Competition Law

Sustainability and competition

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Summary of the main developments included in the draft Guidelines on horizontal cooperation agreements of the European Commission regarding joint sustainability initiatives between competitors.

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The Sustainable Development Goals of the United Nations, intended to be achieved by 2030, are becoming increasingly important in the design of companies' business plans. Investors and authorities use ESG (environmental, social, and corporate governance) criteria to measure the extent to which companies' economic activities are based on the principles of sustainable development.

Some companies find that these objectives can be achieved more effectively through joint projects with their competitors. For example, by agreeing on standards that their products must meet to reduce their environmental footprint and undertaking to market only equipment that meets these standards. However, legal counsels to these companies wonder whether such joint initiatives, which are beneficial for the society as a whole, might entail the risk of fines for potential competition rules infringements.

Competition rules undoubtedly place limits on such collaboration. Even if such a new generation of cleaner products were more expensive, competitors should not coordinate the passing-on of cost overruns to their respective clients, nor should they set a standard that would prevent new entrants from entering the market. Hence, competition law could, rightly or wrongly, be perceived as a barrier to reach such agreements, ultimately disincentivising collective business efforts towards sustainable development.

The European Commission became aware of this bias and intends to solve it by means of the chapter on sustainability agreements between competitors of its draft Guidelines on horizontal cooperation agreements (C(2022)1159)[1]. This document provides guidance on how competing companies can jointly undertake projects towards sustainable development goals. If companies design their joint sustainability initiatives within the parameters of these Guidelines, they will henceforth have legal certainty as to their compatibility with competition rules.

The draft Guidelines on horizontal cooperation agreements provide guidance on a wide range of issues. We have published two newsletters on other categories of agreements between competitors that fall within the scope of the draft Guidelines. In this newsletter we will confine ourselves to describing its main developments on sustainability agreements. [2]

1. The draft Guidelines are available via the following link.
2. In separate newsletters we have referred to the impact of this draft regulation in other areas: (i) joint ventures; consortia and subcontracting agreements). ; and mobile infrastructure sharing agreements (available via the following link); and (ii) information exchanges (available via the following link)

1. Concept of sustainability agreements.

Sustainable development refers to the ability of society to consume and use the available resources today without compromising the ability of future generations to meet their own needs. It encompasses activities that support economic, environmental and social (including labour and human rights) development.

The term "sustainability agreement" refers in general to any type of horizontal cooperation agreement that genuinely pursues one or more sustainability objectives, irrespective of the form of cooperation, and that seeks to minimise the negative externalities that would be generated in an alternative scenario (with individual production and consumption decisions; instead of collective actions that foster sustainable production or consumption).

The draft Guidelines on horizontal cooperation agreements include within the concept of sustainability objective, inter alia, the following goals:

- Addressing climate change (for instance, through the reduction of greenhouse gas emissions).
- Eliminating pollution.
- Limiting the use of natural resources.
- Respecting human rights.
- Fostering resilient infrastructure and innovation.
- Reducing food waste.
- Facilitating a shift to healthy and nutritious food.
- Ensuring animal welfare.

In order to achieve these objectives, competitors may enter into standardisation agreements. The draft Guidelines cite some examples of agreements falling into this category, such as sector-specific initiatives, aimed at: (i) phasing out, withdrawing or replacing unsustainable products and processes with sustainable ones; (ii) harmonising packaging materials to facilitate recycling or harmonise packaging sizes to reduce waste; (iii) purchasing production inputs only if the purchased products are manufactured in a sustainable manner; or (iv) agreeing on certain conditions that improve animal welfare. These "sustainability standardisation agreements" or "sustainability standards" may lead to establishing a green label, logo or brand name for products that meet certain minimum requirements.

2. Sustainability agreements complying with competition rules

The draft Guidelines list categories of sustainability agreements between competitors that are compatible with competition rules. Firstly, the agreements that do not affect the parameters of competition on the market (such as price, quantity, quality, choice or product innovation) are competition law compliant. The draft Guidelines contain several examples of agreements that are compatible on this ground:

- Sustainability agreements that do not concern the economic activity of competitors, but their internal corporate conduct (for instance, an agreement between competitors whereby, in their respective offices, the temperature will not exceed X degrees in winter).
- Sustainability agreements on the creation of a database containing information (i) about suppliers that have sustainable value chains, use sustainable production processes and provide sustainable inputs, or (ii) distributors selling products in a sustainable manner.
- Agreements between competitors relating to the organisation of industry-wide awareness campaigns or campaigns raising customers' awareness of the environmental footprint of their consumption.

Secondly, sustainability standardisation agreements that meet the following conditions, set out as a “soft safe harbour” in the draft Guidelines, are also held compatible:

- The procedure for developing the sustainability standard is transparent and all interested players can participate in the process leading to the selection of the standard.
- The sustainability standard should not be binding on third parties outside the initiative.
- Participants should remain free to adopt for themselves a higher sustainability standard than the one agreed with the other parties to the agreement.
- The parties to the sustainability standard should not exchange commercially sensitive information that is not necessary for the development, the adoption or the modification of the standard.
- Effective and non-discriminatory access to the outcome of the standardisation procedure should be ensured. Companies that have not participated in the standard development process should have the choice to adopt the standard at a later stage.
- The sustainability standard should not lead to a significant increase in price or to a significant reduction in the choice of products available on the market. In the examples section, the draft Guidelines state that, for example, a 12 % price increase will already be considered significant.
- There should be a mechanism or a monitoring system in place to ensure that companies that adopt the sustainability standard actually comply with the requirements of the standard.

Thirdly, sustainability agreements with restrictive effects on competition that generate sufficient efficiencies and benefits for consumers to outweigh their restrictive effects are also compatible (according to the four conditions of Article 101(3) of the Treaty on the Functioning of the European Union).

According to the first condition, the agreement must contribute to objective efficiencies (considered in broad terms) as encompassing not only reductions in production and distribution costs but also increases in product variety and quality, improvements in production or distribution processes, and increases in innovation. The draft Guidelines allow for a broad spectrum of sustainability benefits resulting from the use of specific ingredients, technologies, production processes to be taken into account as efficiency gains, such as the use of cleaner production or distribution technologies, reduced pollution, increased resilience of infrastructures or supply chains, etc. A particularly important efficiency is the reduction of the time it takes to bring sustainable products to the market.

The second condition implies that the agreement must only include restrictions of competition that are indispensable to ensure a successful outcome of the sustainability agreement. An agreement will be 'indispensable' to achieve a given sustainability objective when there are no other economically viable and less restrictive means of achieving the sustainability benefits. Against this background, where there is sufficient demand for sustainable products, cooperation between competitors may be unnecessary. However, the draft Guidelines acknowledge that even in such cases, agreements between competitors may be necessary and indispensable for reaching the sustainability goal in a more cost efficient way or to overcome market failures.

Furthermore, the agreement may also be necessary in cases where consumers are not able to adequately balance the future benefits they obtain from an agreement against the immediate harm they may suffer as a result of, for example, a foreseeable price increase of the product generated by the agreement. In this scenario, sustainability benefits (i) would not be achieved if the choice between the sustainable and non-sustainable option is left to the free interplay of market forces; or (ii) could only be achieved more cost efficiently if undertakings cooperate. For example, a sustainability agreement may be necessary to avoid free-riding on the investments required to promote a sustainable product and to educate consumers (overcoming the so-called "first mover disadvantages").

The third condition requires that direct or indirect users of the products covered by the agreement receive a fair share of the claimed benefits. The draft Guidelines recognise three different categories of benefits to be taken into account in making this assessment:

- Individual benefits derived from the use of the product that directly improve consumers' experience of the product in question (for instance, improvements in the quality of the product or lower prices). Consumers can enjoy higher quality by the mere fact of consuming the product in question. These qualitative efficiencies can offset the harm caused by higher prices (for instance, because the agreement imposes the use of more expensive sustainable raw materials) or reduced variety (due to the agreement to stop using an unsustainable product). These qualitative benefits should be significant enough to outweigh the detriment caused by increased prices or reduced consumption choices.

- Individual benefits of value unrelated to product use, that indirectly improve consumers' experience of the product in question (for instance, consumers may prefer to buy a washing powder not because it cleans better, but because it generates less water pollution).

- Collective benefits generated by the positive externalities of the agreement, in favour of the society as a whole. Valuing these collective benefits makes particular sense when consumers are initially unwilling to pay a higher price for a product made with an environmentally friendly but expensive technology. To ensure that the benefits associated with the use of such green technology are realised, an agreement between competing manufacturers to phase out the polluting technology may be necessary. These benefits are called "collective benefits", as they occur independently of individual consumers' appreciation of the product. They will be positively valued if (i) they objectively benefit the direct consumers of the product; and (ii) those consumers are part of the broader group of beneficiaries. An example would be the launch of a more expensive fuel that pollutes less, which benefits society as a whole and not only the purchasers of the fuel. The draft Guidelines thus open the possibility for the benefits of the sustainability agreement to be considered in favour of society as a whole and not only in respect of the direct consumers of the product covered by the agreement. In any case, in order for such a broad assessment of the beneficiaries to be accepted, it must be proven that consumers (drivers in this example) form a substantial part of the group of beneficiaries (citizens) as a whole.

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Finally, according to the fourth condition the agreement must not allow the parties the possibility to eliminate competition in respect of a substantial part of the products in question

3. Involvement of public authorities.

The involvement of public authorities in the process of conclusion of sustainability agreements, or the knowledge by those authorities of the existence of such agreements, does not imply that such agreements are automatically compatible with the competition rules. Such involvement or knowledge on the part of public authorities does not release the parties to the sustainability agreement from self-assessing their compatibility with the competition rules. In particular, if acts of public authorities merely encourage, or make it easier for undertakings to engage in autonomous anti-competitive conduct, those companies remain subject to the competition rules' prohibitions on anti-competitive agreements.

However, the parties to a sustainability agreement that restricts competition will not be held liable for competition law infringements if they have been compelled or required by public authorities to conclude the agreement or where the public authorities reinforce the effect of the agreement.

4. Competition restrictions disguised in a sustainability agreement.

An agreement between competitors to promote sustainability may no longer be compatible with the competition rules (i) if it involves an agreement to pass on increased costs resulting from the adoption of a sustainability standard into increased sale prices towards their clients; or (ii) if the companies participating in the sustainability standard put pressure on third parties to refrain from marketing products that do not comply with the sustainability standard.

5. Entry into force.

The European Commission has launched a public consultation on the draft Guidelines on horizontal cooperation agreements containing these rules on sustainability. Once the final version is published in the Official Journal of the European Union, it is expected to enter into force on 1 January 2023.