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BP Doesn't Deserve a Liability Cap

The best way to deter future spills is to expose drillers to the full costs of any mistake and not let any company without proper insurance near an oil derrick.

By RICHARD A. EPSTEIN

Our national frustration continues to rise with each new drop of BP oil that leaks into the Gulf of Mexico. Everyone knows we can't legislate away environmental risks without consigning ourselves to the Stone Age. What's needed going forward is a comprehensive legal strategy that addresses the risks though a combination of regulation before the fact and tort liability (and criminal sanctions where appropriate) afterwards.

Tort remedies are essential to protect people (and their property) who do not have contractual relations with defendants from harms such as air and water pollution. The legal system should never allow self-interested parties to keep for themselves all the gains from dangerous activities that unilaterally impose losses on others—which is why the most devout defender of laissez-faire must insist, not just concede, that tough medicine is needed in these cases. The fundamental question here is one of technique: What mix of before and after sanctions will do the job at the lowest cost?

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A controlled burn is viewed from the air over the site of the BP oil well in the Gulf of Mexico.

The first element in the mix is a no-nonsense liability system that fastens full responsibility on the parties who run dangerous operations, no excuses allowed. Accordingly, we have to be especially wary of statutory caps on tort damages, including the current law, under which, in the case of the oil industry, the "total of liability . . . with respect to each incident shall not exceed for an offshore facility except a deepwater port, the total of all removal costs plus $75,000,000." That $75 million is chicken feed. Fortunately, the law removes that cap if the incident was caused by "the gross negligence or willful misconduct" of any party, or its failure to comply with any "applicable Federal safety, construction, or operating regulation."

BP has waived the cap by expressing its willingness to pay "any legitimate claim." No surprise here, especially as the evidence to date suggests the cap will be blown off precisely because of the two exceptions. But we'd all be much better off if there were no statutory liability cap and if operators both big and small were required to purchase insurance—amounting to the tens of billions if necessary—when they operate in dangerous waters or terrains.

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A tough liability system does more than provide compensation for serious harms after the fact. It also sorts out the wheat from the chaff—so that in this case companies with weak safety profiles don't

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get within a mile of an oil derrick. Solid insurance underwriting is likely to do a better job in pricing risk than any program of direct government oversight. Only strong players, highly incentivized and fully bonded, need apply for a permit to operate. This logic also suggests that the Price Anderson Act's $375 million cap on damages for each responsible party to cover incidents at a nuclear power facilities should be rethought.

Tort liability does not preclude direct government safety inspection and regulation, especially in the Gulf of Mexico, where the government itself leases the drilling rights. So by all means work hard to make these better. Just be skeptical that this or any other presidential administration will reform the Department of Interior's hapless Minerals Management Service.

The rash decision of the Obama administration to shut down for six months all drilling in over 500 feet of water highlights the converse risk of regulatory overreaction. Why impose a ban on competitors with better safety records? Why extend it to relatively shallow waters?

Matthew Kaminski and Joe Rago of the WSJ Editorial Board discuss the challenges in Afghanistan and Kyrgyzstan, the Left's panning of Obama's BP speech, and the early-retiree fiasco.

Unfortunately, the administration sidestepped these questions by claiming falsely that it was only following the recommendations of an expert team of National Academy of Sciences engineers. Its second misstep was to insist that BP pay for the lost wages of the workers on these wells that its own ill-advised ban would lay off. (BP does face, properly, potentially huge exposure to make good on the income of other workers laid off because of damage caused by the leaking oil.) But don't worry, taxpayers, for the U.S. government has complete statutory immunity from tort liability when acting in its "discretionary" capacity.

Oddly enough, what is needed is a relaxation of the permit mentality in locations most suitable for drilling—including dry land and shallow waters, and ditto for nuclear power generation. In the case of nuclear energy, political parochialism also has killed plans to build a major nuclear waste disposal site at Yucca Mountain, Nev. The result is that large quantities of nuclear waste are housed in more dangerous temporary facilities throughout the land, generating a slew of complex lawsuits against the government for its failure to remove the waste.

Legal reform should not just be limited to oil spills. Environmental priorities also need to be straightened out. To take just one example, in virtually every coastal location today, acerbic green lobbies parade about as if new luxury beachfront homes are the moral equivalent of oil pollution. Those histrionic outbursts create civic discord and stunt our economic base. They can be stopped by insisting that private developers be compensated for the full costs of any new-fangled land use restrictions, at which point popular support for such lobbying will collapse.

Ultimately, the current BP disaster has its roots in the loss of our focus in developing a sound overall energy and environmental policy within the framework of a leaner and more responsive legal system. This disaster is proof we need to change course.

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