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Memorandum

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To: Max Gruenberg
From: Gregg Erickson
Subject: Economic Issues in Proposed Exxon Settlement

During the Special Committee's meeting on March 27, you requested that I work with your staff to follow-up on several issues. Some initial comments are given below. An additional memorandum addressing the more general issue of valuing natural resources injuries is in preparation.

Natural Resources Damages

What is meant by "natural resources damages"?

If Mr. A. smashes Mr. B's car, justice requires that Mr. A repair the car to its condition before the crash, or provide an equivalent replacement vehicle, or sufficient money to make Mr B indifferent to the injury inflicted on his car. The money that Mr. B gets is his "damages," not the injury to his car.

Natural resource damages are, like the money paid to Mr. B, "compensatory and remedial" (see the definition on p. 5 of the consent decree), but from an economist's standpoint they differ from ordinary damages in two ways: (1) the injured property must in some sense be held in common ownership; and (2) the injury must be so broadly inflicted that private parties have an insufficient economic incentive to recover all the damages.

The injured resource need not be a part of nature's endowment; for example, injury to cultured fish in an artificial lake would almost certainly give rise to natural resources damages, provided the lake and fish were public resources. Commercial fishermen who lose income because of an oil spill are usually not thought to have a claim to natural resources

damages, as long as they have sufficient economic incentive to pursue private litigation.

What are natural resources services?

Natural resource services are a flow, distinct from the natural resources themselves, which are the stock of assets that provide the flow. If Mr. A destroys Mr. B's House, Mr A is not only liable for replacing the house (the stock), but also liable for providing Mr. B a place to live (maintaining the flow of housing services) while the new house is being built. The robins that arrive in Juneau each April are a valuable natural resource stock, providing insect control, bird-song, pleasure to bird-watchers, food to certain predators, and other valuable natural resources services .

Do natural resources damages include economic losses as from lost tax revenue? If not, is the state then giving up these claims?

It is unlikely that lost tax revenue would be considered natural resources damages.

Excepting the municipal portion of the fish taxes, the settlement explicitly extinguishes the state's tax-loss claims. There is no provision in the consent decree for making good the loss to the general fund. This contrasts to the cleanup and damage assessment claims, for which general fund reimbursement is explicitly provided. The state's negotiators may have decided that the tax loss claims had little merit, or that reimbursement was bargained away for things they judged to be of greater importance. The restitution to be paid under the criminal plea agreement may have figured in the negotiator's thinking. The attorney general denies any role in that agreement, however, and in any event, the restitution monies may only be appropriated for specific purposes, and thus do not directly compensate for the unrestricted revenue the lost taxes would have provided.

Why are the state's natural resources damages being treated as if the are inseparable from those of the federal government?

In principle, "ownership" can be determined for tidelands, submerged lands and a few other resources injured by the oil spill. Most of the natural resources damages, however, arise from injuries to biological resources to which the notion of ownership can be related only with difficulty. Who owns the sea otter, or the salt water she swims in? Who owns the clams she eats or the plankton that feed the clam? And if the sea otter dies because the clams die because the plankton die because of the oil, how is the injury and damages to be divided among the various "owners"? From an economic perspective, the notion of a joint trusteeship, whatever its deficiencies, must be measured against the expenditure of human talent and public funds that efforts by the governments to "divide the baby" would entail.

What limits are there to the "acquisition of equivalent resources"?

The federal Clean Water Act defines "restoration" as including "replacement and acquisition of equivalent resources." The question of how far one can stretch the notion of equivalent resources has been the object of considerable legal and bureaucratic discussion within the trustee agencies and among them and their legal advisers. Good economic arguments have been advanced to support the "equivalence" of a wide range of alternative resource acquisitions. For example, boat launching facilities near Talkeetna might be an economically and cost effective way to compensate sport fishermen for lost opportunities in Prince William Sound. "Equivalent resources" is an elastic concept, but restoration planners were advised that the further they chose to stretch it, the greater the risk of doing something that would be ruled non-reimbursable. Absent a compelling policy reason to push the limits, and anticipating vigorous challenges from Exxon, the attorneys counseled caution.

The Dept. of Law has addressed restoration questions in a number of contexts, including a 1990 memorandum responding to concerns among staff at the Department of Natural Resources that the purchase of upland habitat scheduled for logging might be going beyond the definition. The committee may wish to request a copy of this and other memoranda addressing the definitions of restoration in federal law.

Restitution

On what sorts of things might the state properly spend the $50 million that may come to the state as restitution under the criminal plea agreement?

The plea agreement provides that within 30 days of the agreement's acceptance Exxon will pay the state $50 million in "remedial and compensatory payments...to be used by the State of Alaska exclusively for restoration projects related to the EXXON VALDEZ oil spill." Restoration includes "restoration, replacement *and enhancement of affected resources*, acquisition of equivalent resources and services, and long-term environmental monitoring and *research programs directed at the prevention, containment, cleanup and amelioration of oil spills.*" (emphasis added)

In contrast to the rest of the definition, the italicized words are not found in federal statutes. The statutory language probably allows for a wide range of alternative resource acquisitions and restoration strategies. The addition of "enhancement" and "research programs directed at...oil spills" further widens the range of options available for spending the restitution money. The committee may wish to inquire concerning the origins of this new language.

Re-Opener Clause

The proposed consent decree allows the governments to collect up to $100 million from Exxon after the year 2002 for additional restoration projects, but only if the governments can prove that "the injury [requiring restoration] could not reasonably have been known nor ... anticipated by any Trustee from any information in the possession of or reasonably

available to any Trustee on the Effective Date." Is there any basis for determining the likelihood of this condition being met?

Speaking from the damage assessment perspective, it is a difficult though probably not impossible standard to meet.