said to be retroactive if they apply to oil and gas leases entered into pre-enactment, notwithstanding that an oil spill at one of those lease locations occurs after enactment.

This memorandum surveys the **constitutional issues** raised by this proposed retroactive increase in the $75 million liability cap, where no exceptions operate to eliminate the cap, and does not speak to the breach of contract arguments related to British Petroleum's offshore lease. The retroactive nature of the

[1] 33 U.S.C. §§ 2704(a)(3).

[2] OPA § 1004(a)(3); 33 U.S.C. § 2704(a)(3).

[3] For relevant exceptions, see OPA § 1004(c)(1)-(2), 33 U.S.C. § 2704(c)(1)-(2). OPA also states three narrow defenses to liability, OPA § 1003(a), 33 U.S.C. § 2703(a), which could eliminate all of a responsible party's liability under the Act.

cap increase invites examination of five constitutional provisions. The memorandum concludes that claims based on three of these – the Takings Clause, Substantive Due Process, and Bill of Attainder Clause – appear to have at best a modest chance of success, while claims under two others – the Impairment of Contracts Clause and Ex Post Facto Clause -- seem to have almost no chance of success. It must be immediately stressed, however, that how the legislative history of an enacted law characterizes the predecessor bill – especially whether a broad and legitimate public purpose for the bill is convincingly set forth – may affect the analysis, especially with regard to the Bill of Attainder Clause (see discussion below). That legislative history, of course, does not yet exist. The reader is further cautioned that prediction of how courts will rule when applying the broadly worded tests of constitutional law is always attended by some uncertainty, particularly where, as here, the analysis must proceed without full knowledge of the relevant facts.

Introduction

The Constitution disfavors retroactivity. At least five constitutional provisions, noted above, embody the notion that "individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not lightly be disrupted."[4] A legislature's responsiveness to political pressures, the Supreme Court has said, "poses the risk that it may be tempted to use retroactive legislation as a means of retribution against unpopular groups or individuals."[5]

Nonetheless, each of these five constitutional provisions has its special concerns and is of "limited scope,"[6] recognizing that within reasonable bounds, the retroactive application of statutes can be an acceptable and unavoidable means of achieving a legitimate public purpose. As the Court has said –

> Retroactivity provisions often serve entirely benign and legitimate purposes, whether *to respond to emergencies*, to correct mistakes, to prevent circumvention of a new statute in the interval immediately preceding its passage, or simply *to give comprehensive effect to a new law Congress considers salutary*.[7]

Accordingly, several Supreme Court decisions in the past half-century to address retroactive federal statutes have found them constitutionally inoffensive.

Before turning to the five retroactivity-concerned constitutional provisions, the meaning of OPA section 1018(c) must be addressed.[8] That subsection, enacted in 1990 as part of the original OPA, declares that "[n]othing in this Act ...shall in any way affect, or be construed to affect, the authority of the United States ... to impose additional liability or additional requirements ... relating to the discharge ... of oil." By its literal terms, this provision seems to say that parties entering into Outer Continental Shelf leases since 1990 (such as British Petroleum in connection with the lease here) are on notice that the United States may change the liability caps in OPA, even retroactively. Read in this manner, several of the constitutional issues discussed in this memorandum (and the breach of contract issue) disappear. A responsible party likely would not be heard by a court to complain of a liability cap increase the

[4] Landgraf v. USI Film Products, 511 U.S. 244, 265 (1994). *See also* General Motors Corp. v. Romein, 503 U.S. 181, 191 (1992) ("Retroactive legislation ... can deprive citizens of legitimate expectations and upset settled transactions.")

[5] *Landgraf*, 511 U.S. at 266.

[6] *Id.* at 267.

[7] *Id.* at 267-268 (emphases added).

[8] 33 U.S.C. § 2718(c).

possibility of which was expressly authorized at the time that party's involvement at the affected offshore site began.

It is entirely possible, however, that OPA section 1018(c) has a narrower meaning that does not apply to the retroactive amendment of OPA proposed by S. 3305 and H.R. 5214. CRS declines to speculate here what those narrower meanings might be. The following analysis is written as if section 1018(c) would not apply if one of the bills were enacted.

Takings Clause

The Takings Clause safeguards "private property" against government interference by promising "just compensation" in the event that the interference amounts to a "taking."[9] The success of a taking claim depends critically, therefore, on whether the interest alleged by plaintiff to be taken is one recognized as "property" by the Takings Clause. Moreover, how the analysis proceeds may depend on the type of property involved. Based on a limited understanding of the Deepwater Horizon situation, CRS supposes that at least three interests may be implicated: (1) a claimed right to having the relevant law (the current liability cap) remain unchanged; (2) the money disbursed by a responsible party over and above the current liability cap, up to the new cap in the bills; and (3) an alleged contract right under British Petroleum's lease of the affected area to bar application to the lease of laws enacted after it was entered into.

The interest in the law remaining unchanged. In the substantive due process context, the interest in the law remaining unchanged has long been held not to constitute a vested property interest: "No person has a vested interest in any rule of law, entitling him to insist that it shall remain unchanged for his benefit."[10] More recently, takings decisions have adopted the same proposition.[11] Thus, the bare fact that the bills would change the law existing when an offshore lease was entered into is not, of itself, a basis for a taking claim.

Responsible-party disbursements in excess of the current liability cap. Money is held to be property under the Takings Clause,[12] so this preliminary hurdle is surmounted here. Thus, an OPA responsible party would be able to argue, under the canonical *Penn Central* test for regulatory takings,[13] that the bills effect a taking of its disbursements to cover damages beyond the existing liability cap. Under the *Penn Central* test, used by the Supreme Court for takings challenges to retroactive monetary liability,[14] the court must examine (1) the economic impact of the government action, (2) the degree to which it interferes with reasonable, distinct investment-backed expectations, and (3) the "character" of the government action.[15]

[9] U.S. Const. amend. V.

[10] New York Central RR Co. v. White, 243 U.S. 188 (1917).

[11] *See, e.g.*, Branch v. United States, 69 F.3d 1577-1578 (Fed. Cir. 1995) ("no one is considered to have a property interest in a rule of law"); Johnson v. American Leather Specialties Corp., 578 F. Supp. 2d 1154, 1173-1174 (N.D. Iowa 2008).

[12] Philips v. Washington Legal Found., 524 U.S. 156 (1998).

[13] Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

[14] *See, e.g.*, Eastern Enterprises v. Apfel, 524 U.S. 498 (1998) (plurality opinion); Concrete Pipe & Products, Inc. v. Construction Laborers Pension Trust, 508 U.S. 602 (1993). *Concrete Pipe* rejected plaintiff's contention that the appropriate analytical framework in the case of retroactively added monetary liability should be either the Court's per se test for government interferences that totally eliminate the value of property or the Court's per se test for permanent physical occupations of property. *Id.* at 643-644.

[15] *Penn Central*, 438 U.S. at 124.

Each of the *Penn Central* factors may pose a daunting obstacle for a taking claim based on the retroactively increased monetary liability in the bills. As for the economic impact factor, the *Penn Central* test requires that the impact be very substantial, if not severe, before this factor weighs in favor of a taking. In one case, the Supreme Court held that a retroactively imposed monetary liability amounting to 46% of shareholder equity, combined with the "proportionality" of that impact with plaintiff's conduct, was insufficient to count the economic impact factor as favoring a taking.[16] Thus, based on reports as to the net worth or market capitalization of British Petroleum, the potential additional liability under the bills -- between $75 million and $10 billion -- may fall short of the *Penn Central* threshold, though it might not fall short as to other, smaller responsible parties (in this or future oil spills from offshore facilities).

The second *Penn Central* factor is the degree of government interference with the reasonable and distinct investment-backed expectations of the property owner. This factor often involves courts in a review of the legal landscape at the time the property interest alleged to be taken was acquired, with a view toward gauging the reasonableness of the property owner's expectations of economically exploiting that property interest. Oil and gas operations on the Outer Continental Shelf have been heavily regulated since the 1950s, under the Outer Continental Shelf Lands Act.[17] Moreover, by 2008 when British Petroleum entered into the lease at issue here, federal oil spill liability limits had been increased, some twice and some by multiples approaching the 133-fold increase the bills would effect.[18] As the Supreme Court has said in addressing a takings claim to retroactive monetary liability, "Those who do business in [a] regulated field cannot object if the regulatory scheme is buttressed by subsequent amendments to achieve the legislative end."[19] The Court noted further in the case:

> Because legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations ... even though the effect of the legislation is to impose a new duty or liability based on past acts, [petitioner's] reliance on [the statute in question's] original limitation of contingent liability to 30% of net worth is misplaced, *there being no reasonable basis to expect that the legislative ceiling would never be lifted.*[20]

Thus, a company entering into an Outer Continental Shelf lease in recent decades faces an uphill climb in arguing that the bills' increase in the liability cap interferes with its reasonable expectations.

As much a barrier as each of the first two *Penn Central* factors may be to a takings challenge to the bills, it is the third factor, the character of the government action, that most likely will prove fatal – independently of the size or other circumstances of the responsible party. Initially, there is the oft-repeated phrase that government programs adjusting the benefits and burdens of economic life (as with the bills) are less likely to be takings than government-caused physical invasions of property. More cogently, there is the "generalized monetary liability" principle. The principle stems from the fact that the character of the government action factor demands that the government conduct target *specific* property, according to

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[16] *Concrete Pipe*, 508 U.S. at 645.

[17] 43 U.S.C. §§ 1331-1356a.

[18] *See* Rachel M. Hopp and Benjamin H. White, *Oil Spill Liability and Compensation*, Proceedings of the Marine Safety and Security Council 41 (Spring, 2010) (table at page 46 titled "Oil Pollution Limits of Liability Over Time"), available at www.uscg.mil/proceedings. The reference in the text to the bills' "133-fold increase" in the current liability cap for offshore facilities was derived by dividing the existing cap, $75 million, into the bills' cap, $10 billion. According to the table in the Hopp and White article, the minimum liability for tank vessels under the Federal Water Pollution Control Act of 1972 was $250,000, but by the time British Petroleum entered into its lease had risen to $22 million for single-hull tank vessels of 3,000 gross tons or greater – an 88-fold increase.

[19] Id.

[20] *Id* (emphasis added; footnotes and quotation marks deleted).

the concurring justice and four dissenters in a 1998 Supreme Court decision (that is, a majority of the Court).[21] Thus, a taking claim may arise when government appropriates money from a specifically identified fund of money.[22] But a statute imposing a generalized monetary liability – e.g., that A pay B out of unspecified funds – is not a taking. Lower courts – most importantly the Federal Circuit, to which any takings claims based on the bills likely would be appealed -- have endorsed this principle.[23] In light of the principle, it is very unlikely that the bills' increase in the OPA liability cap for offshore facilities – an increase in generalized monetary liability – would be regarded as a taking.

Eastern Enterprises v. Apfel should be distinguished.[24] There, a four-justice plurality opinion of the Supreme Court did indeed hold a federal statute's retroactivity to effect a taking, explaining that the statute imposed severe retroactive liability (attaching new liabilities to events that occurred decades earlier) on a limited class of parties that could not have anticipated the liability, and that the extent of liability was substantially disproportionate to the company's experience in the affected field. These elements found by the plurality to be constitutionally offensive, at least in the aggregate, seem a far cry from the modest retroactivity of S. 3305 and H.R. 5214. As applied to the Deepwater Horizon spill, those bills reach back only a short time (to April 20, 2010). Moreover, an increase in liability could have been anticipated given Congress' already noted history of liability increases in the oil spill area. Finally, the extent of liability imposed by the bills is "proportionate to the company's experience," since the added liability would be only for damages stemming from a company's own oil spills. Of course, the precedent value of *Eastern Enterprises* is further undercut by the fact that only four justices supported the takings analysis of the statute's retroactivity; the other five justices, a majority, concluded that retroactivity is best analyzed under substantive due process, not takings.[25]

Note that both before and after *Eastern Enterprises*, every court to address the matter rejected takings (and substantive due process) challenges to the Superfund Act, whose retroactivity liability scheme offers some parallel to that of the bills.[26]

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[21] Eastern Enterprises v. Apfel, 524 U.S. 498 (1998).

[22] *See, e.g.*, Brown v. Washington Legal Found., 538 U.S. 216 (2003) (interest on lawyers' trust accounts); Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980) (interest on interpleader fund).

[23] Commonwealth Edison Co. v. United States, 271 F.3d 1327, 1338-40 (Fed. Cir. 2001) (en banc); Swisher International, Inc. v. Schafer, 550 F.3d 1046 (11th Cir. 2008), *cert. denied*, 130 S. Ct. 71 (2009); Empress Casino Joliet Corp. v. Giannoulias, 896 N.E.2d 277 (Ill. 2008), *cert. denied*, 129 S. Ct. 2764 (2009). CRS is aware of no lower court decision to have expressly rejected the generalized monetary liability principle.

The text statement that the taking suit likely would be appealed to the Federal Circuit (after a ruling by the U.S. Court of Federal Claims) warrants elaboration. The possibility exists that a responsible party under OPA might challenge the increased liability limit as a taking and seek injunctive rather than the customary monetary relief. Injunctive relief is justified when, as here, the challenged statute "requires a direct transfer of funds mandated by the government." Eastern Enterprises v. Apfel, 524 U.S. 498, 521 (1998). In that event, "a claim for compensation would entail an otherwise pointless set of activities" – in the present instance, the United States paying the responsible party a dollar of compensation for each dollar above $75 million that the responsible party pays out for damages. Thus, the presumption of Tucker Act jurisdiction in the U.S. Court of Federal Claims (authorizing the payment of monetary compensation only) must be reversed. *Id. See* 28 U.S.C. § 1491(a) (Tucker Act). Absent Tucker Act jurisdiction in the Court of Federal Claims, jurisdiction presumably would lie in a U.S. district court.

[24] 524 U.S. 498 (1998).

[25] *See, e.g.*, Franklin County Convention Facilities Authority v. American Premier Underwriters, 240 F.3d 534, 552 (6th Cir. 2001) ("We conclude that *Eastern Enterprises* has no precedential effect on this case because no single rationale was agreed upon by the Court.")

[26] *See, e.g.*, United States v. Alcan Aluminum Corp., 315 F.3d 179, 189-190 (2d Cir. 2003) (collecting cases). The Superfund Act, 42 U.S.C. §§ 9601-9675, is more formally known as the Comprehensive Environmental Response, Compensation, and Liability Act.

Alleged contract right under British Petroleum's lease to exclude application to the lease of laws enacted after it was entered into. Leases are in the nature of contracts, and contract rights generally are held to be property for purposes of the Takings Clause.[27] That being so, a taking argument might be made by British Petroleum that the bills are essentially an abrogation – a taking -- by Congress of a contract/lease term to which the United States had agreed. Presumably, such an argument would focus on the clause in the company's lease stating that "The lease is issued subject to [the Outer Continental Shelf Lands Act, existing regulations thereunder, and certain future regulations thereunder] and all other applicable statutes and regulations." The company might argue that "all other applicable statutes" refers solely to statutes existing when the company entered into its lease – not those, such as S. 3305 and H.R. 5214, enacted by Congress later on. Indeed, there is solid Supreme Court support for this interpretation. In 2000, the Court interpreted the same "catchall" language in another Outer Continental Shelf lease to "include only statutes and regulations already existing at the time of the contract ...."[28] The argument concludes that "all other applicable statutes" must incorporate into the contract the current $75 million cap, which the bills abrogate.

More important, however, is the longstanding and consistent preference of the U.S. Court of Federal Claims and its appellate court, the Federal Circuit, to address disputes revolving around written contracts with the United States under a breach of contract, rather than a takings, theory.[29] Again, it is in these courts that any taking claim against the United States based on the bills likely would be litigated.[30] As noted at the outset, this memorandum does not reach any breach of contract issues raised by the bills.

Substantive Due Process

The Due Process Clause of the Fifth Amendment declares that no person shall be "deprived of life, liberty, or property, without due process." The clause has long been read to demand not only procedural due process, but *substantive* due process as well. Substantive due process in the realm of economic legislation – the realm of S. 3305 and H.R. 5214 -- imposes only a very lax, highly deferential standard: that there exists a plausible rational basis that the legislative body could have had in mind linking the means chosen and the legitimate public purpose sought to be achieved.

In a leading retroactivity/substantive due process decision, the Court explained --

> To be sure, insofar as the [Act being challenged] requires compensation for disabilities bred during employment terminated before the date of enactment, the Act has some retrospective effect. .... But our cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations. .... *This is true even though the effect of the legislation is to impose a new duty or liability based on past acts.*[31]

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[27] *See, e.g.,* Lynch v. United States, 292 U.S. 571, 579 (1934) ("Valid contracts are property, whether the obligor be a private individual, a municipality, a State, or the United States.")

[28] Mobil Oil Exploration & Producing Southeast, Inc. v. United States, 530 U.S. 604, 616 (2000).

[29] The Federal Circuit has offered a variety of explanations for the breach of contract preference. *See, e.g.,* Hughes Communications Galaxy, Inc. v. United States, 271 F.3d 1060, 1070 (Fed. Cir. 2001) ("[t]akings claims rarely arise under government contracts, because the government acts in its commercial or proprietary capacity .... "); Castle v. United States, 301 F.3d 1328, 1342 (Fed. Cir. 2002) (nothing is taken in the constitutional sense when the plaintiff, as is typical, retains the full range of breach of contract remedies).

[30] *But see* note 23, *supra.*

[31] Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15-16 (1976) (emphasis added).

The Court did add a caution to this expansive view: "The retrospective aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former." But that burden, said the Court in a later decision, "is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose."[32] It would seem that the retroactive application of the increased liability limits in S. 3305 and H.R. 5214 back to the April 20 spill easily satisfies this test: Congress could reasonably suppose that for the foreseeable future, most of the exceedance of the current OPA liability cap would derive from this one huge spill. To exclude that spill from the bill's cap increase would compromise substantially the (assumed) public purpose of the bills to lay a greater portion of economic damages per oil spill at the feet of the responsible party. Similarly, not applying the bills to other existing leases (that is, confining the bills to leases entered into post-enactment) would greatly undercut the effectuation of that public purpose.

As noted in the takings discussion above, all substantive due process challenges to the retroactive liability scheme in the Superfund Act have been unsuccessful.[33]

In sum, the sounder argument is that the retroactive application of the $10 billion liability cap in the bills does not offend substantive due process.

Bill of Attainder Clause

The Constitution's Bill of Attainder Clause bars legislative enactments that effectively declare the guilt of, and impose punishment on, an identifiable individual or entity, without a judicial trial.[34] Such enactments are seen to usurp the judicial function, thereby offending the separation of powers principle so fundamental to the U.S. Constitution. An example of a law held to be void as a bill of attainder is a statute making it a crime for a Communist Party member to serve as an officer or employee of a labor union.[35] As pertinent here, the argument might be that S. 3305 and H.R. 5214, by reaching back to April 15, 2010, depart from the usual prospective-only application of enactments solely to bring in one particular oil spill: the Deepwater Horizon incident. This retroactive feature of the bills, the argument concludes, betrays an underlying intent to punish parties responsible for that incident. Then, too, the punishments that may be found constitutionally offensive are "not limited solely to retribution for past events, but may involve deprivations inflicted to deter future misconduct."[36] Thus, one can imagine an argument that the bills punish existing offshore facilities generally.

In the Court's most comprehensive statement of its test for bills of attainder, *Nixon v. Administrator of General Services*, the Court indicated that to offend the Bill of Attainder Clause, the law must (1) single out a specific person or class and (2) be punitive.[37] The Court then listed several indicators that a federal law is punitive. First, the law may impose punishment traditionally judged to be prohibited by the Clause. Second, even in the absence of such a traditional punishment, the law may not be rationally describable as

[32] Pension Benefit Guaranty Corp. v. R.A. Gray & Co., 467 U.S. 717, 730 (1984).

[33] *See supra* note 26 and accompanying text. *Accord*, Franklin County Convention Facilities v. American Premier Underwriters, 240 F.3d 534 (6th Cir. 2001) (rejecting substantive due process challenge to Superfund's retroactive liability scheme, in part because "Congress acted rationally by spreading the cost of cleaning hazardous waste sites to those who were responsible for creating the sites. Cleaning abandoned and inactive hazardous waste disposal sites is a legitimate legislative purpose which is furthered by imposing liability for response costs upon those parties who created and profited from those sites.").

[34] U.S. Const. art. I, § 9. *See* Nixon v. Administrator of General Services, 433 U.S. 425, 468 (1977).

[35] United States v. Brown, 381 U.S. 437 (1965).

[36] Selective Service System v. Minnesota Public Interest Research Group, 468 U.S. 841, 851-652 (1984).

[37] 433 U.S. 425 (1977).

furthering a nonpunitive legislative purpose. And third, the legislative history may evince a congressional intent to punish. The Court may also consider whether less burdensome alternatives would have achieved the same non-punitive purpose. A statute need not satisfy all these factors; rather, a court weighs them together.

Arguably, the bills meet the first, specificity requirement. One indication: the identity of the individual entity (British Petroleum) or class (responsible parties for offshore facilities generally) was "easily ascertainable" when the legislation was passed.[38] We need not dwell on the specificity requirement, however, because it is likely – assuming Congress does not "evince a congressional intent to punish" in passing S. 3305 or H.R. 5214 -- that a court would find the bills not to satisfy the second, punitive requirement and thus not to be a bill of attainder. First, monetary liability for the injuries one causes is not a type of punishment historically prohibited by the Bill of Attainder Clause. Second, the bills can reasonably be said to further a nonpunitive legislative purpose: the attaching of liability to the entity that caused the oil spill injury in lieu of the taxpayer. In language plainly relevant to the Deepwater Horizon spill, a court has noted: "[E]ven if the [law in question] singles out an individual on the basis of irreversible past conduct, if it furthers a nonpunitive legislative purpose, it is not a bill of attainder."[39] Thus, as long as the committee reports and floor debates during deliberations on the bill that is enacted do not suggest punitive motive, the bill is unlikely to be deemed a bill of attainder. It would seem, as suggested above, that there are obvious candidates for nonpunitive purposes that Congress might put forward in the legislative history of the bills.

Impairment of Contracts Clause

The Supreme Court has held that the impairment of contracts clause in the Constitution,[40] by its terms applicable only to the states, does not apply to the Federal Government indirectly through the Fifth Amendment Due Process Clause.[41] Therefore, this clause is no impediment to S. 3305 and H.R. 5214.

Ex Post Facto Clause

This clause prohibits Congress from passing an ex post facto law[42] – that is, a law attaching new negative legal consequences to pre-enactment conduct. Since the early years of the nation, however, the Supreme Court has construed the clause to apply only to penal legislation.[43] By contrast, the OPA liability to which the $75 million cap and S. 2205/H.R. 5214 apply is civil, not criminal, liability. Thus, the Ex Post Facto Clause poses no obstacle to the bills.

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[38] *Brown*, 381 U.S. at 448-449.

[39] Seariver Maritime Financial Holdings, Inc. v. Mineta, 309 F.3d 662, 674 (9th Cir. 2002).

[40] U.S. Const. art. I, § 10.

[41] PBGC v. R.A. Gray & Co., 467 U.S. 717, 733 (1984).

[42] U.S. Const. art. I, sec. 9, cl. 3.

[43] Landgraf v. USI Film Products, 511 US 244, 266 n.19 (1994), *citing* Calder v. Bull, 3 Dall. 386, 390-391 (1798).

Attachment B: Offshore Energy Insurance Market

The offshore energy market – particularly the market for windstorm insurance – has undergone important changes in recent years as the result of claims arising both from Hurricane Katrina and from storms that struck in 2008, including Hurricane Ike, which reportedly caused $3 billion in damage to the offshore industry.[1] One report indicates that "[b]etween 2004 and 2008, offshore energy insurers in the Gulf of Mexico collected $3.7 billion in premium and paid nearly $12 billion in losses," producing a deficit that, when coupled with other business factors, required "dramatic changes" in the offshore windstorm energy market to ensure the survivability of the market in the face of the damages that might arise from another major storm.[2] Among other changes, insurers "narrowed their coverage" and reduced total capacity from about $12 billion in 2008 to less than $7 billion in 2009; limits were also reduced and rates were significantly increased.[3]

In response to the changes in the insurance market, in 2009, many offshore operators reportedly self-insured or chose to drop coverage for windstorms all together.[4] One report indicates that "rates went up 60%" for wind insurance, but "premium intake increased only 30%."[5] However, "hopes that reduced premium income would prompt insurers with income targets to offer more favorable deals later in the Gulf's renewal season proved largely misguided," and instead, "offshore energy underwriters changed the way they bought reinsurance."[6] In some cases, underwriters simply "bought less reinsurance" than they had purchased in previous years; in other cases, underwriters "secured deals that allow reinsurance premiums to adjust based on direct premium income earned" or bought "quota-share reinsurance," under which "losses are shared between insurer and reinsurer."[7] Market observers indicate that insurance firms sought to make earnings targets through other business areas, and were satisfied with less premium income from this line of business in return for more control over risk exposure.[8] However, the Insurance Information Institute (III) notes that the "[a]bsence of major storm in Gulf of Mexico in 2009 means new underwriting strategies unveiled in wake of Hurricane Ike have yet to be tested" [sic.].[9] Further, the National Oceanographic and Atmospheric Administration has predicted an "active to extremely active"[10] hurricane season for 2010 which opened on June 1 – which is likely to have additional effects on the offshore energy insurance industry, particularly for windstorm coverage.

III notes that prior to the *Deepwater Horizon* incident, "energy insurance pricing was declining 15%," but that the loss of that rig is obviously a "major event for the offshore energy insurance and reinsurance market" and "rates for offshore accounts are expected to rise significantly."[11] Some observers have suggested there will be pressure to soften the language in some insurance policies so

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[1] Zack Phillips, "Hard Market for Offshore Rigs Drives Firms to Self-Insure," *Business Insurance* (June 2009).
[2] *Id.*
[3] *Id.*
[4] Zack Phillips, "In Tight Market Energy Firms Drop Cover, Cross Fingers," *Business Insurance* (August 31, 2009).
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] Robert P. Hartwig, Ph.D., CPCU, President and Economist, III, *Deepwater Horizon Gulf Oil Spill and Insurance Market Impacts* (June 3, 2010), at 39, www.iii.org/presentations.
[10] National Oceanographic and Atmospheric Administration, *NOAA Expects Busy Atlantic Hurricane Season* (May 27, 2010), http://www.noaanews.noaa.gov/stories2010/20100527_hurricaneoutlook.html.
[11] Robert P. Hartwig, Ph.D., CPCU, President and Economist, III, *Deepwater Horizon Gulf Oil Spill and Insurance Market Impacts* (June 3, 2010), at 39, www.iii.org/presentations.

that insurers may pay more than anticipated.[12] Until the regulatory actions that are taken in the wake of the incident are clear, the market will face deep uncertainty about the levels of liability likely to be imposed on both offshore facilities and vessels and even about the amount of liability that facilities in particular may be required to demonstrate to obtain permission to operate.

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[12] *Id.*

OPEING STATEMENT OF
THE HONORABLE RUSS CARNAHAN
HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE

Hearing on
Liability and Financial Responsibility for Oil Spills Under the Oil Pollution Act of 1990

Wednesday, June 9, 2010

Chairman Oberstar and Ranking Member Mica, thank you for holding this hearing to review the liability and responsibility for oil spills under the Oil Pollution Act.

It is estimated that the losses associated with the Deepwater Horizon oil spill range from $1 billion to $3.5 billion far exceeding the current liability cap of $75 million for offshore facilities and potentially the costs could surpass the balance of the Oil Spill Liability Trust Fund.

In the aftermath of the Deepwater Horizon oil spill, it is clear we must review the current liability caps set by existing law. These caps are based on accidents involving seafaring vessels, which unlike an offshore drilling facility, a reasonable estimate of just how much oil could be released by the vessel is achievable. Thus making it easier to set liability cap and required levels of insurance than in the case of the Deepwater Horizon disaster.

This makes clear the need to update our laws to ensure the liability cap and required levels of insurance reflect the complex nature of deep water drilling, instead of relying on the levels set for vessels.

As the costs of clean up of the Deepwater Horizon continue to rise, it is also clear we need to increase the per barrel crude oil tax in order ensure there are sufficient funds in the Oil Spill Liability Trust Fund to cover the costs. That is why I voted for legislation to increase this tax to 34 cents per barrel.

The Deepwater Horizon spill has also shined a light on the need for the Federal government to have a greater role in safety issues surrounding deep water oil drilling. We cannot allow the industry to self-police itself. It is critical that just as much effort and energy is devoted to developing the technologies needed to stop and clean up and stop a potential oil spill as is invested in methods to drill at greater depths.

In closing I want to thank our witnesses for joining us today and I look forward to your testimony.

Kathy Castor
FL-11

Testimony of Representative Kathy Castor
Before the Committee on Transportation and Infrastructure
"Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes"
June 9, 2010

Chairman Oberstar, Ranking Member Mica and Members of the Committee. Thank you for the opportunity to testify on the need to update the Oil Pollution Act 1990. In the face of BP's Deepwater Horizon disaster, we must work together to take swift action to update this outdated law lift the liability cap on offshore oil drilling companies like BP.

breadth, depth of knowledge

It is difficult to characterize "liability" when we are talking about the worst environmental disaster that the United States has ever seen. Those of us living on the Gulf Coast will be struggling with the impacts for years and years to come. Last week, I met with residents and business owners in my district to hear first hand about the impact. The fear and frustration they expressed was profoundly disheartening.

$10.9 B
175,000 jobs

Floridians are used to dealing with natural disasters. In the last decade, we have confronted nearly half a dozen hurricanes rated Category 3 or higher. These storms are terrifying, yet we know what needs to be done to overcome them. Each and every community in Florida has a detailed plan that they've rehearsed and refined many times over the years. When June 1st rolls around, residents are on alert that Hurricane Season in Florida has begun, and preparations should be finalized and ready to act upon, if necessary. Dealing with this oil disaster is nothing like anything Floridians have ever encountered. worst fears come true It feels like a major hurricane has been lurking in the Gulf for ~~48 days~~ months scaring off tourists and threatening to devastate our economy.

Clean water and clean beaches are our economy's lifeblood, and tourism and fishing is the engine that drives it. When the tourists get a whiff of oil, they choose to

play it safe and go to a different destination. From what we've seen in Louisiana, Mississippi, and Alabama, it is proving nearly impossible to keep the oil from hitting the coastline once it pushes beyond the artificial protective barriers. Huge swaths of the Gulf have literally been shut down to thousands of fishermen, charter boats, and others who make their living on the water. All best are off that we'll be able to attract the tourists that sustain our economy once the oil hits the sand. Tourists are already cancelling their summer vacations in droves, and this is leading to a chain reaction that could force small business owners to close up shop for good.

Many of us have pressed BP ~~America President Lamar McKay to~~ clarify the extent of BP's liability in a hearing a few weeks back. We asked him about environmental damages, clean up costs, and lost wages. There are many more things to consider, of course, including lost tax revenue, loss of use, ongoing environmental research, decreases in property values—the list goes on and on. Over and over, he responded that BP would pay "all legitimate claims." Obl P A 90 doesn't match today's reality ~~As Mr. Holt said in his testimony, BP has lost credibility with the American people because it continues to distort the facts and withhold key information from the public.~~ Equally troubling, victims of this tragedy all along the Gulf Coast are having difficulty being reimbursed for their damages. Leaving it up to BP to determine what is "legitimate" would be a huge injustice, given their role in creating this disaster in the first place.

Coast Guard Comm Thad Allen BP too lax clarify

Mr. Chairman & Committee Members we need to process claims your diligent efforts

~~That is why I joined Mr. Holt as a co-sponsor of his bill~~, the Big Oil Bailout Prevention Act. I sincerely thank my colleagues in this committee who are cosponsors of the legislation. The bottom line should be: If oil cannot afford to prevent catastrophic disasters, they should not be operating in federal waters. The resources of the Gulf and

other federally protected waters along the Outer Continental Shelf belong to the American people, not Big Oil. They should be protected to the full extent of the law~~, and~~ ~~if~~ The law that ~~was in effect before the spill needs to be changed to reflect this, then~~ we ~~need to update~~ it. The $75 million cap now in effect, and all that ~~BP~~ is legally required to pay above and beyond clean-up costs, is a drop in the bucket compared to what it will take to restore the Gulf Coast. We must bring ~~our~~ bill to the floor ~~so that we can demonstrate to the~~ American people ~~that we are committed to holding BP accountable for this catastrophe.~~

The truth is, the resources of this region are priceless, and we all know this. The wildlife, the fisheries, the marshes, the emerald green waters, the sugar-white sand, the family vacations, this is where much of America goes to blow off steam (I've spoken to many of you directly)… I am unsure that any amount of money can replace or insure these national treasures. The Deepwater Horizon oil disaster has confirmed my worst fears about the potential ramifications of oil drilling off of Florida's coast. We must act now to protect ~~Florida's~~ economy and environment from the fallout. ~~My bill, the Florida~~ Coastal Protection Act, would prohibit oil drilling, ~~leasing,~~ preleasing and any related activities off the Florida coast. Currently, the law banning offshore drilling only runs through 2022. The Florida Coastal Protection Act would ban oil drilling and leasing ~~activities permanently.~~

~~Our jobs, our tourism economy, and our fishing economy are too important~~ to leave to an industry that has cut corners ~~and~~ does not have the ability to respond to a disaster like BP's ~~Deepwater~~ Horizon catastrophe. BP must be held fully accountable, ~~and I am devoting my time and energy to make sure that happens. I will continue to lead~~

the charge to ensure Florida is protected from oil drilling off of our coast. I will also continue to press BP officials on a regular basis to take full responsibility for this horrendous disaster. Given the extent of this spill, there should be no doubt that the law needs to be changed to place the burden of liability where it belongs—on the responsible part, BP. American taxpayers should not have to foot even one cent of the bill. Going forward, we need to make the moratorium permanent so that we never have to face this environmental and economic tragedy again.

Mr. Chairman and members of the Committee, thank you for giving me the opportunity to testify today. BP's hubris has held the Gulf Coast hostage for the past 49 days. It is obvious now that they had no backup plan whatsoever in the event of a catastrophic spill. They led us to believe that the technology was too advanced to ever let that happen. Their only backup plan was to hope that nothing would ever go wrong. On April 20th, the oil started gushing, and BP started scrambling. The rest is history in the making.

STATEMENT OF
THE HONORABLE JERRY F. COSTELLO
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
"LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES"
JUNE 9, 2010

- Thank you, Chairman Oberstar and Ranking Member Mica for holding a second oversight hearing to examine ongoing issuer from the Environmental and Economic Disaster in the Gulf of Mexico known as *Deepwater Horizon*. Given the scope of the potential damages arising from the spill, it is imperative that the full Committee assess current liability caps on oil drilling accidents.

- While the magnitude of the oil spill is still unknown because the leak is not fully contained, the Gulf Coast residents, local businesses, the ecosystem, and its natural resources have already been severely impacted by this disaster. Our previous hearing revealed the exploded rig was built in South Korea, is registered in the Republic of the Marshall Islands, whose registry is maintained by a little-known company in Reston, Virginia, and owned and operated by the foreign company British

Petroleum (BP). I share the concerns of the Chairman that this relationship complicates and limits the ability of the Coast Guard to fully investigate and inspect the operations. I believe that anyone operating in our territorial waters must undergo a thorough inspection by the Coast Guard.

- A careful investigation must be carried out to closely examine the circumstances surrounding this oil spill, how the companies responsible for the spill and the Federal government have responded, and what steps should be taken in the future avoid a similar disaster. I support the Obama administration's 6 month moratorium on new oil drilling to certify and inspect drilling in deep waters to ensure these rigs are safe.

- While the Federal government is not responsible for containing the leak, we are in charge of making a determination regarding the clean up required after an oil spill occurs. In addition, the Federal government also

manages the Oil Spill Liability Trust Fund (OSLTF). Currently, the Trust Fund receives 8 cents per barrel of oil and only has a balance of $1.6 billion. The Oil Pollution Act of 1990 authorizes payment from the Trust Fund for costs and damages from an oil spill that are not covered by the responsible party. Further, there is a per incident cap of $1 billion allowed to be paid from the Trust Fund for expenditures and a $75 million liability cap the responsible party must pay for impacts to natural resources, services, and other eligible damages.

- The House recently passed legislation to first, raise a company's payment on its barrels of oil to 34 cents in order to increase the amount of money flowing into the Trust Fund and second, boost the per incident payment cap to $5 billion. However, the $75 million liability cap has not yet been addressed. Given that current estimates suggest that the losses associated with this incident will be at the low end between $1 billion and $3.5 billion in total claims, the damages resulting from the oil spill will far

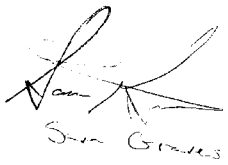
exceed the current liability cap of $75 million applied to offshore facilities, as well as the current per incident expenditure limit of $1 billion from the Trust Fund.

- Pending the outcome of this investigation, I believe taxpayers should Not be required to pay for any claims that the responsible party is held liable. Finally, I support efforts to address the liability caps issue, provide greater safety standards for deep sea oil rigs, and to strengthen our oversight for oversight for drilling operations in U.S. coastal areas.

- I welcome our panel of witnesses and look forward to their testimony.

- Thank you, Mr. Chairman.

Congressman Sam Graves
Opening Statement
T&I Full Committee Hearing
June 9, 2010



"Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes"

[WHEN RECOGNIZED]

Thank you Chairman Oberstar and Ranking Member Mica for holding this important hearing today focused on liability limits for oil spills imposed by the Oil Pollution Act of 1990.

Mr. Chairman, first I would like to express my deepest sympathies to the families of those who lost loved ones on the Deepwater Horizon rig on April 20, 2010. Hopefully we learn from this tragic event in a way that we can prevent something like this from happening again.

I would also like to thank the men and women that are working around the clock in the Gulf as part of the relief efforts. The cleanup and prevention efforts are having a positive impact, but there is still much work to be done.

Mr. Chairman, I am glad we are holding this hearing today. I believe it is vitally important that Congress examines current liability limits while also allowing time for investigators to thoroughly investigate the Deepwater Horizon incident and let the facts of the incident come out before overreacting with possible legislative action.

In the interest of time, I will keep my comments short. However, I would ask the Chairman for permission to submit for the record a letter sent to members of this committee from the Independent Petroleum Association of America.

Chairman Oberstar: Without objection so ordered.

Thank you Mr. Chairman. This letter simply asks Congress not to rush into a legislative solution – such as substantially increasing liability limits - without first considering all of the consequences of what may happen, in this case an increase in the cost of gas for consumers.

I look forward to hearing the testimony from all of our witnesses today. I yield back.

SENIOR DEMOCRATIC WHIP

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
CHAIRWOMAN, SUBCOMMITTEE ON WATER RESOURCES & ENVIRONMENT
SUBCOMMITTEE ON AVIATION
SUBCOMMITTEE ON RAILROADS

COMMITTEE ON SCIENCE AND TECHNOLOGY
SUBCOMMITTEE ON RESEARCH AND SCIENCE EDUCATION
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DEMOCRATIC STEERING AND POLICY COMMITTEE

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STATEMENT OF
THE HONORABLE EDDIE BERNICE JOHNSON, CHAIRWOMAN
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
HEARING ON "LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES"
JUNE 9, 2010

Thank you, Mr. Chairman, for holding today's hearing on liability and financial responsibility for oil spills.

To put this hearing in context, today marks day 51 of the ongoing BP oil spill disaster in the Gulf of Mexico.

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While this Committee's last meeting focused on what went wrong, and how we have gotten to where we are today, today's hearing focuses on what needs to be done to make sure a similar disaster does not happen again.

Today witnesses will focus on liability and financial responsibility for oil spills and the resulting damages.

This issue is becoming increasingly important as the impact of the Gulf spill is currently unknown, but is still under assessment, and as questions arise on who will ultimately bear the responsibility for clean-up costs and economic damages.

Today, this Committee will investigate how the Oil Pollution Act of 1990 and other statutes should be amended to increase or lift the cap on liability for companies or individuals responsible for oil spills.

BP testified under oath that it will pay all "legitimate claims" and will not be bound by the $75 million liability cap under the Oil Pollution Act.

However, as Congress continues its investigation of the BP oil spill disaster, this Committee should rightly question whether or not the current $75 million cap makes sense or if it should be adjusted or eliminated.

The President and Members of Congress have called for significant changes to the liability cap or for the cap to be eliminated altogether.

In light of ~~those~~ these proposals, today's hearing compels us to ask important questions about how much liability we should expect oil companies to maintain and how much financial responsibility we should expect them to have when accidents of this nature happen.

According to the *Washington Post* earlier this week, BP is currently capturing as much as 15,000 barrels a day with its latest effort.

This is in sharp contrast to the amount BP has reported is leaking. It seems to me that we have to rely on BP for data and information and we have no way of confirming it.

Given that we may not know the full extent of the oil spill for years to come, it may not make sense for us to cap the amount of financial responsibility for BP and other oil companies. And that is what we are here to discuss today.

While the entire story of this disaster may not be told for decades, we have an obligation to see those responsible for this spill held accountable for their actions – not only to the people of the Gulf Coast, but to the American people.

We also have an obligation to learn from this disaster and make necessary changes to our laws to ensure companies are held accountable in the future.

Thank you, Mr. Chairman.

Rep. Rick Larsen
Opening Statement
House Transportation and Infrastructure Committee Hearing
"Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes"

Mr. Chairman, thank you for holding this hearing. As federal agencies work to contain and clean up this spill, we must also begin to examine the liability and financial responsibility issues arising from this tragedy.

The *Deepwater Horizon* oil spill is a major human and environmental disaster of potentially unprecedented proportions. As a representative from the Puget Sound, I understand how devastating an oil spill would be to a coastal region. I want to do everything possible to prevent an oil spill from occurring in Puget Sound and other areas of the country – and hold the responsible parties fully accountable for all cleanup, natural resource and economic damages.

The *Deepwater Horizon* spill raises significant concerns regarding the future of offshore drilling in the United States. I propose that the country take a step back to ensure

that any future offshore drilling in the Gulf will live up to oil companies' claims of safety and reliability.

Future offshore drilling must occur within a legal framework that leaves no doubt that companies are fully responsible for any spills or leaks they cause. Congress must act to lift the liability caps in the Oil Pollution Act in order to match the potential magnitude of spills and leaks.

It is also troubling to me that under the Oil Pollution Act of 1990, offshore facilities are not required to demonstrate their financial capability to meet liabilities exceeding $150 million, even though they are liable for all clean up costs and up to $75 million in damages. The financial responsibility requirements should be raised to reflect the high costs of cleaning up large spills.

The Oil Spill Liability Trust Fund must also be replenished and the per barrel fee raised to match the increased hazard of deep sea drilling.

While the final impacts of this potentially massive environmental disaster remain unknown, the situation has raised a number of troubling questions. I look forward to investigating these questions and examining the best ways to strengthen our nation's oil spill response and prevention laws.

Statement of Rep. Harry Mitchell
House Transportation and Infrastructure Committee
6/9/10

Thank you, Mr. Chairman, and thank you for calling this important hearing.

The oil spill in the Gulf of Mexico is a disaster of epic proportions. It is grave. It is growing. Lives have been lost, and ways of life are being threatened.

There are various estimates as to the rate at which oil is still spilling into the Gulf. According to the United States Geological Survey, the oil is spilling at rates between 12,000 and 19,000 barrels a day.

BP has promised to stop the leak, and pay for the damage that has been caused – and while I certainly hope they will, based on their performance so far, I would be lying if I said I wasn't skeptical. They must be held accountable.

But beyond the needs of the immediate crisis, which are considerable, serious questions have been raised about liability limits for oil spills imposed by the Oil Pollution Act of 1990, and whether current liability limits for offshore facilities and vessels should be raised going forward. The crisis has also raised questions about whether the levels required for the demonstration of financial responsibility should be raised.

We will examine these and related issues today.

I look forward to hearing form our witnesses.

At this time, I yield back.

STATEMENT OF
BOB ABBEY
ACTING DIRECTOR
MINERALS MANAGEMENT SERVICE
DEPARTMENT OF THE INTERIOR

BEFORE THE
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE 0F REPRESENTATIVES

HEARING ON "LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES"

JUNE 9, 2010

Thank you, Chairman Oberstar, Ranking Member Mica and members of the Committee for the opportunity to testify about the Minerals Management Service's (MMS) authority under the Oil Pollution Act of 1990 ("OPA 90"). Before I begin my testimony, I want to express how saddened my staff and I are over the tragedy that occurred on April 20, 2010, on board the Deepwater Horizon. The spill resulting from this tragic accident has been declared a "spill of national significance" by the Department of Homeland Security and is of grave concern to the MMS and the Department of the Interior. The Obama Administration and the Department are dedicating every available resource to mitigate this disaster, prevent further damage to our environment, help our fellow citizens, and comprehensively and thoroughly investigate this event.

Secretary Salazar appointed me Acting Director of MMS on Friday, May 28, 2010. Our focus at the MMS has been and continues to be dealing with the Deepwater Horizon oil spill and the issues the event has raised regarding the safety of other OCS oil and gas operations. I appreciate the opportunity to be part of the MMS organization for as long as Secretary Salazar needs me to

serve in that capacity. I am honored to talk to the committee today about how MMS performs its duties under the Oil Pollution Act of 1990 (OPA 90).

The Oil Pollution Act of 1990, a law enacted following the Exxon Valdez spill, initiated a National effort to formalize planning, preparedness, and response for oil and hazardous material spills that occur both onshore and offshore. Implemented through Executive Order 12777, OPA 90 gives the Secretary of the Interior authority to regulate spill planning and preparedness activities for facilities seaward of the coastline, other than deepwater ports, that handle, store or transport oil. Subsequently, the Secretary delegated his authority under OPA90 to MMS. MMS's responsibilities include enforcing spill prevention measures, reviewing spill response plans, inspecting spill containment and cleanup equipment, reviewing spill financial liability limits, and certifying spill financial responsibility.

Enforcing spill prevention measures

In ensuring its authorities under OPA are met, MMS, has established procedures, methods, and other requirements for equipment to prevent and to contain discharges of oil and hazardous substances from offshore facilities, including associated pipelines.

Prevention is our most important safety strategy. MMS's approach to prevention has four major program components: 1) the Technology Assessment and Research Program; 2) an extensive offshore personnel training program; 3) a regulatory program, which includes approval of plans, facilities, and operations, and an inspection of those facilities and operations; and 4) accident

investigations. In the case of a spill, MMS also provides representatives to the National Response Team and Regional Response teams.

Accidents reported to the MMS may trigger an investigation by the MMS district office in which the incident occurred. In the case of a major accident, MMS may create an investigative panel of district, regional, and headquarters personnel, as well as representatives of the U.S. Coast Guard and other Federal agencies. Findings from both types of investigations may lead to the issuance of safety alerts, technology assessment and research, changes in the training program, and/or improvements in the MMS regulatory program, all of which are intended to promote greater safety and environmentally sound operations. .

Reviewing Oil Spill Response Plans

The authority for MMS to regulate oil spill planning for affected facilities is derived from OPA 90 and Executive Order 12777. Regulations that direct the owners and operators regarding federal oil spill planning, preparedness, and response requirements are detailed in 30 CFR Part 254 – Oil Spill Response Requirements for Facilities Located Seaward of the Coastline to ensure that private personnel and equipment are available.

30 CFR 254, which became effective on June 23, 1997, requires that all owners or operators of oil handling, storage or transportation facilities located seaward of the coastline submit an Oil Spill Response Plan (OSRP) to MMS for approval. An OSRP is developed by an owner or operator of an offshore oil and gas facility and describes how the owner or operator will respond to a spill from its facility. Regional OSRPs cover multiple facilities or leases of an owner or operator that are located in the same MMS Region. MMS reviews and approves these plans

every two years unless there is a significant change that requires that the plan be revised immediately.

An OSRP must demonstrate that an operator can respond quickly and effectively whenever oil is discharged from their facility. The operator must immediately carry out the provisions of the plan whenever there is a release of oil from a facility. An owner or operator must also carry out and document the training, equipment testing, and periodic drills described in the plan, and these measures must be sufficient to ensure the safety of the facility and to mitigate or prevent a discharge or a substantial threat of a discharge. The plan must be consistent with the National Contingency Plan and the appropriate Area Contingency Plan(s). An operator must take all appropriate actions necessary to immediately abate the source of a spill and remove any spills of oil.

MMS's Inspection Program

MMS has 62 inspectors and 11 field engineers located in 7 districts – there are 5 districts in the Gulf of Mexico, and 1 each in the Pacific Region and Alaska Region. The President's Fiscal Year 2011 Budget Request includes funding for an additional six inspectors for offshore oil and gas facilities in the Gulf.

In order to determine whether an operator's performance on the OCS is in compliance with applicable laws and regulations, the OCSLA provides for scheduled onsite inspections at least once a year of each facility on the OCS and also periodic unannounced onsite inspections where no advance notice is given. If those inspections find noncompliance with applicable

requirements, a wide range of enforcement actions can be taken, depending on the circumstances, ranging from written warnings to financial penalties, to drilling and/or production shut-ins of platforms, wells, equipment, or pipelines.

As a matter of policy, Minerals Management Service inspectors and field engineers conduct complete inspections of all safety devices and environmental standards for drilling activities approximately once a month while drilling rigs are on location. MMS also conducts inspections of up to 3,600 OCS production facilities every year. Finally, MMS conducts unannounced inspections generally targeting operators for whom compliance concerns exist or who are conducting inherently dangerous operations, such as welding, construction activities, and normal production activities at the same time.

If an operator is found in violation of a safety or environmental requirement, MMS issues a citation requiring that the violation be fixed within 14 days. On average about 24,000 inspections per year are conducted and 2,500 Incidents of Non-Compliance (INCs) are issued. Many of these INCs are for minor non-compliance issues such as marking equipment improperly, but some are for serious non-compliance issues such as unauthorized bypassing of safety devices.

Evidence of serious non-compliance may result in the assessment of civil or criminal penalties for failure to comply with requirements under the law, a license, a permit, or any regulation or order issued under the Outer Continental Shelf Lands Act.

In the spirit of working to improve and reform the MMS inspection program, and as part of our MMS reform agenda, in September 2009 the Secretary asked the National Marine Board, an arm of the highly respected National Academy of Sciences, to direct an independent review of MMS's inspection program for offshore facilities. The results of that review are due to us this fall and will help us enhance the effectiveness of that program as we implement our reforms.

But there is room for improving the MMS's inspection activities, and we are working to identify needed improvements.

On May 27th Secretary Salazar delivered to the President the results of the 30-day safety review that he ordered us to undertake. The purpose of that Safety Report was to evaluate oil and gas safety measures that could be put in place on an interim basis before the on-going investigations to identify the root cause of the BP oil spill disaster have been completed. The report recommends a number of specific measures that can be taken on both a short and longer term basis to improve the safety of offshore oil and gas activities, including aggressive new operating standards and requirements for offshore energy companies. Key recommendations include a recertification of all Blowout Preventers for new floating drilling operations; stronger well control practices, blowout prevention and intervention procedures; tougher inspections for deepwater drilling operations; and expanded safety and training programs for rig workers.

MMS strives to conduct an announced inspection of each of the roughly 3,600 Outer Continental Shelf (OCS) production facilities every year. These production facilities range from large multi-well production hubs to small single well caissons. Because inspectors travel to these facilities

by helicopter, it is not uncommon for poor weather conditions to impact this goal; yet MMS routinely inspects 95 to 98 percent of all production facilities per year. In addition to announced inspections of production facilities, we conduct unannounced inspections and generally target those operators for whom we have compliance concerns. In addition, we conduct increased inspections when operators are conducting activities that are inherently dangerous, such as simultaneous operations like welding, construction activities, and normal production activities at the same time. Inspectors regularly witness the testing of devices on these production facilities to ensure they are operating within their specified tolerances.

OPA 90 established requirements for periodic inspection of equipment used to contain and remove discharges from offshore facilities, including associated pipelines. Accordingly, MMS conducts periodic drills of spill discharge removal capacity under relevant response plans for offshore facilities located in both state and federal waters. MMS also conducts both announced and unannounced oil spill drills to determine preparedness. On an annual basis, MMS conducts over 30 unannounced oil spill drills to verify that operators are prepared to quickly and efficiently respond to spills from their facilities. MMS publishes annual reports of these drills.

OPA 90 expanded MMS's responsibility and authority for oil spill prevention and response for both platforms and pipelines in Federal and State coastal waters. These inspections are in accordance with 30 CFR 254.43 (a) where the response equipment is inspected at least monthly and regularly maintained, and (b) in the areas of equipment availability, operational readiness, equipment maintenance and record keeping. Last year, MMS's Oil Spill Removal Organization Equipment Inspection Team conducted nearly forty inspections of the spill response equipment stockpiles.

Reviewing Financial Liability Limits and Certifying Financial Responsibility

Oil Spill Financial Responsibility (OSFR) amounts are assessed based on worst case oil-spill discharge total volumes associated with the covered offshore facility. Although a mobile offshore drilling unit (MODU) is classified as a vessel, a well drilled from a MODU is classified as an offshore facility under OPA 90. For facilities located wholly or partially in the OCS the applicable amount of OSFR to be assured ranges from $35 million for worst case oil spill discharge volumes of over 1,000 to up to 35,000 barrels to $150 million for worst case oil spill discharge volumes of over 105,000 barrels of oil.

OPA 90 provides that parties responsible for offshore facilities must establish and maintain OSFR for those facilities according to methods determined by the President. The responsibility to ensure that offshore facilities are adequately covered by OSFR amounts was delegated to the MMS. This responsibility covers both the OCS and certain State waters. Responsible parties must demonstrate as much as $150 million in OSFR if the MMS determines that it is justified by the risks from potential oil spills from covered offshore facilities (COFs).

Parties responsible for more than one COF must demonstrate the highest amount of OSFR that applies to any one of the COFs.

Responsible parties must provide OSFR certification by surety bond, insurance, self-insurance or guarantee. Coverage must be continuously maintained by the responsible party for all its leases,

permits, and rights of use and easements with COFs. Self insurance can only be used as OSFR evidence if appropriate net worth or unencumbered net assets are demonstrated.

Under Executive Order 12777, the President delegated to the Department of the Interior the responsibility to adjust limits of liability with respect to offshore facilities, including associated pipelines, to reflect increases in the Consumer Price Index.

While the United States has one of the most comprehensive offshore oil and gas regulatory regimes in the world, we recognize there are many areas that would benefit from careful review and improvement. The report that the Secretary delivered to the President on May 27th made a series of recommendations designed to improve safety processes and procedures, including some new testing, inspection and reporting requirements for blowout preventers and related safety equipment. Similarly, the Safety Oversight Board established by Secretarial Order on April 30th is in the initial stages of gathering information necessary to develop recommendations designed to address a wide variety of improvements. The Board is reviewing current practices in areas such as permit approvals, inspections, safety and environmental reviews. We will also carefully review the recommendations of the special Presidential commission that has been established once the commission has completed its review. All of these efforts will contribute to improving our regulatory framework, oversight of these regulations, and enforcement responsibilities to help prevent, to the greatest degree possible, the series of catastrophic events that began with 11 tragic deaths on April 20th from happening again.

Conclusion

Mr. Chairman, that concludes my prepared statement. I would be happy to respond to questions you or Members of the Committee have.

Testimony of
Charles B. Anderson,
SKULD North America, Inc.
on behalf of the
International Group of P&I Clubs

June 9, 2010

Before the House Committee on Transportation and Infrastructure

Subcommittee on Coast Guard and Maritime Transportation

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HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

SUBCOMMITTEE ON COAST GUARD AND MARINE TRANSPORTATION

Testimony of
Charles B. Anderson,
Senior Vice President,
SKULD North America, Inc.
on behalf of the
International Group of P&I Clubs

June 9, 2010

Mr. Chairman and Members of the Committee:

Good morning. My name is Charles Anderson. I am a Senior Vice President of Skuld North America, Inc., the US representative of Assuranceforeningen Skuld Gjensidig which is one of the thirteen Principal Member associations which make up the International Group of P&I Clubs. In addition to my present responsibilities as an executive with Skuld, I have practiced maritime law in private practice and am an Adjunct Professor of Admiralty Law at Columbia University Law School. I am also co-author, with Mr. Colin de la Rue, of "Shipping and the Environment" a comprehensive treatise on legal regimes governing maritime environmental issues in the United States and in the major maritime trading areas of the world.

I very much appreciate the opportunity to speak with you today on behalf of the International Group of P&I Clubs.

A. The International Group and its Interest in the Continued Effectiveness of the Oil Pollution Act of 1990.

The International Group of P&I (Protection and Indemnity) Clubs is made up of 13 not-for-profit mutual insurance associations (Clubs) that insure third-party liabilities relating to the use and operation of ships.[1] Group Clubs between them insure over 90% of world ocean-going tonnage and over 95% of ocean-going tankers. The member Clubs compete among themselves and with the commercial insurance market, but operate a claims-sharing system for larger claims falling on them individually. The member clubs each retain the first US$8 million of exposure, above which level claims are shared across all 13 member clubs through the Group Pool. The Pool is in turn reinsured by commercial reinsurers worldwide, including reinsurers in the US market. Through these pooling and reinsurance arrangements the Group member Clubs are able to offer the highest levels and broadest range of cover for shipowners.

The recent tragic loss of the DEEPWATER HORIZON and the ongoing environmental disaster in the Gulf of Mexico have led to an appropriate and necessary interest in Congress in the legal regimes governing the prevention of and response to marine

[1] The International Group of P&I Clubs is comprised of thirteen principal underwriting associations, six affiliated associations and one reinsured subsidiary, namely ; American Steamship Owners Mutual Protection and Indemnity Association, Inc., Assuranceforeningen Skuld, Skuld Mutual Protection and Indemnity Association (Bermuda) Ltd., Gard P&I (Bermuda) Ltd., Assuranceforeningen Gard, The Britannia Steam Ship Insurance Association Limited, The Japan Ship Owners' Mutual Protection & Indemnity Association, The London Steam-Ship Owners' Mutual Insurance Association Limited, The North of England Protecting & Indemnity Association Limited, The Shipowners' Mutual Protection & Indemnity Association (Luxembourg), The Standard Steamship Owners' Protection & Indemnity Association (Bermuda) Limited, The Standard Steamship Owners' Protection and Indemnity Association (Europe) Ltd., The Standard Steamship Owners' Protection and Indemnity Association (London) Ltd., The Standard Steamship Owners' Protection and Indemnity Association (Asia) Ltd., The Steamship Mutual Underwriting Association (Bermuda) Limited, The Steamship Mutual Underwriting Association Ltd.,The Swedish Club, United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited, United Kingdom Mutual Steam Ship Assurance Association (Europe) Ltd., and The West of England Ship Owners Mutual Insurance Association (Luxembourg).

environmental casualties from vessels as well as offshore facilities. The primary statute governing these types of incidents in the United States is the Oil Pollution Act of 1990 (OPA 90), legislation that was passed in the aftermath of the EXXON VALDEZ casualty in 1989. OPA 90 addresses, among other things, prevention, response planning, and financial and operational responsibility for response to environmental casualties and compensation for pollution damage to third parties. We have roughly twenty years of experience with OPA 90. In reviewing all vessel-source marine oil pollution events since the enactment of OPA 90, we can see that, at least in the vessel sector, the statute has provided a system that ensures sound financial responsibility, promotes effective prevention measures, prompt response, and verifiable contingency planning. OPA 90 also provides prompt relief for third party claimants, and establishes an effective coordination of efforts between industry and government. In my testimony today, I ask that you keep in clear sight these elements of OPA 90 and that your review of OPA 90 provisions be undertaken with a view toward protecting the many positive contributions of that statute. Specifically the International Group suggests that your review consider the following basic points:

- Targeted, not Sweeping, Changes to OPA 90 are Warranted: OPA 90 is a broad statute that covers a wide range of oil spills, including spills from onshore and offshore wells and facilities, ships and other watercraft of all types. Congress should avoid making hasty changes sections of OPA 90 that are not relevant to the recent DEEPWATER HORIZON casualty. The OPA 90 program for vessels has functioned well for two decades, and has been reviewed and updated by Congress and the Coast Guard recently, whereas the OPA 90 program relating to offshore drilling and productions has not. Dramatic changes could have broad and unintended impacts on a wide range of maritime-related industries.

- Vessel Liability Provisions In OPA 90 Strike a Careful Balance: The vessel liability provisions of OPA 90 represent a careful balancing (taking into account both vessel type and tonnage) to provide appropriate levels of financial responsibility for a broad range of watercraft. OPA 90 applies to virtually all vessel types, including fishing vessels, passenger ships, work boats, and cargo vessels, as well as oil tankers. OPA 90 has

ensured that the whole spectrum of vessel operators have appropriate financial security for pollution, at levels that are reasonable and insurable.

- Unlimited or Disproportionate Liability for Vessels Would Undermine Objectives and Operation of OPA 90. The International Group of P&I Clubs strongly advises against any measures to amend OPA 90 that either remove liability limits for vessels or set those limits so high as to be virtually uninsurable. Limits must also be linked to vessel type and size to avoid disproportionate exposure and insurance cost or unavailability of insurance for smaller vessels. The system adopted in OPA 90, which has worked well, relies on the immediate availability of insurance resources to support clean-up and response operations and to pay third-party claimants for damages from an oil spill with minimal delay or litigation. However, unlimited liability is uninsurable. We cannot assume that insurance will always be available regardless of the liabilities and limits imposed or market conditions.

B. Worldwide P&I Cover for Pollution Liabilities.

The cover provided by Group Clubs includes cover for pollution liability. The international insurance industry is one of creative approaches to risk management and compensation for loss. However adaptable this market has been and will be, its resources are finite. Club cover for pollution liabilities is limited to a maximum of US$1 billion. For vessel operations in U.S. waters, the cover limit has proven to be more than adequate adequate to meet the maximum limits under OPA 90.

While the Clubs provide cover for pollution incidents, they do not provide the Certificates of Financial Responsibility (COFRs) required by the United States under OPA 90. These COFRs are issued by a small number of dedicated providers who, in turn, rely on market reinsurance to underwrite the potential exposure arising under their certificates based on the OPA 90 statutory limits applicable to the size and type of vessel covered (which under the current limits could reach approximately $525 million for large tankers).

C. The Oil Pollution Act of 1990

OPA 90 was enacted on August 18, 1990 following the EXXON VALDEZ casualty. EXXON VALDEZ represented an historical turning point for domestic and international

shipping, much as the DEEPWATER HORIZON spill doubtless will be for the offshore oil industry. The VALDEZ incident made it clear that the shipping industry could not continue to do "business as usual." By enacting OPA 90, Congress established, subject to certain narrow defences and rights of limitation, the strict, joint and several liability of the responsible party for removal costs and damages (as defined in the Act) and further established the Oil Spill Liability Trust Fund (OLSTF), a separate compensation fund supported by a tax on both imported and domestic oil paid by the oil industry. In drafting OPA 90 , one of Congress' stated aims was to protect the US taxpayer from having to meet spill response costs and damages, and to ensure that those costs would be shared appropriately within the oil and shipping industries. It is important to recognise that the funding of the OSLTF is not from government/public funds, but rather from oil companies, supplemented by collections from Responsible Parties.

In enacting OPA 90, Congress consolidated a previous patchwork of laws applicable to marine oil spills, including the Clean Water Act, the Outer Continental Shelf Lands Act, the Deepwater Ports Act, and other statutes. OPA 90 was organized around a primary "polluter pays" principle, establishing that responsible parties are liable for any discharge of oil (or threat of discharge) from a vessel or facility, up to specified limits, regardless of fault.

OPA 90 broadened the scope of damages for which a responsible party is liable, including cleanup costs incurred by private persons as well as government entities. In addition, OPA 90 provided for recovery of damages for injury to natural resources, loss of personal property (and resultant economic losses), loss of subsistence use of natural resources, lost revenues resulting from destruction of property or natural resource injury, lost profits resulting from property loss or natural resource injury, and costs of providing extra public services during or after spill response.

OPA 90 limits the responsible party's defenses to acts of God, acts of war, and acts or omissions of third parties (other than those acting as agents or in connection with a contract with the responsible party). OPA 90 also sets liability limits (or caps) for cleanup costs and other damages. Based on vessel types and gross tonnage, these limits ensure that smaller vessel owners and operators do not incur disproportionate liability and insurance costs. The limitations

do not apply, however, in cases of gross negligence or wilful misconduct, violation of applicable regulatory requirements, failure to report an oil spill, failure to cooperate with responsible officials or to comply with a government removal order. These exceptions to limitation have created a strong incentive for shipowners to ensure that their vessels are operated in strict compliance with US and international laws and regulations.

As an additional layer of security, OPA 90 requires that vessels maintain evidence of financial responsibility in the form of Certificates of Financial Responsibility (COFRs), which serve as guaranties of responsible parties' capacity to pay claims. In general, all vessels over 300 gross tons are required to have a valid COFR to operate in U.S. waters. OPA 90 also requires that guarantors submit to direct actions by claimants for removal costs and damages, subject only to the defenses available to the responsible party, or the defense that the incident was caused by the gross negligence or willful misconduct of the responsible party. The P&I Clubs, however, have a longstanding policy of not providing such anticipatory guarantees because of their obligations to the totality of their members, many of whom never trade to the United States, to ensure that mutual insurance structure and reinsurance arrangements noted above are not put at risk. During the Congressional debates on OPA in 1990, the lack of any workable substitute to the International Group's insurance program threatened to cause the withdrawal of the majority of the world's commercial shipping from the US trade, with the possible disruption of the US economy. Fortunately, alternative guarantors willing to provide the necessary guarantees emerged late in the OPA 90 legislative process. It is of the utmost importance to understand, however, that the continuing ability of these guarantors to respond to claims for response costs and damages is dependent on the P&I Clubs' proven record of payment of oil spill claims in the first instance, and on the continued availability of reinsurance in the very rare case that P&I cover is not available. Any proposal to remove the existing OPA vessel limits, if enacted into law, creates a significant risk that the vast majority of reputable shipowners and operators would be compelled to withdraw from the US trade.

For large tankers serving the US Trades today (VLCCs), the maximum COFR requirement under OPA's liability formulae is approximately $525 million. But, because COFRs are issued for a multitude of vessel types, functions, and sizes, the average COFR value is

approximately $65 million under current law. Were Congress to impose a one-size-fits-all liability limit, regardless of vessel capacity or type, the exposure of COFR providers (and the ensuing costs to the industry generally) would be magnified many times for no particular reason, given claims history and the relationship between COFR and P&I coverage. This would require an enormous increase in reinsurance capacity at a time when it is questionable whether such capacity would be available.

OPA 90 also introduced comprehensive requirements for prevention and response to oil spills in the marine environment, including the phase-out of single-hull tank vessels and their replacement by modern double-hull tankers and verifiable requirements for oil spill contingency planning and response to pollution incidents. As mandated by OPA 90, the US Coast Guard carries out an intensive program of port state control inspections of all US and foreign-flag vessels calling at US ports. These inspections include verification of vessel response plans which require the identification and engagement of the resources necessary to respond to a worst-case discharge of the vessel's entire cargo in adverse weather conditions. It should be emphasized that the US Coast Guard does not rely on industry self-assessments but rather on systematic and vigorous on-site inspections by highly motivated and well-trained personnel of all vessels entering US ports to verify compliance with federal law and regulations and applicable international conventions. The statistics (which will be provided in a separate submission to the Committee) confirm that the Coast Guard port state control program, in partnership with the shipping industry, has led to a remarkable decrease in the number of ship-source oil pollution incidents both in the US and worldwide.

D. Differences Between Offshore Drilling and Vessel Operations Warrant Different Liability Regimes

The risk profile and exposures of offshore production and exploration activities are very different from those entailed in commercial shipping activity. Vessels have a finite cargo and fuel capacity. Vessel owners and operators are required by OPA 90 to respond to a discharge of the vessel's entire cargo in adverse weather conditions. The "worst case" discharge from a vessel is measurable and the necessary response resources must be identified and their

availability assured by contractual arrangements verified by the US Coast Guard in advance of a spill incident. (By contrast, a "worst case discharge" from an offshore facility is defined in OPA 90 as the "largest **foreseeable** discharge in adverse weather conditions [emphasis added]." As the DEEPWATER HORIZON spill has made abundantly clear, a "foreseeability" standard in relation to offshore exploration and drilling in the deep ocean environment is simply unworkable even with the best engineering and technology.)

As noted above, OPA 90 provides for strict liability of the responsible party up to specified monetary limits of liability which, in the case of commercial vessels, are tonnage-based and vary by vessel type and construction characteristics. The right to assert defenses to liability or to limit liability under OPA 90 is narrowly circumscribed. The economics of the vessel industry are also distinguishable from those of the offshore exploration and extraction industry. Vessel owners often operate at relatively low profit margins and are frequently organized in relatively small, but numerous corporate and partnership entities. Although some major oil companies still operate tank vessels, the trend in the industry has been for major oil companies to curtail or eliminate their shipping operations and to rely on smaller, independent shipowners for transport of oil and petroleum product. These smaller, independent enterprises lack the capital resources of large international oil companies.

E. Limitation and Insurability

The right of a shipowner to limit liability is an integral part of International Conventions as well as OPA and is fundamental to the insurability of such liability. No insurer will underwrite unlimited liability. Without insurance (and adequate evidence thereof) a shipowner cannot trade. The current OPA 90 limits provide certainty of exposure for the purposes of facilitating certification of insurance or other evidence of financial responsibility for such exposure. If enacted into law, the Administration's current proposals, and in particular the strikeout of the current vessel type and tonnage based limitation system and replacement with an as yet unquantified damages limit (which is mirrored in the proposed COFR changes) would bring to an end the current system of certification of financial responsibility, with no practicable alternatives.

The effect of the proposed legislation would also eliminate the need for oil industry participation in financing of the National Pollution Fund, since responsible parties for vessels would be strictly liable for 100 per cent of all cleanup costs and damages, even where the vessel owner and operator were in full compliance with their regulatory responsibilities.

F. The Record of OPA 90 Since its Enactment Has Been Positive.

The offshore drilling provisions of OPA, administered by the Minerals Management Service, have been largely untested and unchanged since the mid-1990s. Reviewing and reforming those provisions and the MMS oversight and enforcement program represents a substantial legislative undertaking. However, current problems stemming from the DEEPWATER HORIZON incident are specific to the offshore exploration and production sector. The original OPA 90 limits for offshore facilities, in contrast to the provisions limiting vessel liability, have never been revised since OPA 90's enactment. To the extent amendments to OPA 90 are needed to address the type of exposure and liabilities arising out of the DEEPWATER HORIZON incident, they should be proportionate and specific to offshore activities and should not, intentionally or inadvertently, extend to the carriage of oil cargoes by vessels where the risk and exposure is different and where an effective and proven compliance system is already in place.

By contrast, the OPA 90 provisions relating to vessel liability (administered by the Coast Guard) have been tested regularly in actual spill situations and were updated by Congress as recently as 2006 in the Delaware River Protection Act. The Coast Guard adjusted the vessel limits again in 2009 to account for significant increases in inflation. The current liability limits reflect an almost threefold increase in the original limits. There is no pressing need to revisit the vessel limits at this time, particularly where many segments of the US economy could be affected. Data maintained and reported by the Oil Spill Liability Trust Fund confirm that very few incidents exceed OPA 90 limits.

Vessel liability limits under OPA 90 have been proven to be adequate and workable. In the few cases where vessel limits have been exceeded, additional resources have come from oil industry funding – not taxpayers – via the Oil Spill Liability Trust Fund (OSLTF). The OSLTF,

an industry-funded resource held in trust by the US Coast Guard, has been adequate to meet additional liabilities. The OSLTF is a key element of OPA 90's balanced and tiered response to financial responsibility, ensuring that oil industry resources are available to pay for oil spills that exceed vessel owners' individual liability thresholds.

G. Summary and Conclusion

(1) The current OPA system for limitation of liability and the associated COFR provisions have worked well in the context of commercial vessel operations.

(2) Changing the system to impose on shipowners unlimited liability for removal costs and a single vessel limit for damages not dependent on vessel type or size will undermine the insurance and COFR arrangements on which the success of OPA 90 rests.

(3) The DEEPWATER HORIZON incident may indicate a need to review the provisions relating to liability arising from offshore exploration and production where the nature of the risk and exposure is very different from the commercial shipping sector. Addressing offshore sector issues does not require a parallel review of the commercial shipping sector where the system is robust, has been reviewed and adjusted over the years, and is effective in promoting prompt response and quick settlement of claims.

(4) Subjecting vessel operators trading to the U.S. to unlimited and uninsurable liabilities will place at risk the ability of the majority of the world's commercial fleets to trade to the United States. Such action would not be consistent with Congress' aim of having a comprehensive energy transportation system with an effective, predictable liability and response regime. The absence of limits of liability, or limits set at uninsurable levels, will exclude all participants other than a very few, very large companies that can self-insure -- or worse, undercapitalized risk-takers who are willing to gamble with financial extinction in return for short-term enrichment on inflated transport rates.

The International Group of P&I Clubs is grateful for this opportunity to comment on these important issues and stands ready to assist the Committee as it conducts its review of liability and financial responsibility provisions of the Oil Pollution Act of 1990.

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TESTIMONY OF
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ON LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES
BEFORE THE
HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

JUNE 09, 2010

Good morning Chairman Oberstar and distinguished members of the committee. Thank you for the opportunity to testify before this committee on the BP/Deepwater Horizon oil spill.

On the evening of April 20, 2010, the Transocean-owned, BP-chartered, Marshall Islands-flagged Mobile Offshore Drilling Unit (MODU) DEEPWATER HORIZON, located approximately 72 miles Southeast of Venice, Louisiana, reported an explosion and fire onboard. This began as a Search and Rescue (SAR) mission—within the first few hours, 115 of the 126 crewmembers were safely recovered; SAR activities continued through April 23, but the remaining 11 crewmembers were never found.

Concurrent with the SAR effort, the response to extinguish the fire and mitigate the impacts of the approximately 700,000 gallons of diesel fuel onboard began almost immediately. After two days of fighting the fire, the MODU sank into approximately 5,000 feet of water on April 22. On April 23, remotely operated vehicles (ROVs) located the MODU on the seafloor, and, on April 24, BP found the first two leaks in the riser pipe and alerted the federal government. Within the first 24 hours, the Coast Guard's Federal on Scene Coordinator (FOSC) accessed the Oil Spill Liability Trust Fund (OSLTF) to ensure funds were available to speed the federal response to the threat of an oil spill. ROVs continue to monitor the flow of oil.

As the event unfolded, a robust Incident Command System (ICS) response organization was stood up April 23 in accordance with the National Response Framework (NRF) and the National Oil and Hazardous Substances Pollution Contingency Plan (NCP). ICS is utilized to provide a common method for developing and implementing tactical plans to efficiently and effectively manage a multi-agency response to an emergency, such as an oil spill. The ICS organization for this response includes Incident Command Posts and Unified Commands at the local level, and a Unified Area Command at the regional level. It is comprised of representatives from the Coast Guard (FOSC), other federal, state, and local agencies, as well as BP as a responsible party.

The federal government has addressed the BP/Deepwater Horizon Oil Spill with an all-hands-on deck approach from the moment the explosion occurred. During the night of April 20—the date of the explosion—a command center was set up on the Gulf Coast to address the potential environmental impact of the event and to coordinate with all state and local governments. After the MODU sank on April 22, the National Response Team (NRT)—led by the Secretary of Homeland Security and comprised of 16 federal agencies including the Coast Guard, other DHS offices, Department of Interior (DOI), the Environmental Protection Agency (EPA), National Oceanic and Atmospheric Administration (NOAA),—as well as Regional Response Teams (RRT), were activated.

On April 29, Secretary Napolitano declared the event a Spill of National Significance (SONS), which enhanced operational and policy coordination at the national level and concurrently allowed the appointment of Admiral Thad Allen as the National Incident Commander (NIC) for the Administration's continued, coordinated response. The NIC's role is to coordinate strategic communications, national policy, and resource support, and to facilitate collaboration with key parts of the federal, state and local government.

LESSONS LEARNED FROM PAST RESPONSES

The Coast Guard has been combating oil and hazardous materials spills for many years; in particular, the 1989 major oil spill from the EXXON VALDEZ yielded comprehensive spill preparedness and response responsibilities.

In the 20 years since the EXXON VALDEZ, the Coast Guard has diligently addressed the nation's mandates and needs for better spill response and coordination. For example, a SONS Exercise is held every three years. In 2002, the SONS Exercise was held in New Orleans to deal with the implications of a wellhead loss in the Gulf of Mexico. In that exercise, the SONS team created a vertically integrated organization to link local response requirements to a RRT. The requirements of the RRT are then passed to the NRT in Washington, D.C, thereby integrating the spill management and decision processes across the federal government. The response protocols used in the current response are a direct result of past lessons learned from real world events and exercises including SONS.

Although the EXXON VALDEZ spill shaped many of the preparedness and response requirements and legislation followed to this day, other significant events since 1989 have generated additional lessons learned that shape our response strategies. The Coast Guard and EPA FOSCs have accessed the OSLTF to respond to over 11,000 oil spills or significant threats of an oil spill in the 19 years since the establishment of the Fund. The liability and compensation regime contained in Title I to the Oil Pollution Act of 1990 is well rehearsed and integrated into the FOSC's daily operations. Use of the Fund, oversight of the responsible party's obligation to advertise for and receive claims from those damaged by oil pollution, and cost recovery from the responsible party of all federal funds expended are all part of the pollution response exercise cycle. These functions were most recently exercised during the Spill of National Significance (SONS) 2010 exercise that took place in Maine in March 2010.

ROLE OF THE OIL SPILL LIABILITY TRUST FUND

The Oil Spill Liability Trust Fund (OSLTF), established in the U.S. Treasury, is available to pay the expenses of federal response to oil pollution under the Federal Water Pollution Control Act (FWPCA)(33 U.S.C. § 1321(c)) and to compensate claims for oil removal costs and certain damages caused by oil pollution as authorized by the Oil Pollution Act of 1990 (OPA) (33 U.S.C. § 2701 *et seq.*). These OSLTF expenditures will be recovered from responsible parties liable under OPA when there is a discharge of oil to navigable waters, adjoining shorelines, or the Exclusive Economic Zone (EEZ).

> *The United States established an exclusive economic zone, the outer limit of which is a line drawn in such a manner that each point on it is 200 nautical miles from the baseline from which the breadth of the territorial sea is measured. The U.S. EEZ is the largest in the world, containing 3.4 million square miles of ocean and 90,000 miles of coastline.*

The OSLTF is established under section 9509 of the Internal Revenue Code (26 USC § 9509), which also describes the authorized revenue streams and certain broad limits on its use. The principal revenue stream is an 8 cent per barrel tax on oil produced or entered into the United States (see the tax provision at 26 U.S.C. § 4611). The per barrel tax increases to 9 cents for one year beginning on January 1, 2017, and the per barrel tax expires at the end of 2017. Other revenue streams include oil pollution-related penalties under 33 U.S.C. § 1319 and § 1321, interest earned through Treasury investments, and recoveries from liable responsible parties under OPA. The current OSLTF balance is approximately $1.5 billion. There is no cap on the fund balance but there are limits on its use per oil pollution incident. The maximum amount that may be paid from the OSLTF for any one incident is $1 billion. Of that amount, no more than $500 million may be paid for natural resource damages (26 U.S.C. § 9509(c)(2)).

OPA further provides that the OSLTF is available to the President for certain purposes (33 U.S.C. § 2712(a)) including federal removal costs, claims for uncompensated removal costs and damages, and payment of select federal administrative, operating and personnel costs addressed by the OPA.

NATIONAL POLLUTION FUNDS CENTER FUNDING AND COST RECOVERY

The National Pollution Funds Center (NPFC) is a Coast Guard unit that manages use of the OSLTF, making available the emergency fund for federal removal as well as trustee costs to initiate natural resource damage assessment. The NPFC also pays qualifying claims against the OSLTF that are not compensated by the responsible party. Damages include real and personal property damages, natural resource damages, loss of subsistence use of natural resources, lost profits and earnings of businesses and individuals, lost government revenues, and net costs of increased or additional public services that may be recovered by a state or political subdivision of a state.

In a typical scenario, the FOSC, Coast Guard, or EPA accesses the emergency fund to carry out 33 U.S.C. § 1321(c), that is, to remove an oil discharge or prevent or mitigate a substantial threat of discharge of oil to navigable waters, the adjoining shoreline or the EEZ. Costs are documented and provided to NPFC for reconciliation and eventual cost recovery against liable responsible parties. Federal trustees may request funds to initiate an assessment of natural resource damages and the NPFC will provide those funds from the emergency fund as well.

OPA provides that all claims for removal costs or damages shall be presented first to the responsible party. Any person or government may be a claimant. If the responsible party denies liability for the claim, or the claim is not settled within 90 days of being presented, a claimant may elect to commence an action in court against the responsible party or to present the claim to the NPFC for payment from the OSLTF. OPA provides an express exception to this order of presentment for state removal cost claims. Such claims are not required to be presented first to the responsible party and may be presented directly to the NPFC for payment from the OSLTF. These and other general claims provisions are delineated in 33 U.S.C. § 2713 and the implementing regulations for claims against the OSLTF in 33 CFR Part 136. NPFC maintains information to assist claimants on its website at www.uscg.mil/npfc.

NPFC pursues cost recovery for all OSLTF expenses for removal costs and damages against liable responsible parties pursuant to federal claims collection law including the Debt Collection Act, implementing regulations at 31 CFR parts 901-904 and DHS regulations in 6 CFR part 11.

Aggressive collection efforts are consistent with the "polluter pays" public policy underlying the OPA. However, the OSLTF is intended to pay even when a responsible party does not pay.

THE EMERGENCY FUND AND DEEPWATER HORIZON

The OSLTF consists of two major components, the main fund, or Principal Fund, and an Emergency Fund.

The Emergency Fund is available for Federal On-Scene Coordinators (FOSCs) to respond to oil discharges and for Federal natural resource trustees to initiate natural resource damage assessments, pending reimbursement by the Responsible Party. The Emergency Fund is authorized to receive an annual $50 million infusion of funds through an apportionment from the OSLTF Principal Fund. In addition, the Emergency Fund may receive an advance of $100 million from the Principal Fund to supplement Emergency Fund shortfalls. (See 33 U.S.C. § 2752(b)).

In FY2010, the Emergency Fund has already received its annual $50 million apportionment. On May 3, 2010, since the initiation of the BP/Deepwater Horizon response, it received the statutorily authorized $100 million advance. These funds have been used to support the ongoing response efforts of 27 federal entities as well as response funding provided directly to the affected states.

While all funds expended will be billed to BP and, ultimately, recovered, these funds are deposited into the principal fund, not the emergency fund. As of June 1, 2010, obligations against the Emergency Fund for Federal response efforts totaled $93 million. At the current pace of BP/Deepwater Horizon response operations, funding available in the Emergency Fund will be insufficient to sustain Federal response operations within two weeks. Should this occur, the FOSC will not be able to commit additional funds for the agencies involved to provide critical response services, including for logistical, scientific and public health support.

On May 12, the Administration proposed a legislative package that will: enable the Deepwater Horizon Oil Spill response to continue expeditiously; speed assistance to people affected by this spill; and strengthen and update the oil spill liability system to better address catastrophic events.

The bill would permit the Coast Guard to obtain one or more advances—up to $100 million each—from the Principal Fund within the OSLTF to underwrite federal response activities taken in connection with the discharge of oil associated with the BP Deepwater Horizon spill. This provision would ensure that the Emergency Fund has sufficient resources to support the Federal response. To enhance the ability to address generally the harms created by oil spills as well as to strengthen and update these laws, the bill would, for any single incident, raise the statutory expenditure limitations for the OSLTF from $1 billion to $1.5 billion and for natural resource damage assessments and claims from $500 million to $750 million.

LIABILITY LIMITS AND FINANCIAL RESPONSIBILITY

The Administration's May 12 legislative package also includes significant increases to OPA liability limits for vessel and facility source oil discharges, particularly relating to liability for oil removal costs.

Current law provides that a vessel's liability limit for oil removal costs and damages is a single fixed amount based on the vessel gross tonnage and vessel type. There are also certain fixed minimum amounts that may apply. Beginning in January 2007, the Coast Guard has annually reported on the adequacy – or rather, the inadequacy - of vessel liability limits. In the most recent 2009 Report on Oil Pollution Act Liability Limits, the Coast Guard's NPFC concluded as follows:

> The NPFC continues to anticipate the OSLTF will be able to cover its projected non-catastrophic liabilities, including claims, without further increases to liability limits. However, **increases to liability limits for certain vessel types would result in a more equitable division of risk between the Fund and responsible parties, have a positive impact on the balance of the Fund, and reduce the Fund's overall risk position [emphasis added]**.
>
> The limited data available indicates, as in previous reports, that increasing liability limits per incident for single hull tank ships, tank barges and non-tank vessels greater than 300 gross tons in particular would result in a more balanced cost share between responsible parties and the Fund while positively impacting the Fund's balance.[1]

Companies participating in offshore drilling, shipping, and other activities currently covered by Oil Pollution Act liability caps must demonstrate that they have the financial capacity to address anticipated clean-up costs and damages from their operations. Oil and other companies participating in offshore drilling activities should be strictly liable (jointly and severally) and responsible for all of the damages their activities could impose on persons, businesses, and the environment, thereby not only ensuring full compensation in the event of a spill, but also greatly aiding the prevention of future spills in the first place. Similarly, oil spill liability caps established by the Oil Pollution Act of 1990 for activities other than offshore drilling activities, such as shipping, should be reviewed and increased as appropriate to more fully reflect the spill risk associated with those activities. We look forward to working with Congress to change liability rules going forward and implement those changes within a reasonable transition period.

[1] The full Limit of Liability report is available on the NPFC web site at: http://www.uscg.mil/npfc/docs/PDFs/Reports/Liability_Limits_Report_2009.pdf

OPA CLAIMS PROCESS AND DEEPWATER HORIZON

BP and Transocean acknowledged in writing on May 10 their responsibility to advertise to the public the process by which claims may be presented; the NPFC has directed the responsible parties to use one phone number and one process so as not to confuse claimants, and all claims are being processed centrally through BP. As of May 31, 30,619 claims have been opened with BP, and more than $39 million has been disbursed; no claim has been denied, though many have yet to be processed.

So far, the majority of claims have been for lost income and lost profits for individuals and small businesses; as more oil comes ashore, property damage claims will likely increase. The interagency community continues to oversee BP's claims process. BP has set up 30 claims processing centers throughout the affected region, with over 480 managers and claims adjusters in the field. BP has also established a 1-800 number that is available 24/7, as well as web-based claims submission capabilities. While OPA 90 requires the responsible party to advertise and accept claims, NPFC has asked BP to be responsive to requests for information or action to ensure the claims process is meeting the needs of the citizens of the Gulf. The NPFC is in daily communication with BP regarding its claims administration and is raising concerns as they emerge. For example, in response to an NPFC request, BP is now providing translation services in Vietnamese and Spanish in certain communities, as well as on the 1-800 phone line. BP has also established a mediation capability for claimants who desire.

That said, we do not yet have complete, ongoing transparency into BP's claims process including detailed information on how claims are being evaluated, how payment amounts are being calculated, and how quickly claims are being processed. We are working with BP's senior executives to make sure we have the information we and appropriate representatives of State governments need to meet our responsibilities to the public.

BP's current claims capacity can take in 6,000 claims per day, while the current rate is well under 2,000. BP reports that it can surge to a capacity of taking in 15,000 claims per day, with over 2,500 adjusters and managers in the field in a matter of days. However, BP has not responded to all of NPFC's requests for data. BP currently provides daily summary data on claims that does not provide enough visibility into the claims process to fully view claims amounts and processing times.

Claims can be paid for the following damages (33 U.S.C. § 2702(b)):

- Unreimbursed Removal Costs
- Real or Personal Property Damage
- Loss of Profits or Earning Capacity
- Loss of Government Revenue
- Cost of Increased Public Services
- Natural Resource Damages
- Loss of Subsistence Use of Natural Resource Damages (NRD)

Claims can be submitted within the following statute of limitation:

- For Removal Costs: six years after date of completion of all removal actions.
- For Damages: three years after the date on which the injury and its connection with the discharge are reasonably discovered with due care.
- For NRD: three years from the date of completion of the NRD assessment.

As stated earlier, claimants who are denied by a responsible party can bring their claims directly to the NPFC for adjudication. If the NPFC finds the damage to be OPA-compensable and pays it, the cost of that claim will be billed to BP and recovered. In enacting these provisions, Congress made it clear that the Fund was available to pay so that claimants would not be required to go through costly litigation to be compensated. Fund payments are aggressively recovered from responsible parties to the fullest extent of the law consistent with the "polluter pays" policy underlying OPA, but the Fund remains available as the ultimate insurer for compensation of removal costs and damages under the OPA.

There are a number of advantages to claimants of having a responsible party pay the claims. BP can pay for more than just OPA compensable damages if it chooses, and BP may be liable for other damages, such as personal injury, covered by other laws. BP may also choose to pay a claim with less documentation than the government would be required to obtain. Further, BP can negotiate claim settlement, and is offering mediation services.

CONCLUSION

Through the National Incident Command, we are ensuring all capabilities and resources—government, private and commercial - are being leveraged to protect the environment and facilitate a rapid, robust response effort. OPA and its claims provisions provide a cornerstone to the relief and recovery of the tens of thousands of residents of the Gulf region affected by this tragedy. Every effort is being made to ensure that those damaged by the oil spill are compensated, and that the polluter pays. Thank you for the opportunity to testify today. I look forward to your questions.

Testimony
House Transportation and Infrastructure Committee
Jack Gerard, President and CEO
American Petroleum Institute
1220 L Street, N.W.
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June 9, 2010

Good morning Chairman Oberstar, Ranking Member Mica, and members of the committee.

I am Jack Gerard of the American Petroleum Institute. API's 400 member companies represent all sectors of America's oil and natural gas industry. Our industry supports 9.2 million American jobs – including many in the offshore development business – and provides most of the energy the nation needs to power the economy and our way of life.

The tragic and heartbreaking accident in the Gulf was unprecedented, and our thoughts and prayers go out to the families who lost loved ones, to the workers who were injured, and to all of our neighbors in the Gulf who were affected.

The people of the oil and gas industry understand our responsibility to find out what happened and why, and to work in cooperation with the government to come up with recommendations for improving this process across the board.

We have already assembled the world's leading experts to conduct a top-to-bottom review of offshore drilling procedures, from operations to emergency response. And our industry is providing data and expertise to the federal government to stop the flow of oil, clean up the environment, understand the causes and correct them.

As Congress considers legislative changes that impact domestic oil and natural gas production from our offshore resources, it is critical that proposals both protect taxpayers and advance our country's energy and economic interests. This nation's energy and economic security demands must be met by increased domestic oil and natural gas production now and for the next several decades. We want to work with Congress and the administration as we consider the best way to protect taxpayers and provide the energy our country needs.

I'm here today to address one of the important mechanisms we have that addresses liability and financial responsibility for oil spills.

The Oil Pollution Act of 1990 (OPA '90) established the Oil Spill Liability Trust Fund (OSLTF) as an important "insurance policy" to cover the costs of potential economic damages from oil releases from exploration, production or transportation

accidents. The OSLTF is funded exclusively by a per barrel tax on the oil industry – not by taxpayers. The industry has contributed 100% of the amount currently in the Fund, and we accept the responsibility to ensure this important safety net is adequately funded into the future.

Because there has been confusion in media reports and elsewhere, it is very important to reiterate that OPA '90 requires that for offshore facilities responsible parties pay ALL cleanup costs related to a spill from an offshore platform. Only then can responsible parties use the Trust Fund to cover up to $1 billion for consequential damages if those claims exceed the OPA's $75 million liability cap. Further, the liability cap for consequential damages does not apply in instances of gross negligence, willful misconduct, or violation of applicable federal regulations. Injured parties may also file claims in state courts, which are not subject to the liability limits.

In response to the Deepwater Horizon incident, BP has made it clear in writing that it will pay 100% of the environmental cleanup and all legitimate claims for economic damages without seeking reimbursement from the Trust Fund. Nevertheless, some are proposing to increase liability limits for economic damages from $75 million up to $10 billion, or even to remove the limit altogether. We recognize that changes are needed, but believe that proposals to arbitrarily raise or remove the fund's cap would threaten the viability of offshore operations and could significantly reduce U.S. domestic oil and natural gas production, cost jobs and harm U.S. energy security.

Nor are we alone in this assessment, as independent insurers and analysts have reached similar conclusions. Preliminary analysis indicates the following are some anticipated results of increasing the liability limits for economic damages from $75 million to $10 billion:

- Some of the leading insurance companies in the oil and gas market have told Congress that they would be unable to offer adequate insurance protection for offshore operations under proposals to increase liability limits for economic damages to $10 billion, making the economic risk of conducting offshore operations too great for most small, mid and even large sized companies.

- Estimates indicate that—aside from the national companies owned by foreign governments—only a few of the very largest oil and natural gas companies could meet a potential $10 billion financial assurance test for self insurance.

- Lack of insurance created by a $10 billion cap would, in effect, push all small, medium and even most of the major integrated companies out of the Gulf.

- An estimated 170,000 direct and indirect jobs are supported by the oil and natural gas industry in the Gulf of Mexico. As the companies that could meet the self insurance threshold account for about 15 percent of the total Gulf production, raising the liability cap to $10 billion would place about 145,000 jobs at risk.

- Even the largest companies would see premiums for additional insurance skyrocket, raising overall costs for offshore operations by as much as 25%. The impacts would be devastating. For example, Wood Mackenzie (Upstream Insight, May 2010) estimates that just a 10% increase in development costs could render seven current discoveries sub-economic, reducing production, jobs, and putting $7.6 billion in future government revenue at risk.

As Congress considers this issue, thoughtful consideration must be given to harmonize the need to provide necessary resources to this important industry-funded safety net and protect our environment, while allowing us to safely and reliably provide the energy our nation relies on for our economic and energy security. To help achieve these critical objectives, API has initiated an effort with our member companies to quickly develop and provide to Congress and the administration our recommendations on how to effectively address liability limits and financial responsibility requirements for offshore exploration activities. We are committed to providing quick and constructive input to this important policy debate, and will provide our recommendations in the coming weeks.

This concludes my statement, Mr. Chairman. Thank you.

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June 17, 2010

Chairman James L. Oberstar
House Committee on Transportation and Infrastructure
2165 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Oberstar:

In response to your request from last week's full committee hearing entitled "Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes," please find responses to the following questions:

Mr. OBERSTAR. We expect, based on daily reports and observations and comments from Admiral Allen, the incident manager, that it will be August before relief wells begin to reach their goal, relieve the pressure. Some countries require relief wells to be drilled at the same time as the main well. Should we have a similar requirement?

ANSWER: No. Our concern is that requiring the drilling of a relief well in tandem with the main well effectively doubles the risk exposure for an exploratory well. Recent press reports mention a Canadian policy that recommends oil and natural gas operations--in certain arctic areas with short drilling windows--have the capability to drill a relief well in the same drilling season. This policy is currently under review by Canadian authorities, and it is unclear whether Canada has ever imposed this as condition of issuing a permit to drill.

Mr. OBERSTAR. The American Petroleum Institute has developed the standards for construction of blowout preventers, including the one used by Deepwater Horizon. There is a great deal of concern that there is little oversight by government of industry and little capacity by the Coast Guard to undertake such regulatory action because they don't have in-house capacity. We are going to have legislation that will direct the Coast Guard to establish that capacity, to understand the industry much better, much better than the Minerals Management Agency has done. And we are also considering directing the Coast Guard to develop the standards, much as the FAA establishes standards for aircraft and engines. What would be your view, that of the American Petroleum Institute, in response to such a requirement?

ANSWER: API and its member companies are committed to working with Congress and the Administration towards policies that promote safe and environmentally responsible operations while ensuring domestic oil and gas resources are available to meet our nation's energy needs. Effective oversight and regulation are a critical component to meeting those objectives and we look forward to providing further input as Congress develops its proposals.

Regarding the development of industry standards, the National Technology Transfer and Advancement Act (NTTAA, PL 104-113) requires that all federal agencies use standards developed by voluntary consensus standards organizations, instead of in-house government standards, whenever possible. These entities include trade associations and professional and technical societies. The law also encourages federal agencies to participate in the standards development process.

In the 14 years since the Act's passage, there are many examples of successful public-private sector standards development efforts that help reduce the cost to and improve the effectiveness of government, promote public safety, and protect the environment. These activities take place in a broad spectrum of industries such as aerospace, defense, and fire protection--in addition to oil and natural gas.

The Minerals Management Service references 78 API standards in its offshore regulations. Overall, nearly 100 API standards are referenced in more than 270 citations by government agencies, including the Environmental Protection Agency, the Department of Transportation and the Occupational Safety and Health Administration.

Specific to blow out preventers, the MMS incorporates by reference portions of API RP53, *Recommended Practices for Blowout Prevention Equipment Systems for Drilling Wells*. The legal effect of incorporation by reference is that the material contained in the referenced standard has the full force and effect of the law. This reference is in addition to the 12 separate specific regulations on blow out preventers and related equipment contained in Title 30 of the Code of Federal Regulations, Part 250, Oil and Gas and Sulphur Operations in the Outer Continental Shelf.

Mr. OBERSTAR. Mr. Gerard, the pressure at the 18,000-foot level, below mud line where the oil reservoir has been located, is by various estimates in the range of 2,300 to 12,000 pounds per square inch, or psi. Was the blowout preventer tested at those pressures?

We have no knowledge of the test pressures used in the case of the Macondo well.

API Specification 16A (Spec 16A) requires that when manufactured, BOPs are tested to their rated working pressure [rated working pressures in Spec 16A are (in psi) are 2,000; 3,000, 5,000, 10,000; 15,000; and 20,000]. The "shell" that houses all of the BOP equipment (rams, annular, etc.) is actually required to be tested to a pressure exceeding the rated working pressure.

Once in service, MMS regulations (30CFR 250.448) require that BOPs are tested upon installation and every 14 days after that. Ram-type BOPs must be tested to either the rated working pressure of the equipment or 500 psi greater than the calculated maximum anticipated surface pressure (MASP) for the applicable section of hole. If an operator chooses to use the MASP + 500 psi option, the test pressures must have been approved by the MMS in the Application for Permit to Drill (APD).

Spec 16A also requires that during manufacturing shear ram BOPs be tested to determine the shearing and sealing capability for selected drill pipe samples. Spec 16A specifies the minimum grade of drill pipe that must be used in the test.

Once in service, MMS regulations (30 CFR 250.416) require that an operator wishing to drill on the OCS must provide information that shows the blind-shear rams installed in the BOP stack are capable of shearing the drill pipe in the hole under maximum anticipated surface pressures.

Mr. OBERSTAR. I want to have that response in writing because API sets the standards for blowout preventer infractions. The manufacture is done by another industry representative or organization, but it is an API standard. And the standard was not set by MMS or the Coast Guard, and it is vitally important to know was it designed and tested to operate against those pressures from oil at that depth and against the thicker casings of steel for the pipe at that level, which is different from the thickness of steel for a 300- to 600-foot well, correct? [See API response in #3 above] **Supply both the API standard and the response from BP; but it was Transocean, the driller, that actually acquired the blowout preventer and installed it with the confidence that it would operate at those levels. If it is not, if it was not capable of withstanding pressures of that—of those numbers that I just cited, then even if the sheer had worked and had been able to cut through the steel and shut off the flow, it might nonetheless have exploded at that level. We don't know that because it hasn't been tested.**

Mr. OBERSTAR. There are a great many comparisons here between aviation safety and maritime safety. We have passed a Coast Guard authorization bill that substantially, dramatically changes the way in which Coast Guard will conduct marine safety, and I won't go into all of those specifics, but it addresses this. The Senate has passed a similar bill, it doesn't have our provisions in it, and we are working those differences out before conference, but the human factor in drilling operations, the master of the vessel is licensed by the Coast Guard, meaning that that person has to meet certain standards. But to the best of my knowledge, the drill master is not licensed by anyone, by any government organization, that is, hired by the company and certified by the company to be capable, but there is no government standard, no Federal Government standard that the drill master must meet; is that correct? But every mechanic who works on an aircraft, every carman in the railroad industry has to meet standards that the government has set. You are a licensed avionics and power plant—airframe and power plant technician, and if that technician does not sign off the ticket on that aircraft, it doesn't move. That is the kind of standard I am looking for in this industry.

ANSWER: There is no Federal Government standard that a drill master (the person doing the actual drilling of the well) must meet. MMS regulations (30 CFR 250.1500 – Subpart O) establish the performance criteria for industry training programs – an operator must ensure that its employees and contract personnel engaged in well control operations understand and can properly perform their duties. The operator is responsible for establishing a suitable training program and providing adequate training. MMS in turn is responsible for assessing an operator's training program through training system audits, employee interviews, employee testing, and/or hands-on production simulator or live well testing.

Mr. OBERSTAR. Mr. Gerard, you said or you suggest that the proposal to go to $10 billion is too severe. What is the number between $75 million and no limit that the industry would support?

ANSWER: We believe a comprehensive approach is necessary to address concerns with the OSLTF, so we are not prepared today to recommend a specific number for the liability limits for economic damages. As I noted in my testimony, API is currently engaged in an effort with our member companies to quickly develop and provide recommendations on how to effectively address liability limits and financial responsibility requirements for offshore exploration activities. We commit to continuing a dialog with you and your staff so we can provide constructive input as soon as possible to this important policy debate.

Mr. OBERSTAR. I think the advantage of having long service in the Congress is to have been present when this body of law was created. I remember very well in the aftermath of the Torrey Canyon and the Amoco Cadiz the hearings we held in the Marine and Fisheries Subcommittee on the extent of liability that should be imposed upon the industry, and the repeated claims that you had to have a number against which the industry could insure. That became the standard for oil pollution liability in the1978 act and the 1988-1989 act and the OPA 90. Those were measures aimed at known quantities. We know how much oil there was onboard the Exxon Valdez and the Amoco Cadiz and Torrey Canyon and the big supertankers. That is a definable, measurable amount. But when a well breaks at 5,000 feet from a reservoir that is another 18,000 feet further, and the amount of oil in that reservoir is only an estimate, you have an unknown or unknowable quantity of oil coming out against which it is very difficult to insure. I understand that. So if the damages are in excess of a billion, $5 billion, or $10 billion, whose responsibility is it then?

ANSWER: BP has made it clear in writing that it will pay 100% of the environmental cleanup and all legitimate claims for economic damages from the Deepwater Horizon incident, without seeking reimbursement from the Trust Fund. If a responsible party were to choose to go to the Trust Fund to recover an amount above its liability limit requirement, the Fund would only reimburse to the current per incident cap amount of $1 billion. However, Congress is currently proposing to raise this per incident cap to $5 billion through "tax extenders" legislation—HR 4213. We commit to continuing dialogue with you and your staff on the appropriate per incident cap within the OSLTF.

Thank you for the opportunity to testify before the House Committee on Transportation and Infrastructure. I look forward to working with you further as Congress debates the important issues surrounding the Deepwater Horizon incident. Please let me know if we can provide additional information.

Sincerely,

Jack Gerard
President and CEO

Testimony for the
U.S. House of Representatives
Committee on Transportation and Infrastructure
Hon. James Oberstar, Chair
10:30 a.m., June 9, 2010

on

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

by

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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 vehicles 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 costs[13]—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 1989[15] and $5 billion in 1990[16]. 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 polices 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 companies[31]—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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[2] Ibid.
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[4] International Tanker Owners Pollution Federation, "Cost of Spills," available at http://www.itopf.com/spill-compensation/cost-of-spills.
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[7] CBS News, "In Alaska, Painful Memories of Exxon Valdez," May 3, 2010, available at http://www.cbsnews.com/stories/2010/05/03/national/main6456927.shtml.
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[20] Sima Gandhi, *The Big Oil Discount* (Washington: Center for American Progress, 2010).
[21] Jonathan Ramseur, "Oil Spills in U.S. Coastal Waters: Background, Governance, and Issues for Congress" (Congressional Research Service, 2010).
[22] John Cranford, "Oil, Water, Profit and Peril," *CQ Weekly*, June 6, 2010.
[23] 33 USC 2716
[24] Insurance Information Institute, "The Deepwater Horizon Disaster: Insurance Market Impacts" (2010), available at http://www.iii.org/presentations/the-deepwater-horizon-disaster-insurance-market-impacts.html.

[25] Energy Information Administration data, available at http://tonto.eia.doe.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFP3FM2&f=A.
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[27] Energy Information Administration data, available at http://www.eia.doe.gov/oiaf/aeo/otheranalysis/ongr.html.
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[30] See John Podesta and Dan Weiss, "America Needs an Oil Reform Agenda" (Washington: Center for American Progress, 2010); Sima Gandhi, "The Big Oil Discount" (Washington: Center for American Progress, 2010); and Sima Gandhi, "Pumping Tax Dollars to Big Oil" (Washington: Center for American Progress, 2010). All CAP publications are available at www.americanprogress.org.
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[32] Center for American Progress, *Idea of the Day: Earmarking BP's Money in Escrow for Clean Up and Compensation* (2010).
[33] Kate Gordon and Richard Caperton, "Life After the BP Gulf Gusher" (Washington: Center for American Progress, 2010).
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[35] John Podesta and Dan Weiss, "America Needs an Oil Reform Agenda" (Washington: Center for American Progress, 2010).

STATEMENT OF MICHAEL GREENSTONE

MASSACHUSETTS INSTITUTE OF TECHNOLOGY
THE HAMILTON PROJECT
THE BROOKINGS INSTITUTION

HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE HEARING

"LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES"

JUNE 9, 2010
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Testimony of Michael Greenstone
before the House Transportation and Infrastructure Committee
June 9, 2010

Thank you Chairman Oberstar, Ranking Member Mica and members of the committee for inviting me here today.

My name is Michael Greenstone and I am the 3M Professor of Environmental Economics at the Massachusetts Institute of Technology, the Director of The Hamilton Project, and a Senior Fellow at the Brookings Institution. My research focuses on estimating the costs and benefits of environmental quality and the consequences of government regulation. I appreciate the opportunity to speak with you today about the economic incentives around drilling decisions that impact the chances of oil spills.

The Deepwater Horizon spill is the greatest spill our country has experienced, in terms of both environmental and economic impacts, and I fear that we have yet to understand its full impacts. A key purpose of my testimony is to use economic theory and evidence to take a critical look at existing legislation that regulates drilling, with an eye toward identifying regulatory changes that would allow our country to better meet its energy objectives.

I. INTRODUCTION

As I see it, we have two objectives related to oil drilling. The first is to support energy security through increased energy production in the United States. In my view, energy security refers to the reliable and affordable supply of energy in a manner that does not constrain our policy objectives in other arenas, particularly our national security. As a recent Council of Foreign Relations report put it, countries that rely on imported energy have repeatedly seen that "their growing dependence (on imported energy) increases their strategic vulnerability and constrains their ability to pursue a broad range of foreign policy and national security objectives.[1]" Indeed, it has been an ongoing goal of policymakers to maximize our nation's capacity for energy production so that the U.S. economy is not beholden to the decisions of foreign oil producers.

The second objective is to protect the environment by making sure that energy producers put the appropriate safeguards in place against oil spills and other environmental damages. The American people place tremendous value on clean air and water. After all, a clean environment is necessary for safe recreation at beaches, healthy habitats for wildlife, industries like tourism and fishing, and ultimately preserving the planet for future generations.

These two objectives are often in conflict with each other. Let's look at the two extreme cases: On the one hand, removing all environmental controls would maximize domestic energy production. On the other hand, the one guaranteed way to protect the environment from oil spills would be to stop drilling entirely. Of course, neither of these extremes is practical nor desirable.

The American people depend on the government to find an appropriate middle ground, and to determine the appropriate level, type and location for drilling. An important part of these efforts can

[1] Deutch, John and James Schlesinger, "National Security Consequences of U.S. Oil Dependency" (2006) Independent Task Force Report No. 58, Council on Foreign Relations, New York: New York

be achieved through sensible government regulation -- setting safety standards and conducting inspections. The challenge, however, is that the government is almost always at an information disadvantage relative to the oil companies. This is to be expected because the oil companies set up the rigs, know the local conditions, and generally invest many more worker hours on site analyzing the resulting data. Without access to full information, it is practically impossible for the government to know all of the decisions that are key for preventing spills. And, of course, it is vital that government regulators conduct independent inspections free of influence from the regulated companies.

In the face of this information disadvantage, it is crucial that drillers face the proper economic incentives to prevent spills. This requires that oil companies be held responsible for clean-up costs and economic damages. The assignment of full liability to oil companies means that market forces will guide oil companies investment decisions and cause them to consider the full costs of potential spills in making these decisions.

However, current law protects oil companies and actually provides economic incentives for spills, rather than preventing them. The 1990 Oil Pollution Act capped firms' liability for economic damages from oil spills at $75 million, not adjusted for inflation and in addition to all removal costs.

My primary argument here today is that the removal, or substantial increase, of the liability cap on economic damages from oil spills is the most effective way to align oil companies' incentives with the American people's interests.

It is natural to ask whether the removal of the liability cap would compromise our energy security goals by reducing U.S. production. This question cannot be answered definitively without access to data from oil, shipping, and insurance companies that is not currently in the public domain. Nevertheless if the removal of a cap were to compromise energy security goals, it could be paired with economically sound polices that promote domestic production or reduce oil consumption without putting our environmental goals at risk. Such a pairing would allow us to achieve our energy security <u>and</u> environmental goals.

II. CONSEQUENCES OF THE EXISTING CAP ON LIABILITIES

As I noted above, the $75 million cap on liabilities for economic damages means that oil companies do not bear full responsibility for oil spills. This misalignment of incentives is a classic case of moral hazard. Firms and people behave differently when they are protected from the consequences of their actions.

Indeed, the cap creates incentives for spills.

To illustrate this point, consider oil companies' motivations. Market forces require them to focus on advancing the interests of their shareholders. The result is that oil companies make decisions about where to drill, and which safety equipment to use, based on benefit-cost analyses of the impact on their bottom line. If the expected costs outweigh the expected benefits, most private sector firms will decide against moving forward. However, if the expected benefits exceed the expected costs, the decision to move forward will appear sound.

In the case of drilling, the benefits are the expected value of the oil. The costs include equipment used and wages paid to employees. But, the costs also include the expected payouts for potential spill damages to shorelines, local economies and the environment.

So, the cap inevitably distorts the way companies make these decisions. Locations where damages from a spill may be costly – for example, places near coasts or in sensitive environmental areas – seem more attractive for drilling with the cap than if firms actually were responsible for all damages. Further, investments in safety equipment, like blow-out preventers, or the use of safe, but time-consuming methods, are less likely to appear beneficial with the liability cap.

The result is that the cap effectively subsidizes drilling and substandard safety investments in the very locations where the damages from spills would be the greatest.

In the case of the Deepwater Horizon venture, the rules of the game were such that the British Petroleum Company and its partners were able to make the decision to drill and decisions about safety equipment with the legal guarantee of a $75 million cap on economic damages from spills. By some estimates, the economic damages will actually be more than 100 times the cap.

We cannot know whether the result would have been different without the cap, but what is clear is that there were economic incentives for companies to cut corners. Those incentives will remain as long as the cap is set at such a low level relative to the potential risk.

III. OBJECTIONS TO LIFTING THE CAP

There are many interests who will oppose raising the liability cap and they will make forceful arguments for their side. Here, I evaluate several of these arguments from an economic perspective.

1. *Would lifting the cap lead to higher oil prices?*

We are bound to hear that lifting the liability cap will mean higher prices for businesses and consumers. The answer to this charge is simple: In the massive global market for petroleum, lifting the cap will only have a small, likely imperceptible, impact on gasoline prices.

A few statistics help to make this clear. The Gulf of Mexico accounts for only 2.3% of global oil production. Additionally, the Gulf of Mexico accounts for just 0.3% of proven reserves worldwide[2]; the entire U.S. only accounts for 1.4% of worldwide proven reserves[3]. So even if raising the liability cap reduces use of some of these reserves, the world oil price will not be affected materially.

Indeed in different contexts, the big oil companies have made it clear that changes in their production are unlikely to have a meaningful impact on world oil prices. As Robert Malone, then chairman and president of BP America Inc. said in 2008, "We cannot change the world market.[4]" Further, according to

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[2] Energy Information Agency, "Petroleum Supply Monthly, Table 26" (May 2010) and "International Petroleum Monthly, Table 1.1d" (April 2010). Data for January 2010.

[3] Energy Information Agency, "U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Proved Reserves, Table 4" (2008) and Oil and Gas Journal. Data for 2008.

[4] CNN Money. "Don't blame us for prices - oil execs" (May 21, 2008). http://money.cnn.com/2008/05/21/news/economy/oil_hearing/index.htm?cnn=yes.

the American Petroleum Institute, "No one company or group of companies has control over that price. In terms of market power, large international oil companies own less than 10 percent of the world's oil resources.[5]" Given the relatively small quantity of oil that comes from the Gulf and the number of players in the market, lifting the cap seems very unlikely to affect the global oil price.

2. ***Will lifting the cap result in job loss?***

There is no doubt that lifting the cap will raise the costs for drilling in some locations. This could reduce the overall level of production and that would cause some job losses. However, it is important to underscore that these job losses would be limited to employment at sites where the expected damages from spills are substantial. These are the risky sites that are only viable economically due to the subsidy from the liability cap.

I would be remiss if I failed to point out that oil spills can have negative employment consequences. For example, the Deepwater Horizon spill is causing significant economic damages in the Gulf by limiting activity in multiple industries, including fishing and tourism. The rate at which these jobs will return depends on the how quickly the Gulf recovers (which is a question of scientific debate).

Finally, it is relevant to consider the impact of the spill on government budgets and the resulting impact on employment. Due to the spill, federal, state and local governments are on the hook for unemployment insurance payments, food stamps, and other payments. This spending likely crowds out other government activities that could increase job creation.

3. ***Would lifting the cap unfairly punish smaller drillers, rig operators, and other oil service companies?***

Many observers have expressed concerns that removing the cap on liabilities will disproportionately hurt small or independent drillers or oil service companies. This need not be the case. The lifting of the cap would increase costs for companies that currently fail to take adequate safety precautions, regardless of their size. One of the appeals of lifting the cap as a form of regulation is that it does not pick winners and losers -- rather, it lets the market sort out the safer operators from the less safe ones.

4. ***Would lifting the cap on damages from spills from the transportation of oil unfairly harm shipping companies?***

The argument for raising the cap on spills from shipping companies is identical to the one for drillers. Lifting the cap would cause shipping companies to bear the full risks associated with their operations and cause them to take proper safety precautions.

5. ***Does the Deepwater spill make lifting the cap unnecessary?***

Some have argued that the publicity around the Deepwater Spill will cause oil companies to take all available precautions. I would not be surprised if oil companies are currently implementing new

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[5] American Petroleum Institute. "API Statement to Senate Judiciary on the State of the Oil & Natural Gas Industry and Market Conditions" (February 2, 2006). http://api-ep.api.org/Newsroom/testimony/senate-judiciary.cfm.

safeguards against spills. However, memories about the current tragedy will undoubtedly fade as time goes by. The advantage of lifting the cap is that it will provide a permanent incentive to prevent spills.

IV. IMPORTANT CONSIDERATIONS FOR IMPLEMENTATION

If the cap on liabilities is raised or removed, there are a number of important issues to consider. I discuss a few of them here.

1. Should a higher cap apply only in deepwater or in shallow water as well? What about for productive versus exploratory wells?

From an economic perspective, there is no difference in the appropriate response based on where the well is located or its purpose. In all cases, a cap on liability for damages creates a moral hazard problem that provides incentives for spills. The lifting of the cap is the best solution to this problem.

2. If the cap is raised, what can be done to prevent companies from avoiding the higher liabilities?

There are a series of corporate reorganizations that firms could take to evade a higher cap. This might include dividing themselves into smaller entities and making liberal use of bankruptcy statutes in the case of a spill or the formation of limited partnerships. To prevent such practices, any increase in the cap should be accompanied by a requirement for proof of liability insurance, a certificate of financial responsibility, or the posting of a bond to cover damages.

3. Should a higher cap be applied prospectively and/or retrospectively?

For all the reasons listed above, the economic case for raising the cap prospectively is a strong one.

The case for applying a higher cap to existing drilling operations is a more difficult question. On the affirmative side, it seems evident that the potential damages from oil spills are larger than had been previously understood. In light of this new information, it might seem appropriate to effectively alter the regulations that operators face. After all these operators are making decisions every day that affect the probability of a spill and these decisions should reflect the new information about the potential damages from spills. A part of this affirmative argument is that when firms make investment decisions, they understand that there is always some chance that the regulatory environment will change in a way that affects their bottom line. This is especially so with regards to environmental regulation where understanding of the risks are evolving.

On the negative side, a country that frequently changes its regulatory environment and creates uncertainty in the marketplace could weaken the incentives for investment economy-wide. In the worst case, the alteration of the liability cap could dampen investment throughout the economy.

Economics does not provide an easy answer here because we cannot know in advance which effect is bigger. One possibility that has some intuitive appeal would be a transitional strategy -- to raise the liability cap on existing operations slowly over the course of several years.

4. Will a higher liability cap compromise our energy security goals?

It is possible that lifting the cap will reduce the domestic production of oil and reduce our energy security. If this is the case, it could be paired with economically sound polices that promote domestic production or reduce oil consumption without putting our environmental goals at risk. Such a pairing would allow us to achieve our energy security and environmental goals.

V. CONCLUSIONS

To summarize, I have tried to provide an economic analysis of how to reduce future oil spills. There are four main conclusions:

1) The Oil Pollution Act of 1990 distorts market forces and provides economic incentives for oil spills by limiting the liability for economic damages to $75 million.

2) The lifting, or substantial raising, of the liability cap is the most effective way to align oil companies' incentives with the interests of the American people.

3) Any increase in the cap should be accompanied by a requirement that oil companies provide proof of the necessary insurance or certificates of financial responsibility.

4) To continue to promote energy security while raising or eliminating the cap, the government may also want to consider complementary policies to boost domestic production or lower domestic consumption of oil.

I would like to thank the entire committee once again for inviting me to participate in this discussion. I will gladly respond to any questions.

Hearing on the Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes

House Committee on Transportation and Infrastructure

Testimony of

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New York, NY

June 9, 2010

Washington, DC

Thank you, Representative Oberstar, Ranking Member Mica and members of the Committee.

Good afternoon. My name is Robert Hartwig and I am President and Economist for the Insurance Information Institute, an international property/casualty insurance trade association based in New York City.[1] I am also a Chartered Property Casualty Underwriter (CPCU) and have worked on a wide variety of insurance issues during my 17 years in the property/casualty insurance and reinsurance industries, including research into the energy and marine insurance markets. The Institute's members account for nearly 70 percent of all property/casualty insurance premiums written in the United States. Its primary mission is to improve understanding of the insurance industry and the key role it plays in the global economy.

I have been asked by the Committee to provide testimony on the insurance implications of the Deepwater Horizon accident. Specifically, I will address the following three issues:

(i) The insurance arrangements in place at the time of the Deepwater Horizon accident;
(ii) The immediate and current insurance market reaction to the accident; and
(iii) The potential market reaction to proposed changes by Congress to various Acts governing the limits of liability associated with offshore drilling activity and the spillage of oil.

Background on the Deepwater Horizon Accident[2]

On April 20, 2010, at approximately 10PM Central Time, a fire was reported on the Deepwater Horizon, a semi-submersible mobile offshore drilling rig located in the Gulf of Mexico off the coast of Louisiana and owned by Swiss-based Transocean Limited. The fire and explosion claimed the lives of 11 workers and injured 17 others. The rig

[1] Contact information: Tel: (212) 346-5520; Email: bobh@iii.org.
[2] The Insurance Information Institute maintains a comprehensive PowerPoint presentation on the insurance issues related to the Deepwater Horizon accident. It is available for download at: http://www.iii.org/presentations/the-deepwater-horizon-disaster-insurance-market-impacts.html

itself sank on April 22 in 5,000 feet of water. The rig was insured for approximately $560 million, a sum that has largely already been paid to the rig's owner by its insurers due to the fact that Deepwater Horizon is viewed as a total loss.

As displayed in Figure 1, with an estimated 798,000 barrels of oil spilled through June 1, the Deepwater Horizon incident is the second largest oil well blowout in world history and the largest ever in U.S. waters. Although there has been some success at reducing the flow of oil into the Gulf during the first week of June, it is likely that the total spill volume will exceed one million or more barrels before complete control of the well is regained and the flow is completely stopped. By way of comparison, the Deepwater Horizon spill as of June 1 is approximately eight times the magnitude of the largest prior offshore platform spill in U.S. history, in which 100,000 barrels of oil were released into the Pacific Ocean off the California coast in January 1969. Prior to Deepwater, the largest and best known oil spill in American history involved a tanker, not a platform. The Exxon Valdez, after running aground in March 1989, spilled 257,000 barrels of crude into Prince William Sound, Alaska. The Deepwater Horizon spill as of June 1 was approximately triple that size.

The Exxon Valdez spill is also relevant because much of the key regulation governing the assignment and magnitude of liability associated with oil spills dates to legislation passed by Congress in the wake of that event, the Oil Pollution Act (OPA) of 1990 being the most significant among these. The OPA will be discussed in greater detail later in my testimony.

Offshore Energy Facilities: Insurance Market Considerations

Offshore oil platforms are among the most difficult and complex commercial risks to insure, subject to a unique set of environmental conditions because of their location at sea and their constant exposure to catastrophes and loss.

Despite the risks they face from hurricanes and other weather events, loss events for oil rigs and platforms are relatively infrequent, but have the potential to generate large losses when they do occur. For example, the 2005 hurricane season in the Gulf of Mexico

produced record losses for the offshore energy sector. These losses, however, were largely confined to physical damage sustained by the rigs and undersea pipelines, not pollution from oil spills.

The world's worst offshore oil disaster to date occurred in 1988, when an explosion and resulting fire destroyed the Piper Alpha platform in the North Sea, killing 167 men. The total insured loss amounted to $3.6 billion in 2009 dollars. The Piper Alpha, operated by Occidental Petroleum (Caledonia) Ltd., accounted for around 10 percent of the oil and gas production from the North Sea at the time. The large loss of life and the cost of the rig itself, rather than pollution, were the primary drivers of loss in the Piper Alpha incident.

Due to the complex nature of the risks involved, developing an insurance program for an offshore energy operator is a sophisticated process that requires special knowledge and expertise on the part of the global insurance and reinsurance markets.

Risk management solutions may feature a number of risk financing components, such as self-insurance, high retentions and deductibles, traditional insurance, reinsurance, participation in mutual insurers, and the use of captives and the capital markets.

Many of the largest offshore energy operators, like BP, are self-insured for physical damage to their property and equipment. Self-insurance may be preferable when the high values and exposures involved would make the cost of insurance prohibitive.

Others may participate in industry-dedicated mutual insurers whereby member companies pay into a common fund that responds in the event of loss.

Summary of Key Offshore Energy Coverages

A number of insurers offer tailored insurance programs to help offshore energy operators protect their physical assets as well as their legal liability. Key insurance coverages relevant to the Deepwater Horizon accident include:[3]

Physical Damage: provides coverage for physical damage or loss to a company's offshore property and equipment, including offshore fixed platforms, pipelines and production and accommodation facilities. Other equipment such as offshore loading buoys may also be covered. Coverage is also available for mobile drilling rigs such as jack-ups, semi-submersibles and drill ships.

Business Interruption/Loss of Production Income: provides coverage for energy businesses against loss due to temporary interruption in oil/gas supply from an offshore facility as a result of physical loss or damage to an offshore facility.

Operators' Extra Expense (Control of Well): provides coverage for costs incurred by energy businesses when regaining control of a well after "blowout". Coverage may include: redrilling expenses incurred in the restoring or redrilling of a well after a blowout; and seepage and pollution liability coverage to pay third party bodily injury, damage to and loss of third party property, the cost of clean-up and defense expenses emanating from a blowout.

Comprehensive General Liability: provides coverage for claims an energy business is legally obligated to pay as a result of bodily injury or property damage to a third party.

Environmental/Pollution Liability: provides coverage for bodily injury, property damage, and clean up costs as a result of a pollution incident from a designated site.

Workers Compensation/Employers Liability: covers energy businesses for claims arising from injury or death of employees occurring in the course of their employment.

Insurance Arrangements Associated with the Deepwater Horizon Event

As discussed earlier in my testimony, offshore oil platforms are difficult and complex commercial risks to insure. This fact combined with the possibility of large scale losses means that the insurance arrangements themselves are complex, usually involving many insurers around the globe. To date, approximately 20 insurers have announced losses associated with the Deepwater Horizon accident, and more are likely to do so in the

[3]Insurance Information Institute, "Offshore Energy Facilities: Insurance Considerations," April 28, 2010: http://www.iii.org/articles/offshore_energy_facilities_insurance_considerations.html

month ahead. The key insurance arrangements related to the Deepwater Horizon event have been reported as follows:[4]

- **BP**: With a 65% interest in the Deepwater Horizon joint venture, BP says it is self-insured. BP's captive (Jupiter Insurance Ltd) has $6 billion in capital, but does not purchase outside reinsurance protection. Jupiter's per occurrence limit on physical damage and business interruption is $700 million and is not expected to cover environmental clean-up costs or third party liability.

- **Andarko Petroleum:** With a 25% interest in the Deepwater Horizon joint venture, Andarko Petroleum is believed to have a $100 million owner's extra expense policy (covers re-drilling, re-gaining control of well, etc).

- **Mitsui Oil Exploration:** With a 10% interest in the Deepwater Horizon joint venture, Mitsui is believed to have a $45 million owner's extra expense policy.

- **Transocean:** The drilling contractor is believed to have $560 million of physical damage insurance, which is highly syndicated. Insurers have already paid the majority of losses under this coverage. In addition, Transocean carries some $950 million in third party liability insurance, of which $700 million excess of $50 million is thought to cover offshore risks.

- **Cameron:** The manufacturer of the blowout preventer that failed on the rig has a $500 million liability insurance policy.

- **Halliburton:** Service provider to Deepwater Horizon and supplier of cement used to plug the well has liability insurance in excess of $1 billion.

Insured loss estimates currently range between $1.4 billion and $3.5 billion. The actual economic damages will greatly exceed the insured loss amount. This is in part due to the

[4] Barclay's Capital research note, May 10, 2010; Credit Suisse research note, May 11, 2010.

fact that the BP, the lead firm on the project, is self insured. The company has repeatedly stated that it will pay all "legitimate" claims arising from the spill.

Immediate Insurance Market Reaction to the Deepwater Horizon Accident

The global energy insurance market is accustomed to infrequent but large scale losses. Historically, in the wake of such events, markets have behaved in an orderly manner consistent with the basic principles of supply and demand. In energy insurance markets, as in all insurance markets, the supply of insurance (also referred to as capacity) is a function of the amount of available capital which in turn is dependent on the rate of return that can be earned on that capital for any given level of demand. Of course, the riskier the venture, the greater the required rate of return. Needless to say, insuring deep sea drilling platforms is a risky business.

As the magnitude of the Deepwater Horizon incident became apparent in late April and as repeated early efforts to contain the spill failed, it became clear to insurance underwriters that Deepwater Horizon would likely become one of the most expensive events in history for the offshore energy insurance market. Current insured loss estimates range from $1.4 billion to $3.5 billion dollars. The wide range in loss estimates is primarily attributable to uncertainty surrounding the magnitude of business interruption losses if significant quantities of oil wash ashore.

Capacity and Pricing

The global energy market response to the Deepwater Horizon loss has been orderly. Capacity has not fled the market. Prices have risen, but commensurate with the rapidly changing outlook in demand for liability coverages and mounting uncertainty over government action related to limits of liability combined with the outlook for a very active 2010 hurricane season.

Moody's estimates that property coverages are 15 percent higher for rigs operating in shallow water and up to 50 percent higher for deep water rigs.[5] Insurance broker Willis

[5] Moody's Investors Service, Special Report, "*Deepwater Horizon Losses Sting Insurers and Reinsurers as Hurricane Season Looms,*" June 2010.

cites certain insurers' belief that the Deepwater Horizon event is "market changing" in terms of physical loss but that the "true market-changing loss dynamic will continue to take place in the liability arena." Indications are that the magnitude of increase is higher for rig operators in the Gulf of Mexico than in other parts of the world. According to the CEO of AonBenfield Reinsurance, offshore energy policies in the Gulf are expected to "virtually double."[6] Elsewhere in the world, anecdotal reports suggest the price of energy coverage could be headed up by 10 to 15 percent over the next year as policies renew. It is also likely that reinsurance rates will rise for energy risks, the ultimate increase being dependent on the size of any damage incurred by hurricanes this year.

In terms of capacity, the typical third party liability limit purchased by large operators is approximately $1 billion. By way of reference, worldwide energy market premiums total between $2.5 billion and $3 billion on an annual basis. There is no indication that liability capacity is shrinking to any appreciable extent. At the same time, higher prices do not appear to be attracting additional capacity. This is likely due to extreme uncertainty surrounding not only the ultimate liability losses arising from Deepwater Horizon, but the liability environment going forward given Congressional interest in raising the limits of liability associated with oil spills. Requirements that energy firms demonstrate higher limits of financial responsibility will increase the demand for liability coverage among drillers and increase the risk to insurers willing to offer higher coverage limits.

Contributing to the skittishness of new capital is the fact that the Deepwater Horizon event could well unleash one of the largest tort actions in United States history. It will be years before the final cost of this accident is known. By way of reference, litigation from the 1989 Exxon Valdez lasted nearly 20 years, having finally been settled by the U.S. Supreme Court in 2008.

According to the *National Law Journal* and as displayed in Figure 2, a total of 126 Deepwater Horizon lawsuits had been filed as of May 24 against the four primary

[6] Dow Jones News Service interview with AonBenfield Reinsurance Brokers CEO Jan-Oliver Thofern, *"Energy Insurance Rates May Double in the Gulf of Mexico,"* June 7, 2010.

companies involved in the spill: BP, Transocean Ltd., Halliburton Energy Services and Cameron International Corporation.[7] Suits alleging environmental damage were the most common, accounting for 30.2 percent of those filed, following suits alleging damage to person property (17.2 percent) and torts to land (12.9 percent).

Other types of litigation are, of course, possible in the months and years ahead, including health claims by workers assisting in the clean-up operation as well as coastal residents alleging bodily injury due to exposure to oil and chemical dispersants.

It is worth noting that on June 1 the U.S. Attorney General announced that federal authorities had opened civil and criminal investigations into the spill. In addition to the Oil Pollution Act of 1990 (discussed in the next section), the U.S. government has a wide range of laws under which it can bring charges, including:[8]

- **The Clean Water Act:** primary federal law in the U.S. governing water pollution;
- **The Migratory Bird Treaty Act:** federal statute makes it unlawful to harm over 800 species of migratory birds;
- **The Refuse Act:** - federal statute governing use of waterways that prohibits dumping of refuse into navigable waters;
- **The Endangered Species Act:** makes it unlawful to harm or kill any animal on endangered species list.

Conviction on criminal charges could result in a fine equal to twice the cost of economic and environmental damages and is not covered by insurance.

Possible Insurance Market Impacts of Proposed Changes to OPA Limits of Liability

The Oil Pollution Act of 1990, enacted amid rising public concerns in the wake of the 1989 Exxon Valdez spill, is the principal statute governing the assignment of liability and the requirements of financial responsibility for events involving oil pollution. Since the

[7] National Law Journal, May 24, 2010.
[8] U.S. Department of Justice, Office of the Attorney General; Environmental Protection Agency (EPA); U.S. Fish and Wildlife Service.

Deepwater Horizon incident, there has been a great deal of discussion in Congress and public policy circles about changing (i.e., increasing) the limits of liability from those that currently exist under the OPA.

Before discussing in detail how changes in the OPA might impact energy insurance markets, a brief review of the relevant provisions of the law affecting those markets is provided here.

The Oil Pollution Act of 1990's Financial Responsibility and Liability Framework

With respect to liability, the OPA establishes a financial responsibility requirement and compulsory liability insurance combined with strict liability rules that seek to achieve several objectives:[9]

- Prevent oil pollution damages from offshore energy facilities;
- Establish oil spill financial responsibility (OSFR) for lease holders of offshore facilities to demonstrate the capability to meet liability for possible removal costs and damages;
- Establish a standard for measuring natural resource damages (worst case oil spill for an offshore energy facility), and
- Establish penalties for not complying with the Act.

Specifically, the OPA features a compulsory liability insurance structure as part of the oil spill financial responsibility (OSFR) requirement combined with strict liability rules for oil pollution damages associated with offshore energy facilities. The financial responsibility and compulsory insurance requirements provide the funds to pay for damages, and the strict liability rules allow third-party claims to be made directly against the insurer, irrespective of negligence. This regulatory structure serves to avoid time-

[9] This section, with minor edits, is drawn from testimony provided by Rawle O. King of the Congressional Research Service before the Senate Committee on Energy and Natural Resources, May 25, 2010.

consuming and costly litigation and the need for oil spill victims to prove negligence as the primary test of liability for oil pollution damage. The rational basis for the compulsory insurance/strict liability structure is threefold: (1) the loss, however caused, is more than the victim can be expected to bear without hardship; (2) the compensatory system is not a liability system, as such, but, instead, a means to speedily compensate oil pollution victims; and (3) the regulatory scheme needs resources from which to pay unlimited compensation.

Insurance Requirements[10]

Under Section 1016 of the OPA, parties responsible for offshore facilities must establish and maintain oil spill financial responsibility (OSFR) capability to meet their liabilities for removal costs and damages caused by oil discharges from an offshore facility and associated pipelines. The OSFR is demonstrated in various ways including surety bonds, guarantees, letters of credit and self insurance, but the most common method is by means of an insurance certificate. The insurance certificate spells out the limit required under Section 1016 of OPA. Lease holders of a covered offshore facility (COF) must demonstrate a minimum amount of OSFR of $35 million per 35,000 barrels of "worst case oil-spill discharge" up to a maximum of $150 for COF located in the OCS and $10 million in state waters. As an illustration, a worst case oil-spill discharge volume of 35,000 barrels (bbls) requires $35 million in OSFR while a volume of 35,001 bbls requires $70 million. The MMS calculates the worst case oil-spill discharge volume for a facility. An exemption to the OSFR is provided for persons responsible for facilities having a potential worst case oil-spill discharge of 1,000 bbls or less.

Insurance Market Impacts Associated with Raising Existing OPA Limits of Liability

Under OPA the owner or operator of a facility from which oil is discharged ("responsible party") is liable for damages resulting from the spill and costs associated with the containment or cleanup of the spill. However, the OPA contains limits of liability as well as exceptions to those limits as follows:

[10] *Ibid.*

- **Limits of Liability:** OPA establishes limits for oil spills. Responsible parties (holders of leases or permits) for offshore facilities are liable for up to $75 million per spill, plus removal costs;

- **Liability Exception:** The limit of liability ***does not*** apply if the incident was caused by gross negligence or willful misconduct or violation of a Federal safety, construction or operating regulation

In the wake of the Deepwater Horizon spill, legislation has been introduced in Congress to raise the limit of liability (retroactively) under OPA to $10 billion from the current limit of $75 million. As discussed earlier in this testimony, the typical maximum available limit of third-party liability coverage in the offshore energy market today is approximately $1 billion and with perhaps as much as $1.2 billion to $1.5 billion available under some circumstances.

As a practical matter, energy insurers and reinsurers simply cannot provide $10 billion in capacity. There are numerous obstacles for insurers and buyers alike:

- The entire global energy insurance market currently consists of no more than $3 billion in annual premiums;
- Higher limits of liability will increase the demand for coverage, perhaps greatly, exhausting available capacity;
- Underwriting for very low probability, extreme severity events is very challenging for insurers and reinsurers;
- The increase in demand coupled with increase in risk assumed by insurers implies that the cost of providing the coverage will be much higher than today;
- The higher cost of coverage could disadvantage offshore operators that cannot self insure;
- The current tort liability environment increases uncertainty as to the frequency and severity of future events, and

- If Congress retroactively raises the limits of liability on OPA, it may well do so in the future, raising potential future payouts unexpectedly, thereby increasing the uncertainty (and cost) associated with offering such coverage.

Insurer Risk Management Response

While the exact cause of the Deepwater Horizon catastrophe is still under investigation, the findings, if history is any guide, will provide valuable insights into the chain of events—both mechanical and human—that led to the failure.

While the federal government has taken a variety of steps to improve the safety of offshore drilling facilities in the weeks since the Deepwater Horizon, including imposing a moratorium on new drilling activity and stepped up inspections, insurers are also digging deeper into the operations of offshore drillers. Steps taken by insurers include even more stringent reviews of an operator's safety record and compliance with new and existing regulatory protocols governing the operation of offshore facilities.

Summary

The global energy market response to the Deepwater Horizon loss has been orderly. Markets remain stable and capacity has not fled the market, despite insured losses that are expected to total as much as $3.5 billion. At the same time, prices have risen, reflecting not only the Deepwater Horizon event itself but increased demand for liability coverage and mounting uncertainty over government action related to limits of liability.

While available capacity for liability coverage in offshore energy insurance markets remains at pre-Deepwater Horizon levels of approximately $1 billion to $1.5 billion, it is highly unlikely that insurers could provide coverage limits sufficient to meet the proposed $10 billion limit of liability being discussed in the context of the Oil Pollution Act (OPA).

Thank you for you for the opportunity to testify before the Committee today. I would be happy to respond to any questions you may have.

Figure 1. Largest International Oil Well Blowouts by Volume, as of June 1, 2010

INSURANCE INFORMATION INSTITUTE

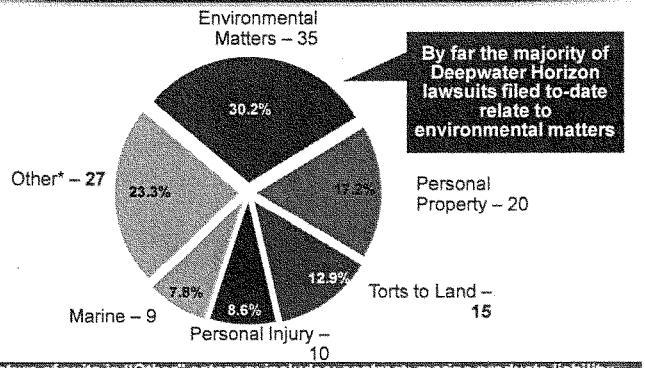
Date	Well	Location	Bbl Spilled
June 1979-April 1980	Ixtoc I	Bahia del Campeche, Mexico	3,300,000
April 20, 2010-present	**Deepwater Horizon**	**Gulf of Mexico, USA**	**798,000 (est.) thru June 1***
October 1986	Abkatun 91	Bahia del Campeche, Mexico	247,000
April 1977	Ekofisk Bravo	North Sea, Norway	202,381
January 1980	Funiwa 5	Forcados, Nigeria	200,000
October 1980	Hasbah 6	Gulf, Saudi Arabia	105,000
December 1971	Iran Marine International	Gulf, Iran	100,000
January 1969	Alpha Well 21 Platform A	Pacific, CA, USA	100,000
March 1970	Main Pass Block 41 Platform C	Gulf of Mexico	65,000
October 1987	Yum II/Zapoteca	Bahia del Campeche, Mexico	58,643
December 1970	South Timbalier B-26	Gulf of Mexico, USA	53,095

*Top end of U.S. Geological Survey (USGS) range of 12,000 to 19,000 barrels per day announced June 7. An earlier estimate from the U.S. Dept. of Interior suggested as much as 25,000 bbls of oil per day may have spilled.

Source: American Petroleum Institute (API), 09/18/2009; http://www.api.org/ehs/water/spills/upload/356-Final.pdf

Figure 2. Deepwater Horizon Lawsuits: Nature of Suits Filed To-Date

INSURANCE INFORMATION INSTITUTE



*Nature of suits in "Other" category includes: contract; marine products liability; other statutory actions; Outer Continental Shelf Lands Act; personal injury product liability; products liability; property damage; property damage/products liability; real property; securities/commodities and stockholder suits.

Source: National Law Journal, 05/24/10

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CONGRESSWOMAN SHEILA JACKSON LEE, OF TEXAS

STATEMENT BEFORE THE

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

HEARING ON

"LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES"

WEDNESDAY, JUNE 9, 2010

Thank you, Chairman Oberstar for holding this very timely and important hearing today. Let me also thank the Ranking Member, John L. Mica. I am also pleased to be joined by my colleagues Representative Rush

Holt (NJ-12th) and Representative Kathy Castor (FL-11th), who are here to testify regarding the liability and financial responsibility for oil spills under the Oil Pollution Act of 1990 (OPA) and related statutes.

Mr. Chairman, as Chair of the Homeland Security Subcommittee on Transportation Security and Infrastructure Protection, and as a member of the Judiciary Committee, I have been actively engaged in seeking answers to the causes, as well as solutions to the devastating consequences of the Gulf oil spill relating to the April 20, 2010 explosion on the Deepwater Horizon.

As recently as last week, I spent time at the United Command Center in Hammond, Louisiana and flew over the impacted areas to assess the devastating damage to the Gulf region and visited Plaquemarins Parish, Pointe a La Hache (Hash), Louisiana to meet with local oystermen and other individuals affected by the oil spill. My experience left me heart wrenched and even more determined to work with my colleagues to develop an aggressive proactive strategy to assist the victims of the oil spill and to develop measures to prevent it from happening again. Indeed, I am interested as are you in learning more about the causes of and responses to this oil spill, including efforts to ensure that our communities are made safe and that we use all available legal measures to provide relief to those who

suffered damages as a result of the oil spill. I believe the work of this Committee represents an important undertaking in this regard.

Mr. Chairman, this Committee is here today to examine the liability issues resulting from the April 20, 2010 explosion on the Deepwater Horizon oil vessel that killed 11 crew workers and led to the resulting environmental and economic disaster that is taking place in the Gulf Coast region. This is a matter of serious proportions as evidenced through the loss of life, valuable resources, livelihood, and basic peace of mind as to the safety conditions and a way of life for the people in the Gulf Coast region and beyond. Thus, those who are responsible for the oil spill must be held accountable to the fullest extent of the law such that those whom they harmed are made whole.

I will focus my testimony on three areas: (1) the current law that governs the right through which legal liability claims may be bought; (2) the current claims process that exists for those victimized by the oil spill; and (3) propose necessary legislative changes to existing laws that can potentially provide legal remedies for those victimized by the Gulf oil spill.

I. Current Applicable Law

In determining liability for harms resulting from events occurring offshore, a number of laws must be applied to the facts of this incident. Currently,

the Oil Pollution Act of 1990 caps economic damages beyond the direct cost of cleanup at $75 million per incident from the party or parties responsible for an oil spill.

With respect to those killed or injured on the Deepwater Horizon, in addition to general maritime law, at least two federal statutes – the Death on the High Seas Act (DOHSA) and the Jones Act – will govern the extent to which injured workers and dependent family members of deceased workers can recover damages.

A. Oil Pollution Act of 1990 (33 U.S.C. § 2701-2761)

In response to the massive oil spill in Alaskan waters by the *Exxon Valdez* in 1989, Congress passed the Oil Pollution Act of 1990 (OPA), which unified the liability provisions of existing oil spill law and created a freestanding liability regime. OPA makes responsible parties liable for any discharge of oil (or threat of discharge) from a vessel or facility to navigable waters, adjoining shorelines, or the exclusive economic zone of the United States (i.e., 200 miles beyond the shore).

Under OPA, a responsible party is liable for all cleanup costs incurred, not only by a government entity, but also by a private party. In addition to cleanup costs, OPA significantly increased the range of

recoverable damages to include the following: injury to natural resources, loss of personal property (and resultant economic losses), and loss of subsistence use of natural resources.

B. The Jones Act allows for compensation for loss of seaman on the high seas.

II. Current (Problems with) Claims Process

A. Multi-district problem-

-It is important to look at the question of how the multi-district procedure will impact negatively on the injured and families of those who lost their lives. I support suggestions made by the Mississippi Attorney General, Jim Hood, who suggested that the anti-injunction act be amended to specify that no federal court may enjoin parallel litigation pursued by a state in its own courts.

B. Lifting the Cap

-Congress should amend the OPA to increase the 75 million dollar damage cap that victims of oil spills are allowed.

C. Eligibility Criteria for process of Claims –complicated process of claims for collateral damages

- We need a claims process on the Gulf coast to remedy the harm cause by the oil spill before it is compounded by delay and we need to ensure that claims are evaluated and paid through an expedited equitable and transparent process.

There are numerous accounts of concerns of claimants that have underscored the importance of the federal government's demand that BP set up a totally independent claims process, and set up structures to process claims without delay. We know that victims are seeking assistance, but have experienced complicated claims procedures to follow, and have not been able to obtain relief or compensation from BP but rather, a hard way to go and the never-ending claims requirements to satisfy the claims they have brought against BP.

Take for example, the story of Byron Encalade, President, Louisiana Oysters Association, and owner of Encalade Fisheries, and who testified before the House Judiciary Committee two weeks ago. Mr. Encalade, as owner of his own fishery company, and as President of the Louisiana Oysters Association, has sought to file claims with BP to recover damages suffered as a result of the Gulf oil spill. Unfortunately, Mr. Encalade has had a horrible experience with the ever-changing claims process.

On Monday, June 7, Mr. Encalade met with Mr. Daryl Willis, Vice President, Resources, BP America, and some BP claims adjusters in Pointe

a' la Hache (Hash). Though Mr. Encalade came with the paperwork he was originally told to provide BP claims adjusters, he was told that he needed to provide his tax statements in order to be compensated for his loss. When inquiring about a second $5,000 check he was supposed to receive from BP, he was told that the check was in the mail. He has yet to receive the check.

At that same meeting, Mr. Encalade had inquired about a discussion Mr. Encalade and I had with BP CEO, Tony Hayward in which Mr. Hayward agreed to a proposal that would have allowed Mr. Encalade to receive a six-month payment to compensate for loss in income, etc. Mr. Willis told Mr. Encalade he had no knowledge of the agreement. Mr. Encalade said that he was also informed at that meeting that his claim would be based upon his net receipts and not his gross receipts. This policy puts Mr. Encalade and many others in a situation where they cannot recover the full value of their losses due to investments that were made to fishing boats that were lost in Hurricane Katrina. As such, this policy will prevent many fishers and shrimpers from recovering the full value of their loss.

The next day, Mr. Encalade again met with different claims adjusters to provide tax statements and was told that he needed to provide additional information. Mr. Encalade has found the claims process to be nothing more

than an opportunity for BP to continue delaying processing the claims of those who have suffered tremendous losses from the Gulf oil spill. He has also stated; "that although he has urged BP to establish categories of claimants, as fisherman should not be treated the same as a hotel owner, they have refused to do so and have lumped all claimants together." Finally, Mr. Encalade indicates that his story is not unique. According to him, every fisherman at the claims office was complaining about the claims process.

I call also tell you the story of the owner of a small seafood restaurant in Houston, Texas, who I have known for years and have supported. She is in trouble at this very moment, because she is wondering whether her business will remain open to long-time customers like me. Whether she, as a small business owner and woman, can afford to pay the bills and continue to earn a livelihood. She is a victim of the oil spill, although she is hundreds of miles away from the actual site of the oil spill. How might she be affected you ask? Well, her restaurant relies on a variety of suppliers of Gulf seafood, and she bills her establishment as one which prides itself on seafood from Louisiana, a part of the Gulf region. So, now she confronts two issues that could prove fatal to her business. One, if the seafood is from the Gulf region or Louisiana in particular, perhaps it is tainted by the oil.

Two, the prices of seafood from the Gulf continues to increase, making it impossible for the restaurant to carry certain items. Many items on the menu her patrons can no longer afford. It is the classic Catch-22 situation, and what is clear to me is that unless this Congress acts and acts quickly restaurants like the one in Houston, Texas will be history.

Cleanup costs for the ongoing oil spill are expected to reach billions of dollars. To date, BP has spent a total of about $760 million in cleanup and containment efforts. In addition, approximately 110 lawsuits have been filed against each of the four main companies involved in the explosion and resulting oil spill. So far, the claims against the companies range from wrongful death to stockholders suits and involve personal injury, environmental harm, and economic loss to communities and individuals.

The principal questions that must be addressed are: (1) what is the nature and the extent of the damages inflicted by this catastrophe; (2) who or what caused the incident and thus, who bears and shares in the costs?; and (3) what federal measures must be put in place to ensure that the victims of this catastrophic event of historic proportions shall be made whole and to prevent such disasters in the future.

There have been numerous hearings related to the Gulf Coast disaster, both in the House and Senate. This hearing today gives this Committee and the public yet another opportunity to hear from those connected closest to the events relating to the oil spill disaster, and gather valuable information relating to legal liability issues surrounding this tragedy and on-going safety concerns in the Gulf Coast and surrounding areas.

We must get to the bottom of who is responsible for the tragic loss of the eleven workers, and the on-going catastrophe that is putting at risk, the people who work and live near the Gulf Coast, local wildlife, and the environment. An incident like this must never happen again so we must use everything at our disposal, including legal liability measures, to deter and prevent such actions that have led to the disaster.

I suggest the following changes be made:

1. The Jones Act should be under a temporary moratorium to provide for compensation for family members of victims that were not employed as seaman. As we learned from Mr. Keith Jones, in his testimony at the House Judiciary Committee two weeks ago, his family will not be able to be fully compensated for the loss of their loved one, Gordon Jones, because he was an engineer and not a seaman as required to obtain damages from their

employers for the negligence of the ship-owner, the captain, or fellow members of the crew under the Jones Act. Gordon Jones left a widow and two children who should rightfully to be compensated for the tragic loss of their loved one.

2. The OPA should be amended to increase the liability limit which is currently capped at 75$ million. While officials from BP have indicated that the company will pay all claims even if they exceed the statutory cap of $75 million per incident, there currently is no legal requirement that BP so; and with BP's current claims process, there is nothing to indicate that BP will keep such a promise:

3. I also suggest that the OPA be amended to allow for an immediate release of $100 million or more from the Oil Trust Fund for the Coast Guard. The U.S. Coast Guard National Pollution Funds Center (NPFC) was commissioned to administer the Oil Spill Liability Trust Fund (OSLTF). The funds are used to support liability and compensation regimes pertaining to pollution from oil and hazardous substances, respectively. There is at least $1 billion accumulated in this trust fund and I call for the release of at least $100 million of these funds:

4. I also recommend that a six-month lump sum payment to impacted businesses, including the fishing industry be provided;

5. That a requirement be established that BP not assess the loss of those in the fishing and shrimp industry on BP's business structure, but on the business structure of the fishing and shrimp industry. In the fishing and shrimp industry, it is not customary to keep detailed records, and as such requirements of such records to substantiate a loss claim will prevent recovery of damages and in turn will mean the loss of businesses.

6. Liabilities must be considered among all parties involved to include availability of counter-claims; liability must be spread over a number of parties;

7. There must be discussion of all parties involved to establish a trust to be utilized for collateral impact; and

Thank you, Mr. Chairman and Members of the Committee for allowing me to present my views on these very important issues.

Statement of

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Liability and Financial Responsibility for Oil Spills
Under the Oil Pollution Act and Related Statutes

Before the
Committee on Transportation and Infrastructure
United States House of Representatives
Washington, DC

June 9, 2010

Good morning, Mr. Chairman, Congressman Mica, and Members of the Committee. I am Buckley McAllister, Vice President and General Counsel of McAllister Towing. Founded in 1864, McAllister is a fifth-generation, family-owned company operating a fleet of more than 70 tugboats and 12 barges along the East Coast of the United States. Our company is headquartered in New York City and maintains offices in Staten Island; Baltimore; Jacksonville; Philadelphia; Providence; Portland, Maine; Fall River, Massachusetts; Hampton Roads; Wilmington, North Carolina; Charleston, South Carolina; Port Everglades; and San Juan. McAllister vessels provide ship docking services for hundreds of steamship companies each year. We are also engaged in harbor towing, coastal towing, and bulk cargo transportation, and operate three ferries that carry about 400,000 automobiles and one million passengers each year between Bridgeport, Connecticut, and Port Jefferson, New York.

I am testifying this morning on behalf of McAllister Towing and The American Waterways Operators (AWO), the national trade association for the inland and coastal tugboat, towboat, and barge industry. I serve as Chairman of AWO's Atlantic Region and a member of the AWO Executive Committee. I am also on the Board of Directors of Steamship Mutual Underwriting Association (Bermuda) Limited, a Protection and Indemnity Club, though I am not speaking on behalf of Steamship Mutual today. Thank you very much for the opportunity to speak to you today about liability and financial responsibility under the Oil Pollution Act of 1990 (OPA 90).

McAllister Towing and the 350 member companies of AWO share a deep commitment to leadership in marine safety and environmental stewardship. Safely transporting our customers' cargoes – the building-block commodities that are essential to our nation's economy – is, quite simply, our reason for being. We well understand that spills of oil or hazardous chemicals are unacceptable to the American people and to the Congress. They are unacceptable to our customers and to the men and women who crew our vessels. They are a threat to the natural environment and they jeopardize our ability to stay in business as a company.

Mr. Chairman, we did not come to this realization in April, as the environmental and public policy impact of the Deepwater Horizon spill began to manifest itself. Our industry got its wake-up call two decades ago, when Congress passed the landmark Oil Pollution Act of 1990 in response to the grounding of the tank ship Exxon *Valdez* in Prince William Sound, Alaska. Since that time, we have worked every day to make our operations safer, to reduce our environmental footprint, and to go above and beyond the requirements of law and regulation to demonstrate our commitment to safety and environmental stewardship.

Our fundamental message to you today is this: with respect to vessel spills, OPA 90 is working. The well-crafted package of prevention measures, response planning requirements, and liability and financial responsibility requirements that Congress imposed 20 years ago has been a remarkable public policy success. Let me cite just a few examples:

- Tank barge oil spill volumes have plummeted by 99.6 percent since OPA 90, with a record low of 4,347 gallons in 2009. This is the lowest spill volume from tank barges since 1973, when Coast Guard recordkeeping began. With nearly 69 billion gallons of oil transported by barge on U.S. waterways, this means that 99.99 percent of oil moved by tank barges is delivered safely.

- Today, more than 90 percent of U.S. tank barges are fitted with double hulls, a full five years ahead of the OPA 90 deadline.

- Coast Guard-approved tank vessel response plans require vessel owners to plan for a worst-case discharge: the loss of a vessel's entire cargo in adverse weather. A rigorous program of training and drills ensures that such plans are ready to deploy immediately in the event of a spill or the threat of a spill.

- Since the largest number of spills occurs during product transfers, new regulations require tank overfill alarms and more rigorous training and certification for personnel overseeing cargo transfers.

- Comprehensive drug and alcohol testing programs are in place throughout the maritime industry, and zero tolerance for drug or alcohol abuse is the norm in our industry.

- To address human error as a cause of spills, the tugboat, towboat and barge industry has embraced the Crew Endurance Management System (CEMS), a science-based approach to reducing the risks of operating in a 24/7 environment. AWO is currently working with Northwestern University's Center for Sleep and Circadian Biology on a multi-year study aimed at developing practical interventions to improve the quality and quantity of sleep that towing vessel crewmembers obtain.

- Since OPA 90, our industry has been challenged – rightly, in our view – to shoulder the responsibility to lead improvements in safety and environmental stewardship, above and beyond the requirements of law and regulation. Developed in 1994, the AWO Responsible Carrier Program, a safety management system for tugboat, towboat, and barge companies, has been a condition of membership in AWO since 2000. All AWO members must undergo an independent third-party audit every three years to demonstrate their continued compliance. Companies that fail their audit forfeit their membership.

- Inspired by OPA 90, the Coast Guard-AWO Safety Partnership, the first public-private partnership of its kind in the maritime industry, was established in 1995 to track trends in industry safety performance and facilitate collaborative efforts to improve safety and stewardship. In the past 15 years, the Partnership has launched more than 30 Quality Action

Teams to tackle some of the most pressing safety issues in the industry, from tank barge spills to crew fatalities to bridge allisions.

- The tugboat, towboat, and barge industry has recognized the role of Congress and the Coast Guard in further raising the bar of safety for our industry. In 2004, AWO joined the Coast Guard in supporting the passage of historic legislation to bring towing vessels under a Coast Guard inspection regime and require all towing vessels to have a safety management system, as recommended by the National Transportation Safety Board. We have worked with the Coast Guard through the congressionally established Towing Safety Advisory Committee to develop regulations to implement this statutory mandate, and we continue to urge the Department of Homeland Security to publish its notice of proposed rulemaking immediately.

- The liability and financial responsibility provisions of OPA 90 have been an important contributor to this record of enhanced prevention and more timely and effective response. OPA 90 drove home the principle that the party responsible for a spill pays. Vessel owners must demonstrate financial responsibility up to statutorily imposed limits that were raised by Congress in 2006 and by the Coast Guard in 2009 to ensure that they keep up with increases in the Consumer Price Index. (Those limits can be breached in the event of gross negligence, willful misconduct, or the violation of applicable regulations.) Today, liability limits for tank and non-tank vessels are two to three times higher than they were in 1990, and a regulatory mechanism is in place to continue to increase the limits as needed over time. We applaud the leadership of this Committee in scrutinizing the limits and passing the legislation that established this common-sense mechanism (the Delaware River Protection Act of 2006).

Mr. Chairman, the record I have just described is a success story. It is the story of carefully crafted legislation passed by a Congress that has continued to

exercise its oversight responsibility and challenge industry to live up to the public's ever-higher expectations for safety and environmental stewardship. We welcome that oversight because it helps us do our jobs better.

In exercising its oversight mission today, against the backdrop of the Deepwater Horizon spill, we urge this Committee to be mindful of the context we have shared and the unintended but potentially severe consequences of changes in the liability and financial responsibility regime for vessel owners.

The current statutory and regulatory framework established pursuant to OPA 90 reflects a careful balance. This framework ensures that vessel owners have access to appropriate levels of insurance cover – typically $1 billion for companies like mine that obtain coverage through membership in a Protection and Indemnity (P&I) Club. If the costs of a spill exceed those limits, or in the rare event that a responsible party cannot be found, claims are paid from the Oil Spill Liability Trust Fund (OSLTF). The OSLTF is not a pool of money drawn from the general Treasury to shift the cost of spills from polluters to U.S. taxpayers. Rather, it is essentially a supplemental insurance fund that is funded by the oil industry though a per-barrel tax on oil. In the 20 years since OPA 90, this system has proven effective in covering the cost of spill cleanup and ensuring timely payments to claimants.

We are troubled by proposals to further increase liability limits for vessel owners as a reaction to the Deepwater Horizon disaster. Tank vessels are not oil rigs. A worst-case discharge from a tank vessel is a quantifiable amount: the loss of the vessel's entire cargo. A worst-case discharge from a non-tank vessel is the loss of all fuel or other oil carried on the vessel. The liability limits for tank vessels, unlike the limits for oil rigs, have been examined by Congress and the Coast Guard and adjusted as needed over time. They reflect the careful consideration of both Congress and the Coast Guard, and were set at levels that recognize the

response and cleanup costs that could result from the loss of the vessel's cargo and fuel.

Moreover, it is important to remember that for a vessel owner, insurance is a finite commodity. There is not an unlimited supply. Clearly, unlimited liability is uninsurable, and I know of no domestic vessel owner who is able to independently self-insure his liability. However, it is not only unlimited liability that threatens companies like mine and other small- and medium-sized independent vessel owners. Proposals to raise liability limits to "all removal costs plus X" – an unspecified number – also threaten to raise the costs of insurance to a price that none but the largest companies can afford.

Under Coast Guard regulations for Certificates of Financial Responsibility (COFRs) under OPA 90, vessel owners must demonstrate financial responsibility up to the limits prescribed by regulation. However, even though the amount of insurance carried by most vessel owners far exceeds the limitation amount, vessel owners cannot rely on participation in a P&I Club as evidence of financial responsibility. Thus, vessel owners must demonstrate financial responsibility for purposes of the COFR regulations through self-insurance or supplemental COFR insurance. As liability limits are raised, it becomes increasingly difficult for all but the largest companies to demonstrate sufficient U.S. assets over worldwide liabilities to meet the self-insurance requirements. Thus, most vessel owners are required to purchase COFR insurance. The vessel owner receives no real value – beyond regulatory compliance – from incurring this significant additional expense. Significantly increasing the liability limits for vessel owners will exacerbate the financial burden on vessel owners and threaten the availability of insurance for small- and medium-sized companies like mine. And, it will do so to no good end since the existing liability limits are already appropriate and will increase over time given the changes Congress enacted in 2006.

We urge the Committee to be sensitive to the impacts that such changes would have on responsible, taxpaying, American companies that employ tens of thousands of American citizens, providing family-wage jobs aboard our vessels and on shore. We urge you to be thoughtful and judicious as you exercise your very important oversight responsibility and as you seek to identify the changes needed to ensure that a catastrophe like the Deepwater Horizon spill does not happen again. We urge you to recognize the differences between a tank barge or a tank ship and an oil rig, and the differences in the applicable statutory and regulatory regimes.

There is precedent for the kind of careful, reasoned, well-thought-out public policy that we ask you to strive for – even against the backdrop of a large-scale environmental disaster. That precedent is OPA 90, and you were its authors.

Thank you very much. I would be happy to answer any questions that members of the Committee may have.

Department of Justice

STATEMENT

OF

THOMAS J. PERRELLI
ASSOCIATE ATTORNEY GENERAL

BEFORE THE

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE OF REPRESENTATIVES

HEARING ENTITLED

"LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES"

PRESENTED ON

JUNE 9, 2010

TESTIMONY OF
THOMAS J. PERRELLI, ASSOCIATE ATTORNEY GENERAL,
U.S. DEPARTMENT OF JUSTICE

BEFORE THE
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
UNITED STATES HOUSE OF REPRESENTATIVES

June 9, 2010

Chairman Oberstar, Ranking Member Mica, and members of the Committee, thank you for the opportunity to testify today about liability and financial responsibility issues related to offshore oil production. Before I begin, I would like to take a moment to express my condolences to the families of those who lost their lives and to those who were injured in the explosion and sinking of the Deepwater Horizon.

INTRODUCTION

The explosion and fire that took place aboard the Deepwater Horizon Mobile Offshore Drilling Unit on April 20 and the spill of oil into the Gulf of Mexico that followed have created a potentially unprecedented environmental disaster for the people and fragile ecosystems of the Gulf Coast. President Obama, the Department of Justice, and the entire Administration are committed to ensuring that those responsible for this tragic series of events are held fully accountable.

From the moment these events began to unfold, this matter has had the close attention of Attorney General Holder. While Administration efforts have focused on responding to the disaster and ensuring that the responsible parties stop the discharge, remove the oil, and pay for

all costs and damages, the Department of Justice has been carefully monitoring events on the ground and providing legal support to the agencies involved in the response efforts.

To handle the multiple legal issues that a disaster of this magnitude raises, the Attorney General has assembled a team of attorneys from our Civil and Environment and Natural Resource Divisions who have experience with the legal issues that arise out of oil spills and other environmental disasters, as well as the United States Attorneys for the districts that are being, or are likely to be, affected by the spill. The United States Attorneys have critically important knowledge of their communities and local matters. We at the Department of Justice are working to coordinate our efforts not only with the other federal agencies involved but also with the state Attorneys General for the affected states and with representatives from local communities.

My testimony today will focus on the Oil Pollution Act of 1990, or "OPA." As you know, OPA was passed in the wake of the Exxon Valdez disaster to provide specific legal authority for dealing with the consequences of oil spills. OPA assigns responsibility and liability for cleaning up such spills. It also provides a liability scheme for payment of damages ranging from the immediate and ongoing economic harm that individuals and communities suffer to the potentially devastating and long-term harm done to precious natural resources.

Although OPA is the primary federal vehicle for addressing liability for response costs and damages resulting from oil spills, it is not the only legal vehicle for seeking compensation for incidents such as those now unfolding in the Gulf. It is important to remember that OPA expressly preserves state and other federal mechanisms for pursuing damages for injuries caused by such incidents and for assessing penalties for the underlying conduct that may cause such

disasters. There may be additional legal authorities available under both state and federal law, but the focus of my testimony today is OPA.

I assure you that this Administration will explore all legal avenues to make sure that those responsible for this disaster pay for *all* of the devastation that they have caused. Our mandate is to make sure that we recover every dime that the United States Government spends for the removal of the oil and the damages caused by this catastrophe. We will work tirelessly to carry out that mandate and to ensure that the American people do not pay for any of the costs and damages for which others are responsible. Those responsible for these events must be held fully accountable. To this end, we will enforce the appropriate civil – and, if warranted, criminal – authorities to the full extent of the law.

THE OIL POLLUTION ACT OF 1990

OPA provides a strict-liability scheme for payment of removal costs and damages resulting from a discharge of oil from a vessel or facility into or upon the waters of the United States, including the area in which the Deepwater Horizon explosion, fire, and oil spill occurred. That means that those companies that are "responsible parties" under OPA are responsible for paying costs and damages under the statute, regardless of whether they are found to be at fault. Here, under OPA, the Coast Guard has designated the source of the spill and has thus far identified BP, Transocean, and BP's co-lessees as responsible parties under the statute.

OPA establishes certain limits on liability according to a formula that varies based on the size and nature of the vessel or facility that is the source of the spill. For discharges of oil from an offshore facility (other than a deepwater port), a responsible party is liable for *all removal*

costs: There is no cap on such a responsible party's liability for removal costs. OPA defines removal costs as the costs of removing spilled oil from water and shorelines or taking other actions as may be necessary to minimize or mitigate damage to the public health or welfare, including wildlife and public and private property. The responsible party must pay in full for the removal costs incurred by the United States, a state, or an Indian tribe, or by a private party acting in accordance with the National Contingency Plan.

In addition to being responsible for all removal costs, a party responsible for a discharge of oil from an offshore facility is also liable for *damages* from the spill. With recognized exceptions, a responsible party's liability for damages for a discharge of oil from an offshore facility is limited to $75,000,000 per incident. One of the recognized exceptions is that the liability cap does not apply if the discharge was caused by the gross negligence or willful misconduct of the responsible party or of any of its agents, employees, or contractors. Another exception is when the spill resulted from the responsible party's – or its agent's, employee's, or contractor's – violation of an applicable Federal safety, construction, or operating regulation. A third exception occurs when a responsible party fails or refuses to provide all reasonable cooperation and assistance requested by a responsible official in connection with removal activities. Under such circumstances, a responsible party is strictly liable for *all* damages covered by the statute. Damages that are recoverable include injuries to natural resources, loss of subsistence use of such resources, destruction of property, loss of tax revenue, loss of profits or earning capacity, and net increased costs for additional public services, including protection from fire, safety, or health hazards.

I note that BP has stated in Congressional testimony – including in testimony before this Committee on May 19 – that it will not use the $75 million cap to limit its payment of legitimate claims under OPA. We expect BP to uphold this commitment. Rest assured, however, that the United States Government is committed to making sure that all responsible parties are held fully accountable for all the costs and damages they have imposed on our people, our communities, and our precious resources.

In addition, under OPA, the Oil Spill Liability Trust Fund is available to pay compensation for removal costs and damages to the extent that a responsible party does not do so. The Fund is financed primarily by an 8 cent per barrel tax on oil collected from the oil industry. For any one oil-pollution incident, the Fund may pay up to $1 billion or the balance of the Fund, whichever is less. Fund expenditures for natural resource damage assessments and claims in connection with a single incident are limited to $500 million of that $1 billion. If the Fund pays compensation to a claimant, it becomes subrogated to that claimant's rights to recover from the responsible party under OPA *or* from any party under any other law. That is, the Fund steps into the shoes of claimants that the Fund pays and assumes any rights of action that the claimants would otherwise have.

PROPOSED AMENDMENTS TO OIL POLLUTION ACT

As you know, the President recently submitted to Congress a legislative proposal designed to improve our ability to respond to oil spills. The proposal requests additional funding for many of the agencies that are responding to the present unprecedented oil spill.

Of more direct relevance to this hearing, the proposal would do two things: First, it would *lift* any applicable caps on damages for responsible parties beyond the current limits. Second, it would increase the amount in the Oil Spill Liability Trust Fund by increasing the tax on industry through which the Fund is financed and would increase the amount the Fund could pay for cleanup and damages related to any given incident.

The Administration supports a significant increase in liability for offshore oil and gas developers whose actions pollute our oceans and coastlines and threaten our wildlife and other natural resources. For the future, we support removing caps on liability for oil companies engaged in offshore drilling. Companies participating in such risky activities should have every incentive to maximize safety and must bear full responsibility for all of the damages their actions impose on individuals, businesses, and the environment. The liability caps for other activities covered by OPA should be reviewed and increased as appropriate to more fully reflect the inherent risks associated with those activities.

We look forward to working with you to develop the appropriate caps and transition rules for some of the activities that are covered by OPA. There are a number of factors to consider in establishing the new framework for liability under the statute. We must ensure that the liability rules provide the appropriate incentive for companies working in this field to fully account for the damages their actions may cause and to mitigate the risks of a catastrophic event. We must establish a legal framework that provides confidence that an individual or business harmed by an oil spill will be able to seek – and receive – fair compensation, and that the trustees charged with protecting our precious natural resources can secure adequate restoration and other compensation for any harm done to those resources. In addition, we must consider the ways in which new

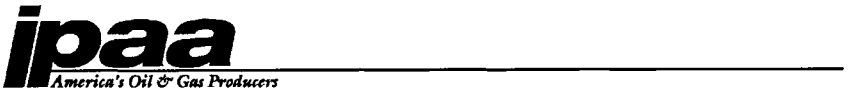
liability rules may affect the structure of the offshore oil industry and the number of market participants. We must analyze how changes in the caps will interact with the current liability structure under OPA. Under that structure, the party responsible for a spill is liable for associated costs and damages up to a specified cap, if the cap applies, with liability for additional costs and damages spread across the oil industry as a whole through the Oil Spill Liability Trust Fund.

OPA has not been updated in some time, and it is clear that its liability provisions should be revised to ensure optimal levels of precautions to avoid spills before they happen, and, if for some reason they still do, to ensure that the polluters bear the risks, costs, and damages associated with the harm they cause to individuals, communities, and the natural environment. The Administration is convinced that the old liability framework is simply inadequate to deal with the potentially catastrophic consequences of oil spills.

CONCLUSION

The focus of everyone's efforts right now is – and should be – on ensuring that BP stops the discharge of oil and responds to the immediate aftermath of the spill. The Justice Department will continue its aggressive efforts to ensure that those found responsible for this oil spill are held accountable and that the American people are reimbursed for the costs of this disaster.

The Department strongly supports the Administration's legislative proposal, and we look forward to working with you to see it adopted.



Tuesday, June 08, 2010

The Honorable Jim Oberstar, Chair
Committee on Transportation & Infrastructure
2165 Rayburn House Office Building
Washington, DC 20515

The Honorable John Mica, Ranking Member
Committee on Transportation & Infrastructure
2163 Rayburn House Office Building
Washington, DC 20515

Dear Representatives Oberstar and Mica,

This Wednesday, the Committee on Transportation and Infrastructure will hold a hearing on "Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related Statutes," in response to the current oil spill crisis in the Gulf of Mexico (GOM). The Independent Petroleum Association of America (IPAA) urges members of the Committee to seek a full understanding of the current laws, and the imminent economic impacts that would be caused by any dramatic changes.

It is important to note that the tragic events surrounding the Deepwater Horizon incident in the GOM will have a significant impact on American offshore oil and gas exploration and production for years to come. Our thoughts and prayers go out to the families and communities affected by the tragedy in the Gulf of Mexico and we stand ready to help them as we move forward.

Independent producers have operated responsibly in the GOM for decades and hold roughly 90 percent of the leases, producing about 30 percent of GOM oil and more than 60 percent of GOM natural gas. GOM production represents a significant amount of energy supply for consumers all across America, and it remains an essential component of America's energy portfolio. The entire industry is dedicated to working together to protect the environment and to contain the damage from the spill. Many of our member companies have offered supplies and services; others are directly helping with the clean-up efforts.

Controlling the well and protecting the environment are the main priority of the industry today. We support President Obama's independent commission investigating the Deepwater Horizon incident. It is important that a thoughtful, thorough and timely investigation and analysis of the incident is conducted to fully understand what caused the accident and to ensure the proper, improved safety measures are identified and put into practice to prevent incidents in the future. IPAA supports the following principles to address this important issue:

1. Any company operating offshore or onshore should be fully responsible (financial and otherwise) for all clean-up efforts.

2. There must be a fund to ensure that those affected by such incidents (i.e., fishermen, tourism, local businesses, etc.) will be able to fairly recoup lost costs without being caught in fierce litigation with large corporations.

3. The oil industry, collectively, should contribute to this fund and ensure its long-term viability.

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These principles are already a part of federal law in the Oil Pollution Act of 1990 (OPA 90) and the Oil Spill Liability Trust Fund (OSLTF). Changes may be needed to update out-of-date OSLTF limits with additional industry funding. However, we are strongly opposed to legislation such as H.R. 5214 and other proposals being discussed in Congress that would have negative consequences for independent producers. These changes include increasing offshore liability limits to unrealistic levels that will preclude nearly every company operating in the U.S. offshore from getting insurance to cover their operations. Without the proper insurance coverage, there will not be independent producers with offshore exploration and production – it is that simple. These consequences are not justified based on the performance of independent producers operating in the offshore, who have an outstanding safety and environmental record.

The Congress should not make hasty decisions and advocate legislative and regulatory initiatives that will result in severe limitations to offshore drilling in the United States – consequences that can further harm the Gulf Coast economy. IPAA looks forward to working with the Committee and the entire Congress to find solutions that will allow American producers to continue to operate in the U.S. offshore and explore for the oil and natural gas that is vital to our nation's energy security.

A significant aspect of OPA 90 was the creation of a trust fund filled by crude oil taxes that is intended to be used by injured parties to compensate them for economic damages instead of requiring lengthy litigation. We support the expansion of this industry-wide fund to ensure that future costs and claims are covered and urge the Committee to work within the framework of OPA 90 before taking other actions that will impact American energy production.

The Obama Administration also recently announced a six month moratorium on any offshore drilling in water depths greater than 500 feet. The moratorium includes wellbore sidetracks and bypasses; spudding of any new deepwater wells and is designed to allow the presidential commission investigating the spill to prepare its recommendations. While we understand that many Americans are rightfully concerned about the environmental risks and the safety of offshore drilling, the federal government should methodically review this matter and follow the facts in the incident before taking actions that could impact oil and natural gas production from the offshore for years to come.

A recent analysis conducted by Wood MacKenzie predicted that the moratorium and new regulations will push back into later years 80,000 barrels a day of production scheduled for 2011. The impact of the spill becomes harder to ignore further into the decade. By 2015, Wood MacKenzie predicts stiffer federal offshore permitting and safety regulations will result in more than 350,000 barrels a day of production forecast for that year to be delayed. It is important to note, however, that these predictions assume available capacity for production in the GOM after the current moratorium is lifted. That is an issue that could be in serious jeopardy if rigs currently in the GOM are sent to various parts of the world to begin operations on other projects, and then are not available to return once the moratorium is lifted.

Congress must continue to recognize the importance of energy development in the United States. Rather than enacting legislation such as H.R. 5214 that will destroy the ability of independent, American oil and gas companies from exploring for energy resources in our nation's offshore areas, we need Congress to create a forward-looking, balanced energy policy that recognizes the role oil and natural gas will continue to play in our nation for years to come. Offshore oil and natural gas production creates jobs, revenues and helps stabilize energy prices for American consumers and helps reduce our reliance on energy supplies from unstable regimes across the globe.

As the facts and information surrounding the Deepwater Horizon incident come forward, our nation must develop a reasonable regulatory program that will allow further offshore oil and gas exploration and

production in the United States. Offshore oil and gas production must continue to be an integral part of America's energy portfolio and IPAA is dedicated to finding answers that will help us achieve that goal.

Unfortunately, the implementation of legislation similar to H.R. 5214 into law would dramatically hinder American production of oil and gas. As the Committee probes the issue, IPAA urges members to seek a full understanding of the Deepwater Horizon situation before acting on any legislation. Thank you for your attention to this matter.

Sincerely,

Bruce Vincent
Chairman

COMMITTEE ON TRANSPORT AND INFRASTRUCTURE:

HEARING ON LIABILITY AND FINANCIAL RESPONSIBILITY FOR OIL SPILLS UNDER THE OIL POLLUTION ACT OF 1990 AND RELATED STATUTES: JUNE 9, 2010 AT 12 30

STATEMENT FOR THE RECORD BY THE INTERNATIONAL CHAMBER OF SHIPPING

The International Chamber of Shipping ("ICS") is the principal international trade association for shipowners, with a membership comprising national shipowners' associations from 31 countries, including the United States of America. ICS represents 75% of world tonnage and all sectors and trades.

Various proposals to amend the United States Oil Pollution Act of 1990 (OPA 90) have been made following the Deepwater Horizon oil pollution incident in the Gulf of Mexico in April 2010. The shipping industry is concerned in particular about a proposal to remove the present limitation of liability system for vessels and replace it with a system which would be similar to the system that applies to the oil off-shore/extraction industry.

Summary of ICS position:

- The OPA 90 regime for vessel liability has functioned well for two decades, and the limits have been reviewed and updated as recently as 2006, and were increased further in 2009. The limits have proved to be adequate and workable. Every incident of pollution from a vessel has fallen within the limits of liability of OPA 90 and the Oil Spill Liability Trust Fund (the "OSLTF"). More particularly, in the few cases where vessel limits have been exceeded, additional resources have come from oil industry funding via the OSLTF which ensures sharing of responsibility for the costs of compensation between the shipping and oil industries.

- There are significant factual differences between the risk assessment of a drilling operation and of maritime transportation, and OPA 90 very rightly differentiates between the two sectors when determining the respective limits of liability.

- Changes to the liability and insurance related aspects of OPA 90 for vessels are unwarranted.

- The vessel liability provisions in OPA 90 strike a careful balance (taking into account both vessel type and size) to provide appropriate levels of responsibility for the broad range of vessels to which OPA 90 applies. The levels of liability and financial security for pollution are reasonable and insurable.

- Unlimited or disproportionate liability for vessels would undermine the operation of OPA 90 because the system relies on the immediate availability of insurance resources to support clean up and response operations and compensate third party claimants with minimal delay or litigation.

- Unlimited or disproportionate liability for vessels would also be inconsistent with the aim in OPA 90 of having a comprehensive and vibrant transportation system that enjoys an effective, predictable liability and response regime. Unlimited liability is uninsurable and the providers of the Certificates of Financial Responsibility would not be able to provide COFRs for such liability. This would lead to an inability on the part of the majority of vessel operators trading to the US to continue to do so.

Liability and Compensation under OPA 90

OPA 90 was enacted in response to the Exxon Valdez oil spill in 1989 and is the primary federal statute addressing liability and compensation for oil spills in the US. The owners or operators of facilities or vessels which spill oil are known as "Responsible Parties". Responsible Parties are liable for removal costs and damages (subject to certain defenses and rights of limitation). The system promotes effective prevention measures, prompt response, and verifiable contingency planning. It provides prompt compensation for third party claimants, in the case of vessels, through a system of strict liability together with a fixed limit of liability. The statute ensures the availability of funds from Responsible Parties to meet the liabilities under the Act through the requirement of evidence of financial security (certificates of financial responsibility (COFRs)) and the right of direct action against the COFR provider. In the case of vessels, the liabilities are ultimately met by the shipowners' mutual insurance scheme provided through the P&I Clubs.

In drafting OPA 90, Congress's stated aims were to: ensure that sufficient funds were available to respond to spills and adequately compensate claimants, protect the US taxpayer from having to meet spill response costs and damages, and to ensure that those costs would be shared appropriately within the oil and shipping industries. These aims were fulfilled through establishing high limits of liability for the Responsible Party and through the establishment of the Oil Spill Liability Trust Fund (OSLTF), a separate compensation fund financed largely by a tax on both imported and domestic oil paid by the oil industry. The limit of liability for vessels is assessed by reference to the vessel's size (section 1004(a) OPA 90). The maximum limit of liability for the largest vessels is approximately USD 525 million. Further funding for clean-up and compensation costs is available from the OSLTF up to USD 1 billion per incident. These limits are similar to the limits in the international Conventions – the Civil Liability, Fund, and Supplementary Fund Conventions - of about USD 1.12 billion (at current SDR/USD exchange

rate). It is important to note that the OPA 90 limits can be lost if it can be shown that there has been gross negligence or wilful misconduct or a violation of applicable federal safety, construction or operating regulations.

The incident history shows that OPA 90 has worked successfully for the maritime transportation sector. The package of prevention measures, response planning requirements, and liability and financial responsibility requirements has been very effective. This includes the phase-out of single-hull tank vessels and their replacement by modern double-hull tankers, as well as Coast Guard-approved tank vessel response plans which require vessel owners to plan for three different spill levels; average most probable spill, maximum most probable discharge, and worst case spill i.e. the loss of the entire cargo/fuel A rigorous program of training and unannounced periodic drills ensures that such plans are ready to deploy immediately in the event of a spill or the threat of a spill. The liability and financial responsibility provisions of OPA 90 have contributed to this record of enhanced prevention and more timely and effective response. Vessel owners must demonstrate financial responsibility up to the levels in OPA 90 which are reviewed periodically and were raised in 2006 and 2009. Today, the liability levels for tank and non-tank vessels are two to three times higher than they were in 1990, and a regulatory mechanism is in place to continue to increase the limits as needed over time. The statistics confirm that these measures have led to a remarkable decrease in the number of ship-source oil pollution incidents. Moreover, every incident of pollution from a vessel has fallen within the limits of liability of OPA 90 and the OSLTF. Thus the US taxpayer has not borne the cost of any ship-source pollution incidents.

US Administration's proposals to amend OPA 90

The Administration has proposed to amend the OPA 90 limitation of liability provisions for vessels by removal of the express overall limit, which is assessed by reference to the vessel's size, and replacing it with unlimited liability for removal costs plus an express dollar limit of liability (not yet quantified) for all other claims. In addition to this, the proposal seeks to extend liability of the Responsible Party for other heads of claims such as for employment costs, etc. These claims are expressly stated to be without reference to any limits of liability under OPA 90. Thus in this way, the proposals seek to extend the category of claims which would have no limit. The proposals in relation to unlimited liability for removal costs would bring the provisions in line with the OPA 90 provisions for the oil off-shore/extraction industry.

This proposal is of great concern to shipowners. Shipowners are generally independently owned companies, and depend upon insurance markets to meet their extensive liabilities under both international Conventions and OPA 90. Without such insurance, shipowners would be exposed to a complete loss of equity in their companies for liabilities that could occur even when there is no fault on their part (through the operation of the strict liability provisions). Put

simply, without insurance, a shipowner cannot trade. The international treaties on oil pollution (the Civil Liability and Fund Conventions) recognise a need for a predictable and insurable liability regime for vessel operators and also that an adequate insurance system must be available to ensure the continuation of a reliable and environmentally responsible transportation system. The US also expressly recognised this when the OPA 90 rule making process was underway, noting that the system "is intended to foster a continuing market for providers of financial responsibility". No insurer/provider of financial responsibility would be prepared to underwrite unlimited liability.

In recognition of the fact that the right of a shipowner to limit liability is fundamental to the insurability of such liability, the current OPA 90 provides for defined limits of liability applicable to all claims and thereby certainty of exposure for the purposes of facilitating insurance and certification of such insurance. The removal of limits for clean-up and employment costs resulting in unlimited exposure for shipowners will undermine the insurance and current COFR system. This will lead to an inability on the part of the majority of vessels currently serving US waters to continue to do so.

Furthermore, the application of a single limit for all other claims regardless of vessel size or type will have significant ramifications in terms of the cost and availability of insurance cover and certification, particularly for smaller vessels.

The Administration's proposals are the result of an incident affecting the oil extraction sector and in seeking to address the hardship caused by that particular incident, would make sweeping changes to the entire system when separate and different solutions for the respective sectors are warranted. The present statutory framework recognises the differences between the oil extraction industry and the maritime transportation system, and that while each has the potential for causing a major pollution incident, the consequences of an incident will not be the same. The primary difference is of course that an incident concerning a vessel will result in a finite spill of oil or hazardous substance, being the amount carried on board as cargo or fuel oil. Thus, the potential clean-up costs and other claims are more readily definable and quantifiable. An oil well however, as seen in the case of the Deepwater Horizon, can cause an unknowable and seemingly endless amount of spillage. This difference is recognised in the limitation of liability scheme of OPA 90: vessels are subject to an express overall limit for all claims and clean-up costs (presently a maximum of approximately USD 525 million for the largest vessels). Off-shore facilities on the other hand are subject to an unlimited liability for all removal costs plus USD 75 million for other claims. (Section 1004(a)(4) OPA 90).

CONCLUSION

In seeking to align the OPA 90 provisions on financial consequences of an oil spill from a vessel with that from an off-shore oil facility, the reason for the

original point of distinction is disregarded. In ICS's view, such a proposal is unwarranted and, if effected, would disrupt the mechanism by which vessels fund their liability under the statute, and would make it impossible for shipowners to trade to the US.

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