Sustainability agreements and antitrust – three criteria to distinguish beneficial cooperation from greenwashing

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September 7, 2021 (intended for Chillin'Competition)

This summer, the Commission adopted "Fit for 55" proposals to deliver the Green Deal, and the Council and Parliament adopted a Climate Law. There have been calls for a reassessment of competition policy too. Indeed, DG Comp is considering whether to adopt a more permissive approach to sustainability agreements, in the context of the review of the Guidelines on Horizontal Agreements. Commissioner Vestager is about to decide.

When speaking early this year on this topic at the OECD Open Day on Sustainable Competition Policy, EC Chief Economist Pierre Regibeau put his finger on a sore spot. He asked, I hope rhetorically: "*Can we allow sustainability deals if that means taxing the people who buy, to benefit those who do not buy?*"

That question is of course exactly the wrong way around. Producers and consumers impose costs on society – including climate change, large scale pollution, and loss of biodiversity – that are not included in the monetary price consumers pay. This leads to overconsumption and a "tragedy of the commons", the degrading of our environment, due to overuse. These supply- and demand-side market failures are hard to resolve – why should a supplier produce cleanly if that means higher costs and rivals taking market share; why should a consumer buy green at a higher price if the neighbours keep buying polluting goods? Eminent economist Sir Nicholas Stern said in 2007 that "*climate change is a result of the greatest market failure the world has seen*". We all suffer from this collective action problem, including the consumers themselves.

The Chief Economist should have asked "*Why should we allow producers and consumers to impose costs on those who do not consume?*" Or "*why should we prohibit agreements that could help reduce the social costs of climate change and pollution, if they may make the polluters pay for the damage they cause*?"

Article 191(2) TFEU leaves the Commission no choice in how to answer that question: EU policy, including competition policy, "*shall be based on the … principles … that environmental damage should as a priority be rectified at source and that the polluter should pay.*" See also here. Article 11 TFEU demands that "*environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development.*" And for the avoidance of doubt, Article 7 TFEU requires the Commission to "*ensure consistency between its policies and activities*".

I could go on citing additional Treaty provisions saying the same (like Articles 3(3) and 3(5) TEU), but the message is clear enough: we should allow agreements that efficiently prevent or reduce greenhouse gas emissions or pollution at source, or that make producers pay for removing past emissions and repair of the environment.

Some argue that carbon taxation and an adequate emissions trading price are a better answer (although interesting critiques appeared here and here), or prefer regulation. But regulation is slow, and often ineffective, and carbon taxes especially are deeply unpopular. Carbon trading rights in the EU have gone up from € 25 to more than € 60 recently, but even that level is not enough to compensate for the real (and ever-increasing) social cost of climate change. More important, carbon trading rights don't cover all greenhouse gases, including several that are much more potent than CO_2, and cover only a fraction of the world's economy. The revenues are not dedicated to solving the climate crisis, either. It is counterproductive to prohibit sustainability agreements on the ground that, in theory, taxation or regulation is a better tool, when that regulation is too little, too late. We have to use all available tools to reduce emissions, remove excess greenhouse gases, and repair the environment.

Is the threat of private liability part of the solution? The Dutch "climate tort" judgment recently required Shell to reduce emissions by 45% by 2030 compared to 2019. But Shell is appealing, arguing it should not be held to a standard that does not apply to its competitors. A perfect illustration of the collective action problem. Do we let burglars off the hook because many of their colleagues are not caught and convicted? If everyone reasoned that way, we would never get anywhere. Would it not be better to solve the problem by allowing oil and gas companies to agree that they will *all* comply with at least the same standard as Shell? A "compliance with law" agreement – of course with the right do better than the minimum required by the Paris Agreement? (Yes, I know that may be wishful thinking, but wouldn't it be enlightened and set a great example if they did...) But in the meantime, resolving the *Shell* litigation and pursuing others will take years.

The Commission is tempted to focus on competition as the solution: more competition means more innovation, and innovation is the answer to everything. But as Stiglitz explains, innovation has been suboptimal, and we can't be sure that some innovator will emerge as *deus ex machina* to save the world. And competition is exactly the force that drives firms to use up natural resources and emit greenhouse gases as if there is no tomorrow. The costs will be borne by our children and our grandchildren.

Competition is the answer only in markets where firms know that enough consumers are willing to pay to eliminate all greenhouse gas emissions (and even then, we still have to repair the damage already done). In those markets, firms have an incentive to compete not just to be the cheapest and best, but also the cleanest and greenest supplier. Unfortunately, in many markets, consumers do not have the willingness or the ability to pay. That's when cooperation should be allowed, as a complementary tool, to spread the costs, reduce the risks, and speed up reduction of greenhouse gas emissions.

A few economists, such as Prof Maarten Pieter Schinkel, argue that if we give competitors a finger, they will take the whole arm, and try to avoid having to pay for emissions reduction. They back this up with elegant economic models. But if competition practitioners know anything about economic models, it is that you have to check the assumptions. They may not apply universally in the real world. For instance (and see also here):

(a) Consumers are assumed to be willing to pay as much as is needed to avoid climate damage, and it is always profitable for firms to meet that demand – whereas in reality, the ICPP warns of tipping points with dramatic effect, as well as extreme weather events, meaning climate damage increases in a non-linear way. Cutting half the emissions does not cut half the climate risk, and many people do not realize the dramatic impact of climate change until it happens to them. Because of this information asymmetry and other demand-side market failures, many consumers are not willing to pay (or pay enough) for greenhouse-gas-neutral products, and firms may lose more than they gain if they go green individually;

(b) Regulation is assumed to offer a fully effective solution – which flies in the face of our experience of "regulatory failure" or "political failure" of the last decades;

(c) Firms are assumed to benefit only from (and to seek only) short-term profit maximization, and always collude to minimise green investment or greenwash if they can get away with it, without regard to the long-term impact on them; and

(d) It is assumed that consumers must be fully compensated for any price increase. Out-of-market benefits or improved access to non-market goods (say, clean air or a safe environment) supposedly do not count as compensation.

Let's have a closer look at the last two assumptions.

Consumer welfare and the "fair share". There is nothing in the EU Treaties that says that consumers have to be fully compensated in the very market where the effects of the agreement are felt. Article 101(3) TFEU does not even mention market limits to compensation, and refers to a "fair share" to consumers, not a "full share". We can argue for days on what "fair" means (and some of us have), but surely no one will argue that it is fair for producers and consumers, at no cost to themselves, to pollute the environment and cause climate change problems for others, who have no say in the decisions. "The polluter pays", on the other hand, now *that* is a concise summary of what is a "fair share"!

For these reasons, before 2004, the Commission followed a thoughtful policy. It held in *CECED* that significant "*environmental results for society would adequately allow consumers a fair share of the benefits even if no [in-market] benefits accrued to individual purchasers…."* The Austrians just adopted this principle in the Austrian Competition law. The Dutch and Greek authorities recognize it. In an interesting recent paper on the *"output-welfare fallacy"*, Prof. John Newman explained that "*alleviating a negative externality can reduce output of a relevant product yet increase consumer welfare*" (his emphasis). Commenting on a car makers' agreement with the State of California to produce lower-emission vehicles, he added "*in this market less output might be good, not only for society as a whole but even for consumers of vehicles. There's a variety of markets in which negative externalities can drive output higher, yet even the consumers of the products can be worse off due to a prisoners' dilemma.*" Spot on.

The Commission introduced the idea of "full compensation" and "within-market benefits" in 2004, in the Guidelines on application of Article 101(3) TFEU (para 43). It did so when modernizing competition law, it divested itself of its exemption monopoly, and required companies to "self assess" whether the conditions for exemption where met. But it apparently did not trust companies to get it right, so it took away with the left hand much of what it had given with the right.

In the extraordinary circumstance of a climate crisis, as confirmed by the European Parliament, there is no justification for this restrictive policy choice.

The case law of the court does not stand in the way to returning to a pre-2004 approach. The *Shaw* case -- on which the 101(3) Guidelines relied to exclude out-of-market benefits -- does *not* actually support the proposition that out-of-market benefits don't count. As explained by several people here and here, the case law of the Commission and Court (including *Compagnie Générale Maritime* and *Mastercard*) in fact indicate out-of-market benefits *can* and indeed *should* count, at least so long as the consumers who feel the restrictive effects of the agreements also get some "*appreciable objective advantages"* as a result.

Such advantages can relate to the price and quality of market goods, but also the circumstances in which they are consumed (little benefit in having a cheaper air conditioner if your house is burning as a result of a wildfire), and even non-market goods – such as clean air and water, reasonable ambient temperatures, reduced risk of extreme weather events, preservation of nature and biodiversity, reduced risks of climate disaster, and similar goods that are of immense importance for our existence and enjoyment of life and yet are not traded in markets for a price.

Whether an advantage is "appreciable" is relative, depending on the agreement. But surely it includes lowering the risk of losing one's life, living, or loved ones in climate change-fueled fire or flood. Or limiting the severe consequences of climate change for society and the economy. It may be a future or indirect benefit, but still a "*appreciable objective advantage*": disasters happen to others, until they happen to us…

***Three criteria for sustainability cooperation*.** Prof. Schinkel has shown that where consumers are willing to pay for green products, firms may have an incentive to collude on greenwashing. Of course, we shouldn't allow climate claims to cloak collusion. The Commission made that very clear when it nailed car makers in the AdBlue cartel. And rightly so. But we should not throw out the baby with the bath water. So, how to distinguish a legitimate sustainability agreement from a cartel?

First, there should be market failure, as a result of which the damage caused by greenhouse gas emissions is not fully included in the product price. If enough consumers are willing to pay to fully eliminate or compensate for these emissions, and clear up the damage of the past, firms can and should compete individually on being greener and cleaner. But where there are market failures unresolved by effective regulation, a first mover disadvantage arises, and agreements may be an effective complementary way to eliminate or mitigate climate change and environmental risks.

Second, the agreement must fulfil the criteria for the proportionality analysis under the *Albany*, *Wouters*, and *Meca-Medina* line of cases, or the conditions for exemption under Article 101(3) TFEU (including "necessity", "fair share to consumers", and "residual competition"). We discuss that above and, in more detail, elsewhere.

Third, a very interesting forthcoming paper by Castroviejo, Jenkins, Klein, and Rosenboom of Oxera explains we should in addition look at whether cooperation is in the long-term interest of all participating firms and that of society at large – *i.e.*, whether firms benefit if their rivals eliminate greenhouse gas emissions ("spillover benefits"), and whether these private benefits align with public benefits. If so, firms have a genuine incentive to pursue efficient sustainability goals, and we don't need to assume that they are just out to rip off consumers.

Indeed, companies benefit in various ways if their rivals eliminate pollution and greenhouse gas emissions. Surely long-term survival is the first one, keeping in mind the recent IPCC Report and its dire warnings of climate "tipping points". It's true that managers often pursue short-run profits at the cost of future risks. But more and more firms realize that short-term profits are not the sole measure of success, and that it is worthwhile to pursue longer-term survival of our environment and, therefore, themselves, our economy, and society as a whole. Some Board members, managers, and shareholders read the shocking IPCC Reports, and realize it serves little purpose to be the richest corpse in the graveyard. Yet they may be discouraged from investing enough in clean and green alternatives, for fear that their rivals steal their customers. Their rivals, in turn, may fear the same from them.

Other positive spillover effects include reduction of physical climate risks to their business, faster development of clean solutions (sharing risks, creating economies of scale and scope), or levelling the playing field and avoiding risk of asymmetric liability – as Shell knows, following its liability case. The Oxera paper contains an interesting list of examples of "spillover" benefits, and shows that when economic models are adjusted to take these into account, they show that cooperation (meeting the two conditions above) leads to improved sustainability outcomes compared to conditions of competition. Many of these benefits can be quantified, as Stern and Stiglitz show. See also Dasgupta for quantification of the impact of biodiversity loss. Firms that in good faith pursue these long-term goals should not be presumed to rip off consumers.

Evidence that the participants really sought legitimate climate objectives could be found in internal corporate statements, an objective assessment of the nature of the agreement, and economic analysis. Parties who publish their agreements, open them up to public scrutiny, and discuss them with stakeholders, can be presumed to really seek legitimate benefits and not just to line their own pockets.

To summarize, we are in a climate crisis. We have to pull out all the stops to deal with it. That means advocating taxation (including emissions trading and carbon border compensation), regulation, reforestation, education (climate and civics education in schools), State aid for innovation, integration of climate goals in financial supervision and monetary policy, agricultural reform, as well as cooperation by the private sector. When assessing private cooperation, antitrust authorities should take into account "spill-over benefits". They should also drop the artificial requirement of "full in-market compensation", and not demand apportionment and quantification where climate benefits are clear (since everyone will benefit, directly or indirectly, including current and future consumers). The EU Treaties and the case law do not stand in the way – indeed, the Treaties require it, and economic analysis validates it, as the Oxera paper shows. This is, in the end, a political decision. I have great admiration for Vice-President Vestager. She is one of the few who convincingly express the European ideal. I hope that in making that decision, she has the courage of her green conviction.