

CLEARY GOTTLIB

Sustainable Antitrust

Presentation to METI Study Group

Maurits Dolmans

21 April 2022

clearygottlieb.com



Topics for discussion

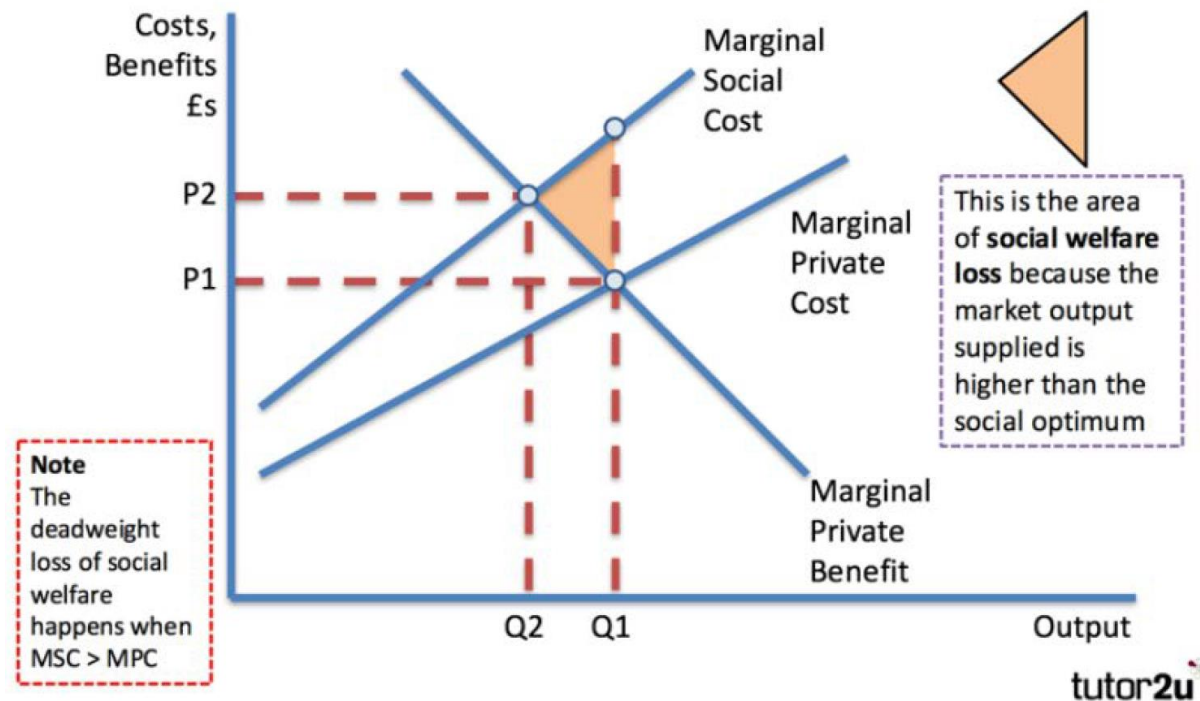
- 1. Barriers to decarbonisation**
- 2. EU efforts to reconsider competition policy for decarbonization**
- 3. Expectations for Japan's competition policy for decarbonization**

1. Barriers to decarbonisation

1.1 We cannot solely rely on markets to solve the climate crisis because of market failures:

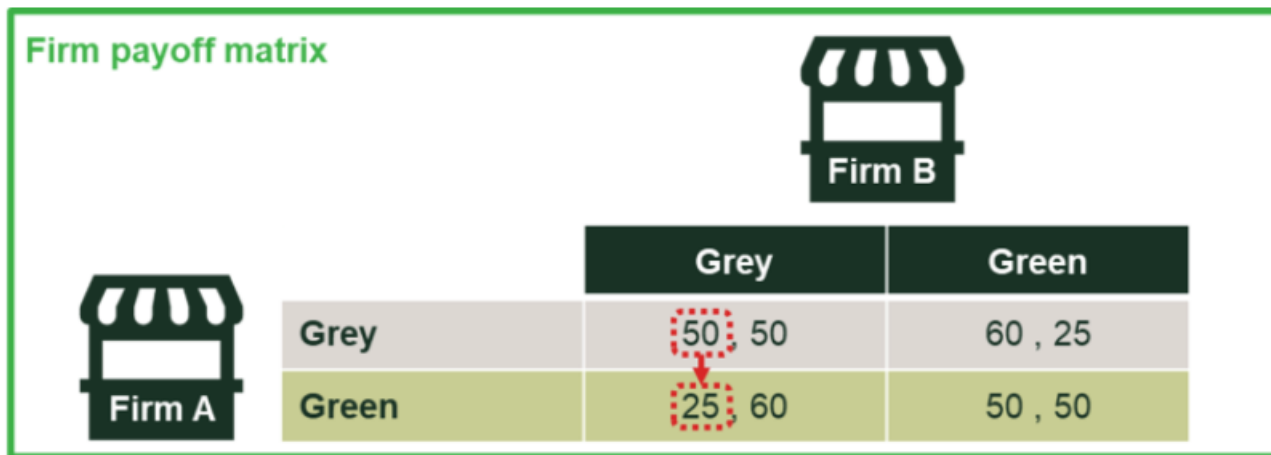
Negative Externalities – The Social Welfare Loss

Market failure happens when prices do not reflect social costs



Market failure and “collective action problem” illustrated:

Figure 1 First-mover disadvantage in green coordination



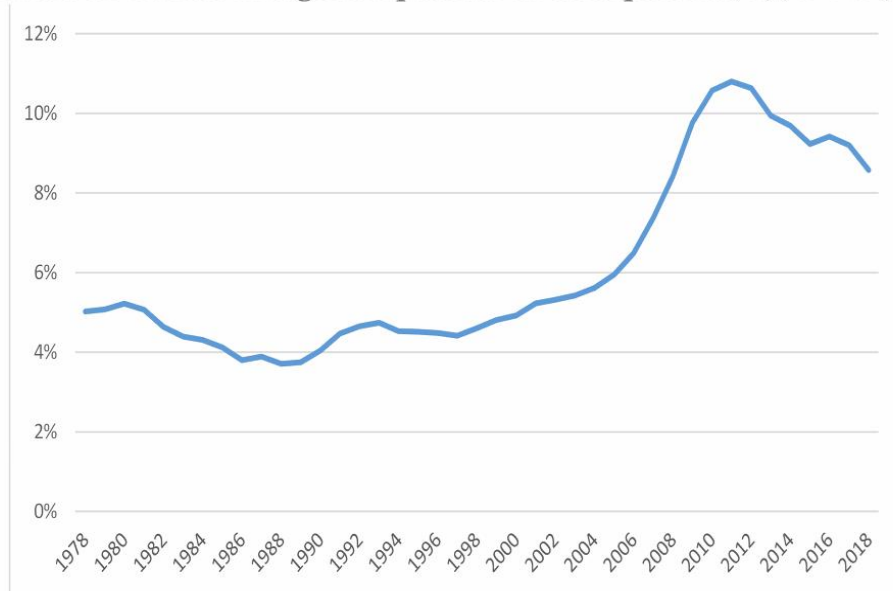
See Jenkins et al (Oxera), *“When to give the green light to green agreements”*

And we cannot solely rely on market-driven innovation:



The pace of low-carbon innovation has slowed down

Share of climate mitigation patents in total patents, 1978-2019



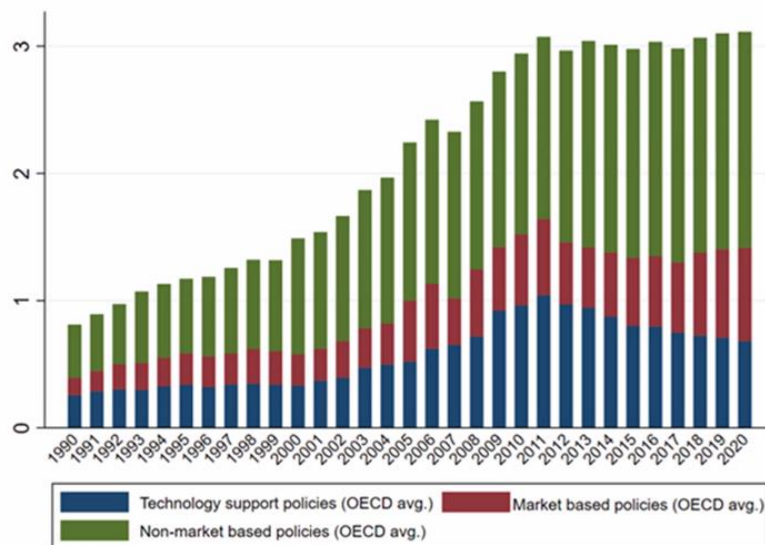
Source: Worldwide Patent Statistical Database (PATSTAT) available through OECD MicroData Lab: <https://www.oecd.org/sti/intellectual-property-statistics-and-analysis.htm#ip-data>,

Market failures are resolved by regulation, but we see policy failure:



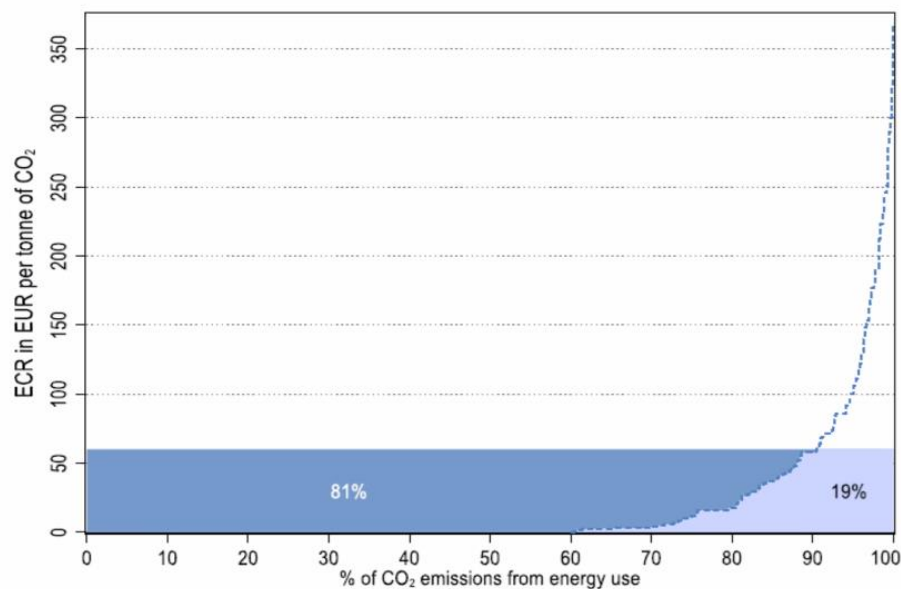
Why? Weak climate policies...

Climate policy stringency in OECD countries, 1990-2020



Source: OECD Environmental Policy Stringency indicator (2021)

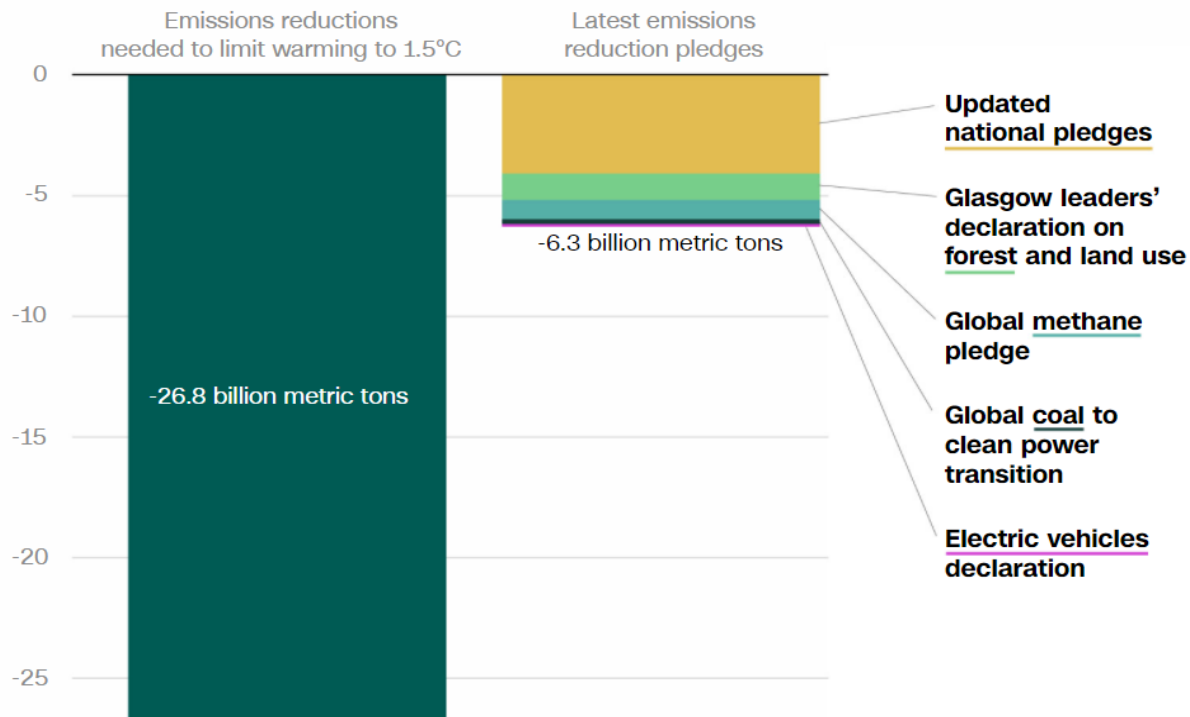
Carbon pricing in 44 OECD and G20 countries, 2018



Source: OECD Effective Carbon Rates (2021)

Because of policy failure, we need private cooperation as a complement to regulation

Estimated reductions in annual global greenhouse gases by 2030, compared to current policies, in billion metric tons of CO₂ equivalents.



Note: Chart uses average estimates for current policy level projections and median estimates for emissions leading to 1.5°C of warming.

Source: Climate Action Tracker

Graphic: John Keefe, CNN

1.2 Yet competition law is a barrier to decarbonisation (1)

“The stakes are high. The case studies I introduce in my article demonstrate that the **fear of prompting antitrust enforcement is preventing companies from addressing environmental and social crises at a time when we need the private sector’s help**. For example, while jurisdictions and companies have made bold commitments to address the plastic waste crisis, antitrust law is preventing the food industry from adopting industry-wide standards that would mandate the use of food-grade recycled plastics. And while apparel companies have attempted to rid their supply chains of forced labor and inhumane working conditions, their efforts to create binding and industry-wide labor standards are scuttled by antitrust scrutiny. While it is true that companies can and do avoid antitrust scrutiny by entering into unilateral and voluntary initiatives, decades of such efforts have produced marginal impacts.

[...] As industry leaders in Europe have pointed out, they cannot meaningfully address systemic risks unless they collaborate with competitors. There are a variety of reasons for this. First, only through collaboration can companies **create sufficient demand for sustainable products**. Second, companies need to collaborate to **produce sufficient quantities of sustainable goods at scale**, such as by jointly financing recycling infrastructure and facilities for food-contact recycled plastic, which today suffers from a global shortage. Third, companies need to enter into **binding agreements to phase out** unsustainable products. Fourth, companies must share commercially-sensitive pricing information to address sustainability and human rights challenges in their supply chains.”

Amelia Miazad, *“Prosocial Antitrust”*

Yet competition law is a barrier to decarbonisation (2)

— The examples in the next slides show there are companies interested in sustainability cooperation;

- Companies that pursue longer term goals, and recognize systemic and existential risks to our economy, our society, and our ecosystem (Unilever, ArcelorMittal, etc)

— And they show that competition law discourages sustainability cooperation

— See also:

- OECD paper
- BIAC note
- Miazad paper
- Kar Survey:

- *“Nearly 6 in 10 businesses have walked away from sustainability projects in fear of being rebuked by competition agencies”*

Examples of corporate initiatives for decarbonisation (from **permissible**, to **discouraged**, to **prohibited**)

- **Joint legislative advocacy** (for policy or legislative changes, such as carbon taxes)
- **Information exchange / benchmarking / joint studies**, such as: cooperation on scientific research and pre-competitive basic technology research and information sharing; benchmarking and exchange of experience on best practices to reduce GHG emissions. *Eucar* (1997); But: *Car Emissions* (2021; jointly avoiding Nox emission regulation)
- **Code of conduct**. Non-binding code to follow specific sustainable practices (*e.g.*, ban on flaring).
- **Support fund**. Pooling funds or assets to mitigate, adapt, or compensate for effects of GHG emissions; Low-Carbon Patent Pledge
- **Standard setting**. To certify compliance with agreed GHG reduction goals: responsible banana procurement (fair wages); “Together for Sustainability” (chemical audits); green steel certification; Fairware Living Wage; *US v. Brown Univ.* (1993) (allowed agreement for “social benefit”)
- **Targets for emission reduction**. Targets for GHG emissions reduction beyond regulation requirements. *ACEA* (1998), *JAMA/KAMA* (1999) (to reduce CO₂ from cars); *CEMEP* (2000) (to reduce sales of least efficient engines by 50%); *Detergents* (2011); Net-Zero Banking Alliance; Net-Zero Asset Owner Alliance; Net Zero Insurance Alliance; Trucks; European Green Digital Coalition
- **Agreement on secondary activities**. To improve practices not affecting price, output, or product diversity (*e.g.*, sustainable packaging, transport, methane control). *Pig castration anaesthesia* (2008)

Examples of corporate initiatives for decarbonisation (from permissible, to discouraged, to prohibited)

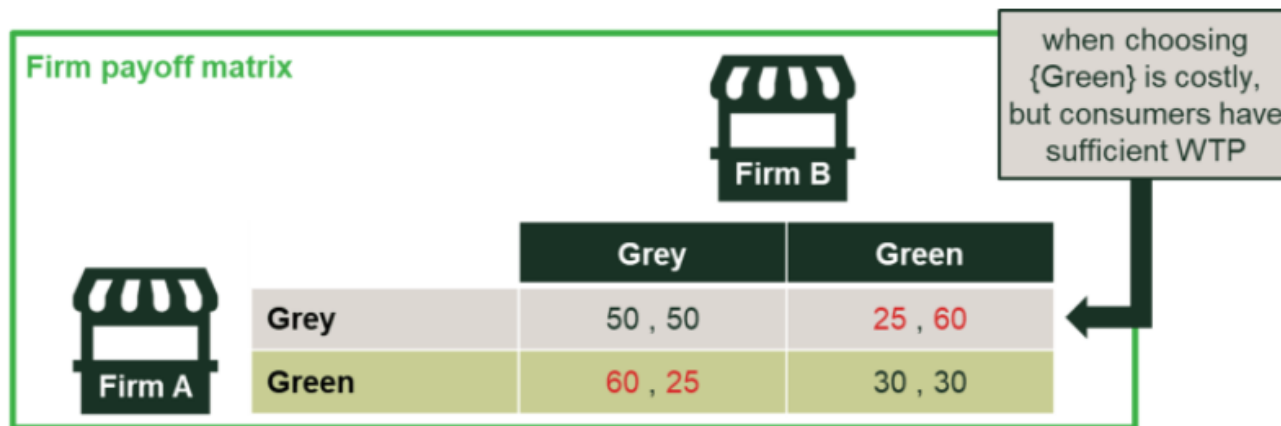
- **Compliance agreements.** To comply with laws to prevent freeriding on non-sustainable illegal activities upstream (e.g., no-deforestation in Indonesia, Brazil)
- **Carbon valuation agreement.** To integrate the social cost of individual GHG emissions and each commit to invest an equivalent amount in initiatives to curb GHG or carbon offset.
- **Joint R&D.** To develop new tech to lower GHG emissions. Joint R&D Block Exemption; joint commitment to offtake CO₂-free lime/4th Gen Nuclear (LFTR) for industrial heat for green steel
- **Joint projects.** To produce non-GHG energy/products where individual action would be too risky or costly. Oil & Gas Climate Initiative (introducing new technology; lowering GHG emissions together)
- **Network and asset sharing.** Agreement to produce non-GHG energy/products that would otherwise be too risky or costly. Introduction of new technology; recycling collection sharing
- **Production phase-out.** Agreement to reduce high-carbon production or sales – **ban on bottom dragnet fishing; joint closure of coal-fired electricity production**/blast furnaces; Cars (failed); *CECED*
- **Purchasing phase-out.** Agreement to reduce purchases of high-carbon input (collective boycott?); agreements **to exit coal insurance** (to ensure social costs are internalized); exit red meat finance
- **Joint purchasing** of clean input materials, First Movers Coalition; or raw materials for **recycling**.
- **JV joint production** introducing new technology; to achieve economies of scale/scope. Example, producing CO₂-free lime and green hydrogen (instead of carbon to extract oxygen from iron ore)

2. EU efforts to reconsider competition policy for decarbonisation – two aspects

2.1 EU efforts to define competition policy for decarbonisation – first step was to take action against greenwashing collusion

If partial WTP, parties who focus only on short-term profits may earn more by colluding on grey than going green individually

Figure 3 Incentive to coordinate on grey instead



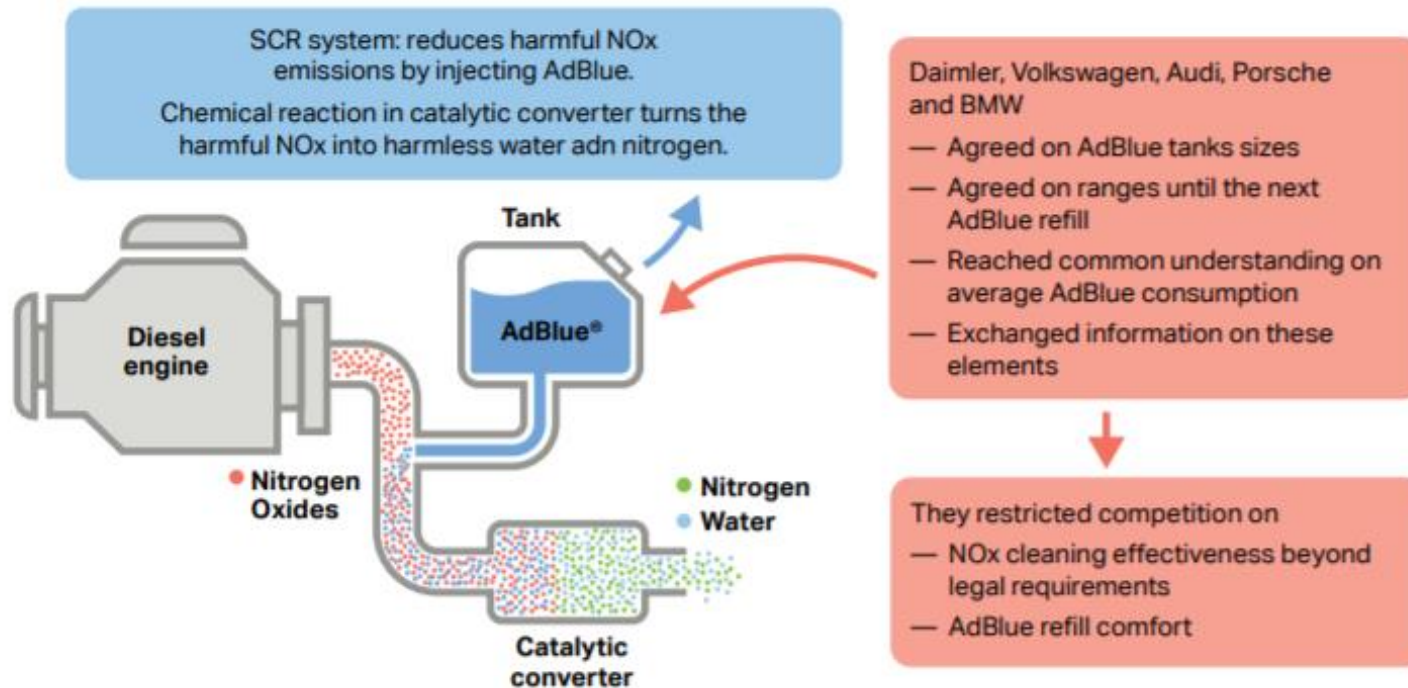
Note: The first entry in a cell reflects the payoff for Firm A and the second entry represents the payoff for Firm B. In this case, firms would actually choose {Green} under competition (for instance, because costs are not too high and there is sufficient willingness-to-pay), but would under coordination choose {Grey}.

Source: Oxera.

Source: “*When to give the green light to green agreements*” (Jenkins et al, Oxera)

Example of action against greenwashing collusion: *AdBlue*

Figure 1 - The Commission's Findings In AdBlue Cartel



Source: European Commission

See also “*Colluding Against Environmental Regulation*” (Jorge Ale-Chilet, Cuicui Chen, Jing Li and Mathias Reynaert) TSE Working Paper 1204, April 2021

2.2 Second step: recognize that firms have incentives to *improve* sustainability where there are “sustainability spill-over benefits”

Firms increasingly realize that (a) they benefit in the long term, if (b) their *rivals* eliminate greenhouse gas emissions (“spillover benefits”), and (c) these private benefits align with public benefits. If so, firms have a genuine incentive to pursue efficient sustainability goals, and competition authorities don’t need to assume that they are just out to raise short-term profits at the expense of consumers.

“where positive spill-overs exist between firms, efforts by one firm also benefit other firms. In this case, the level of sustainability efforts by other firms would actually have a positive effect on a firm achieving its own objectives. Allowing firms to coordinate their sustainability efforts will then lead to higher overall effort levels.”

Examples: reduced existential threat from climate change; genuine social objectives; common cost savings; improved industry reputation; avoiding costly and inefficient regulation

Source: “*When to give the green light to green agreements*” (Jenkins et al, Oxera)

New Horizontal Guidelines – Assessment under Article 101(1) TFEU

- Guidelines confirms that sustainability is a EU policy priority;
- Guidelines confirm sustainability agreements may **fall outside the scope of the prohibition** of Article 101 TFEU, if they do not affect any parameters of competition:
 - agreements that do not concern the economic activity of competitors, but their internal corporate conduct;
 - agreements to create database containing information about sustainable suppliers;
 - agreements for organizing industry-wide or consumers’ awareness campaigns.
- Guidelines describe “soft safe harbor” for widely defined **sustainability standards agreements – even if mandatory** – if 7 cumulative conditions are met:
 - unlimited participation and transparent process for selecting the standard;
 - no obligation for third parties to comply to the standard;
 - participating companies can adopt a higher sustainability standard;
 - no exchange of commercially sensitive information beyond what is necessary;
 - non-discriminatory access to the outcome of the standardization process;
 - no appreciable increase in price nor appreciable reduction in choice;
 - monitoring system ensuring compliance.

New Horizontal Guidelines – Assessment under Article 101(3) TFEU

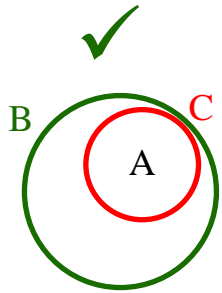
- If an agreement restricts competition, it can still be allowed if it leads to **efficiency gains**: quantitative and/or qualitative sustainability benefits;
- Agreement must prove **necessary** to attain the sustainability objective:
 - overcome first mover disadvantage;
 - cure market failures where public policies and regulations fail to do so;
 - achieve economies of scale;
 - nudge consumers’ preferences.
- Consumers must receive a **fair share**, deriving from three different kinds of benefits:
 - “individual use value benefits” -- such as better quality of product;
 - “individual non-use value benefits” -- benefits resulting from the consumers’ appreciation of the impact of their sustainable consumption on others;
 - “collective benefits” -- positive externalities that benefit society as a whole.
 - HG 603: “*where consumers in the relevant market **substantially overlap** with, or are **part of** the beneficiaries outside the relevant market, the collective benefits to the consumers in the relevant market occurring outside that market, can be taken into account if they are **significant enough** to compensate consumers in the relevant market for the harm suffered.*”
- Residual competition

When (and how much) do collective benefits count? (1)

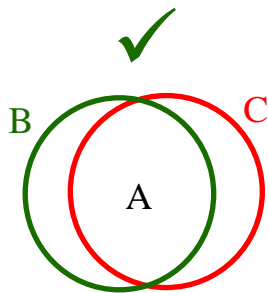
- Until 2001, EC applied **CECED** (1999) precedent
 - *“Individual economic benefits ... savings on electricity bills allow recouping of increased costs of upgraded, more expensive machines within nine to 40 months”*
 - *“Collective environmental benefits ... the benefits to society ... appear to be more than seven times greater than the increased purchase costs of more energy-efficient washing machines. Such environmental results for society would adequately allow consumers a fair share of the benefits even if no benefits accrued to individual purchasers”*
- After that, collective benefits did not count. Until **Mastercard** (2014), para 234:
 - *“appreciable objective advantages of such a character as to compensate for the disadvantages which that agreement entails for competition [Consten & Grundig]”.*
 - As the Dutch ACM explains
 - “this statement by the Court therefore does not determine whether full compensation of negatively affected consumers is necessary or whether these advantages should be in or out of market. ...MasterCard clarifies the case law ... as follows:*
 - (i) out of market benefits are counted towards compensation of the consumers negatively affected, in particular if they affect substantially the same group;*
 - (ii) out of market efficiencies benefiting other consumers can also be counted toward a fair share for consumers overall; and*
 - (iii) full compensation of the negatively affected consumers is not required, just conferral of appreciable objective advantages. “*

When (and how much) do collective benefits count? (2)

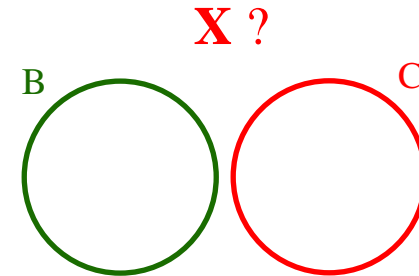
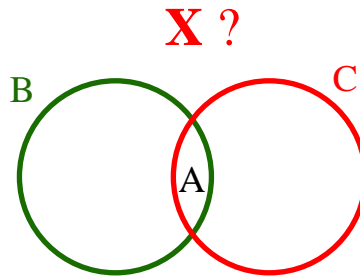
Question 1: Can collective benefits justify restriction only where “consumers in the relevant market substantially overlap with, or are part of the beneficiaries” (as EC proposes in HG para 602-605)?



Consumers (C) paying for clean fuel are also Beneficiaries (B) from clean air (or substantially overlap)



Consumers (C) buying sustainable wood mostly grown abroad: bio-diversity benefits (B) don't count at all?



Consumers (C) buying sustainable cotton made abroad: collective benefits (B) don't count at all?

Question 2: What share of the benefits are counted to balance against competitive harm – All benefits (B)? Or only those experienced by consumers who pay (A), as the EC proposes. This leads to bad results – Example of 1st class fliers asked to pay for sustainable fuel – Agreement not allowed because A is less than the extra price they pay, even it could avoid high social costs (B)?

Proposed answer: “Fair share” analysis should be in two steps

- Step 1: before assessment of the benefit to consumers, social cost (“externalities”) should be internalized to calculate “true price” (as required in “polluter pays” principle Art 191(2) TFEU).
- Step 2: After step 1, if agreement price > “true price”, check if agreement confers “*appreciable objective advantages of such a character as to compensate for the disadvantages which that agreement entails for competition*” (Mastercard)
 - Compensation need not be full, but must be “fair”

Summary: Decision tree for 101(3) or proportionality analysis

Step 1: does the agreement restrict competition?

Agreement to reduce emissions or pollution

Step 2: If it restricts competition, Follow this decision tree

Actual consumer WTP; no market failure

Parties should compete on meeting demand for sustainable products

Agreement “*not indispensable*” unless BER apply, needed to create economy of scale or scope, create synergies, or share prohibitive risk (see Guidelines)

Inadequate WTP; Market failure

Parties pursue short-term profit

Risk of collusion as in *AdBlue*

Agreement does not “*contribute*”

Parties pursue long-term “spill-over benefits”

Ancillary restraint or Art 101(3) TFEU

Agreement “*improves production or distribution, or promot[e] technical or economic progress.*”

“*fair share*” should reflect “polluter pays” principle

3. Expectations for Japan's competition policy for decarbonization

3. Need for more than guidelines.

- Recommendation to integrate sustainability in competition policy, and to count collective benefits – at least for agreement to limit climate change, protect biodiversity, and avoid large scale pollution
- Guidelines are necessary but not sufficient:
 - continued legal uncertainty and threat of future proceedings
- At the very least we could add also: individual guidance to companies which have entered into – or intend to enter into – a sustainability agreement.
- Better: Create legislative basis for exemption, as in Austrian law.
 - *“Consumers receive a fair share when the benefits derived from improving the production or distribution of goods or promoting technical or economic progress contributes appreciably to an ecologically sustainable or climate-neutral economy.”*
- Best: Block exemption for sustainability agreements

Even the EC recognizes legislative change is needed (CAP Regulation) -- Block Exemption would be appropriate for legal certainty

Regulation 1308/2013 on a common organisation of the markets in agricultural products (Article 201a)

Vertical and horizontal initiatives for sustainability

Article 101(1) TFEU shall not apply to agreements, decisions and concerted practices [...] that aim to apply a sustainability standard higher than mandated by Union or national law, provided that those agreements, decisions and concerted practices only impose restrictions of competition that are indispensable to the attainment of that standard.

Paragraph 1 applies to agreements, decisions and concerted practices [...] to which several producers are party or to which one or more producers and one or more operators at different levels of the production, processing, and trade in the [...] supply chain, including distribution, are party.

For the purposes of paragraph 1, “sustainability standard” means a standard which aims to contribute to [...] environmental objectives, including climate change mitigation and adaptation, the sustainable use and protection of landscapes, water and soil, the transition to a circular economy, including the reduction of food waste, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems [...]

Agreements, decisions and concerted practices that fulfil the conditions referred to in this Article shall not be prohibited, no prior decision to that effect being required.



© 2020 Cleary Gottlieb Steen & Hamilton LLP. All rights reserved.

Throughout this presentation, "Cleary Gottlieb", "Cleary" and the "firm" refer to Cleary Gottlieb Steen & Hamilton LLP and its affiliated entities in certain jurisdictions, and the term "offices" includes offices of those affiliated entities.

Some National Cases

- The **Dutch ACM** allowed two initiatives contributing to make the **energy sector** more sustainable:
 - an agreement between the Energy, Environment and Water Association and the Hollandse Kust wind farm, aimed to fix the price of energy for the members of the association in return for a joint long-term purchase commitment;
 - an agreement between grid operators to work together to reduce CO2 emissions by fixing a higher purchase price per ton of CO2.
- The **German FCO** offered guidance to two industry initiatives:
 - a cooperation agreement among food retailers to commit to **common standards for wages** in the banana supply chain, such as responsible procurement practices, and gradually increasing the volume of bananas produced by workers paid a fair salary;
 - an initiative among meat producers and food retailers to pay farmers an animal welfare premium.
- More recently, the FCO also cleared an agreement among milk producers to improve **animal welfare conditions** – such as granting more space, and providing training courses on animal husbandry for staff – **even if it implies an increase in prices.**