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Commissioner Margrethe Vestager
European Commission
Directorate General Competition
Brussel, Belgium

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Subject

Response to the invitation to comment on the "draft Guidelines for sustainable agreements in agriculture" of 10 January 2023, in particular to Chapter 5 and Section 6.5.

Dear Commissioner Vestager,

Thank you for the opportunity to respond to the draft *Commission Guidelines on the applicability of the derogation from Article 101 TFEU for sustainability agreements of agricultural producers pursuant to Article 210(a) of Regulation 1308/2013*, of 10 January 2023.

Article 210a CMO strikes me as very permissive of horizontal agreements with anticompetitive effects. I find it rather idiosyncratic, if not untenable to give such wide exemption possibilities to anti-competitive agreements in just one particular sector – agriculture – on just one particular category of potential social benefits – sustainability – how ever big a sector and important a benefit those are. All the more disagreeable this is, in light of the fact that we are still having a long, wide and deep debate in parallel on the treatment of sustainability agreements under Article 101(3) more generally – in which the Horizontal Guidelines are still in last year's draft today. However, I understand Article 210a CMO is law now and all that remains is to try to contain some of its least desirable consequences with best practices.

General assessment

The draft guidelines to Article 210(a) seem to aspire to demand some substantial actual sustainability benefits from sustainability agreements between competing agricultural producers, before they can be excluded from the application of the cartel prohibition Article 101(1) TFEU. This is the right approach in general, I think. After all, claims of beneficial sustainability agreements in applications for exemption from the cartel prohibition under Article 101(3) are best considered with a healthy dose of scepticism and caution – as competitors are typically not better incentivized to promote sustainability by being allowed to form anticompetitive sustainability agreements. So was the first of two general recommendations in my response 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* – which I attach here for completeness, together with the slide pack to my comments on sustainability and competition policy in the E.CA *Competition Law and Economics Expert Forum*, just held 17 April 2023 in Berlin, that contains some updates. While there may well exist some genuine and valuable sustainability initiatives that are worthwhile to allow in restraint of competition for their substantial advance of sustainability standards, those will be hard to tell apart from cartel greenwashing by any competition authority – and it is important to take account of this.

Without the consumer compensation requirement, the sustainability advance should be expected to be marginal

The guidelines require a minimum advance in sustainability of agricultural producers allowed to make cooperative sustainability agreements in restriction of competition. In Section 3.2.3 is stated that the sustainability standard must be advanced beyond what is already mandated by EU or national law –

Section 3.2.3 – or where there is no mandated standard, beyond the de *facto* level of sustainability – in recital (58). Without the requirement, as in Article 101(3), that consumers of the agricultural products involved receive at least a "fair share" of the sustainability benefits of an agreement, Article 210a CMO lacks the one tool for demanding that an agreement delivers more than just an infinitesimal increase in the existing sustainability standard before it can qualify for exclusion from the cartel prohibition. After all, to make consumers benefit typically requires a sustainability effort above and beyond the minimum advance that collaborating operators will often have incentives to try to pass by the authorities with.

It is very unfortunate – and also quite ironic – that with the simple "[d]ue to the importance of attaining certain sustainability standards in the realm of agriculture", as it is stated in recital (83) of the draft guidelines, the EU co-legislators have cut the consumer compensation requirement and thereby robbed the public authority of its strength to assure that those "certain" sustainability standards will in fact be *substantial* sustainability standards – like Delilah shaving Samson.

The qualified competition authority is left powerless to demand more than only a marginal increase in sustainability. Indeed, it is declared "impossible to indicate the minimum amount by which the adopted sustainability standard must exceed the mandatory sustainability standard" – in recital 61. No more than a marginal improvement of the sustainability standard should be expected – as implies also by the formulation in recital (88) – whereas a substantial and material improvement of sustainability is desired and should be asked for.

Also no consideration is given to the possibility that sustainability levels may develop more *without* the sustainability agreement to be exempted, either in continued competition – where we know that incentives to invest in sustainability efforts are typically stronger than in collaboration whenever buyers some willingness to pay for more sustainably produced goods (see my attached letter of 22 April 2022) – or by stricter future regulation – which operators, once in a sustainability agreement are, in fact, given incentives to lobby against (see my comment to recital (139) all the way at the end below).

The indispensability requirement is only a discrete criterion

With that, only the indispensability requirement is left as a strong tool for competition authorities to prevent operatives from proposing agreements that do little, nothing or negative to advance the sustainability – and in fact are cartel greenwashing attempts. By that requirement, a proposed sustainability agreement needs to be necessary for obtaining the sustainability advance. The draft *Guidelines for sustainability agreements in agriculture* develop this requirement, in line with my second general recommendation to the draft *Horizontal Guidelines*. This is wise, yet does not go far enough, I'm afraid. I have several comments on the indispensability test as set out in Chapter 5 Indispensability under Article 201a and Section 6.5 Ongoing and continuous review of indispensability.

To begin with, it is essential to note that the indispensability requirement is discrete: for any level of sustainability advance projected in a proposal – including the very small ones that the operators involved have an incentive to propose, as explained – either an agreement is necessary to obtain it, or it is not. After all, cooperation by operators in a sustainability agreement to advance the sustainability standard to, say, level X may be necessary only if: (i) each operator faces a hurdle that prevents it from adopting the higher sustainability standard X in competition, so that the sector remains with the existing standard; and (ii) the sustainability agreement assures that all the participating operators overcome this hurdle and will adopt standard X, so that the sector moves to the higher standard.

This conception that operators are not able to individually implement the higher standard, but would be collectively by the proposed agreement, relates to the justification for the policy by pointing out the existence of a so-called 'first mover disadvantage' – in recitals (97) and (98). It is also behind the first tests as laid out in Section 5.3.1, that are represented in the first box in the flowchart in Annex B: 'Can the sustainability standard be attained by operators acting individually?' Yes/No – if 'Yes' then the cooperation would not be covered by Article 210a.

It is essential to know first what problem the sustainability agreement will solve

The literature on what exactly constitutes situations with a first-mover disadvantage that prevents producers from adopting a higher sustainability standard than in competition is still in a rudimentary state. Much more precise theoretical and empirical research is needed. One general conception seems to be the following. A sector may be stuck in a grey competitive equilibrium, in which all producers keep using the old less sustainable technology, whereas there is also a green (competitive) equilibrium, in which all producers would use a new more sustainable technology. The problem is how to move from the grey to the green equilibrium. The grey equilibrium is an equilibrium in the sense that none of the producers has an incentive to unilaterally deviate and adopt the green technology alone, given that the others do not. Yet if the producers make an agreement to all adopt the green technology, the sector moves collectively to the green equilibrium. The role of the sustainability agreement then is to facilitate the transition to the new equilibrium, making the agreement necessary – that is, satisfy the indispensability requirement – for only a relatively short period of time, until the transition is sufficiently underway or complete.

However the role of a sustainability agreement would be altogether different in a situation in which the 'all green' state is *not* a (competitive) equilibrium. That is, if once all producers had adopted the new more sustainable production technology, each (or some) producers would have incentives to deviate from the green technology and revert back to the old grey ways of doing things. If that is the case, operators continuously would want to shirk on the sustainability agreement, so that it will be unstable. The role of the sustainability agreement than is more complex. To be successful in establishing a higher standard, the agreement would need to bind all the producers involved to adhering to the green production technology, against their own profit-incentive. In that role, the agreement remains indispensable as long as reverting back to grey production remains attractive for operators. Also, to be effective such sustainability agreements must contain strong monitoring of, and punishments in case of deviations.

It is generally quite alarming that law and guidelines are written that have such immense consequences as these exemptions from the cartel prohibition are known to can have, without clear and precise conceptions of the situations in which and how such exemptions may and may not contribute to the stated objective of raising the sustainability standard. More concretely should sustainability agreements that are necessary only to transition a sector from a grey to a green equilibrium be relatively hands-off and allowed for the duration of that transition and no longer. On the other hand would sustainability agreements that continuously need to maintain green production with all operators, each of which has incentives to revert back to grey production, if at all workable, need to be sufficiently invasive and controlling for a longer period of time to assure stability of the more sustainable state.

This distinction is not clearly made in the guidelines, yet has several concrete implications. For example need the payback period for investments of the operators involved in a sustainability agreement *not* be the key criterion for the duration for which a sustainability agreement can be allowed, as suggested in recital (117) and Section 6.5.1. Once the agreement has coordinated the sector on the green equilibrium, it should no longer be necessary. The other way around, a sustainability agreement that continuous to need to keep all operators in a market on board and prevent them from reverting back to the old low legal standard should probably cover the market, other than suggested in Section 5.4.2.3. In that case the sustainability agreement must has credible guards against deviation. The guidelines would benefit from developing this distinction in what a sustainability agreement is to achieve and how more.

Recommendation for two additional questions in flowchart Annex B

On this basis, I recommend to include two addition intermediate questions in the flowchart of the assessment of the indispensability test given in Annex B to the draft guidelines. The first is to add as a third boxed question:

Is the proposed cooperation between the operators likely to be effective in attaining the sustainability standard?

Is the answer 'No', then an arrow to the right points to the conclusion: 'The cooperation between operators is not covered by Art. 210a.' Is the answer 'Yes', the next question below is pointed at. Understanding how the proposed cooperation is expected to be effective in attaining the sustainability standard – including whether as a transition to a more sustainable situation that is an equilibrium or not – will inform the answers to some of the subsequent questions, such as on the necessary provisions, and size and duration of the restriction.

A second additional question to include in the flowchart extends on the suggestion in my letter of 22 April 2022 to extend the class of counterfactuals considered in the question whether there are no other economically practicable and less restrictive means of achieving the claimed sustainability benefits. In the current setup, it is asked whether there are least restrictive provisions, restrictions and durations. I propose that the Commission also considers whether the higher standard on sustainability that is promised to be reached by the sustainability agreement is not alternatively implementable as a higher mandatory EU or national standard – that is, vertically, *without* the horizontal restriction of competition. In particular will the operators proposing the sustainability agreement typically be in the position instead to ask, collectively or individually, for the higher regulated standard to be imposed by the designated government body.

Concretely, I propose to add a third boxed question to the flowchart, asking:

Is (the operators (collectively) asking for) a higher mandatory sustainability standard a viable alternative to the restrictive cooperation?

Is the answer 'Yes', then an arrow to the right points at the conclusion: 'The cooperation between competitors is not covered by Art. 210a. An increase in the mandatory EU or national standard is preferred over attaining the standard by cooperation between operators.'

Only in case the answer to this question is 'No' is the flowchart continued down.

In the attached reproduction of Annex B, I have added these two additional questions that I propose, together with the consequences of each of their possible answers, for clarity. My suggestion is that they be included in the final revised version of the guidelines.

Specific comments

In addition to the above, I have specific comments to two individual recitals.

Ad (89): Here is concluded that: "The more uncertain the attainment of the sustainability standard covered by the agreement, the more likely it is that a restriction of competition may be indispensable to ensure that the standard will be attained." I presume what is meant is: "The more uncertain the attainment of the sustainability standard covered by the agreement *without the agreement*, … " – and not *with* the agreement. If so, I suggest to add this clarification. If not, I would object to this being true.

Ad (139): Here it is first stated that after a sustainability agreement is no longer necessary, it "… may still benefit from the exclusion in Article 210a for the period necessary to unwind the agreement and recoup their investments." On this I already commented above: recoupment of investments should not be the prime criterion – rather whether the higher sustainability standard is stable. After this, an unintentional, I presume, perverse incentive is introduced, where it reads: "This would nonetheless not be the case where a sustainability agreement ceases to be indispensable due to a regulatory change establishing a mandatory EU or national standard equal or higher than the standard laid down in the agreement and the entry into force of the mandatory standard was foreseeable at the time of the conclusion of the agreement (or where there is sufficient time between the adoption of the regulation and its entry into force)."

To include this exemption provides operators involved in an exempted sustainability agreement with a strong incentive to lobby against better regulation – even against increases in the mandated standard

only up to the (marginal) increase beyond that standard by their sustainability agreement. This cannot be intended and should therefore be avoided.

With kind regards,

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