

Position Paper

Finding room for sustainability initiatives in the future CAP

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1. Introductory remarks

Sustainability is, without doubt, the most challenging chore of the European Union and its Member States. This is particularly the case for the agricultural and food sector, which is not only a sector which is one of the vulnerable for the effects of climate change, but is also a sector which feels the responsibility to attribute to solutions for a more sustainable future. Realizing more sustainable production methods, with respect for animal welfare is of major importance to safeguard food production on the long term and to make sure that future generations inherit a livable planet. The agricultural sector in Europe, and particularly *Land- en Tuinbouw Organisatie Nederland (LTO Nederland)*, representing the sector in the Netherlands, is well aware of its role and responsibility to realize these objectives.

In order to make sustainability initiatives successful, undertakings in the agricultural sector need to join forces. In seeking the possibilities of cooperation, undertakings frequently come across the boundaries of the European competition rules. For instance, a cooperation which seeks to improve sustainability standards can well have as an effect that less sustainable producers are excluded from the market. In the Netherlands, the *Chicken of Tomorrow ("Kip van Morgen")* is an unsatisfactory example of a well-meant initiative of the poultry and supermarket sectors to make arrangements about the production of broiler meat which was blocked by the Dutch competition authority ACM, because of competition concerns. The cooperation agreement could not benefit the exemption of Article 101(3) TFEU, since the benefits of these sustainability arrangements did not offset the costs.

In the Netherlands, this case has stirred up a debate on the somewhat strained 'relationship' between sustainability initiatives and the competition rules. In the Netherlands, the "Beleidsregel duurzaamheidsinitiatieven" has been adopted, providing guidance on how the ACM will apply the exemption of the cartel prohibition of the Dutch Competition Act on sustainability initiatives. In practice, however, it may not be easy to identify and quantify efficiencies which may offset the costs and therefore justify an exemption. Sustainability objectives, after all, do not always benefit the end user of the products concerned, but moreover society as a whole. In Spring 2017, the Dutch legislator presented the Act on Sustainability Initiatives. This act provides for the possibility for undertakings to submit an initiative to the Ministry, which can adopt that initiative in legislation. The logic behind is that in case the state imposes a specific cooperation agreement, this behavior escapes the applicability of the cartel prohibition, because of the state action defence.

LTO Nederland has welcomed these initiatives of the Dutch legislator. At the same time, LTO Nederland believes that these solutions do not provide a total satisfactory answer, since sustainability challenges demand, by its very nature, an international solution. For that reason, LTO Nederland seeks to find a solution within the EU legal framework and specifically within the Common Agricultural Policy, laid down in the (future) CMO Regulation. LTO is convinced that the current debate on the future CAP provides a unique window of opportunity to explore the opportunities to exempt sustainability initiatives within the agricultural and food sector from the competition rules.

We believe that this initiative of LTO Nederland underscores the ambitions the European Commission has expressed in its presentation of its ideas on the future CAP in November 2017. According to this proposal, the CAP must play an enhanced role in the battle against climate change. Furthermore, the future CAP needs to "continue to address societal expectations regarding sustainable food production, in particular concerning food safety, food quality, environmental and animal welfare standards." Part of that solution should be to provide more room for farmers to find sustainable solutions in cooperation, LTO Nederland finds. This would also help the 'delivery model' of the CAP.

In this position paper, LTO Nederland, in cooperation with law firm BarentsKrans N.V., attempts to explore the existing opportunities and *bottle necks* under the current CMO Regulation to exempt cooperation agreements on the field of sustainability. For the sake of clarity, we will assess the current

competition derogations on the basis of a case study of a fictitious cooperation agreement. Finally, some conclusions and questions are formulated.

2. Case study

This is a case study concerning a fictitious cross-border sector initiative to stop the current beak trimming practice of laying hens. Beak trimming is a common practice, which is done as a preventive measure to reduce damage caused by injurious pecking resulting in cannibalism, feather pecking and vent pecking. The practice of beak trimming is an adequate remedy to improve welfare of laying hens by protecting them against these so-called “ranking order” phenomena among chickens. Beak trimming means that the upper part of the beak (approximately 10%) is being treated with a laser burner. After a couple of days the heated part of the beak will fall off.

Within society, there are objections against the practice of beak trimming, because of reasons of animal welfare. For example, discussions take place in the Netherlands, Belgium and Germany. In the absence of beak trimming, a poultry farmer will need to implement alternative solutions to protect the flock. Alternative solutions are, amongst others, the use of special materials in their chicken houses, the use of other feeds and the use of light. Such alternative solutions require investments, which would have a considerable effect on their production costs. As a result, individual poultry farmers are discouraged to abandon beak trimming and implement alternative solutions. For that reason the poultry sector considers a cooperation agreement with the supermarket sectors in its country, in which these sectors come to the agreement that the supermarkets will solely purchase and sell eggs of chickens which are not beak-trimmed. The sector preferably extends the cooperation to the poultry and supermarket sectors in other Member States and third countries.

In order for the initiative to be successful, it is necessary that the cooperation agreement is extended to the (entire) supermarket sector. After all, experience shows that supermarkets are somewhat reluctant to shift individually to a more sustainable product range, because consumers (still) strongly prefer more affordable consumer products over more expensive sustainable alternatives. For that reason, an agreement between (solely) poultry farmers not to produce non-beak-trimmed chicken eggs would not be sufficient to obtain the objective. Only by making a collective agreement with the supermarket sector, it can be assured that non-beak-trimmed chicken eggs will be purchased by the supermarkets. Besides, for the sector for laying hens, it is necessary that they can recover their increased production costs, which is only possible in case the supermarket sector is willing to pay higher purchase prices.

The cooperation between the poultry sector and the supermarket sector would likely result in a restriction of competition, since the sector collectively decide that eggs of laying hens which are beak-trimmed are being banned collectively by the supermarkets. This would reduce the competition on both the buying market as the consumer market for chicken eggs, be it that this restriction does not concern all competition parameters (like price). Given the fact that the biggest share of chicken eggs is sold in supermarkets, this agreement would likely have an appreciable effect on competition. It goes without saying, however, that there would be public benefits to society, since the welfare of poultry is improved, an aim which is supported by many European citizens.

3. Current exemption possibilities under the CMO regulation

The CMO Regulation provides for various “CAP” derogation provisions. None of them appear to be entirely suitable to derogate the cooperation agreement of the above-mentioned case study from the cartel prohibition.

The **product-specific CAP derogations** do not provide for an adequate basis to derogate the aforementioned sustainability initiative, since these derogations are restricted to cooperation regarding joint sales by producers. Besides, this exemption is solely applicable for cooperation agreements made within producer organizations and does therefore not cover cooperation agreements in which third organizations, such as the supermarket sector, are involved.

Another route may be the possibility for Member States to make the cooperation agreement binding (the possibility of **extension of rules** of Article 164 CMO). It is, however, unclear whether this possibility of extension of rules can also be applied to sustainability initiatives as the one at hand. Besides, it is not possible for a Member State to impose a cooperation agreement on sectors *outside* the agricultural sector, like the supermarket sector. For that reason the cooperation agreement at hand does not fit within the extension of rules provision of Article 164 CMO. But also for agreements which are limited to undertakings active on IBO level, this provision does not provide a solution, since these rules can only be made binding for a limited period of time, whereas sustainability initiatives, such as the one presented, require a long-lasting solution. Another restraint is that it seems that this derogation can only be applied within one Member State unless the initiative is taken by IBOs in more than one Member State or by a recognized cross-border IBO. Final uncertainty is how the condition that the cooperation is in line with the conditions of Article 210(4) CMO is applied (see also below).

3.1. General CAP derogation: Article 209 CMO

The general CAP derogation of Article 209 CMO foresees in two derogation grounds. The first foresees in a derogation for agreements, decisions and practices which are necessary for the attainment of the CAP objectives of Article 39 TFEU. This derogation provision is not suitable, since it follows from the case law of the Court of Justice that this exemption is limited to agreements which are necessary to attain all objectives¹. That is not the case for the cooperation agreement in the above-mentioned case study, which is not, for example, aimed at the improvement of the standard of living of the farmer.

The second derogation possibility seems to provide more room to exempt cooperation agreements. Also agreements of farmers (or farmers' associations or producer's organizations) which concern the production or sale of agricultural products can be exempted from the cartel prohibition, unless (i) the objectives of Article 39 TFEU are jeopardized, the cooperation agreements entail an obligation to charge an identical price or exclude competition. The cooperation above would not benefit this exemption, since the supermarket sector is involved as well. Leaving aside this restriction, it is, in the view of LTO Nederland, perceivable that also sustainability initiatives could benefit from this exemption. It is, however, highly uncertain whether this provision is indeed intended to cover these kinds of cooperation.

First of all, it is uncertain whether an agreement on the ban of eggs of beak trimmed chickens indeed qualifies as an "agreement which concerns the production" of agricultural products. The initiative is aimed at the well-being of laying hens and not at the production of eggs as such. A second uncertainty is how the requirement that an agreement does not exclude competition is applied in practice. It seems little likely that a cooperation agreement, such as the one at hand, which may have as an effect that poultry farmers who still apply beak trimming will no longer be able to sell their eggs to Dutch supermarkets (but are able to export them to third countries), benefit from this exemption. Thirdly, the question may arise whether this initiative is in conformity of the objective of Article 39 TFEU to increase agricultural productivity. After all, these measures may have a mitigating effect on production quantities.

¹ See for example: ECJ in *Frubo* and *Florimex*.

3.2. General CAP derogation: Article 210 CMO

The other general CAP derogation, laid down in **Article 210 CMO**, is solely applicable on agreements of recognized interbranche organizations (IBOs, within the meaning of Article 157 CMO). The fictitious cooperation presented in the above-mentioned case study could not benefit this exemption, since, because of the involvement of the supermarket sector, the cooperation does not take place *within* an IBO. The cooperation may even be extended to recognized IBOs of various Member States. Given the strict interpretation the Court of Justice of the EU has given of the competition derogation for producer organizations in the *French Endives* case, LTO Nederland deems it little likely that the derogation for IBOs of Article 210 CMO can be applied more broadly. Although multiple sectors from various stages of the supply chain (including distribution of products) can be represented in an IBO, it is uncertain whether the retail sector can be registered with an IBO as well.

Leaving aside these restrictions, it should be noted that the exemption only encompasses cooperation agreements which have as their object the carrying out of the activities listed in Article 157 CMO. One of the activities concern:

“seeking ways of restricting the use of animal-health or plant protection products, better managing other inputs, ensuring product quality and soil and water conservation, promoting food safety, in particular through traceability of products, and improving animal health and welfare.”

The cooperation agreement in the above-mentioned case study is undoubtedly aimed at *the improvement of animal health and welfare*. Question is whether the cooperation agreement falls under the scope of this exemption provision, since, strictly speaking, the objective is not aimed to “seek ways” or methods (French translation of this provision: *rechercher des méthodes*) to improve animal welfare. Although, the cooperation is a way to improve animal welfare, it merely concerns an agreement with the supermarket sector not to purchase eggs of beak-trimmed laying hens. Question is whether an agreement whereby competitors do agree on a production method can benefit from the exemption, since the competitors, strictly speaking, do not *seek* better methods, but already found them and make agreements on the way of implementation.

Following the Omnibus Regulation, a new activity was added to Article 157:

“implementing measures to prevent and manage animal health, plant-protection and environmental risks.”

It is however, uncertain what is actually meant by “implementing measures” and whether also encompass agreements which facilitate farmers to realize more sustainable production methods. Discussions between the European Parliament, Council and Commission are still on-going as regards the exact meaning of the new activity.

Furthermore, it is uncertain how the Commission will assess the cooperation in the light of the other criteria of Article 210, para. 4 CMO. For example, when is the sound operation of the market organization affected? Is that already the case when certain egg producers are no longer able to sell their eggs to supermarkets? And which distortions of a cooperation is deemed to be not essential? And is an agreement which does not concern the adjustment of prices, but which has an effect on prices also excluded? It seems that such is the case.

These questions and uncertainties discourage the sector to engage in sustainability agreements. It is true that the sector needs to file a prior notification and therefore get certainty beforehand, but it is uncertain what the outcome of that notification will be.

4. Conclusions

The CAP derogations of the CMO Regulation seem to be somewhat unfit to exempt sustainability initiatives, because of a couple of *bottle necks*:

1. **The objective of the cooperation agreement:** it is uncertain whether the CAP derogations have by their nature the objective to exempt cooperation agreements in the field of sustainability. The CAP derogations are designed in order to improve the (income) position of the farmers within the production chain. On the other hand, there are indications that also sustainability objectives may benefit the exemptions and support the incomes of farmers. For instance, various IBO activities enlisted in Article 157 mention sustainability objectives. LTO Nederland would welcome that in the new GMO regulation a more explicit reference to sustainability initiatives as an instrument of the delivery model of the future CAP.
2. **The extent of the cooperation agreement:** assuming that also cooperation agreements attaining sustainability objectives do by their nature fall under the scope of the CAP derogation, it is uncertain whether the extent of the cooperation agreement is such that it can fall under the derogation. This is especially the case as regards Article 210, which is limited to the activities mentioned in Article 157. It may be considered to add a new category for sustainability cooperation agreements which go further than merely common research to methods of production.
3. **The parties who are involved in a cooperation agreement:** it appears that a cooperation agreement with parties which are not active in the agricultural sector cannot benefit from the CAP derogations of Articles 209 and 210 CMO. This is problematic since many cooperation agreements, such as the one presented above, are dependent on the involvement of other parties in the food production chain, outside the agricultural sector. It may be considered to extend the scope of CAP derogations, for instance by allowing the retail sector to join IBO's and/or to provide room to create (cross-border) associations of IBOs (ABOs) (in analogy to associations of producer organizations).
4. **The effects of the cooperation agreement:** the CAP derogations require that the cooperation agreement does not entail the fixing of prices, does not exclude competition or lead to competition distortion which is not necessary for the attainment of the objectives (Article 210). Whereas it is obvious that an agreement may not entail a price fixing cartel agreement, it is less obvious how the Commission will assess whether an agreement leads to a competition distortion. Another somewhat ambiguous requirement is that the cooperation agreement may not jeopardize the CAP objectives.

In sum, beside the fact that the current CMO Regulation seems not to be fit to encompass all sustainability initiatives, there is uncertainty on how the competition derogations are to be applied in practice. This uncertainty has a discouraging effect, because of the significant (time and cost) effort the parties involved will have to pay before they come to an agreement. It would be helpful in case an (informal) opinion can be requested in an earlier stage, as is the case in the current Article 209 CMO.