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The EU's Draft Horizontal Guidelines: Chilling Innovation on Sustainability?

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The EU's Draft Horizontal Guidelines: Chilling Innovation on Sustainability?

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In response to demand from customers, investors, employees and other stakeholders, as well as new legal requirements, businesses face huge pressure to make their operations more sustainable. While businesses can do a great deal unilaterally, and indeed often compete with one another on sustainability grounds, reaching sustainability goals may require cooperation among competitors, suppliers, customers, and other stakeholders in global supply chains.

However, businesses are constrained from entering into agreements to achieve sustainability objectives (sustainability agreements) by fear of antitrust liability and seek greater guidance on the assessment of such agreements. Antitrust authorities, especially in Europe, have indeed been making significant efforts to develop new approaches and tools.

On March 1, 2022, the European Commission (the Commission) published draft guidelines on the assessment of horizontal cooperation agreements (the Draft HGL) that will replace the current guidelines (the 2011 HGL). The Draft HGL, like the 2011 HGL's predecessor, includes a specific chapter on sustainability agreements. The new chapter's approach to sustainability agreements is in many areas uncontroversial and in fact represents a major step forward, but it falls short in key respects. In particular, the Draft HGL's approach to the "fair share of benefits to consumers" criterion in Article 101(3) TFEU would preclude consideration of benefits accruing to consumers in markets that do not substantially overlap with those in which potential harms are felt. This will often be the case in sustainability agreements involving global supply chains, mixing horizontal and vertical elements.

Potentially most concerning, the Draft HGL's treatment of sustainability agreements risks chilling ongoing work by other European authorities in this area. Because of the Commission's unique role in EU antitrust enforcement, even though the 2022 HGL will technically be non-binding, national authorities may hesitate to diverge from the Commission's approach, and even if they do multinationals may not feel comfortable relying on guidance at the national level. The stakes are high: the 2022 HGL will guide EU competition policy for a decade.

I. Demand Side – Business' Need for Guidance and Flexibility

Multinational businesses face strong and growing pressures to contribute to sustainability goals. While many sustainability initiatives, of course, pose no antitrust risk, cooperative efforts may raise antitrust concerns. Fear of antitrust liability, incomplete guidance from antitrust authorities, and limited experience with tools to identify and quantify sustainability benefits has led to calls for a more "pro-social antitrust" policy.

The issues are well expressed in a note (the BIAC Note) submitted by the Business and Industry Advisory Committee to the OECD (BIAC), an international business network, for a 2021 roundtable on environmental considerations in competition enforcement. BIAC and the International Chamber of Commerce (the ICC) raised similar concerns in a 2020 submission for another OECD roundtable on antitrust and sustainability ("This paper highlights the need for greater room for cooperation between businesses in the fight against climate change and the promotion of other vital environmental sustainability objectives - particularly in the light of the EU (and other) green deals. It shows how competition law (and, even more, the fear of unnecessarily restrictive or unpredictable competition law enforcement) is standing in the way of this.")

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The BIAC Note observes that "businesses—large and small—are and will continue to be called upon to play their part in adopting sustainable practices and products and address climate change, beyond mere compliance with the law, and may be left to fill the gap due to lack of or delayed or inadequate government action. . . . Whilst businesses can determine unilaterally how to pursue environmental objectives, this will not always be feasible in practice. There may be circumstances in which environmental objectives may not be achieved or may not be achieved as comprehensively or as quickly if it is left purely to market forces and the process of competition. This will be particularly true in hard-to-abate sectors, such as iron and steel production and many forms of transport . . . . This is equally true where it is necessary for the majority (if not all) of an industry to change in order to make any meaningful impact. This reality is at odds with antitrust laws. . .. Unilateral efforts are often also hampered by the fear of first-mover disadvantage, this notion that seeking to improve environmental outcomes will place a company at a competitive disadvantage towards its competitors" (footnotes omitted throughout).

However, BIAC continues, "There are legitimate and well-founded concerns for business as to whether [sustainability] initiatives might be found to infringe antitrust rules. Given the sheer breadth and complexity of what is likely to be needed, businesses are understandably wary of the application of competition law to their actions. It is easy to see . . . how collective action could be construed as giving rise to antitrust risk on the basis of: information exchange, standard-setting, collective boycotts, capacity reduction, dampening innovation, and price-fixing."

BIAC calls for a consistent approach to avoid "an unworkable patchwork of different approaches on such an important topic." More specifically, "the assessment should: (i) allow for qualitative, and not just quantitative, efficiencies to be taken into account; (ii) be longer-term in nature and not be based exclusively on "willingness to pay" studies; and (iii) accept "out of market" efficiencies, especially where, as with climate change, the benefits accrue to society as a whole."

II. Supply Side – International Efforts to Develop New Approaches and Tools

As the OECD's 2020 and 2021 roundtables indicate, antitrust authorities around the world are debating how to incorporate sustainability objectives and benefits into antitrust policy. The OECD is not the only forum for such debates. In 2021, the International Competition Network (ICN) meeting in Budapest kicked off with a special host plenary discussion on sustainability and competition law. In 2020, the Commission consulted on ways competition can contribute to the European Green Deal (the Green Deal Consultation).

A number of individual jurisdictions are taking concrete steps to develop new approaches to sustainability agreements and tools for assessing them. In 2021, the Austrian Cartel Act was amended to include an exemption for sustainability agreements, and the Austrian Federal Competition Authority published draft guidelines on the application of the exemption on June 1, 2022 (the AFCA Guidelines). In 2022, the UK Competition & Markets Authority published advice on how competition and consumer laws can help meet the UK's environmental goals and outlined plans for a Sustainability Taskforce. In 2020 and 2021, the Dutch Authority for Consumers & Markets (ACM) published drafts of guidelines on the assessment of sustainability agreements (the ACM Guidelines). Other authorities, including in Greece and Germany, have published studies and working papers on sustainability and antitrust.

European authorities have played a leading role in debates over the antitrust assessment of sustainability agreements. 60% of agencies that responded to a survey conducted for the September 2021 ICN meeting (the ICN Survey) were European, and 32% of European respondents were identified as "more experienced" with sustainability issues (as compared to 5% of non-European agencies). Only 8% of responding agencies had experience assessing agreements in which sustainability was the sole or main defense (defense cases), all of them in Europe. Seven out of nine governmental contributions to the

December 2021 OECD roundtable came from European jurisdictions.

Will Europe continue to play this leading role after 2022 HGL are adopted? It may depend on the Commission. As mentioned, the 2022 HGL will not be legally binding, and in principle they will not preclude national authorities' taking different approaches. In practice, however, multinationals contemplating entering into sustainability agreements with wider than purely national scope will be limited by the Commission's approach.

III. Supply Side – The Draft HGL's Sustainability Chapter

The Draft HGL notes (paras. 545-546) that market failures holding back sustainable development based on unilateral actions can be mitigated or cured by collective actions, for example through public policies, sector specific regulations or cooperation agreements between undertakings that foster sustainable production or consumption. The Draft HGL discuss sustainability agreements not raising competition concerns (paras. 551-554) and sustainability standards (paras. 561-575).

By object/effect. For other sustainability agreements, the Draft HGL outline the framework for analysis under Article 101(3) TFEU. The Draft HGL note (paras. 559-560) that the fact that an agreement genuinely pursues a sustainability objective may lead to a restriction that would otherwise be considered a restriction by object instead being analysed as a restriction by effect. The Draft HGL note (para. 615) that the involvement of public authorities "is not in itself a reason to consider such agreements compatible with the competition rules." But the involvement and especially the encouragement of public authorities may be relevant to show the objective of the agreement (and in fact may create legitimate expectations for the parties cognizable under EU law).

The Draft HGL reviews the application of the four cumulative conditions for exemption under Article 101(3) TFEU in the context of sustainability agreements: efficiency gains, indispensability, fair share of benefits to consumers, and absence of an elimination of competition.

Efficiency gains. The Draft HGL note that Article 101(3) TFEU "allows 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" (para. 577). However, it goes on to state that such benefits must be "objective, concrete and verifiable," and that parties will be required to provide an estimate of such benefits (para. 579). The limitation of efficiency gains to quantifiable efficiencies runs counter to one of the key requirements of the BIAC Note.

Indispensability. The Draft HGL address two important issues in applying the requirement that restrictions in an agreement caught by Article 101(1) TFEU be indispensable to the achievement of efficiencies expected from the agreement: the roles of competition for more sustainable products and the role of regulation.

The Draft HGL state (para. 580) that, "Where there is demand for sustainable products, cooperation agreements are not indispensable for the attainment of sustainability benefits themselves. They may also, however, be indispensable for reaching the sustainability goal in a more cost efficient way." These sentences are confusing, if not contradictory. The first states flatly that a sustainability agreement cannot meet the indispensability condition if there is demand for sustainable products in the market for the contract products, regardless of the nature or extent of such demand. The second suggests, but does not state clearly, that the indispensability condition may in fact be met, notwithstanding demand for more sustainable products, if the agreement permits sustainability benefits to be achieved more cost-efficiently. A better formulation, avoiding potential contradictions while recognizing that competition for more sustainable products is not a black-or-white phenomenon, could be the following:

"Restrictions in sustainability agreements may not qualify as indispensable to the extent that demand for more sustainable products will suffice to incentivize the parties to achieve the same benefits in an equally cost-efficient way."

Similarly, the Draft HGL state (para. 583) that "where EU or national law requires undertakings to comply with concrete sustainability goals, cooperation agreements and the restrictions they may entail, cannot be deemed indispensable . . . because the legislator has already decided that each undertaking alone is required to achieve the goal. In such circumstances, cooperation agreements may be indispensable only for reaching the goal in a more cost-efficient way." It appears, though this is not entirely clear, that a sustainability agreement could meet the indispensability criterion if the agreement helps to achieve an objective required by regulation if the agreement permits the objective to be achieved more efficiently. This point could be reframed more clearly as,

"Restrictions in sustainability agreements may not qualify as indispensable to the extent that the benefits will be achieved in an equally cost-efficient way as a result of legal requirements."

Fair share of benefits. This requirement -- that a fair share of benefits from restrictions assessed under Article 101(3) TFEU be passed to consumers -- is critical to the assessment of sustainability agreements. The Draft HGL helpfully distinguishes between individual use-value benefits, individual non-use benefits and collective benefits, but the analysis of this criterion (paras. 588-609) raises a number of concerns.

Notably, the Draft HGL does not adequately address which consumers are relevant for this purpose. According to the Draft HGL (para. 588), "The concept of 'consumers' encompasses all direct or indirect users of the products covered by the agreement." Sustainability agreements may "cover" a variety of products in different antitrust markets and involve parties at different levels of competition. Particularly where a sustainability agreement aims to achieve benefits across a supply chain, focusing exclusively on one or a few horizontal antitrust markets may exclude the most important benefits. This problem is worsened by the Draft HGL's requirement that "the overall effect on consumers in the relevant market is at least neutral," i.e. that any competitive harms be completely offset by efficiencies in the same market. This seems contrary to Article 101(3) TFEU itself, which requires only that a "fair share" of benefits be passed on to consumers.

The Draft HGL address the treatment of out-of-market efficiencies only in the context of "collective benefits." The Draft HGL state that collective benefits can be taken into account only where "the group of consumers affected by the restriction and benefiting from the efficiency gains is substantially the same" (para. 602) or "substantially overlap" (para. 603) with the consumers who receive the collective benefits from a sustainability agreement.

This approach is problematic for several reasons.

- As noted, focusing on a single horizontal market may be appropriate when analyzing a narrowly focused horizontal agreement but not when analyzing a sustainability agreement potentially affecting multiple vertical and horizontal markets.
- There is no apparent reason why only collective benefits accruing to out-of-market consumers, and not individual benefits, should be relevant.
- The Draft HGL provide insufficient guidance on how the proposed criteria should be applied in practice. For example, if the "substantial overlap" in consumers is 80%, should 80% of the collective benefits to such consumers be applied to offset potential competitive harms, or 100%?
- While the Commission is revising its notice on market definition (expected in 2023) *inter alia* to address rapidly evolving innovation markets, it is unclear whether the Commission will similarly address the impact of rapid changes in sustainability factors for market definition.

The Draft HGL thus fail to address two of the main concerns raised in the BIAC Note: addressing the long-term nature of benefits from sustainability agreements and taking account of "out-of-market efficiencies." The Draft HGL don't discuss the timeframe for the assessment of benefits, which is particularly important in the context of sustainability agreements whose

benefits are likely to be realized over long periods.

No elimination of competition. The Draft HGL's treatment of the "no elimination of competition" criterion (paras. 610-614) is more flexible. The Draft HGL states that the condition may be satisfied even if a restriction covers the entire industry, as long as the parties compete "vigorously on at least one important aspect of competition. For instance, if the agreement eliminates competition on quality or variety, but competition on price is also an important parameter for competition in the industry concerned and is not restricted, this condition can still be satisfied" (para. 611). "Similarly, if competitors decide not to use a particular polluting technology or a particular non-sustainable ingredient in the production of their products, competition between the competitors will not be eliminated if they continue to compete on price and/or quality of the final product" (para. 613) or if competition is eliminated only for a limited period of time (para. 614).

IV. Lowering Barriers to Innovation – Improving the Draft HGL

As discussed, the Draft HGL represents a major step forward in the assessment of sustainability agreements compared to the 2011 HGL, but it falls short of meeting business' demand for new approaches and tools. Worse, if the 2022 HGL fail to resolve these issues, they risk stifling the innovations pioneered by the ACM and other European authorities.

Are there obstacles to improving the Draft HGL's sustainability chapter? In principle, no. As the OECD background paper for the 2021 roundtable (the OECD Background Paper) notes, "there are relatively limited (at least conceptual) difficulties when environmental effects are captured by looking at the non-price dimension of competition. . . . [T]he assessment of non-price effects is part of the competitive assessment, and the fact that it is more difficult to operationalize does not make it less relevant to fulfil the mandate of competition authorities" (pp. 15-16).

Similarly, once environmental benefits are included in authorities' assessment of non-price effects, there is no conceptual reason why out-of-market benefits should not be taken into account. As the OECD Background Paper notes, "[i]t seems possible to conclude, therefore, that, from a legal viewpoint, an approach looking to consider some out-of-market effects, to the extent that they can be apportioned also to the relevant consumers or category of consumers, would not be outside the traditional interpretation of the consumer welfare standard. Operationalising this interpretation would, however, require a better understanding of various possible connected challenges" (p. 19).

The ACM Guidelines illustrate the possibilities for antitrust authorities to meet businesses' needs while strictly applying EU (and Dutch) antitrust laws. With respect to efficiencies that can be taken into account, the ACM Guidelines note (paras. 34 et seq.) that "Only *objective* sustainability benefits will be taken into consideration," but these benefits can include "benefits for the users as well as for society, in the broader sense of the word." Discussing efficiencies from sustainability agreements, the ACM Guidelines note that the "ACM will also take into account long-term benefits, since such are typical of many sustainability agreements.

With respect to the "fair share of benefits" criterion, the ACM Guidelines distinguish between so-called "environmental damages agreements," which "concern the reduction of negative externalities, and, as a result thereof, a more efficient usage of natural resources," and other sustainability agreements. In the case of environmental damages agreements that "help[], in an efficient manner, [to] comply with an international or national standard, or . . . help[] realize a concrete policy goal (to prevent such damage)," "it should be possible . . . to take into account benefits for others than merely those of the users. In such situations, it can be fair not to compensate users fully for the harm that the agreement causes because their demand for the products in question essentially creates the problem for which society needs to find solutions. Moreover, they enjoy the same benefits as the rest of society. In that context, the agreement must contribute (efficiently) to the compliance with an international or national standard (to which undertakings are not bound)

or to a concrete policy objective." With regard to other sustainability agreements, users still need to be fully compensated under the ACM Guidelines for harms they suffer caused by the restriction of competition.

The ACM acknowledges that some efficiencies from sustainability agreements may be difficult, if not impossible, to quantify. The ACM Guidelines note (paras. 53 et seq.) that ACM believes that, "in the following types of cases, it is usually possible to conclude that an agreement meets the [fair share of benefits test] without quantifying the effects of an agreement [where] . .. The undertakings involved have a limited, combined market share [or] . . . The harm to competition is, based on a rough estimate, evidently smaller than the benefits of the agreement."

Under the 2021 Austrian amendment, a sustainability agreement that otherwise qualifies for exemption may be irrebuttably presumed to satisfy the requirement that a fair share of resulting benefits be shared with consumers. To qualify for the presumption, the sustainability benefits must contribute "significantly to an ecologically sustainable economy" (para. 81), but these benefits can be monetary or non-monetary (para. 63); "the exact amount of efficiency gains or their value does not always have to be quantified" (para. 65). Where a quantitative analysis is required, negative effects can be quantified using competition economics tools, while positive effects can be evaluated with environmental economics tools (paras. 101-102); the "[a]ppropriate methods will depend strongly on the individual case" (para. 107). Efficiency gains beyond the near to medium term can be included, even for "future generations," provided the time horizon is "certain or at least foreseeable" (para 65). The AFCA Guidelines thus satisfy the three main criteria set out in the BIAC Note.

However, the AFCA Guidelines limit the relevance of the new Austrian sustainability exemption by specifying that the exemption applies only local to agreements caught by Austrian competition law but not EU competition law. For agreements affecting trade between Member States, which are subject to Article 101(3) TFEU, the AFCA Guidelines refer to the Draft HGL, including the requirement that the group of consumers who benefit from the agreement "substantially overlaps" with the consumers who are negatively affected (e.g., notes 48 and 64).

V. Conclusion

Sustainability is a global issue requiring global action, including through cooperation by business at various levels of global and regional supply chains. Responsible businesses like the members of the BIAC, ICC, and First Mover Coalition are eager to cooperate on sustainability initiatives but understandably concerned about antitrust exposure.

European antitrust authorities such as the ACM, HCC and AFCA have been leading global efforts to develop new approaches to the assessment of sustainability agreements. The Commission's approach, as set out in the Draft HGL, represents an important step forward compared to the 2011 HGL, which did not specifically address sustainability agreements. The Draft HGL can be further improved by relatively minor amendments on issues such as the relevance of government involvement in assessing the objectives of sustainability initiatives and determining whether potential restraints are indispensable to achieving their benefits.

The Draft HGL's exclusion of out-of-market benefits from the assessment of sustainability agreements represents a more difficult challenge. Sustainability agreements commonly involve parties operating at different levels of supply chains, and produce benefits in markets that are upstream (e.g., in the production of inputs such as globally traded commodities) and downstream (e.g., recycling of consumer products) from those in which competing parties are active. The Draft HGL's approach may reflect the review and drafting process; the Commission team preparing the Draft HGL worked in parallel with the team that developed the recently published vertical guidelines (which do not address sustainability agreements). It is perhaps unsurprising that neither set of guidelines addresses the

assessment of mixed agreements involving participants at multiple levels of a supply chain.

The ACM and the AFCA Guidelines illustrate both the potential for European competition authorities to develop new approaches and tools for the assessment of sustainability agreements and the risk that the Commission's approach will chill such innovation. Both authorities have explored new approaches to the treatment of out-of-market, non-quantifiable and long-term benefits. Under the AFCA Guidelines, however, new tools developed tfor the 2021 Austrian sustainability exemption will only apply to purely local agreements.

The 2022 HGL may in fact not be the ideal forum to address the application of Article 101(3) TFEU to mixed horizontal and vertical agreements such as sustainability agreements addressing global supply chain issues. If the Commission is unwilling to significantly revise the Draft HGL in this area, hopefully other approaches, such as developing supplemental guidance to bridge the vertical and horizontal guidelines in the context of mixed sustainability agreements, can be explored. Otherwise, responsible multinationals will likely continue to be deterred from cooperation in pursuit of global and EU sustainability objectives out of fear of antitrust exposure.