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Commissioner Margrethe Vestager
European Commission
Directorate General Competition
Brussel, Belgium

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Subject

Response to the public consultation of the "draft revised Horizontal Guidelines" of 1 March 2022, in particular to Chapter 9 Sustainability Agreements

Dear Commissioner Vestager,

Thank you for the opportunity to respond to the draft revised *Horizontal Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements* of March 1. I have a few comments on Chapter 9 Sustainability Agreements, a topic on which I've done some research and contributed to the public debate – including in response, in November 2020, to your call for contributions to *Competition Policy supporting the Green Deal* and as a speaker in the antitrust panel in your subsequent online conference *Competition Policy Contributing to the European Green Deal*, on February 4, 2021.

The point of departure for my comments, which I have arrived at after careful consideration, is that companies are typically not better incentivized to promote sustainability by being allowed to form anticompetitive sustainability agreements.[1] On the contrary, in fact. While it is certainly often so that companies do too little for green in competition – for known reasons having to do with the social costs of their activities not being internalized in their business costs – competitors are likely to do *even less* when allowed to coordinate their sustainability efforts. This follows from theoretical, empirical and experimental research on the relationship between competition and CSR taking.[2] Hence exempting anticompetitive sustainability agreements from the cartel prohibition risks achieving the exact opposite of what is intended: not more but less efforts by companies to make their business more sustainable.

The intuition for this finding is rather straightforward. At their core, firms are for-profit organizations, and therefore will avoid investments that cost more than they increase revenues. Whenever consumers have some willingness to pay for more sustainably produced goods and services, producing more sustainably is a dimension of competition between firms. Essentially, competitors will try to steal each other's business by offering the greener product. There is ample indication that people are increasingly aware and appreciative of more sustainably produced goods. This growing willingness to pay for more sustainably produced goods and services is a very hopeful engine for greener (and also fairer) economies. The great risk in the green antitrust movement to allow sustainability agreements is that such agreements will choke this engine for green. However (too) small its drive may still be in competition, it is typically weakened, not strengthened by collaboration on the green dimension. In essence, collaborating firms have

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[1] See: Schinkel, M.P. and Y. Spiegel, "Can Collusion Promote Sustainable Consumption and Production?," *International Journal of Industrial Organization*, 53, 2017, 371-398; Schinkel, M.P. and L. Treuren, "Corporate Social Responsibility by Joint Agreement," *Tinbergen Institute Discussion Paper 2021-063/VII*; Schinkel, M.P., Y. Spiegel and L. Treuren, "Production Agreements, Sustainability Investments, and Consumer Welfare," *Economics Letters*, forthcoming. I attach also the slide pack to my latest presentation on the subject, at BECCLE in Bergen, Norway.

[2] See Schinkel, M.P. and L. Treuren, "Green Antitrust: Friendly Fire in the Fight against Climate Change," in: Holmes, S., D. Middelschulte and M. Snoep (eds.), *Competition Law, Climate Change & Environmental Sustainability*, Concurrences, 2021 and Schinkel, M.P. and L. Treuren, "Green Antitrust: Why Would Restricting Competition Induce Sustainability Efforts?," ProMarket, The Stigler Center at the University of Chicago Booth School of Business, March 2021.

incentives to reduce or retard their costly transition to more sustainable production methods – to avoid stranding their assets, for example, and instead keep milking their old and dirty technologies longer. We have shown this intuition to be robust to competition among many firms, with varying product differentiation, small, zero or negative willingness to pay, various cost effects of sustainability efforts, and intrinsically motivated – even 'altruistic', if you want – corporations. Competition remains the stronger driver of sustainability – and sustainability agreements the weakest.

Now there may be exceptional circumstances in which firms by collaboration may overcome a hurtle they face in competition to investing in more sustainable production methods. Such a hurtle may exist in theory, even when there is a potential demand for greener products. The idea would be that in competition all firms wait for another firm to invest first – and so none of them does invest. Such 'first mover disadvantage' situations are mentioned time and again, and quite loosely, by proponents of allowing sustainability agreements – and also in your draft guidelines, once, in recital (584). Rarely is made precise what then would cause one. My current understanding is that essentially a first mover disadvantage situation requires that each firm that invests in sustainability, and thus bears the costs for that, does not itself benefit enough from that investment to overcome its investment costs, while the other firms do benefit – without having to make the costs. Those latter benefits to others are "spill-over" effects in the applicable theory.[3] Such a situation of the competitive equilibrium being 'locked-in' in low sustainability efforts may then be overcome by collaboration amongst the firms, so that they share the costs of the investment in sustainability that they all benefit from.

It turns out quite difficult, however, to think of even mildly convincing examples of such a situation in practice. One that has been floated is with one firm investing in a greener product subsequently establishing a social norm/taste/experience amongst consumers for greener consumption that all firms can then tailor to. In those cases, all firms would benefit from that one first firm's sustainability effort. Yet for this social norm-effect to create a true first mover disadvantage competitive lock-in, these spill-overs should be sufficiently large and the investing firm should not itself benefit enough when going first in competition. Whether that is the case with a 'green norm' is not obvious at all. It certainly seems reasonable that a forerunning firm's transition to greener products helps consumer to transit, develop a greener taste, and request greener products from other firms as well. Yet one would still expect then that the original firm that switched to greener products and built a name for itself as a more sustainable company first would itself also benefits from being the leading company in this domain – at least enough to recoup the costs of its efforts to green its products. Can there be, in other words, such a strong green spill-over effect that competition on the green dimension is fully stuck, and collaboration can get it unstuck, despite the perverse incentive effects on collaborating firms to reduce or retard their costly sustainability efforts? Ultimately, this is an empirical question in specific cases. I submit that guidance is required on whether, and if so under what circumstances, such situations may arise in practice and can be identified as genuinely solvable by exempting an anticompetitive horizontal sustainability agreement.

From this point of departure, I offer a number of specific comments on the chapter – following the numbering of its recitals – and two general recommendations.

Specific comments on Chapter 9 Sustainability Agreements

Ad (545). In light of my main comment that we know very little about the circumstances under which collusion can overcome market failures caused by externalities, cooperation agreements should not, I think, be placed on par with public policies and sector specific regulations, which are well-known, much more common and effective instruments for remedying market failures. The wording in this recital may give the impression though that the Commission thinks of them as quite comparably effective instruments. To avoid this impression, I recommend to add the qualification: "… or, in exceptional circumstances, cooperation agreement …".

[3] In Schinkel, M.P. and Y. Spiegel, "Can Collusion Promote Sustainable Consumption and Production?," *International Journal of Industrial Organization*, 53, 2017, 371-398 we derive the critical level of spill-over effects for sustainability agreements to deliver a higher level of sustainability than in competition.

Ad (546). The premise in the wording "may become necessary" is too strong, I think – as it means that no other ways of achieving the objective would be available and cooperation agreements would be effective in addressing the residual market failures. I recommend to change the wording into: "… may contribute to addressing residual market failures …".

Ad (547). The definition of a 'sustainability agreement' offered here – i.e., by its pursuit it seems, since "irrespective of the form of cooperation" – is rather wide. So far in the public debate, sustainability agreements have been interpreted as agreements about sustainability – such as a label, a standard, or investments and efforts to produce more sustainably – and not also price fixing, production, or market sharing agreements, of the more classical cartel type. Does the Commission here intend to mean that sustainability agreements can also be agreements just on prices or quantities – as long as they would have the effect of increasing sustainability? Certainly can the phrasing "any type of horizontal cooperation agreement that genuinely pursues one or more sustainability objectives, irrespective of the form of cooperation" be read in this way. In fact, we show in our theory papers that agreements to fix prices or quantities (and not (also) sustainability) tend to increase sustainability, whereas agreements on sustainability alone do not.[4] If the Commission indeed intends to also allow such price/quantity-fixing agreements that have as an effect that firms are induced to promote sustainability, I would warn that we find robustly that they only form voluntarily if consumers are worse off and cannot be compensated out of the firms' additional profits.[5] In any event, the guidance here requires clarification.

Ad (548). Here too the wording "are necessary" is strong. I recommend to use "… would be necessary …".

Ad (560). Similar to recital (547) commented on above, here too the impression may be given that the Commission could approve of classic cartel conduct such as "price fixing, market or customer allocation, limitation of output or innovation" if it were part of a strategy that really "genuinely pursues a sustainability objective". If this is what the Commission intends to communicate, I submit that the identification of genuine pursuits and actual effects of sustainability advances will be very hard for a competition authority to identify, monitor and maintain in practice – which is inviting for potential abuse.

Ad (569). It remains unclear why the "three main ways" stated here would be an exhaustive list. I think it isn't. Note for example that quality coordination is also a possible way to restrict competition. Take the example in recital (561) of competitors agreeing jointly to phase out or withdraw certain product varieties that are less sustainable. Typically, these phased-out products will be the cheaper, lower-end product varieties – like the D/E-label washing machines in CECED, or diesel powered trucks. A sustainability agreement amongst competitors to take such product varieties out of the market essentially eliminates the competitive pressures that they exercise, in both intra- and interbrand competition, on the remaining higher-end, i.e. more sustainable, products. As a result, the elimination of the less sustainable products will typically increase the prices and profitability of the remaining more sustainable products when competitors voluntarily propose it collectively. This has detrimental effects on consumers – including those who would already have bought the more sustainable product anyways. The wording here were better chosen more cautiously, therefore, so as to reflect the preliminary nature of what we know about what sustainability standardization agreements can do to competition – and how firms may abuse the possibility of being allowed to make sustainability agreements to restrict competition in ineffective and unwanted ways.

Ad (572). The conditions for a "soft safe harbour" given here cannot, I fear, guarantee that a sustainability standardization agreement is not restrictive of competition and harmful – both to sustainability and consumers. For example, the third requirement – that firms remain free to adopt a higher sustainability standard for themselves than the sustainability level collectively agreed on – may sound reassuring, but it is not. As pointed out, the core problem with sustainability agreements amongst competitors is that they

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[4] See Schinkel, M.P. and Y. Spiegel, "Can Collusion Promote Sustainable Consumption and Production?," *International Journal of Industrial Organization*, 53, 2017, 371-398 and Schinkel, M.P. and L. Treuren, "Corporate Social Responsibility by Joint Agreement," *Tinbergen Institute Discussion Paper 2021-063/VII*

[5] See Schinkel, M.P., Y. Spiegel and L. Treuren, "Production Agreements, Sustainability Investments, and Consumer Welfare," *Economics Letters*, forthcoming.

eliminate sustainability as a dimension of competition. Where firms in competition strive to offer a more sustainable product than their rivals, in collaboration they'd have an incentive to jointly agree to all keep to a lower sustainability standard – and so save the cost of living up to a higher one. Now, the mere freedom to adopt a higher standard – in which solace is sought in this recital – is therefore not enough to rest assured that not less is done, because the firms involved all want to keep to the agreed lower standard. In essence, unilaterally adopting a higher sustainability standard – i.e. taking more sustainability effort – than was collectively agreed would be a form of "sustainability cartel defection". Just like for classic cartels it does not require a legally binding agreement (which is not available, after all) to all adhere to the higher cartel prices – that is, for the cartel to be stable – here the 'legal' freedom to offer a more sustainable product than was agreed does not assure that firms will indeed do this. In fact, if the firms involved would offer a more sustainable product than collectively agreed, no sustainability agreement would form – or, for that matter, have been needed to promote sustainability – in the first place. When one does form, the members of a sustainability agreement therefore will assure stability against any one of them 'cheating' by offering a greener product than agreed on. In fact, the seventh requirement in this recital – i.e., a monitoring system that assures compliance with the requirements of the standard – may well facilitate this stability. Hence, the "soft safe harbour" presented here doesn't appear to be all that safe for welfare. I recommend to rethink this recital.

Ad (573). It is not clear why and how the condition that firms cannot exchange commercially sensitive information would be sufficient to "ensure" that no collusion or limiting of competition takes place. Information exchanged for making sustainability agreements and "commercially sensitive" information cannot easily be disentangled. Conceptually, information about sustainability standard *is* commercially sensitive information. Practically, it will be hard – if not impossible – for a competition authority to distinguish, to stay with the example here, between information exchanged to develop the standard by a "transparent" procedure – which is the first condition in recital (572) – information exchanged to agree on the pass through of higher costs that go with implementing the agreed standard, and any other information, that supposedly is "commercially sensitive". I advise to consider the practicalities in making the distinction that is attempted to be drawn in this recital.

Ad (575). Please note that standards seem to be interpreted as "labels" here now – in fact under the general heading "agreements". However, standards and labels are quite different things – and are discussed as an example of sustainability agreements only in recitals (562)-(564) and (568). It would be useful to clarify what is meant – here and previously, as possibly the preceding recitals were also just about "labels"?

Ad (582). This is a proper recognition: "Where there is … themselves."[6] In fact, as warned for above, when there is a demand for sustainable products, sustainability agreements are likely to *reduce* sustainability efforts – and note that when consumers have no, or negative willingness to pay for more sustainably produced good, should firms not be expected to make an effort in collaboration either. It remains unclear, however, why the next statement in this recital would follow. Why would (or even could) a sustainability goal that is not promoted more by an agreement be reached by such an agreement "in a more cost efficient way"? This recital requires clarification.

Ad (584). Here – and only here in the entire draft guidelines – is reference made to the term "first mover disadvantages". There is, however, no clear definition of it given. As explained above, a situation with first mover disadvantages in competition may in theory justify collaboration. However, these are very special circumstances and if parties would want to make a claim for a need to make a sustainability agreement, they should be able and asked to make the existence of first mover disadvantages hindering their sector to become more sustainable in competition very concrete. For this, a minimum requirement is that it is known what the Commission means by the term "first mover disadvantage". The recital does not accomplish this. Instead several important and well-known problems are mentioned – "market failures", "free-riding", need for "education" – and then there is a jump to the conclusion that a sustainability agreement would somehow solve those by "(overcoming the so-called "first mover disadvantages")." It

[6] See Schinkel, M.P. and Y. Spiegel, "Can Collusion Promote Sustainable Consumption and Production?," *International Journal of Industrial Organization*, 53, 2017, 371-398 and Schinkel, M.P. and L. Treuren, "Corporate Social Responsibility by Joint Agreement," *Tinbergen Institute Discussion Paper 2021-063/VII*

remains unclear why and when this would be the case. I recommend to avoid such loose and imprecise use of this important term. Otherwise this text may become a source of confusion, debate and abuse – instead of a source of clear guidance.

Ad (585). As noted to recital (575); are only "labels" meant here too? Also, please note again that competitors have incentives to collaborate in order to avoid making (fixed) transition costs – e.g. by setting only a marginal standard improvement, which also is less than they would do if they should just remain in competition.

Ad (586). This recital is problematic for several reasons and requires rethinking. For one: it is not clear why or when an agreement would be "necessary" if consumers failed to appreciate the full life-span benefits of products. For that to be true, it would need at a minimum be shown that an agreement would do better for those consumers in the end. Also, what does the Commission mean here exactly? Do consumers just have to be informed about product characteristics? Or do they have to be explained what is good for them? Or should their preferences be shaped? These are increasingly more invasive types of interference. Another problem is: if paternalism is required, why should we expect firms to know, implement and "objectively balance" what is best for their consumers? Instead, it seems more reasonable to expect that firms have incentives to try to benefit themselves from being allowed to collaborate – see *Consumer Detergents* (2011) or *German Car Emissions* (2021). And yet another problem with this recital: how to reconcile this justification that "consumers do not know what is good for them" with the upcoming requirement – described in recitals (588) and (599) – that consumers receive a fully compensating "fair share" of the benefits as they value them, according to recital (599), by their "actual preferences"? To be perfectly clear: the latter – full consumer compensation by consumers' own and actual preferences – is the proper approach, I think. The problem here is the loose and suggestive use of ideas about firms supposedly knowing better what is good for consumers than consumers themselves.

Please note that this recital touches on a very fundamental principle behind why we believe that competition is a desirable social ordering mechanism: consumer sovereignty, which is neither undertakings nor competition authorities to break – and replace by some form of collusive corporate paternalism. I recommend to rethink this recital and avoid potential conflicts with recitals (588) and (599).

Ad (588). I am glad to read that the Commission, despite all of the above, sticks to the interpretation of "fair share" as a fully compensating share for the consumer (i.e. buyers/users) of the products concerned. As explained above, at least this is the stricter criterion to guard against abuses such as cartel greenwashing.[7] I recommend to clarify the foundations of this interpretation of a "fair share" and a "fully compensating share" in the TFEU and jurisprudence of the CJEU – as used to be given in earlier horizontal guidelines.

Ad (602)-(606). The wording in these recitals, which contains "substantially", "the same" and "overlap" a lot, is potentially confusing. What matters is not the extent to which markets in which benefits may materialize overlap, but only whether the consumers in the market where the agreement is made (and hence has negative effects on them) are fully compensated, where that compensation may in part also come from their appreciation of benefits in other markets – or anywhere, as far as I am concerned, which is perfectly possible. Recital (603) states this clearly and that seems sufficient.

The logic here could, I think, be clarified as follows. By the nature of the subject, if there *are* sustainability gains from an agreement on products in a certain market, they will often benefit many people widely, consumers (i.e. buyers/users of the product(s) concerned) and non-consumers (i.e. people who did not buy/use those product(s)). However, by recital (588), the consumers (i.e. buyers/users) of the products concerned should be compensated. Those consumers may benefit from increased use value, non-use value, and *their appreciation* of further collective benefits. So the test is: do consumers (e.g. a representative or average consumer) benefit(s) enough, through these three different classes of benefits taken together,

[7] See Schinkel, M.P. and L. Treuren, "Green Antitrust: Friendly Fire in the Fight against Climate Change," in: Holmes, S., D. Middelschulte and M. Snoep (eds.), *Competition Law, Climate Change & Environmental Sustainability*, Concurrences, 2021 – which has been updated on SSRN at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3749147.

so that they are compensated for the harm (e.g. increased prices) that the sustainability agreement does to them in the market in which they are the consumers? Naturally, consumers should then also benefit from the collective benefits, and therefore be part of the wider group that does. But instead of showing "substantial overlap" between groups of people – consumers and non-consumers – the test should be about the collective benefits to the consumers only. Any more collective benefits to non-consumers are great to have in addition – if they indeed materialize – but they cannot count as benefits towards meeting the consumer-compensation requirement.

I recommend to revise this part of the draft to reflect this logic more clearly. As a necessary condition for clarity, it should also be specified how "consumers" are treated as a group in the balancing of harm and benefits. That is: should all consumers individually be compensated, or rather a representative or "average" consumer? The latter standard applied in earlier horizontal guidelines. How is such an average consumer constructed from the population of buyers/users? And also: do consumers who would have bought in the competitive market but no longer at the high prices resulting from the sustainability agreement proposed count too? They would no longer be consumers once the agreement is in place, but nevertheless be harmed by that very act. So they should probably be taken into account in the "average". There is quite some thinking on these matters already – including in CJEU jurisprudence – that would be good to relate to here, in order to make the requirement as concrete and practical as possible.

General recommendations

My first general recommendation is that the Commission approaches claims of beneficial sustainability agreements in applications for exemption from the cartel prohibition under Article 101(3) with a healthy dose of scepticism and caution. Since the evidence so far is overwhelmingly that competition is the stronger driver of sustainability – and sustainability agreements even the weakest – it is essential, I think, that competition authorities keep a critical attitude towards sustainability claims in defence of proposals to restrain competition – be it proposals for allowing full or partial cartels, or market dominance, mergers and acquisitions. It is important that your enforcement stays – and therefore can stay – strict and demanding with companies making rosy collaborative sustainability claims. Such a basic critical attitude is even more important to adopt in this domain of sustainability agreements than with regards to more classic cost-efficiencies, as sustainability benefits claims are harder to quantify, weight and judge – find wanting or debunk as overly rosy. Chapter 9 of the draft horizontal guidelines therefore presents risks of opportunity for abuse – such as 'cartel greenwashing'. It is not enough – as some proponents have – to say "of course we must guard against and forbid greenwashing". The point is that the exemption possibility invites cartel greenwashing, and competition authorities will generally lack the information to identify the extent of it, or the powers to prevent it.

My second general recommendation is that you further develop the conditions that would apply for the assessment of the indispensability requirement, so as to make what is needed for passing it clearer and stricter. My reason for this is that given the many difficulties, laid out above, in identifying genuine applications for exemptions of sustainability agreements, it is essential that competition authorities stay able to firmly say "no" to agreements that do too little green. Maintaining the full consumer compensation requirement – rather than watered down versions, such as the 'citizens welfare standard' that the Dutch ACM suggested – certainly helps in this regard. Yet the calculus of consumer compensation is complex and open to varying interpretations. Also, it just might happen that the CJEU one day comes to interpret a "fair share" as not necessarily having to be a "fully compensating share" – as several law scholars have argued could/should be the case. The indispensability requirement may therefore prove to be indispensable for the protection of competition.

Section 9.4.2 could be improved with more guidance on how the Commission will interpret and apply the indispensability requirement. In the current text, little is offered about how the Commission will judge whether "there are no other economically practicable and less restrictive means of achieving [the claimed sustainability benefits]" – recital (581). What alternative means will the Commission consider to determine indispensability? The section reads as if it suffices that the proposed agreement promises to improve sustainability somewhat over the competitive status quo. That would be a rather narrow interpretation of "agreement-specific" sustainability benefits. Yet in the longer practice of horizontal merger control, where

an efficiency defence has formally been possible since the 2004 revision of the guidelines, the interpretation of the requirement that those efficiencies be "merger-specific" is rather wide. For example is it quite standard to ask whether instead of the proposed integration, the projected benefits cannot also be obtained by licensing agreements, for example – while the companies involved remain independent entities in competition. Likewise could the Commission consider alternative means to achieve the claimed sustainability benefits of a horizontal agreement, such as vertically implemented forms of self- or government regulation, for example though an isolated part of a business trade-association, an independent NGO, or a government agency. Such kinds of intermediary organizational forms would be less horizontal and thereby avoid much of the need for firm representatives to meet, exchange information that is inescapably commercially sensitive, and agree, with all the risks discussed above attached.

The assessment of horizontal merger-specific efficiencies is conceptually very much similar to that of horizontal agreement-specific sustainability benefits. Together with a similar critical attitude towards efficiency claims in mergers, I recommend to consider a similarly wide class of alternative means of achieving the claimed benefits, that are less restrictive of competition. Those will typically exist and be superior in promoting sustainability.

With kind regards,

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