

# WHO MOVES FIRST? THE QUEST FOR CLARITY ON HOW TO ASSESS SUSTAINABILITY AGREEMENTS

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## 1 A CHICKEN-AND-EGG PROBLEM HINDERS THE INITIATION OF SUSTAINABILITY AGREEMENTS

Collaboration between companies can contribute to climate change goals set out in the Paris Agreement and the national carbon neutrality targets but needs to stay within the boundaries of competition law. The draft of the [revised Horizontal Cooperation Guidelines](#) – the final version of which will be published in the summer of 2023 – contains a new chapter on sustainability agreements between competitors and has received significant attention from industry representatives and competition law practitioners.

To date, the number of sustainability agreements processed by competition authorities has remained low in most EU countries. This may stem, in part, from the novelty of the sustainability agreements coupled with the uncertainty of what is allowed within the boundaries of competition law. Companies (or industry associations) contemplating horizontal sustainability agreements would benefit from greater clarity of the evidence requirements to substantiate the net benefits of their proposed agreements. Competition authorities, in turn, are willing to engage, but more concrete proposals from collaborating companies with documented benefits will be needed for the authorities to establish approaches to the balancing of benefits against any competitive harm.<sup>1</sup> Against this backdrop, referred to as a “chicken-or-egg” problem by some commentators<sup>2</sup>, we took stock of the key building blocks required to substantiate a case for green collaboration and the key uncertainties surrounding assessments of sustainability agreements.

## 2 AGREEMENTS THAT RESTRICT COMPETITION NEED TO MEET FOUR CONDITIONS

The Commission’s draft guidelines set the boundaries for acceptable agreements. First, not all forms of collaboration require an in-depth analysis. Agreements that do not appreciably restrict competition are exempted from scrutiny. Such agreements can entail, for example, improvements

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<sup>1</sup> Some national competition authorities, e. g. the Austrian and Greek competition authorities, have published guidelines on sustainability agreements. See, for example, the [Austrian](#) and [Greek guidelines](#).

<sup>2</sup> This finding was put forward in a recent [PaRR article](#) (14 April 2023, subscription required).

in resource efficiency, a shared database of sustainable value chains, or a joint advertisement for raising environmental awareness.<sup>3</sup>

Agreements that restrict competition through, for example, price coordination must lead to sustainability benefits that outweigh any harm caused by the agreement. This means that there must be verifiable benefits for the users that would not materialise without the agreement. Under the EU competition rules (Article 101(3) TFEU<sup>4</sup>) four criteria must be fulfilled for an agreement to be acceptable, summarised in Box 1.

#### Box 1 An acceptable agreement fulfils four criteria

**1. Efficiency gains: The agreement must lead to objective benefits.**

The sustainability benefits can range from a reduction in greenhouse gas emissions to improvements in respecting human rights or healthier food.

**2. Indispensability: The benefits would not materialise without the agreement.**

The agreement is necessary for a sustainability benefit to materialise.

**3. The users receive the benefit: The consumers must gain the benefit.**

The users can receive the benefit directly through “individual use value”, indirectly through “individual non-use value”, and through collective benefits that apply to the wider society.

**4. No elimination of competition: Elements of competition remain.**

Parties must continue to compete on at least one important aspect of competition: price, quantity, quality, choice, or innovation.

Source: Copenhagen Economics, based on the European Commission's draft revised horizontal guidelines 2022, paragraphs 577–614.

### 3 COLLABORATION CAN BRING ABOUT BENEFITS THAT WOULD NOT OTHERWISE MATERIALISE

An economic assessment would start from establishing the likely scenario without the proposed sustainability agreement, which is the basis against which the envisaged benefits are assessed. In effect, competition authorities would seek to understand how far firms get in advancing sustainability through competition and through policy-based regulation.

Understanding the “counterfactual” version of the world without the agreement requires analysing how the firms would act on sustainability improvements without the proposed agreement. This involves an assessment of whether consumers are willing to pay for sustainability, and whether firms have unilateral incentives to compete on sustainability.<sup>5</sup> Where customers are not willing to pay sufficiently for sustainability improvements, the so-called ‘**first mover's disadvantage**’ could dilute firms' incentives to invest in more sustainable products. Put simply, a firm's incentives to ‘move

<sup>3</sup> The European Commission's draft revised horizontal guidelines 2022, paragraphs 551–554.

<sup>4</sup> See the consolidated version of the Treaty on the Functioning of the European Union, [Article 101](#).

<sup>5</sup> In one extreme, the [European Commission found](#) that car manufacturers colluded on not competing beyond statutory limits of pollution reduction by limiting the size of the AdBlue tanks in passenger vehicles. In other words, the Commission's decision implies that the manufacturers would have gone beyond what was required had they acted independently.

first' and incur the costs of more sustainable production are diluted if customers stick with less sustainable (possibly cheaper) products still supplied by competitors.<sup>6</sup>

Alternatively, collaboration may be necessary to overcome a **cost barrier**. In the presence of high fixed costs and economies of scale, variants of co-investment models can help unlock investments that firms would not pursue independently.<sup>7</sup> By way of an example, in June 2022, the Dutch Authority for Consumers & Markets (ACM) accepted a collaboration that enabled investment into new carbon storage infrastructure. Competitors Shell and TotalEnergies were set to collaborate on capturing, transporting, and storing carbon dioxide in empty gas fields in the North Sea. The high-risk project will cost several billion euros and require a high “launching volume”. The ACM deemed the cooperation necessary to achieve economies of scale to make the project viable and found that the benefits of the capacity of five million tonnes of captured greenhouse gas emissions outweighed any harm to competition. In addition to the project’s contribution to the reduction of CO<sub>2</sub> emissions, an economic assessment of the ‘counterfactual’ appears to have played an important role – namely, whether and how the project could have taken place without the proposed form of collaboration.

#### 4 NO COLLECTIVE VIEW YET ON HOW COLLECTIVE BENEFITS SHOULD BE TAKEN INTO ACCOUNT

The users can receive an “individual use value” benefit from an agreement directly if the sustainability benefit is associated with, say, higher quality. Similarly, when users are willing to pay for an eco-friendlier product and appreciate the value it brings to others, they benefit from an “individual non-use” value. These types of benefits for customers can be quantified by, for example, assessing historical transaction and price data and disentangling consumers’ willingness to pay for “green” attributes. Where historical data is not informative (e.g., for consumers’ non-use value of certain products), consumers’ willingness to pay for more sustainable alternatives could be quantified through a survey-based analysis (e.g., contingent valuation or conjoint analysis).<sup>8</sup>

“Collective” benefits are benefits that do not necessarily accrue to the users of the more sustainable product, and a horizontal agreement is needed to internalise negative externalities to the benefit of the wider society. Environmental economics offers tools to quantify collective benefits, for example, valuation of the social cost of carbon emissions (for further discussion on possible methods, see our article “How to quantify sustainability benefits in competition cases”).

While there are methods to assess the magnitude of collective environmental benefits, there is a degree of uncertainty about how these benefits should be allocated to the relevant set of consumers. In the Commission’s current draft, the consumers of the product or service should substantially overlap with the beneficiaries for the collective benefits to be taken into account, even if there are significant collective benefits for non-users, such as less pollution.<sup>9</sup> Collective benefits such as reductions in greenhouse emissions will to an extent apply to the users that suffer the harm from restricted competition, but these benefits are likely a small fraction of the societal benefits, which may also span over a long period.

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<sup>6</sup> See, for example, Schinkel, M.P. and Spiegel, Y., ‘Can collusion promote sustainable consumption and production?’, *International Journal of Industrial Organization*, 53, p. 371–98, 2017.

<sup>7</sup> The European Commission’s draft revised horizontal guidelines 2022, paragraph 585.

<sup>8</sup> See, for example, the European Commission’s (2022) expert advice on sustainability-related effect analysis; and Copenhagen Economics’ (2021) paper on the quantification of sustainability benefits in competition cases.

<sup>9</sup> Draft revised horizontal guidelines 2022, paragraph 606.

The European Commission is expected to publish the final version of the horizontal guidelines in July 2023, and the question of how broadly collective benefits can be accounted for may change. A recent example of a ‘change of tack’ is the proposal by the UK Competition and Market Authority (CMA) to consider collective benefits more broadly in its [draft guidance on environmental sustainability agreements](#). The CMA states that, specifically in the context of **climate change agreements**, the totality of the benefit to all UK consumers can be considered to compensate for the harm to competition that results from a horizontal agreement between competitors. The CMA’s approach is specifically targeted at climate change agreements where the shortcomings of partial consideration of collective benefits are most apparent. It remains to be seen whether the Commission might opt for a similar approach, which could significantly lower the hurdle for climate-focused agreements to evidence the case for collaboration.

## **5 OVERCOMING THE FIRST MOVER DISADVANTAGE IN EVIDENCING SUSTAINABLE COLLABORATION**

The number of publicly processed and concluded sustainability agreements in the EU remains low, and much of the existing case practice has taken place in the Netherlands. One factor that may explain companies’ cautiousness is uncertainty over how authorities would measure and weigh the envisaged benefits with costs.

Economic tools are available to help articulate what would happen without a proposed sustainability agreement, and to quantify many of the envisaged benefits of sustainability agreements. These methods will become more established through matters processed by the authorities, and through further guidance provided by the Commission and, in some cases, national authorities. This summer, when the European Commission is expected to publish the final version of its guidelines, we will learn the Commission’s stance on collective benefits, arguably the most significant point of contention and uncertainty, especially for any agreements seeking to mitigate climate change. Although competition law is not the primary instrument for achieving climate goals, further clarity on collective benefits would serve the collective interests of collaborating companies and authorities.