**Liability Caps and Financial Responsibility: Summary**

**Staff Draft December 1, 2010**

**ISSUE:**

- BP recently estimated that its total costs from the Deepwater Horizon spill, including the clean-up, penalties and damages, will total nearly forty billion dollars. It is fortunate that BP is able to provide full compensation for damages. If a company with less financial means had caused the spill, the company would likely have declared bankruptcy long before paying anything close to the damages caused.

- Under the Oil Pollution Act of 1990 "responsible parties," including lessees of offshore facilities, are strictly liable for removal costs and certain damages resulting from a spill. However, OPA caps liability for damages from a spill from an offshore facility to $75 million per incident, except in limited circumstances.

- Lessees are required to demonstrate Financial Responsibility in an amount between $35 million and $150 million. MMS regulations establish guidelines for the level of financial responsibility necessary, based on the estimated worst-case discharge from offshore facilities.

- If the responsible party is not able to compensate all of the damages caused by the spill, the Oil Spill Liability Trust Fund is available to cover certain damages. However, the amount authorized per incident is currently $1 billion and, until recently, the overall limit on the Fund was $2.7 billion. Even though the $2.7 billion cap has been removed by Congress, it is not clear that the OSTLF would provide sufficient backup.

- Therefore, under the current regime: 1) the liability cap creates little incentive for offshore drillers to take actions to mitigate the risk of spills; 2) if there is another spill of the magnitude of the BP spill significant portion of the injuries caused to individuals and natural resources could go uncompensated, or the taxpayer will bear the burden of compensating victims.

- There are several pending legislative proposals designed to address these issues. The proposals do one or all of the following: eliminate of the liability cap for offshore facilities; change financial responsibility requirements by raising limits or requiring the Secretary of the Interior to review requirements; require participation in a mutual liability pool; and raise the amount of available per incident funding in the OSTLF.

- Opposition to some of these proposals has been based on a concern that raising or eliminating liability caps would result in the inability of smaller companies to remain in the oil exploration and production business, in large part because they would not be able to afford insurance.

- In Commission staff's view, there are good reasons for smaller companies to remain in the business, but all companies should be able to demonstrate a level of financial responsibility that bears some resemblance to the magnitude of potential costs from a spill.  A risk evaluation by the government based on specific criteria should help inform the required level of financial responsible for a particular firm or activity. Insurance companies will also play a role in providing incentives to companies to mitigate risks, through establishing premium levels and other mechanism.

- Commission staff also finds that over time, the insurance industry will likely adjust to increased demands for insurance, based on increased liability caps, although this finding is somewhat dependent on the amount of increase.

**RECOMMENDATIONS**

Congress should:

1. Raise the liability caps, using a phased in approach
2. Raise financial responsibility requirements, using a phased in approach
3. Ensuring an evaluation of risk by the regulator in setting criteria for financial responsibility levels, and/or by insurance companies in determining premiums
4. Increase the per-incident limits on payout from the Oil Spill Liability Trust Fund