Iustum Aequum Salutare
VI. 2010/4. · 277–283.

VARIA

– KÖZLEMÉNY –

COMPETITION OR ENVIRONMENTAL PROTECTION: IS IT NECESSARY TO CHOOSE?

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Although at first it seems that competition and environmental policies are in conflict with each other, they can in fact better be described as complementary: both seek to correct market failures and enhance social welfare.

Many questions can arise in relation to these two policies: Can competition be restricted based on environmental reasons? If it can, what are the conditions and reasons for the exemption? Can competition help to achieve environmental goals?

I. Introductory remarks

As a consequence of increasing environmental damage and limited natural resources, environmental protection is becoming a major concern and a centre of interest. Even so, economic factors often play a greater role in consumers' decisions than environmental considerations, due to low environmental awareness. The aim of any undertaking is to realize its interest and gain profit, and environmental protection is usually not a priority. The connections between environmental protection and competition are therefore an important topic, since the integration of the two fields could result in more efficient environmental protection.

The importance of the topic was recognized by the Organization of Economic Co-operation and Development (OECD), and a round table was organized in 2006 with the title "Competition Policy and Environmental Protection"[1]. At this conference, the OECD drew attention to the global problem of pollution. Since pollution is of a global nature, it cannot be handled and solved as an isolated

[1] www.oecd.org/dataoecd/39/15/37981_581.pdf

phenomenon, but is linked strongly to other (legal) matters. All possible means to alleviate pollution must be applied, one of which is competition law.

Environmental regulation can, however, reduce competition in the market through diverse channels. It may result in higher prices for consumers; it may create barriers to entry in particular markets and increase concentration. Environmental regulation may also enable various anticompetitive practices.

At the current low level of environmental awareness, competition may in fact set back the achievement of environmental goals. Environmental issues are only rarely taken into account in the decisions of an undertaking's management, and consumers may also tend to choose cheaper goods instead of environmentally friendly ones.

In spite of the above-mentioned facts, if people were fully aware of the necessity of environmental protection, competition could theoretically further environmental aims.

II. Externalities

The free market economy, which depends on competition as the most efficient allocation mechanism, can lead to environmental damages. This is due to the fact that a low level of environmental pollution does not appear as a cost in the decisions of economic agents, but pollution entails a large cost for the whole population in the long run. These non-immediate realized costs are environmental externalities. The existence of externalities (costs and benefits not taken into account – not internalized – by the decision-maker) is a well-known fact of economics. The first definition of externalities was introduced by A.C. Pigou[2] in the beginning of the 19th century.

With the internalization of the externalities into the prices of the goods and services, competition could force undertakings to introduce environmentally friendly products, since these entail lower externalities, and thus lower costs.

III. Article 11 (ex Article 6 TEC): the basis for the integration

Article 11 of the TFEU[3] integrates environmental protection with other community policies. Article 11 states: "*Environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities*, *in particular with a view to promoting sustainable development."*

From the structure of the TFEU it is clear that sustainable development and a high level of environmental protection feature among the aims of Union's competition law. The sole problem is that some aims are difficult to reconcile with each other. The only solution is to accept the aims as one and indivisible, so each policy serves each aim.[4]

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[2] http://www.econlib.org/library/Enc/bios/Pigou.html

[3] Treaty on the Functioning of the European Union.

[4] Hans Vedder: *Competition Law and Environmental Protection in Europe*. Europe Law Publishing, Groningen, 2003, 13–16.

The integration of environmental protection is not an aim but a means to reduce pollution and enable a better quality of life.

IV. The functions of competition and its effect on the environment

The following functions of competition could theoretically further the aim of environmental protection. A high level of environmental awareness is necessary, however, to achieve success.

Welfare function: competition allows consumers to choose the product which grants them the largest welfare. As high environmental quality is an aspect of welfare, competition contributes to environmental protection accordingly.

Allocation function: competition gives producers incentives to invest in products which comply with the needs of the consumers. If consumers require a clear and pollution free environment, production and investment will act to satisfy this demand.

Efficiency function: undertakings are forced to develop increasingly efficient technologies which enable them to lower production costs and sell their products at a lower price. Therefore, undertakings – among others – are encouraged to reduce energy usage to save on costs.

V. Horizontal agreements

The increase in environmental awareness creates a number of new economic activities and markets in connection with environmental protection. These newly emerging markets present the opportunity to conclude various environmental agreements. As a result of the outcome of these new agreements, the European Union has published guidelines (Guidelines on the applicability of Article 81 of the EC Treaty to horizontal agreements (2001/C 3/02)) to ensure the uniform interpretation of Article 101 (ex Article 81 TEC).

The Guidelines contain the conditions for exemptions from environmental agreements, since horizontal cooperation may on the one hand lead to competition problems, but on the other hand to substantial benefits. Cooperation can be a means to share risks, save on costs, pool know-how and launch innovation faster.

According to the Guidelines, environmental agreements are those by which the parties undertake to achieve pollution abatement, as in environmental law, or environmental objectives in particular, as set out in Article 191 (ex Article 174 TEC) of the Treaty. Thus the target needs to be directly linked to the reduction of the pollutant or a type of relevant waste. This excludes agreements which are only the by-product of pollution abatement.

There are three different types of environmental agreements: (1) agreements setting out standards, (2) agreements at the same level of trade and (3) comprehensive, industry-wide schemes (set up in many Member States) to comply with environmental obligations on recycling obligations.

Through standards, products and production processes can be regulated by considering their environmental effects, with which both parties have to comply. At the same level of trade, undertakings sometimes conclude agreements in relation to

the recycling of certain materials, reducing emission or improving energy-efficiency. Furthermore, in many Member States comprehensive, industry-wide schemes are set up. These agreements are based also on recycling systems.

Environmental agreements can be classified into three categories according to their impact of competition law.

In the first category are agreements that almost always come under Article 101 (1). These modes of cooperation do not, in fact, have an environmental objective. On the one hand, such an agreement can serve as a tool to engage in a disguised cartel (i.e. otherwise prohibited price fixing, limiting of output, or dividing up the market), on the other hand, it may be used as one of many means to sustain a broader restrictive agreement, with the aim of excluding actual or potential competitors.

The second category contains agreements that may fall under Article 101 (1). "Environmental agreements covering a major share of an industry at national or EC level are likely to be caught by Article 101 (1) where they appreciably restrict the parties' ability to devise the characteristics of their products or the way in which they produce them, thereby granting them influence over each other's production or sales."[5] Furthermore, restrictions between the parties – due to an environmental agreement – may also reduce or substantially affect the output of third parties, either as suppliers or as purchasers.

For instance, when the parties have a significant market share, environmental agreements, which may phase out or significantly affect an important segment of the parties' products or production processes, or in which the parties allocate individual pollution quotas, may fall under Article 101 (1).

Similarly, agreements may also appreciably restrict competition, whereby parties holding significant market shares in a substantial part of the common market appoint an undertaking as exclusive provider of collection and/or recycling services for their products. An exclusive collection and/or recycling service agreement may also appreciably restrict competition if the principal undertaking has a significant market share, provided that other actual or potential providers exist on the market.

In the third category there are agreements that do not fall under Article 101 (1). Irrespectively of the parties' market share, a number of environmental agreements are not likely to fall under Article 101 (1).

The characteristics of these agreements are that there is no precise individual obligation placed upon the parties or that the parties are loosely committed to contribute to the attainment of a sector-wide environmental target. The discretion of parties in relation to the means that are technically and economically available for the fulfilment of the environmental target is crucial for the classification. The more varied the available means, the less appreciable the potential restrictive effects.

Consequently, this category of agreements either does not appreciably affect product and production diversity, or the market share of the undertakings is so marginal that environmental agreements do not fall under Article 101 (1). Furthermore, agreements which genuinely give rise to new markets (for instance recycling agreements) will not

[5] Guidelines on the applicability of Article 81 of the EC Treaty to horizontal agreements (2001/C 3/02).

generally restrict competition, provided that the parties would not be capable of conducting the activities in isolation, whilst other alternatives or competitors do not exist.

There are a fair number of environmental agreements which do not fall under Article 101 (1). Other agreements are prohibited under Article 101 (1), but because of their positive aim, they can (similarly to other types of agreements) be exempted under Article 101 (3). The conditions of exemption are the following: economic benefits, indispensability and no elimination of competition.

5.1. Economic benefits

Beside restricting competition, environmental agreements can also go hand in hand with long term economic benefits. The Commission supports the idea of environmental agreements to achieve the aims of Article 191, as long as the positive effects outweigh the negative ones.

To fulfil this condition, there must be net benefits in terms of reduced environmental pollution resulting from the agreement. If the agreement is in line with such a condition, the Commission does not take any action. In other words, the expected economic benefits must outweigh the costs. These extra costs could be the price raising effects of lessened competition, compliance costs for the parties or the decrease of quality. The basis for the exemption could be consumers' positive rate of return from the agreement under reasonable payback periods or a cost-benefit analysis.

5.2. Indispensability

For exemption, the indispensability of the means described in the agreement must be essential to achieve the environmental aim. The more objectively the economic efficiency of an environmental agreement is demonstrated, the clearer the exemption from the prohibition.

"For instance, it should be very clearly demonstrated that a uniform fee, charged irrespective of individual costs for waste collection, is indispensable for the functioning of an industry-wide collection system."[6]

5.3. No elimination of competition

The restriction of competition based on environmental aims could be justified, but the agreement must not eliminate competition in terms of product or process differentiation, technological innovation or market entry. Competition promotes innovation as well as efficient and cheaper technology, which have a positive effect on the realization of environmental aims as well.

In Hungary a modern provision exists regarding the encouragement of environmental agreements. The Hungarian Competition Act declares an exemption

[6] Guidelines on the applicability of Article 81 of the EC Treaty to horizontal agreements (2001/C 3/02).

on the basis of the improvement of environmental protection, although it has not been used in practice since it was introduced.

Act LVII of 1996 on the Prohibition of Unfair Trading Practices and Unfair Competition Session 17

The prohibition defined in Section 11 shall not apply to an agreement if:

a) it contains facilities to improve the efficiency of production or distribution, or to promote technical or economic development, or the improvement of means of environmental protection or competitiveness;

VI. Case law analysis

As can be seen from the above-introduced guideline, environmental agreements and their potential effects have to be analyzed case by case in the interest of an exemption. The following cases are good examples of agreements which could be exempted and others that could not.

The CECED case[7]

CECED is an association based in Brussels comprising manufacturers of domestic appliances and trade associations. These trade associations contain further undertakings, such as manufacturing and selling a wide range of domestic appliances under various brands in various Member States. Furthermore, the market share of the undertakings interested in CECED is over 90%.

The members of CECED concluded an agreement in which some members committed themselves to improving the energy efficiency of household dishwashers.

Household dishwashers sold in the European Union are classified and labelled according to their energy efficiency. There are seven categories of energy efficiency ranging from A to G. A is the most efficient, and G is the least efficient machine.

The aim of the agreement was to reduce the average energy consumption of dishwashers by 20% by the year 2002, so the members agreed that they would not produce or sell dishwashers with energy efficiency ratings of D to G. Due to the agreement, the choice of consumers narrowed and cheaper dishwashers were excluded from the market.

According to CECED the agreement would improve the efficiency of dishwashers sold in the European Union. Consumers would allegedly obtain savings through reduced electricity bills, which allows the recoupment of higher purchase costs.

Analysis of the case: the agreement grants the parties control over individual production and consumers' choice, which is partly focused on the environmental characteristics of the product, is reduced and prices will probably rise. Therefore the agreement falls under Article 81 (1) [now Article 101 (1) TFEU].

However, dishwashers in the category A-C significantly reduce an environmental problem, so the net contribution to the improvement of the environmental situation overall outweighs increased costs. Furthermore, with the lower running cost (reduced

[7] Notice published pursuant to Article 19 (3) of Council Regulation No 17 (O.J. 2001/C 250/02).

energy consumption), the purchasers could rapidly recoup the price increase. In addition, varied technical means are economically available to the parties in manufacturing products, which do comply with the agreement, and thus they can compete in other characteristics of the machines. Therefore, the conditions for an exemption under Article 81 (3) [now Article 101 (3) TFEU] were fulfilled.

The VOTOB case[8]

VOTOB is the Dutch association of independent tank storage enterprises. Its members offer storage facilities to the chemical industry. In order to anticipate legislation, VOTOB concluded a covenant with the Dutch authorities to reduce emissions. Because they were unable to bear the full costs themselves, VOTOB plans would be partly subsidized by the Dutch government, but ultimately the government withdrew the aid.

Even so, VOTOB decided to continue with the implementation of its covenant obligations and collected the extra environmental cost from the real polluters, namely, the chemical industry. The parties added to their prices a uniform fixed environmental surcharge, which would compensate for the loss of the subsidy. Furthermore, it was listed separately on the invoices.

The Commission established that the above-mentioned behaviour was a price fixing agreement. The uniform surcharge does not motivate environmental developments and the real environmental cost also remains hidden. Therefore these types of agreements are prohibited under Article 81 (1) [now Article 101 (1) TFEU].

Analysis of the case: the uniform surcharge could not act on undertakings in a different situation. It did not motivate the undertakings to make developments in relation to the reduction of emission. It was only a flat rate, behind which the real cost of pollution remained hidden. Competition was excluded and the consumers had not received any benefit from the agreement. This type of behaviour is therefore prohibited.

VII. Conclusion

Environmental protection and competition have a parallel "connection". A process has recently begun in the European Union to integrate these two fields. Competition is crucial to the achievement of sustainable development, otherwise development could not continue. With the internalization of the environmental externalities, competition could help in a more efficient way.

The environment constitutes a value, but the economy (which is protected by competition law) is only a means, so if the two fields collide, environmental protection has to have priority. This theory is not declared, even if there are "guidelines" which set the course. However, we should keep in mind that competition is the inducement of development, so it should not be excluded totally.

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[8] Eric w. Orts – Kurt Deketelaere: *Environmental contracts: comparative approaches to regulatory innovation in the United States and Europe.* Kluwer Law International, 2001, 257.