The role of environmental protection in EC competition law and policy

Kingston, S.E.J.

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Promotor:	prof. dr. P.J. Slot
Overige leden:	prof. dr. L.J. Brinkhorst
	prof. L. Krämer, (College of Europe, België en Universiteit van Bremen, Duitsland)
	prof. dr. M. Pallemaerts (Universiteit van Amsterdam)
	dr. J. Temple Lang (Trinity College Dublin, Ierland)
	prof. dr. J.J.M. Theeuwes (Universiteit van Amsterdam)
	prof. dr. R.C. Tobler
	prof. F.O.W. Vogelaar (Universiteit van Amsterdam)

Do m'athair agus i gcuimhne mo mháthair

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Chapter 1: Introduction

> *"I have referred to [antitrust] as a subcategory of ideology; it is not far-fetched to view antitrust as a microcosm in which larger movements of our society are reflected and perhaps, in some small but significant way, reinforced or generated. The walls of ideological subcategories are permeable; battles fought and won or lost in one are likely to affect the outcome of parallel struggles in others."*[1]

Bork, Introduction to *The Antitrust Paradox*, at 10

This thesis considers whether environmental protection factors presently play any role in Community competition policy, and whether they should play a role.

These questions are likely, on their face, to elicit one of two instinctive reactions. On the one hand, those familiar with the present movement of the Commission towards more scientific, economics-based competition analysis, inspired by the so-called "Chicago School" US-led body of competition theory,[2] will probably answer that "non-economic" factors, including environmental protection, are best dealt with by legislation, not by competition policy; that such factors will simply distort the efficiency of competition policy. On the other hand, those aware of the trend towards the use of economics-driven, "market"-based regulatory instruments in Community and Member State environmental policies, of the Community's obligation to integrate environmental protection requirements into all of its policies, and of the urgent need to increase the effectiveness of environmental protection, will likely be dissatisfied with this response. We live in a time where "green thinking" should pervade every aspect of regulation: why should competition policy be an exception?

This thesis investigates which position is most defensible. More broadly, it has three overarching aims. The first aim is to set out a sound theoretical framework for analysing the proper relevance of environmental factors to Community competition analysis, and to provide practical proposals for how such theoretical analysis should change present Community competition enforcement practice. The second aim is to bring an interdisciplinary analysis to bear on the issue. In the present author's view, a convincing answer to the above questions demands a broader approach than a purely legal one, drawing on the disciplines of economics and political science. The third aim is to bridge the schism which is sometimes evident between academic discourse in the competition policy and environmental policy fields, in particular by considering the implications of market-based environmental policy approaches for competition policy.

The thesis is divided into three Parts. Part I takes an environmental policy perspective. It first considers the principal developments in Community environmental policy which are of potential relevance to competition policy, focusing in particular on the ambiguous notion of "sustainable development" and on the requirement laid down in the EC Treaty to integrate environmental protection requirements into other Community policies. Second, it examines the distinction between direct environmental regulatory instruments and market-based (economic) environmental regulatory instruments, and looks at the most important market-based instruments used in Community environmental policy to date.

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[1] Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York, Basic Books, 1978, 1993 reprint with new introduction and epilogue), at 10.

[2] In the development of which Robert Bork's *The Antitrust Paradox*, quoted above, played a pivotal role.

Part II shifts to a perspective from competition theory. It first surveys the approaches taken by the leading schools of competition thought to the role of non-economic factors in competition analysis. Second, it focuses on environmental factors, and asks whether, as a normative matter, they ought to be excluded from competition analysis. Three theoretical arguments are put forward for why this should not be so, and a theoretical framework is set out for deciding when and how to take environmental factors into account in competition decisions.

Part III examines, as an empirical matter, what the present approaches to environmental factors are in the various fields of Community competition policy, namely Articles 81, 82, 86 and 87 EC, as well as in Community merger policy. Using Part II's theoretical conclusions, it considers whether, as a normative matter, these approaches are defensible and, where this is not the case, proposes alternative approaches.

Finally, Part IV summarises the conclusions of the research.

Part I: An Environmental Policy Perspective – Developments in Community Environmental Policy of Relevance to Competition Policy

In order to understand the potential significance of environmental policy to Community competition law analysis, it is first necessary to be familiar with certain key features of this policy. This Part outlines the principal developments in Community environmental policy since its inception which are of potential importance to competition analysis. Chapter 2 gives a brief overview of the main stages in the evolution of Community environmental law from 1957 to date, and focuses on two elements of Community environmental policy of particular importance to competition policy: the ambiguous notion of "sustainable development" and the imperative of integrating environmental protection requirements into other Community policies. Chapter 3 examines the distinction between direct and market-based (economic) environmental regulatory instruments. Finally, Chapter 4 examines the three market-based instruments used in Community environmental policy which are of most importance to Community competition policy: state subsidies and taxes, tradable permit schemes, and voluntary environmental agreements.

Chapter 2: The Evolution of Community Environmental Policy and the Role of Sustainable Development and the Integration Principle

This Chapter aims first to outline the principal formative stages in the development of Community environmental policy, describing its spectacular growth from an area not mentioned at all in the 1957 Treaty of Rome to its position 50 years later as, in the perception of many, one of the pre-eminent EU competences. Second, it takes a closer look at two features of Community environmental policy which, it will be argued, are of particular relevance to competition analysis: the aim of "sustainable development" and the obligation to integrate environmental policy into other Community activities (the "integration" principle).

1. A swift tour through the evolution of Community environmental policy since 1957[1]

The remarkable development in the Community's environmental policy may usefully be broken down into five periods: 1957 – 1972, 1973 – 1986, 1987 – 1992, 1993 – 1998 and 1999 – present.

a. Prelude: 1957 – 1972

The beginnings of the Community's environmental policy were inauspicious. There was no express mention of the area at all in the 1957 Treaty of Rome. This was, of course, due to the essentially economic impetus for the 1957 Treaty: although the achievement of peace was at the long-term core of the EEC project, this was, following the vision of Robert Schuman and Jean Monnet, to be achieved by setting specific economic aims.[2] Nor was this surprising: when the Treaty of Rome was concluded, the field of "environmental" law, as we now know it, was a relatively new area within the signatory Member States, though national laws had long existed governing certain aspects of the current field, such as rules on private property and public health.[3] At international level, a collection of rules was just beginning to emerge in discrete environment-related areas, a process which had begun with the bilateral fisheries treaties of the mid-nineteenth century and in which the 1949 United Nations Conference on the Conservation and Utilisation of Resources (UNCCUR) was a landmark event. These developments undoubtedly contributed to the subsequent emergence of Community environmental law.

Despite the Treaty of Rome's lack of an express "environmental" chapter, 1957 – 1972 nonetheless constitutes the first period of what can now be viewed as the Community's environmental policy. As such, it broadly corresponds to what Joseph Weiler has termed the "foundational period" of Europe – a period in which the Community "*assumed, in stark change from the original conception of the Treaty, its basic legal and political characteristics.*"[4] Though "environmental" discourse became increasingly prevalent in the late 1950s and

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[1] See, further, for example, Jans and Vedder, *European Environmental Law* (Groningen, Europa, 2008), Chapter 1; Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), 740; Sands, 'European Community Environmental Law: The Evolution of a Regional Regime of International Environmental Protection' (1991) 100 Yale Law Journal 2511; Holder and Lee, Environmental Protection, Law and Policy, 155; Krämer, "Thirty years of EC environmental law: perspectives and prospectives" (2000) Yearbook of European Environmental Law 155; McGillivray and Holder, Locating EC Environmental Law (2001) 2 Yearbook of Environmental Law 67.

[2] Thus, by the preamble to the 1957 Treaty, Europe was to be built "*through practical achievements which will first of all create real solidarity, and through the establishment of common bases for economic development.*"

[3] See Lazarus, *The Making of Environmental Law* (Chicago, University of Chicago Press, 2004) and Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), 25-35.

[4] Weiler, The Transformation of Europe (1991) 100 Yale L.J. 2403, 2410.

in the 1960s at international level,[5] there was little appetite for Community activity in the environmental field as the institutions and Member States alike were immersed in the task of defining the Community legal and political order in this period. At a legal level, the European Court of Justice was preoccupied with "constitutionalising" the Community legal order (via the doctrines of direct effect, supremacy, implied external powers, and so on) - which doctrines were quite controversial enough without at the same time trying to read a Community environmental competence into the Treaty. At a political level, this period marked the rather painful hammering out of far-reaching veto rights for Member States in the Council of Ministers (via de Gaulle's 1965 "empty chair" policy and the subsequent Luxembourg Accord, in effect preserving a right of veto for Member States over proposed Community legislation).

Nonetheless, a small amount of Community legislation was adopted in these years on what would now be considered to be "environmental" matters. In this period, as well as in the second period (1972 – 1986), two legal bases were used for such legislation, each requiring unanimity of voting in the Council. The first was Article 100 (now Article 94 EC), empowering the Council to "issue Directives for the approximation of such provisions laid down by law, regulation or administrative actions in Member States as directly affect the establishment or functioning of the common market". The second was Article 235 (now Article 308 EC), empowering the Council to adopt measures where "action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community" and where the Treaty had not provided the necessary powers. The Community's first legislative attempt to address environment-related issues was the 1967 adoption of a Directive on the classification, packaging and labelling of dangerous substances:[6] based on Article 100, however, it was explicitly aimed at removing the hindrances to trade caused by differing national legislation on the matter, rather than at environmental protection *per se*.[7] This early legislation, therefore, was premised on economic, rather than environmental, reasoning - any achievement of environmental improvement by Community legislation was, in principle, a side effect.

b. The true beginnings: 1973 - 1986

The first real sign of a distinct Community environmental policy came in the run-up to the landmark 1972 United Nations Conference on the Human Environment in Stockholm, convened in 1968 by the United Nations General Assembly.[8] In this way, the birth of Community environmental law occurred simultaneously with the beginning of a new period in international environmental law: as concern mounted for the "*continuing and accelerating impairment of the quality of the human environment*",[9] the impetus for international and regional environmental action grew. Thus, while Article 2 of the Treaty of Rome, which set out the EEC's aims, had listed among these aims "*a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, and accelerated raising of the standard of living*", the 1972 Paris Summit of the European Council made clear that to focus solely on economic growth was wrong-headed, declaring that

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[5] See Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), at 32-34.

[6] Directive 67/548 OJ 1967 L 196/1 (subsequently amended).

[7] However, protection of public health was mentioned as an aim in the preamble.

[8] UNGA Res. 2398 (XXIII)(1968). See Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), 36-40.

[9] Resolution adopted in July 1968 and a precursor to the convening of the Stockholm Conference: ECOSOC Res. 1346 (XLV)(1968).

"*economic expansion is not an end in itself. Rather, its aim is to reduce disparities in living conditions and to improve the quality and standard of living.*" The declaration continued,

> "*as befits the genius of Europe, particular attention will be given to intangible values and to protecting the environment so that progress may really be put to the service of mankind.*"[10]

The Commission had already, however, got the ball rolling: the Paris Declaration followed the Commission's 1970 announcement that it would draw up a Community action programme on the environment, and the 1971 Commission Communication on Community environmental policy, in which it proposed using Article 235 (now 308 EC) as a legal basis for potential Community environmental measures.[11] In 1973, the first Action Programme for the Environment was adopted, in the form of a political declaration by the Council and the representatives of Member States' governments meeting in the Council, due to France's concern that the Treaty provisions were, in their then form, not an appropriate basis for a European environmental policy.[12] In setting out the Community's environmental programme for the next four years, the First Action programme specified that the Community's Article 2 task of promoting throughout the Community a harmonious development of economic activities and a continuous and balanced expansion "*cannot now be imagined in the absence of an effective campaign to combat pollution and nuisances or of an improvement in the quality of life and the protection of the environment.*"[13]

By thus reading in environmental protection as a necessary component of the aim of achieving economic growth, despite the fact that it was not expressly mentioned as an Article 2 aim of the Community, the programme opened the way for the adoption of Community environmental legislation. This movement was very much rooted in a what may be viewed as a form of neo-functionalism, in that the adoption of environmental law and policy took place as a functional "spillover" from the primary economic aims of the Community.[14] Following the first Action programme, three further Action programmes were adopted between 1972 and 1987.[15] More than 150 pieces of Community environmental legislation were passed between 1972 and 1987, covering such diverse areas as environmental impact assessments, waste control, the protection of flora and fauna, and water and air quality.[16] In addition, the Community signed its first international environmental treaties in this period.[17] Such legislation was, by necessity, based on either Article 100 (where it could be argued that the legislation aimed to help

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[10] Paris Declaration of the European Council, cited in the preamble to the First Action Programme on the Environment, OJ 1973 C 112/1.

[11] Commission Communication on a Community Policy for the Environment SEC (71) 2616 (July 22, 1971).

[12] See Krämer, *EC Environmental Law* (London, Sweet and Maxwell, 6th edition 2006), ch. 1.

[13] Preamble to the First Action Programme on the Environment, OJ 1973 C 112/1.

[14] On neo-functionalism generally, see, for example, Haas, "European Integration: The European and Universal Process" International Organization 4 (1961) 607, Greilsammer, Theorising European Integration in its Four Periods, 2 Jerusalem Journal of International Relations (1976) 129 and Weiler, The Transformation of Europe (1991) 100 Yale L.J. 2403, 2455.

[15] Second Programme (1977 – 1981) OJ 1977 C 399/1, Third Programme (1982 – 1986) OJ 1983 C46/1, Fourth Programme (1987 – 1992) OJ 1987 C 328/1.

[16] See, for example, Directive 85/337 on environmental impact assessments OJ 1985 L 175/40, Directive 75/442 on waste OJ 1975 L 194/23, Directive 79/409 on the conservation of wild birds OJ 1979 L 103/1, Directive 75/440 on surface water OJ 1975 L 194/26, Directive 84/360 on the combating of air pollution from industrial plants OJ 1984 L 188/20.

[17] See, for example, the Paris Convention for the Prevention of Marine Pollution from Land-Based Sources, Decision 75/437 OJ 1975 L 194/5.

achieve the common market)[18] or Article 235 (where no common market rationale could reasonably be found, but there were non-economic reasons for action at Community level);[19] indeed, most legislation was based on both articles.[20] In 1985, the ECJ in the landmark *ADBHU* case confirmed the validity of using Article 235 EC as a legal basis for environmental legislation on the basis that environmental protection was "one of the Community's essential objectives" justifying certain limits on the principle of freedom of trade.[21] In so holding, the ECJ gave important approval of the Paris Summit's approach that environmental aims were inherent to the Community's objective of economic expansion – meaning that, before any appearance of an environmental title in the Treaty, the enaction of Community environmental legislation lacking any obvious economic motivation was permissible.[22] This significant judgment, with its constitutionalising effects, was one of the first indications of the pro-environment stance for which the ECJ has since become known.

c. Formalisation of status: 1987 – 1992

The rather uncertain status of Community environmental policy was formalised by Article 25 of the Single European Act (SEA) 1986, which inserted a new Title VII on the Environment into the Treaty,[23] making environmental protection an express objective of the Community. While it was clear that this remained an ancillary, "flanking", policy to the primary Community aim of achieving the internal market, the Title nonetheless contained a specific legal basis for environmental legislation (Article 130s), making it unnecessary to find an economic justification for the legislation or to use the "catch-all" Article 235 provision. Voting remained, however, subject to unanimity under Article 130s, though Member States could maintain or introduce more stringent protective measures than those passed on the basis of Article 130s, if compatible with the Treaty and notified to the Commission (Article 130t, one of the so-called "environmental guarantee" provisions).[24]

In contrast, and equally as importantly for the development of the Community's environmental policy, the SEA introduced a new Article 100a allowing internal market legislation (with some exceptions) to be passed by qualified majority – a revolutionary development which greatly freed up the legislative process.[25] Moreover, environmental measures passed under this provision had to take "as a base a high level of

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[18] For example, Directive 80/778 on drinking water OJ 1980 L 229/11, Directive 73/404 on detergents OJ 1973 L 347/51. The practice of basing such legislation on Article 100 was in principle confirmed as compatible with the Treaty by the ECJ in Case 92/79 *Commission v Italy* [1980] ECR 1115.

[19] See, for example, Directive 79/409 on the conservation of wild birds OJ 1979 L 103/1.

[20] See, for example, Directive 85/337 on environmental impact assessments OJ 1985 L 175/40, Directive 84/360 on combating air pollution from industrial plants OJ 1984 L 188/20, and Directive 78/319 on toxic and dangerous waste OJ 1978 L 84/43.

[21] Case 240/83 *ADBHU* [1985] ECR 531, para 13.

[22] The judgment should be seen in the context of what Weiler has termed the "*mutation*" of jurisdiction and competences which occurred in the Community between 1973 and 1986, entailing the "*brick-by-brick demolition of the wall circumscribing Community competences*." Weiler, "The Transformation of Europe" (1991) 100 Yale L.J. 2403, 2449.

[23] Articles 130r-t – present Articles 174 – 176 EC.

[24] On the functioning of Article 130t (now Article 176 EC), see, for example, Case C-6/03 *Deponiezweckverband Eiterköpfe* v *Land Rheinland-Pflaz* [2005] ECR I-2753.

[25] The insertion of this Article led to a myriad of legal basis disputes before the ECJ on the question whether a given piece of environmental legislation ought to have been passed on the basis of Article 130t (unanimous voting, consultation of the Parliament) or Article 100a (qualified majority voting, cooperation procedure with the Parliament), such as Case C-300/89 *Commission v Council (Titanium Dioxide)* [1991] ECR 2867.

environmental protection"[26] and Member States had the possibility of notifying the Commission if they deemed it necessary to "apply" national provisions in order to protect the environment despite the adoption of Community harmonising legislation (another environmental guarantee provision).[27]

The SEA expressly set out the objectives of the newly formalised Community environment policy (Article 130r(1)) – preserving, protecting and improving the quality of the environment, contributing towards protecting human health, and ensuring a prudent and rational utilization of natural resources. Importantly, it also set out a number of what it termed "principles", which were to form a foundation of the Community's environmental policy (Article 130r(2)). These were: (1) the principle that "*preventive action should be taken*"; (2) the principle that "*environmental damage should as a priority be rectified at source*"; (3) the principle that the polluter should pay; and (4) a type of "integration" principle, requiring that environmental considerations be "*a component of the Community's other policies*" – a concept which will be discussed in detail below. Although not forming part of Article 130r(2), another *de facto* "principle" of environmental law formalised by the SEA was that of subsidiarity (Article 130r(4)).[28] The SEA also made express provision for the Community to participate in international environmental agreements (Article 130r(4)).

Pursuant to these changes, a separate Directorate-General for the Environment (at that time, "DG XI") was formed in the Commission. These developments had a momentous effect on the development and formalisation of the Community's environmental policy. The amount and scope of Community environmental legislation increased steadily.[29] Some of the Commission's proposals - for example, the proposal for a carbon tax, discussed in Chapter 4 - were, at the time, too ambitious for the Member States, however, and were put to one side.

d. Consolidation: 1993 – 1998

The entry into force of the Maastricht Treaty brought with it a subtle upgrade in the perceived importance of the Community's environmental policy compared to other policies. Immensely politically significant was the first insertion into Article 2 EC - the fundamental aims of the Community - of an express reference to environmental protection, including as one of the aims of the Community "*the promotion, throughout the Community, of a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment.*" Though this was criticised by some as a pale imitation of the true concept of sustainable development, Maastricht also introduced substantial, more practical, changes for the Community's environmental policy - most

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[26] Article 100a(3).

[27] See Article 100a(4), "*If, after the adoption of a harmonization measure by the Council acting by a qualified majority, a Member State deems it necessary to apply national provisions on grounds of major needs referred to in Article 36, or relating to protection of the environment or the working environment , it shall notify the Commission of these provisions. The Commission shall confirm the provisions involved after having verified that they are not a means of arbitrary discrimination or a disguised restriction on trade between Member States.*"

[28] Article 130r(4) provided that, "*The Community shall take action relating to the environment to the extent to which the objectives [of Community environmental policy, set out above] can be attained better at Community level than at the level of the individual Member States.*" The notion of subsidiarity had been present from the beginning in the Community's environment policy, featuring prominently in the Community's First Environment Programme.

[29] Significant legislation passed included including legislation creating the European Environment Agency and legislation introducing an eco-label for environmentally-friendly products (Regulation 1210/90 on the Establishment of the European Environment Agency and the European Environment Information and Observation Network OJ 1990 L 120/1, Regulation 880/92 on a Community eco label award scheme OJ 1992 L 99/1).

notably, the introduction of qualified majority voting for the environment legal basis (Article 130s EC, subject to certain express exceptions);[30] the formalisation of the status of the environmental action programmes;[31] and the addition of the "precautionary principle"[32] to the principles of the Community's environmental policy. Further, the Treaty definition of the "integration principle" was beefed up, from the SEA's requirement that environmental considerations be a "component" of other Community policies to the requirement that, "*environmental protection requirements must be integrated into the definition and implementation of other Community policies*" (emphasis added). Finally, the principle of subsidiarity, which had been inserted by the SEA into the title on the environment, was elevated to Part One of the Treaty, on the fundamental "Principles" of the Community (Article 3b) – meaning it was henceforth horizontally applicable to all areas of Community competence save, by its terms, areas of exclusive Community competence.[33]

e. Further promotion: 1999 – present

The Treaty of Amsterdam, which entered into force in May 1999, marked a further promotion and concretisation of the Community's environmental aims. First, it introduced the promotion of a "*high level of protection and improvement of the quality of the environment" as an Article 2 EC objective of the Community*.[34] This clearly represented a significant elevation in status – albeit in the form of a policy guideline, rather than a legal rule. At the same time, it modified the wording of Article 2 EC to refer to the aim of promoting a "*harmonious, balanced and sustainable development of economic activities*" (in place of the SEA's reference to "*balanced development*" and "*sustainable growth*"). Likewise, the Treaty on European Union was amended to include among its objectives the promotion of "*economic and social progress and [of achieving] balanced and sustainable development.*"[35] Second, the integration principle followed subsidiarity in being upgraded from its position in the Environment Title (former Article 130r EC) to be included in Part One of the Treaty on the "Principles" of the Community - becoming Article 6 EC, and for the first time

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30 See Article 175(2) EC (fiscal measures and measures concerning town and country planning, land use other than waste management, and management of water resources remained subject to unanimity of voting).

31 Article 175(3) EC. This led to, *inter alia*, the avoidance of specific commitments in such programmes, and a preference instead for language such as "*priority areas for action*": see Krämer, "Thirty years of EC environmental law: perspectives and prospectives" (2000) Yearbook of European Environmental Law 155, 164.

32 Although this is not defined anywhere in the Treaty, the Commission has come close to a definition in its Communication on the Precautionary Principle (COM (2000)1 final) as a risk management strategy to be employed "*when there are reasonable grounds for concern that potential hazards may affect the environment or human, animal or plant health, and when at the same time the available data preclude a detailed risk evaluation*" (meaning that the benefit of the doubt may be given to protection of health).

33 In addition, Community financial support for environmental projects was bolstered by the insertion of Article 130d(2) (present Article 161(2) EC), providing for a Cohesion Fund to be set up in the field of the environment.

34 It also modified the wording of Article 2 EC to refer to the aim of promoting a "*harmonious, balanced and sustainable development of economic activities*"

35 Article 2, TEU, from the Maastricht version of promotion of "*economic and social progress which is balanced and sustainable.*" Further important environmental changes brought about by Amsterdam were: (1) the "environmental guarantee" provisions of Article 95 (ex 100a) EC were expanded to specify that Member States could, despite the passing of Community harmonisation measures, maintain in force existing environmental measures or introduce new environmental measures, as long as these measures satisfy the requirements set out in Articles 95(4) or (5) EC respectively; and (2) the switch in decision-making procedures for (as it then was) Article 130s EC (present Article 175 EC) from the co-operation procedure to the co-decision procedure. While this did not as such make passing environmental legislation easier, or improve the standard of environmental protection, it meant a greater, co-legislative role for Parliament, thus increasing the democratic credentials of Community environmental legislation.

specifying the promotion of sustainable development as its principal aim. This change has, it will be argued, important implications for the principle's function and the importance of the duty which it places on those defining and implementing Community policies and activities.[36]

As a result of, *inter alia*, these Treaty changes, we have seen a huge surge from this period to date in the amount of Community environmental legislation emanating from Brussels, generally corresponding to the "priority areas" flagged in the applicable Environmental Action Programmes.[37] This has also been reflected in the remarkable increase in the environmental cases coming before the Court over the last 10-15 years.[38] These cases have dealt with sectoral issues ranging from issues of interpretation of secondary legislation such as the Waste Directive, the Wild Birds Directive and the Habitats Directive, to more horizontal "constitutional" issues such as in the landmark ruling that the Commission is entitled to base proposals requiring Member States to criminalise serious environmental offences on a legal basis in the EC, rather than the EU, Treaty.[39]

No significant change was made to the environmental provisions by the Treaty of Nice.[40] Nor will the Lisbon Treaty, if and when ratified by all Member States, bring substantial changes in these provisions. In particular, though environmental values do not feature in the new Article 2 EU list of values upon which the Union is "*founded*", Article 3(3) EU provides that the Union, "*shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment.*"[41] The Lisbon Treaty retains the Constitutional Treaty's provision specifying that one of the goals of the Union's external relations policy is the "*sustainable development of the Earth*" (Article 3 EU). This is confirmed, and more detail added, by Article 10a EU.[42]

As regards the Treaty on the Functioning of the European Union (TFEU), the present Article 6 EC environmental integration principle has been shifted to Article 11 TFEU,

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[36] On the implications of this shift, see Wasmeier, The integration of environmental protection as a general rule for interpreting Community law (2001) CML Rev 159, at 161.

[37] For example, the Fifth Environmental Action Programme entitled "Towards Sustainability", which covered the period from 1993 to 2001, saw particular legislative activity in the Programme's eight "priority" areas: climate change and ozone layer depletion; air quality; nature protection and biodiversity (e.g., the Habitats Directive); management of water resources; the quality of the urban environment; noise; regulating coastal zones; and waste management.

[38] See further, Jacobs, "The Role of the European Court of Justice in the Protection of the Environment" Journal of Environmental Law 18 (2006) 185. For instance, Jacobs observes that nigh on one third of all of the Article 226 EC infringement cases lodged before the ECJ are environmental cases: *ibid.* Insofar as particular Community environmental legislative and policy measures or Court judgments are of relevance to competition policy, they will be considered in subsequent Chapters.

[39] Case C-176/03 *Commission* v *Council* [2005] ECR I-7879.

[40] The institutional changes made in preparation for the challenges of enlargement are clearly equally relevant to the legislative procedure for environmental legislation, however.

[41] It is interesting to contrast this with the arguable "demotion" of competition policy in Article 3 EU, with the removal from the list of the former Article 3(1)(g) EC activity of "*a system ensuring that competition in the internal market is not distorted*" at the behest of French premier Nicolas Sarkozy. The significance of this will be discussed further in Chapter 6.

[42] Article 10a EU includes as part of the EU's aims in external relations the aim of fostering "*the sustainable economic social and environmental development of developing countries*", though this is explicitly "*with the primary aim of eradicating poverty*". New Article 4 TFEU confirms that competence to make environmental policy is shared between the Member States and the Union. Note that the term "Community" is deleted from the Treaties by the Lisbon Treaty, with all references to "Community" becoming references to "Union".

under the heading "*Provisions having general application*".[43] As such, this maintains the upgrading achieved by the Treaty of Amsterdam from the sectoral, environment-specific provisions of the Treaty to its horizontally-applicable provisions. Further, other diluted forms of integration principle have been added under this heading (e.g., on discrimination and equality), though these are less strongly worded than Article 11 TFEU. Under the environmental title, the Article 174 TFEU aims of the Union's environmental policy are amended so as explicitly to include the fight against climate change as one of the regional or worldwide problems with which the Union's international action in the environmental field is tasked with dealing.[44] Further, a *passerelle* clause is included in the environmental legal basis provision, Article 175 TFEU, whereby those exceptionally sensitive areas which have to date been subject to unanimity of voting[45] may be made subject to qualified majority voting following a unanimous decision of the Council and after consultation of the Parliament – without the necessity for Treaty amendment. Finally, under the title on energy, the aims of the EU's energy policy are specified to include "*the development of new and renewable forms of energy*".[46]

2. Focus on sustainable development and the integration principle

From this brief historical overview of the substantial formal changes in Community environmental law since 1957, we can extract two elements of Community environmental policy which, it will be argued, are of particular relevance to competition policy: the aim of sustainable development and the integration principle. These elements are widely viewed as forming part of the trend towards "modernisation" of environmental policy, a trend which aims at integrating economic and environmental interests into decision-making to arrive at what are often termed "win-win" solutions.[47] Although formally separate principles of Community law, they are closely linked: each is premised on the belief that economic growth may be achieved while respecting and even promoting environmental protection; and each has come under fire for being unimpeachable in principle, but unattainable in practice. This section analyses the meaning of each of these principles. The analysis will form the basis of the assessment of the implications of these principles for competition policy in Parts II and III.

a. The role of the "sustainable development" goal in Community law and policy

i. Economic origins of the goal

The principle of sustainable development is, in essence, an attempt to "solve" one of the classic problems with which economists have tried to grapple for years: the "sustainability" problem. This problem may be summarised briefly thus.[48] The human population is increasing rapidly - according to the UN, the world's population will

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[43] It is also present in the Charter of Fundamental Rights, to which Article 6 EU accords binding status by reference, at Article 37, "A high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the Union and ensured in accordance with the principle of sustainable development."

[44] Article 174(1) TFEU, fourth indent.

[45] For example, town and country planning.

[46] Article 176a TFEU.

[47] See European Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final: "*by adapting and building on existing environmental policy approaches and seeking win-win solutions*."

[48] Perman, Ma, McGilvray and Common, *Natural Resources and Environmental Economics* (3rd ed., Essex, Pearson Education Limited, 2003), ch. 2.

increase by 2.5 billion by 2050, from the 2006 figure of 6.7 billion to 9.2 billion.[49] Much of this population is desperately poor. As poverty alleviation which depends on redistribution from the better-off to the poor encounters resistance from the better-off, many economists' standard solution to poverty is economic growth - thus increasing the size of the "cake" to be distributed.[50] However, the world's resource base is limited, and the economy and the environment are inextricably inter-related.[51] An increase in population size and *per capita* affluence will inevitably, in most economists' view, have a greater impact on the environment.[52] The sustainability problem, from an economist's perspective, is therefore: How can poverty be alleviated in a way which does not affect the natural environment such that future economic prospects suffer?[53]

There is, as one might predict, a huge spectrum of views among economists as to the best answer to this question. Some economists think that economic growth has, ultimately, positive effects on the environment. This view is epitomised by Beckerman, who argues that, because there is a strong correlation between incomes and the extent to which environmental protection measures are adopted, "*in the longer run, the surest way to improve your environment is to become rich.*"[54] Such economists often reach this conclusion on the basis of what is termed the "environmental Kuznets curve". Under this view, a relationship exists between environmental degradation and affluence similar to the Kuznets curve - that is, the inverted "U" figure which Kuznets posited existed between inequality in income distribution and affluence (Figure 1 below).

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[49] UN Press Release of 13 March 2007, POP/952, available at: http://www.un.org/News/Press/docs//2007/pop952.doc.htm.

[50] Indeed, one of the leading economists of the twentieth century, J.M. Keynes, viewed economic growth as the potential solution to what was taken to be the ultimate economic problem - the problem of scarcity - such that economists themselves would become redundant.

[51] For example, the environment performs essential services enabling economic activity, such as providing a resource base (e.g. for extraction of minerals), a waste sink, and a base for amenity services (e.g., recreation), not to mention its overarching "life support" service to all plant and animal life. See further, Chapter 8.

[52] A useful, though simple, equation used by economists to denote the interrelationship between economic activity, population and the environment is the "IPAT identity": I = P x A x T, where I is impact on the environment, measured as mass or volume; P is population size; A is per capital affluence, measured in currency units; T is technology, meaning the amount of the resource used or waste generated per unit production. See Perman et al, note 2 above, at 29.

[53] Perman et al, note 48 above, at 16.

[54] Beckerman, "Economic Growth and the Environment: Whose Growth? Whose Environment?" World Development 20, 481-496, (1992).

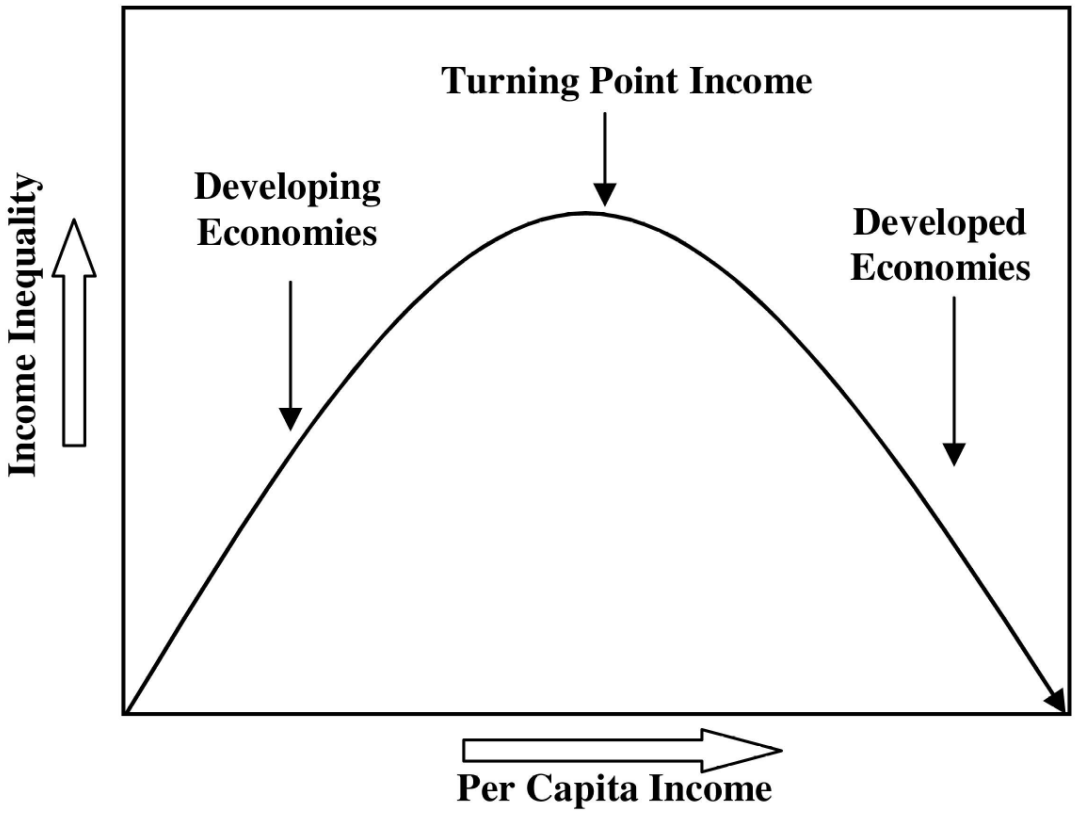

Figure 1: Model Kuznets Curve[55]

In an "environmental Kuznets curve", the "income inequality" axis is replaced by an "environmental degradation" axis (e.g., pollution). Essentially, the argument is that, at the outset of economic development, industrialisation increases and agricultural and other resource extraction intensifies, meaning that resources are depleted more quickly than they are generated and waste generation increases sharply. As development progresses, however, the importance of information-based industries and the services sector in the economy tends to grow. This factor, combined with greater environmental awareness, the development of environmental regulation, better technology and more expenditure on environmental protection, puts a stop to environmental degradation and ultimately results in environmental improvement.[56]

If the environmental Kuznets curve hypothesis held, this would imply that, far from there being a conflict between economic growth and environmental protection, economic growth in fact holds the key to environmental improvement in the long run - though it is damaging to the environment in the short- and medium-term.

The truth of the environmental Kuznets curve hypothesis is, however, hotly disputed as an empirical matter.[57] Many economists argue that there are definite limits placed on

[55] Adapted from Kuznets, "Economic growth and income inequality" American Economic Review 49, 1-28 (1955).

[56] See further, Panayotou, Empirical Tests and Policy Analysis of Environmental Degradation at Different Stages of Economic Development, Working Paper WP238, Technology and Employment Programme, International Labor Office, Geneva (1993).

[57] See further, for example, Panayotou, "Economic Growth and the Environment", Paper prepared for and presented at the Spring Seminar of the United Nations Economic Commission for Europe, Geneva, March 3, 2003, available at: http://www.unece.org/ead/sem/sem2003/papers/panayotou.pdf. For a scientific (and surprising) view, arrived at after a large scale scientific investigation, that the environmental

economic growth by the environment and by the fact that natural resources are limited. This view was epitomised by the work of Meadows et al in their 1972 publication, *The Limits to Growth* (also known as the "Club of Rome" report), which was highly influential at the time.[58] Taking as premises the ideas that there are limits to the amount of land available for agriculture, limits to the agricultural output of land, limits to the amounts of non-renewable resources available for extraction, and limits to the environment's ability to assimilate waste, their conclusions were that, if present growth trends in world population, industrialisation, pollution, food production and resources depletion continue, the limits to growth on Earth would be reached sometime within the next 100 years. The most probable result of this, in their view, would be a "*sudden and uncontrollable decline in both population and industrial capacity*." They noted, however, that it may be possible to change these trends and to achieve a sustainable global equilibrium, so that the basic material needs of each person on Earth might be satisfied. The authors updated and reconfirmed their findings in 1992, on the occasion of the UNCED conference in Rio de Janeiro.[59]

The original Club of Rome report set the economic foundation for the policy developments of the early 1970s in sustainable development at international and Community level.

ii. The emergence of sustainable development as an international policy goal

Promoted to the fundamental objectives of the Community in Article 2 EC by the Treaty of Amsterdam, the concept of "sustainable development" was put forward by the 1987 Brundtland Report of the UN's World Commission on Environment and Development, entitled *Our Common Future*. That report coined what has become the classic definition of sustainable development, as,

> "*development which meets the needs of the present without compromising the ability of future generations to meet their own needs*."[60]

Brundtland went on to set out a broad concept of sustainable development, with two distinct elements – one social, one environmental: (1) the (social) aim of "meeting the basic needs of all and extending to all the opportunity to fulfil their aspirations for a better life"; and (2) the limited nature of environmental resources by the state of technology and society and by the biosphere's ability to absorb the effects of human activities.[61] The multifaceted nature of the concept was developed by the 1992 UN Convention on Environment and Development (UNCED) in Rio in its principle 3, "*the right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations*"; and principle 4, "*in order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.*" The Rio conference led to the development of "Agenda 21" - a non-binding "*blueprint for action*" towards a "*global partnership for sustainable development*",

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Kuznets curve hypothesis only holds true for birds, see Naidoo and Adamowicz, "Effects of Economic Prosperity on Numbers of Threatened Species", Conservation Biology, 15(4), 1021 (2001).

[58] Meadows, Meadows, Randers and Behrens, The Limits to Growth: A Report for the Club of Rome's project on the Predicament of Mankind (New York, Earth Island, Universe Books, 1972). See further, Dobson, *Green Political Thought* (London, Routledge, 2000).

[59] Meadows, Meadows and Randers, Beyond the Limits: Global Collapse or a Sustainable Future (London, Earthscan, 1992).

[60] Brundtland et al, *Our Common Future* (Oxford, Oxford University Press, 1987).

[61] This acceptance of certain "limits to growth" was an attempt at a compromise between advocates of economic growth in the 1970s/1980s and those who believed that there were strict limits to growth as the earth's resources are finite.

which was adopted by 178 governments of UN members at the UNCED conference in 1992.[62] The theme was continued in the Declaration of the 2002 UN World Summit on Sustainable Development (WSSD) in Johannesburg, by which the signatories agreed to,

> "*assume a collective responsibility to advance and strengthen the interdependent and mutually reinforcing pillars of sustainable development - economic development, social development and environmental protection - at the local, national, regional and global levels.*"[63]

The Johannesburg Declaration illustrates well what have come to be accepted internationally as the three "pillars" of sustainable development: its economic, social and environmental elements – bound together by the overarching very long-term aim of meeting the "needs of future generations". In particular, Johannesburg represented a subtle shift in emphasis from the environmental pillar of sustainability to the aim of reducing - and ultimately eliminating - poverty.[64] The extent to which the outcomes of the UNCED conference and the Johannesburg Declaration have made a real practical difference to UN members' laws and policies is, however, highly debatable. Many commentators are of the view that the practical value of such non-binding, "soft" law instruments is very little, and that they fail to trammel UN states' policies liable to result, for example, in environmental damage.[65]

iii. Sustainable development as an EU goal: the policy developments

At EU level, the three-dimensional sustainability concept has become a central pillar of EU policy. Although, post-Rio, the Community (in conjunction with the Member States) had issued a first Community sustainable development programme,[66] the process was kick-started again in 2001 with the Commission's proposal of an EU "Sustainable Development Strategy" ("SDS") to the Gothenburg European Council – a proposal very much inspired by the sustainable development limb of the Community's Fifth Environmental Action Programme.[67] The Commission's proposal contained the

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[62] Agenda 21 was divided into a number of elements: (1) social and economic dimensions of sustainable development, such as combating poverty, protecting and promoting health, and integrating the environment and development in decision-making; (2) conservation and management of resources for development, such as protection of the atmosphere and combating deforestation; (3) strengthening the role of specific groups in sustainable development, such as young people, business and farmers; (4) means of implementing the policy of sustainable development, such as research and education. While laudable in principle, it is questionable whether Agenda 21 has had much practical impact on governments' policies internationally. As such, it is arguably a good example of typical "soft" law international recommendations on sustainable development.

[63] Johannesburg Declaration, para 5.

[64] The Johannesburg Plan of Implementation stated that, "*eradicating poverty is the greatest global challenge facing the world today and an indispensable requirement for sustainable development, particularly for developing countries.*" Johannesburg Plan of Implementation, para 7.

[65] See, for example, for a critical review of the Johannesburg conference and declaration, Wapner, "World Summit on Sustainable Development: Toward a Post Jo'burg Environmentalism", (2003) 3(1) Global Environmental Politics 1.

[66] See the Resolution of the Council and the Representatives of the Governments of the Member States on a Community programme of policy and action in relation to the environment and sustainable development OJ 1993 C 138/1.

[67] Commission, "A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development" COM (2001) 264 final and Fifth Environmental Action Programme, "Towards Sustainable Development" OJ 1993 C 138/1.

following (more or less concrete) elements to tackle what it identified as the key trends towards sustainability:[68]

- The improvement of policy coherence. This means that, "*All policies must have sustainable development as their core concern*" (emphasis in the original).[69] Thus,

> "*[s]ustainable development should become the central objective of all sectors and policies. This means that policy makers must identify likely spillovers – good and bad – onto other policy areas and take them into account. Careful assessment of the full effects of a policy proposal must include estimates of its economic, environmental and social impacts inside and outside the EU.*"[70]

- Getting prices right to give signals to individuals and businesses, meaning that the Commission will, "*give priority in its policy and legislative proposals to market-based approaches that provide price incentives, whenever these are likely to achieve social and environmental objectives in a flexible and cost effective way.*"[71]

- Investment in science and technology for sustainable development, focusing on "*basics and applied research into safe and environmentally-benign technologies, and on benchmarking and demonstration projects to stimulate faster uptake of new, safer, cleaner technologies.*"[72]

- Improvement in communication and the mobilisation of citizens and business to create popular "ownership" of the goal of sustainable development, including encouraging a greater sense of "corporate social responsibility" and "*establishing a framework to ensure that businesses integrate environmental and social considerations in their activities.*"[73]

- Ensuring that the EU's internal and external policies actively support efforts by third countries to achieve more sustainable development.[74]

Though recognising that it was an "*ambitious vision*", the Commission hoped the strategy would be a "*catalyst for policy-makers and public opinion in the coming years and…a driving force for institutional reform, and for changes in corporate and consumer behaviour.*"[75] At the Gothenburg Summit, the European Council welcomed the proposal,[76] declaring that it was adding a

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[68] Namely, combating climate change, ensuring sustainable transport, addressing threats to public health, such as chemicals pollution, unsafe food and infectious diseases, managing natural resources more responsibly and stopping biodiversity decline, combating poverty and social exclusion, and meeting the challenge of an ageing population: *Ibid*, 4.
[69] *Ibid*, 6.
[70] *Ibid*, 6. See further, Chapter 3.
[71] *Ibid*, 7. See further, Chapter 3.
[72] *Ibid*, 7.
[73] *Ibid*, 8.
[74] *Ibid*, 9. See, Commission Communication, "Towards a Global Partnership for Sustainable Development" COM 2002 2 final and Regulation 2493/2000 on Measures to Promote the Full Integration of the Environmental Dimension in the Development Process of Developing Countries OJ 2000 L 288/1.
[75] *Ibid*, 3.
[76] See the Presidency Conclusions at http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ec/00200-r1.en1.pdf.

third limb to the "Lisbon Strategy"[77] and agreeing that a stocktaking of progress on sustainable development should take place at the annual Spring European Council.[78]

The EU's Sixth Environment Action Programme for 2002 – 2012 formed the basis for implementing the SDS in Community environmental policy.[79] This was followed by the 2005 review of the SDS by the Commission and an accompanying European Council Declaration which, *inter alia*, urged Member States to review their own national sustainable development strategies in the light of the EU's SDS and to consider how to integrate their policy instruments with EU action.[80] This was reaffirmed by the Council in adopting the final text of the renewed EU SDS in 2006.[81]

iv. Sustainable development as an EU goal: the practice

In practical terms, sustainable development has two distinct elements at EU policy level: procedural and substantive.

The first, procedural, aspect of sustainability is impact assessment. The 2001 SDS laid the foundation for this aspect of the EU's sustainable development strategy. Following a 2002 Commission Communication, an extended ex-ante impact assessment must be undertaken by the Commission (and, where Member States exercise the right of legislative initiative under the third pillar, by Member States) when proposing all major policy measures.[82] Completed Commission Impact Assessements are made public. This multilateral, procedural approach enables the environmental, economic and social impacts of legislative proposals to be considered, involving not only DG Environment and the "lead" DG (i.e., the DG which has primary responsibility for the proposal), but also other DGs – requiring a sustainability impact assessment for all major policy proposals.[83] Pursuant to the inter-institutional agreement on Better Lawmaking of 2003,

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[77] I.e., the goal set for the Union in at the Lisbon European Council "*to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better gobs and greater social cohesion.*" See Presidency Conclusions of the Lisbon European Council, March 23, and 24, 2000, relaunched in 2005 (Presidency Conclusions of the Brussels European Council, March 22 and 23, 2005). A new cycle of the Lisbon Strategy was launched in 2008 (Presidency Conclusions of the Brussels European Council, March 13 and 14, 2008).

[78] In the 2005 SDS review, the Commission recognised this stocktaking commitment had not been successful, and announced the development of a reinforced review system: "The 2005 Review of the EU sustainable development strategy: initial stocktaking and future orientations" COM (2005) 37.

[79] Decision 1600/2002 laying down the Sixth Community Environmental Action Programme OJ 2002 L 242/1.

[80] "The 2005 Review of the EU sustainable development strategy: initial stocktaking and future orientations" COM (2005) 37; Presidency Conclusions DOC 10255/05, Brussels European Council, June 16 and 17, 2005. The firmly environmentally modernist approach was reaffirmed in the 2005 mid-term review of the Lisbon Strategy, where the Commission stated its aim as to make, "*a renewed Lisbon agenda our strategy for growth and jobs; allowing us to use the motor of a more dynamic economy to fuel our wider social and environmental ambition. In this way, Lisbon remains an essential component of the overarching objective of sustainable development set out in the Treaty: improving welfare and living conditions in a sustainable way for present and future generations.*"

[81] See Council Doc. 10117/06 of June 9, 2006: "*The EU SDS forms the overall framework within which the Lisbon Strategy, with its renewed focus on growth and jobs, provides the motor of a more dynamic economy. These two strategies recognise that economic, social and environmental objectives can reinforce each other and they should therefore advance together…*" (para. 8). The Commission is to submit a progress report on the implementation of the renewed SDS every two years, starting in September 2007. See, "Progress Report on the Sustainable Development Strategy 2007" COM (2007) 642 final.

[82] Commission Communication on Impact Assessment, COM (2002) 276 final.

[83] Defined by the Commission as those presented by the Commission in its Annual Policy Strategy or its work programme (*Ibid*, 5): "*The principle is that all Commission legislative and all other policy proposals proposed for inclusion in the Annual Policy Strategy or the Commission and Work Programme as established in the context of the strategic planning and programming cycle will be subject to the impact assessment procedure, provided that they have a potential economic, social and/or environmental impact and/or require some regulatory measure for their implementation.*"

the Parliament and Council may, in cases where they amend a Commission proposal under the co-decision procedure, also carry out an impact assessment on the social, environmental and economic impacts of the amendments.[84] The Commission has recognised the limitations of impact assessments, flowing from the fact that such assessments focus on identifying potential consequences of a proposal, without necessarily offering solutions.[85] Nonetheless, the importance of this procedural aspect was emphasized in the Commission's 2005 Review of the EU's SDS, which recommends that Member States should also carry out impact assessments when spending public funds or carrying out "programmes" or "projects".[86]

The second, substantive aspect of sustainability is the bilateral, sectoral integration of sustainable concerns into all Community policy areas. In the case of the environmental protection - as opposed to the social - limb of sustainable development, this is mandated by the Article 6 EC "integration principle" and is considered separately below.

In addition to the considerable utilisation of the sustainable development concept at EU policy level, it has sometimes - though rarely - been employed as a legal standard in EU secondary legislation. The main example is the integration of the sustainability concept into Community arrangements on foreign development funding, via the insertion of "conditionality" clauses in funding agreements analogous to those which appear in the case of human rights standards - i.e., effectively conditioning funding on the third country's compliance with the standards indicated.[87] It has also, on occasion, been employed by the ECJ. One of the earliest examples of this is the Opinion of AG Léger in *R v Secretary of State for the Environment, Transport and the Regions, ex parte First Corporate Shipping Ltd,*[88] where AG Léger observed that sustainable development,

> "*does not mean that the interests of the environment must necessarily and systematically prevail over the interests defended in the context of the other policies pursued by the Community…On the contrary, it emphasises the necessary balance between various interests which sometimes clash, but which must be reconciled.*"[89]

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[84] Interinstitutional agreement on better law-making, OJ 2003 C321/1, paras 27-30.

[85] "*An impact assessment will not necessarily generate clearcut conclusions or recommendations. It does, however, provide an important input by informing decision-makers of the consequences of policy choices.*" *Ibid*, 3.

[86] "The 2005 Review of the EU sustainable development strategy: initial stocktaking and future orientations" COM (2005) 37 final, at 14. It should be recalled that this procedural approach was not a new strategy for Community environmental law: in particular, Member States were subject to a binding obligation to undertake an impact assessment on the likely environmental effects of projects falling within the scope of the Environmental Impact Assessment Directive (Directive 85/337 OJ 1985 L 175/40, as amended) – i.e., projects "*likely to have significant effects on the environment by virtue, inter alia, of their nature, size or location*".

[87] See Regulation 2493/2000 on Measures to Promote the Full Integration of the Environmental Dimension in the Development Process of Developing Countries OJ 2000 L 288/1, now replaced by the "External Action: Thematic Programme For Environment and Sustainable Management of Natural Resources including Energy" COM (2006) 20 final. Additional examples of the use of sustainability in Community secondary legislation include the integration of sustainability requirements into funding given out by the LIFE financial instrument, and the relatively frequent use of the concept in the preamble to Community secondary legislation: See, for example, Directive 92/43 on the conservation of natural habitats and of wild fauna and flora OJ 1992 L 206/7.

[88] Case C-371/98 *R v Secretary of State for the Environment, Transport and the Regions, ex parte First Corporate Shipping Ltd* [2000] ECR I-9235, which concerned the issue whether, in drawing up a list of proposed "Sites of Community Interest" under the Habitats Directive, there was an obligation or, alternatively, a discretion for Member States to take economic interests into account. As sustainable development was mentioned as an aim in the Directive's preamble, AG Léger felt it necessary to give a view on what the concept meant, finding that Member States had a discretion to take economic interests into account, but that it could not be excluded that economic and social considerations may mean a site is left off the list.

[89] At para 54.

The ECJ did not, however, deal with the matter in its judgment.[90]

v. Some problems with sustainability as a goal

1. What does it mean?

One of the principal criticisms of the sustainability concept – in its three-limbed, WSSD and Gothenburg form – is that it is too broad to be useful; it can mean "all things to all men".[91]

A look at how economists view sustainability illustrates this divergence of meaning well. Some economists, for example, might define a sustainable state as one in which utility - that is, individuals' pleasure or happiness - or consumption does not decline over time (i.e., sustainability as "constant consumption"). Such economists may be further divided into those holding views of "weak" sustainability (sometimes categorised as "environmentalism"), and those holding views of "strong" sustainability (sometimes categorised as "ecologicalism").[92] Though both views start from the definition of sustainability as constant consumption, they differ over what is necessary to realise this concept in practice. The difference revolves around the role of "natural capital" - i.e., any environmental assets which provide services to the economy, such as water systems, fertile land, crude oil, forests, fisheries, and the earth's atmosphere.[93] In essence, proponents of the "weak sustainability" viewpoint believe that there is little inherent difference between natural and other forms of capital. This means that, in order to achieve sustainable development, it suffices to maintain or increase the total stock of all capital - natural, physical and human - even if, taken separately, the value of natural capital is decreasing. In contrast, proponents of "strong sustainability" propound that neither physical nor human capital can amount to a true substitute for natural capital: nature performs ecological services which cannot be carried out by other means.[94] The distinction between strong and weak sustainability is reflected, to a certain extent, in the different economic disciplines of ecological and environmental economics, respectively. Still other economists reject the notion of sustainability as constant consumption, considering a sustainable state to be one in which resources are managed so as to maintain production opportunities for the future (i.e., sustainability as intergenerational justice).[95] The implications for competition policy of the ambiguity of the notion of sustainability are considered further in Chapter 6.

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[90] Further examples of references to sustainability by the ECJ are the Rotterdam Convention cases, Case C-94/03 *Commission v. Council* [2006] ECR I-1 and Case C-178/03 *Commission v. Parliament and Council* [2006] ECR I-107. The ECJ based its finding that the Rotterdam Convention on Hazardous Chemicals and Pesticides in International Trade should have been based on the dual legal basis of Article 133 EC (common commercial policy) and Article 175 EC (environment) partially on the principle of sustainable development.

[91] See, for example, Jacobs, "Sustainable Development as a Contested Concept" in Dobson (ed.), *Fairness and Futurity: Essays on Environmental Sustainability and Social Justice* (Oxford, Oxford University Press, 1999), at 22.

[92] See further, Chapter 8.

[93] This is contrasted with physical capital (plant equipment, buildings etc), human capital (skill stocks which individuals have), and intellectual capital (the state of technology, viewed separately from particular individuals).

[94] See Pearce and Barbier, *Blueprint for a Sustainable Economy* (London, Earthscan, 2000), at 23-4. One can see, for example, the "strong" concept of sustainability in UNESCO's statement that, "*Every generation should leave water, air and soil resources as pure and unpolluted as when it came on earth. Each generation should leave undiminished all the special of animals it found on earth.*" UNESCO statement, cited in The Economist, "The Great Race: A Survey of the Global Environment", July 6, 2002, at 3.

[95] See, for example, Perman, Ma, McGilvray and Common, *Natural Resources and Environmental Economics* (3rd ed., Essex, Pearson Education Limited, 2003), at 86. However, economists differ on what (b) - the concept

2. Uncertainty of outcome

A second, related criticism of the concept of sustainable development is that, due in part to the difficulties in pinpointing its meaning, the concept inherently fails to establish a pecking order among the three "pillars" of sustainable development – economic, social, and environmental. As such, it gives policy-makers leeway to choose which of the three pillars gets priority in drawing up a specific legislative proposal. This leads to the possibility legitimately to prioritise, in particular, the economic pillar of sustainability - i.e. the aim of achieving economic growth and development - over environmental aims, making "deep greens", in particular, very suspicious of the concept.[96]

In the international context, for instance, such fears are arguably borne out by the Johannesburg Declaration and Plan of Implementation which, with their emphases on reducing poverty as the "greatest global challenge facing the world today", represented a shift in focus at UN level from the environmental pillar to the social and economic pillars of sustainable development. In the EU context, it is arguable that, though sustainability often features as a green catchword in policy documents and in the preamble to legislation, it rarely noticeably alters the substantive rules or standards ultimately adopted (in contrast to the more concrete integration principle, discussed below). In the European Council's March 2008 launch of a new cycle of the Lisbon Strategy (for 2008-2010), for instance, the goal of environmental protection was not expressly mentioned at all (despite, as we have seen, the Gothenburg Council's declaration that sustainable development formed the third pillar of this strategy).[97] Indeed, as Krämer aptly notes, a prioritisation of economic goals is still inherent in the very structure of the EC Treaty - which *prima facie* prohibits obstacles to intra-Community trade and anti-competitive practices, for example, but does not as such prohibit causing significant damage to the environment.[98] Such prioritisation is also evident, for example, in judicial dicta such as that of AG Léger in *First Corporate Shipping* considered above - from which the clear inference is that economic (or other) considerations may, in some circumstances, trump environmental considerations. As a result, many feel that the practical effect of the sustainability principle in promoting environmental protection has in fact been minimal.[99] Indeed, to some, sustainability's

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of intergenerational justice - actually means. The clearest setting for this analysis is the situation where a non-renewable resource, of which there is by definition a finite amount in existence, is used in production. Most economists believe that, rather than there being an absolute obligation to bequeath a certain amount of the resource to the following generation, we should simply make sure to bequeath satisfactory substitutes for the particular resource. See, for example, Solow, On the intergenerational allocation of natural resources, Scandinavian Journal of Economics 88(1), 141 (1986) and Brown-Weiss, *Fairness to Future Generations: International Law, Common Patrimony, and Intergenerational Equity* (New York, Transnational Publication and the United Nations University, 1989).

[96] See, for example, Jacobs, "Sustainable Development as a Contested Concept" in Dobson (ed.), Fairness and Futurity: Essays on Environmental Sustainability and Social Justice", p. 22: "*Sustainable development is a smokescreen put up by business and development interests to obscure the conflicts between ecological integrity and economic growth, and between the interests of the rich North and poor South.*"

[97] Presidency Conclusions of the Brussels European Council, March 13 and 14, 2008. Admittedly, however, the second part of these conclusions dealt with "Climate Change and Energy" – but as a separate topic to the launch of the new cycle of the renewed Lisbon Strategy.

[98] Krämer, "Thirty years of EC environmental law: perspectives and prospectives" (2000) Yearbook of European Environmental Law 155, 157, who refers to the proposal of the Avosetta Group that a new provision be inserted into the EC Treaty that, "*Subject to imperative reasons of overriding public interest, significantly impairing the environment or human health shall be prohibited.*" This provision would mirror the structure of Articles 28 and 30 EC on free movement of goods.

[99] Still others contend that this ambiguity of the notion of sustainable development, or its "contestability", itself serves a useful purpose in that it stimulates and enhances political debate. See, for example, Jacobs, "Sustainable Development as a Contested Concept" in Dobson (ed.), *Fairness and Futurity: Essays on*

aim of "squaring the circle" between economic, social and environmental goals is inherently utopian and a virtually impossible task.

b. The role of the integration principle in Community law and policy[100]

As we saw above, the present Treaty formulation of the integration principle (Article 6 EC) provides that,

> "*Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities…in particular with a view to promoting sustainable development.*"[101]

The idea behind, or rationale of, the principle, in the Commission's words, is that, "*environmental policy alone cannot achieve the environmental improvements needed as part of sustainable development.*"[102] It is clear from the wording of Article 6 EC that the integration principle is not a means in itself, but rather a means to achieving the ultimate end of sustainable development. As such, the integration principle comprises a vital, substantive, pillar of the Community's sustainable development strategy.[103] Examination of how the principle has been implemented can be usefully divided into two levels: implementation at EU level, and implementation at Member State level within the scope of EU law.

i. Implementation of the integration principle at EU level

The integration principle has been implemented into EU law and policy at a variety of institutional levels, including at the levels of the European Council, Council of Ministers, Commission and Community courts.

At the European Council level, the principle was lent extra political weight by its 1998 launch of the "Cardiff process", by which different formations of the Council of Ministers were requested to develop strategies to achieve environmental integration, starting with energy, transport and agriculture.[104] This led, at the Council of Ministers level, to the development of bilateral integration strategies and programmes for a wide number of Council formations, including the internal market (which encompasses competition policy),[105] industry,[106] development,[107] fisheries,[108] general affairs and external

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Environmental Sustainability and Social Justice (Oxford, Oxford University Press, 1999), at 27. For a counter-argument, see Lee, *EU Environmental Law: Challenges, Change and Decision-Making* (Oxford, Hart, 2005), at 47.

100 See generally, Borràs Pentinat, "The Process of the Integration of Environmental Protection into Other European Union Policies" in Fajardo de Castillo *et al* (eds.), *Strengthening European Environmental Law in an Enlarged Union* (Aachen, Shaker 2004), Lenschow (ed.), *Environmental Policy Integration: Greening Sectoral Policies in Europe* (London, Earthscan 2002), Alves, "La Protection intégrée de l'environnement en droit communautaire", Revue juridique de l'environnement, 2/2003 p. 1, Wasmeier, "The integration of environmental protection as a general rule for interpreting Community law" (2001) CML Rev 159.

101 This type of integration - the integration of environmental objectives into other sectoral policy areas (i.e. those areas referred to in Article 3 EC) - has been termed "external" integration by some commentators. This is contrasted with "internal" integration – the rejection of divisions traditionally made within environmental policy itself. Examples of "internal" integration include the rejection of medium-specific environmental regulation, as illustrated by Directive 96/61 on integration pollution prevention and pollution control OJ 1996 OJ L 257/26.

102 Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final, 2.

103 See the Gothenburg European Council conclusions adopting the EU's Sustainable Development Strategy, June 15 and 16, 2001.

104 The Cardiff Summit followed a Commission Communication, "Partnership for Integration" (COM(98) 333), which identified a variety of necessary steps to translate Article 6 EC into concrete results.

105 See the Council's report to the Helsinki European Council, November 1999, doc. No. 13622/99.

106 *Ibid.*

relations[109] and economic and financial affairs[110] formations, in addition to the energy,[111] transport[112] and agriculture[113] formations. The need for the Council and the Commission to implement these strategies was emphasised by the 1999 Helsinki European Council, as well as by the 2001 Gothenburg European Council, in the context of its acceptance of the EU Sustainable Development Strategy and its addition of a third environmental pillar to the EU's Lisbon Strategy for Growth and Jobs. [114]

At the Commission level, the integration principle has various manifestations, as announced in its 1998 Communication "Partnership for Integration" - a policy document mirroring the principle's legal promotion by the Treaty of Amsterdam to become one of the Community's fundamental principles.[115] First, a variety of bilateral sectoral environmental integration strategies have been developed by the Commission in a wide range of policy areas, mirroring the Council's sectoral strategies. The sixth (current) Environmental Action Programme further emphasises this approach, setting out a variety of thematic strategies for integration. In addition, in 2004, the Commission undertook to carry out an annual stocktaking of the progress of the Cardiff process, which complements its annual environmental policy review.[116] A number of less significant institutional changes, such as designation of an environmental liaison official in the Directorates-General other than DG Environment, have also taken place.[117] Finally, the procedural requirement that the Commission must undertake an impact assessment when proposing all major policy measures, discussed above as a component of the EU's SDS, clearly also contributes to achieving greater integration of environmental concerns into other policy areas.

A number of recent legislative and policy initiatives, some of which we will focus on in later chapters, are outcomes of the application of the holistic approach dictated by the integration principle. These include the 2003 shift in approach in the Common Agricultural Policy from direct payments to farmers for production to "single farm payments" conditioned on farmers' contributions to rural development measures, including respect for environmental standards;[118] the inclusion of renewable energy and

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[107] *Ibid.*

[108] See the Council Conclusions on integration of environment and sustainable development into the Common Fisheries Policy, April 26, 2001, doc. No. 7885/01.

[109] See the COREPER Report 7791/01of 4 April 2001, adopted at the General Affairs Council of 10 April 2001. See also, the movement to develop a "Green Diplomacy Network", which is aimed at creating an informal network of environmental experts within foreign ministries, an initiative launched by the Thessaloniki European Council in June 2003.

[110] See the Council's Report to the Nice European Council of November 27, 2000 doc. No. 13054/1/00.

[111] See the Council's adoption of an energy integration strategy, November 1999, doc. No. 9994/99.

[112] See, for example, Council Resolution, "Follow-up to the Cardiff/Helsinki Summit on the integration of environment and sustainable development into the transport policy", doc. No. 7329/01.

[113] See the Council's adoption of an agriculture integration strategy, November 15, 1999, doc. No. 13078/99.

[114] Presidency Conclusions of the Helsinki European Council, December 10-11, 1999; Presidency Conclusions of the Gothenburg European Council, June 15-16, 2001. Wurzel, "The EU Presidency and the Integration Principle: An Anglo-German comparison" (2001) European Environmental Law Review 7, has underlined the crucial role of the Member State which holds the 6-month rotating Council Presidency in implementing the integration principle by tabling "cross-cutting" environmental aspects in discrete sectoral Council formations.

[115] Commission Communication, "Partnership for Integration" COM (98) 333 final.

[116] See "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final.

[117] McGillivray and Holder, Locating EC Environmental Law (2001) 2 Yearbook of Environmental Law 139, 154.

[118] See, for a summary, Commission Press Release IP/04/1540 of December 23, 2004.

biofuel targets in the EU's energy package; and, importantly for our purposes, the broader use of market instruments in the EU's environmental policy (discussed in Chapter 4) and the adoption of Guidelines on Environmental State aid (discussed in Chapter 15). The integration principle has also been used to quell industry's concerns that higher environmental standards within the Community will damage global competitiveness. Again, the Commission's line has been, in the words of Commissioner Verheugen, "*nothing that is ecologically wrong can be economically right.*"[119] These attempts to integrate the concerns of industry and environmental protection go to the core of our present analysis, and will be discussed further in later Chapters.

At the ECJ level, one can see a drive towards integration from a relatively early stage in the Court's jurisprudence. This has certainly got stronger since the promotion of the integration principle to Article 6 EC, and arguably has increased since then.[120] The following three examples illustrate this drive well.

First, the Court's jurisprudence holding environmental protection to be a "mandatory requirement" justifying indistinctly applicable restrictions on free movement of goods resulting from national legislation represents a manifest attempt to reconcile internal market and environmental goals. This movement began with the *Danish Bottles* judgment, just after *ADBHU* (discussed above) and in tandem with the insertion of explicit environmental aims for the Community by the SEA (in the form of present Article 174 EC).[121] Even more significantly, as will be discussed further in Chapter 7, the ECJ has, in certain cases, accepted environmental justifications for directly discriminatory (distinctly applicable) Member State measures which restrict the free movement of goods contrary to Article 28 EC. Such judgments, which include the *Walloon Waste*, *Dusseldorp*, *Aher-Waggon*, *PreussenElektra* and, more recently, *Inn Valley* judgments,[122] go against the ECJ's standard internal market case law, according to which the only acceptable justifications for distinctly applicable measures are those set out in Article 30 EC (where environmental protection, as such, does not feature).[123] In some of these cases - most notably, *PreussenElektra* - the Court has expressly referred to the Article 6 EC integration principle in coming to its conclusion to this effect. Similarly, a process of integrating environmental considerations has taken place in public procurement law (environmental

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[119] SPEECH/06/371 of June 13, 2006, "Sustainability and Competitiveness". He continues, "*the renewed Lisbon strategy [for growth and employment] and the European strategy for sustainability do not contradict but complement each other…More growth can only be sustainable growth…Modern European industrial policy is integrated, inter-disciplinary policy.*" See also, Speech of Commissioner Dimas in November 2006 setting out eight reasons why being green is "good for business" and declaring, "*It is perfectly possible for industry to be green and profitable at the same time – and that the most successful businesses will be those that learn to reap the benefits from the continued public and political attention to environmental issues.*" SPEECH/06/676 of November 9, 2006, "Environment and Industry: How Ambitious Environmental Standards Can Promote Business Competitiveness in Europe?"

[120] See, for example, the Opinion of AG Léger in Case C-227/02 *Wood Trading* [2004] ECR I-11957: "*In future, the principles framing environmental law could be accorded increased importance.*"

[121] Case 302/86 *Commission v Denmark* [1988] ECR 4607, Case 240/83 *ADBHU* [1985] ECR 531.

[122] Case C-379/98 *PreussenElektra* [2001] ECR I-2099, Case C-2/90 *Commission v Belgium* [1992] ECR I-4431, Case C-320/03 *Commission v Austria (Inn Valley)* [2005] ECR I-9871.

[123] This has led many commentators - including Advocates General Jacobs and Geelhoed - to call for the express recognition of environmental protection as equivalent to the express Article 30 EC derogations. See the Opinion of AG Jacobs in *PreussenElektra* and the Opinion of AG Geelhoed in *Commission v Austria*, note 122 above. The possibility of inserting environmental considerations into Article 30 EC as an express ground for derogating from the principle of free movement of goods was considered and rejected by the authors of the Treaty of Amsterdam. This is despite the fact that the result of the above judgments effectively implies that the Court, in some cases, equates environmental considerations to Article 30 EC express derogations. As a result, the present situation is, not least from a legal certainty perspective, unsatisfactory.

criteria are acceptable in awarding public service contracts)[124] as well as in environmental state aid.[125]

Second, the Court has relied on the integration principle in a number of legal basis judgments. In its *Titanium Dioxide* judgment, for example, the Court expressly relied on the integration principle to justify its conclusion that the proper legal basis of the Directive on waste from the titanium dioxide industry was Article 95 (then 100a) EC, on internal market legislation, rather than Article 175 (then 130s) EC, on environmental legislation.[126] Most recently, the ECJ relied on Article 6 EC in its controversial judgment in the *Environmental Criminal Penalties* case, holding that,

> "*in the words of Article 6 EC '[e]nvironmental protection requirements must be integrated into the definition and implementation of the Community policies and activities', a provision which emphasises the fundamental nature of that objective and its extension across the range of those policies and activities.*"[127]

Third, the Court has considered Article 6 EC as an aid to the interpretation of secondary legislation,[128] including when deciding how to apply Article 174(2) EC principles of Community environmental law.[129]

Importantly, however, the Court has stopped short at pronouncing the integration principle to be justiciable in the sense of giving rights to individuals or providing a self-standing ground of annulment of Community legislation, though some of its Advocates Generals would have gone this far.[130] One of the most convincing views from the bench on the role of Article 6 EC is that of AG Geelhoed in *Austria* v *Parliament and Council (Ecopoints)* who equates Article 6 EC to a general principle of Community law analogous to the principle of proportionality: review of the legality of Community legislation for compliance with the integration principle is possible, but annulment will only take place where there has been a "manifest error" of the Community legislature in failing to take

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[124] See Opinion of AG Mischo and judgment in Case C-513/99 *Concordia Bus* [2002] ECR I-7213, Directive 2004/18 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts OJ 2004 L 134/114, Directive 2004/17 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors OJ 2004 L 134/1, and Commission Communication, "Public procurement for a better environment" COM (2008) 400/2 (Commission proposing that, by 2010, 50% of all tendering procedures should be green, in the sense of compliant with endorsed common core green public procurement criteria).

[125] See Chapter 15.

[126] Case C-300/89 *Commission v Council (Titanium Dioxide)* [1991] ECR I-2867, paras 22 – 24. See analogously, Case C-17/90 *Pinaud Wieger* [1991] ECR I-5253 (confirming a similar approach towards the common transport policy) and *Opinion 2/00* [2001] ECR I-9713, where the Court confirmed that Article 6 EC was "*in full harmony*" with the *Titanium Dioxide* doctrine, and Case C-336/00 *Huber* [2002] ECR I-7699. See also, the Opinion of AG Kokott in Case C-94/03 *Commission v Council (Rotterdam Convention)* [2006] ECR I-1.

[127] Case C-176/03 *Commission* v *Council* [2005] ECR I-7879, at para 42. See also, the Opinion of AG Ruiz-Jarabo Colomer and Case C-440/05 *Commission v Council (Ship-Source Pollution)*, judgment of October 23, 2007, not yet reported.

[128] See, for example, the Opinion of AG Kokott, Case C-304/01 *Spain v Commission* [2004] ECR I-7655 (interpretation of fisheries legislation).

[129] See, for example, Joined Cases T-74/00 etc *Artegodan* [2002] ECR II-4945 (precautionary principle), Opinion of AG Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769 (polluter pays principle). See also, the Opinion of AG Alber in Case C-444/00 *Mayer Parry Recycling* [2003] ECR I-6163.

[130] See, for example, Advocate General Jacobs in Case C-379/98 *PreussenElektra* [2001] ECR I-2099: "*Article 6 is not merely programmatic; it imposes legal obligations*". AG Cosmas in Case C-321/95P *Greenpeace* [1998] ECR I-1651 recommended that the integration principle should be capable of direct effect.

the requirements of the principle into account in drawing up legislation.[131] Thus, he opines that,

> *"[a]lthough [Article 6 EC] is drafted in imperative terms, contrary to what the Republic of Austria asserts, it cannot be regarded as laying down a standard according to which in defining Community policies environmental protection must always be taken to be the prevalent interest. Such an interpretation would unacceptably restrict the discretionary powers of the Community institutions and the Community legislature. At most it is to be regarded as an obligation on the part of the Community institutions to take due account of ecological interests in policy areas outside that of environmental protection stricto sensu. It is only where ecological interests manifestly have not been taken into account or where they have been completely disregarded that Article 6 EC may serve as the standard for reviewing the validity of Community legislation.*"[132] (emphasis added)

The Court never had an opportunity to rule on the matter, as Austria withdrew its action prior to judgment.[133] However, it will be argued in Chapter 6 that AG Geelhoed's view fits excellently with the post-Amsterdam position of Article 6 EC in Title I on "Principles" of the Community.

ii. Implementation of the integration principle at Member State level

The integration principle is a norm directed not only at Community institutions (in the "*definition and implementation of Community policies*", using the terminology employed by Article 6 EC), but also at Member States (in the "*implementation*" of Community policies). This should, it is submitted, be interpreted to mean that it applies to Member States when acting within the scope of Community law - i.e., in situations to which Community law applies (whether or not they are acting to "implement", in the narrow sense of the term, Community secondary legislation) - in order to ensure the Article's *effet utile*. The words "definition and implementation" of Community policies make it evident that the principle applies to all stages of preparing, adopting, implementing and enforcing Community law.[134] Accordingly, the Commission, in its 2004 stocktaking of the implementation of the integration principle, cites two ways in which Member States could improve this. A first is via stringent implementation of Community impact assessment legislation – namely, the Environmental Impact Assessment Directive and the Strategic Environmental Assessment Directive.[135] A second is by regularly exchanging "*good integration practice*" at national, regional and local level.[136] More broadly, the national sustainable development strategies which most Member States have now

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131 See, analogously, for the proportionality principle, for example, Case 331/88 *FEDESA* [1990] ECR I-4023.

132 Case C-161/04 *Austria v Parliament and Council* [2006] ECR I-7183, Opinion paras 59 – 60.

133 Order of the Court of September 6, 2006. See also, Case T-461/93 *An Taisce and WWF v Commission* [1994] ECR II-733 and Case T-585/93 *Stichting Greenpeace Council (Greenpeace International) and Others v Commission* [1995] ECR II-2205. In each of these cases, it was argued that a Commission decision should be annulled for failure to comply with the integration principle. However, the Court did not decide the issue in either case, as each was declared inadmissible.

134 See further, Dhondt, *Integration of Environmental Protection into other EC policies* (Groningen, Europa Law Publishing, 200), 3.

135 European Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final, 36. See Directive 85/337 on the assessment of the effects of certain public and private projects on the environment OJ 1985 L 175/40, as amended, and Directive 2001/42 on the assessment of the effects of certain plans and programmes on the environment OJ 2001 L 197/30. See also, the Declaration attached to the Treaty of Amsterdam that, "*the Commission undertakes in its proposals, and that the Member States undertake in implementing those proposals, to take full account of their environmental impact and of the principle of sustainable growth.*"

136 European Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final, 36.

developed will, in the Commission's view, contribute to successful integration.[137] An excellent example of integration at Member State level is the recent decision of UK central government that all ministries must integrate the carbon cost of their decisions into decision-making.[138]

iii. Some problems with the integration principle

As a policy guideline, the integration principle has been a qualified success. Though, as with sustainability, few would deny it to be a laudable aim, it suffers from similar indeterminacy as a guideline for policy-makers and as a legal standard: how are policy areas to be integrated, and how is the success of such integration to be measured? This problem has led to the complaints of certain commentators that, rather than using the integration principle to integrate environmental interests into other policies, the tables have been turned: the principle has been used to integrate business and other non-environmental interests into environmental policy. The outcome, it is argued, is often marginalisation of the environmental agenda, rather than vice versa.[139]

Given this indeterminacy, it is no surprise that the integration principle has, to date, had limited practical effects. Numerous commentators have concluded that, as an empirical matter, the objective of integrating environmental policy considerations into broader EU policy areas has, to a large extent, not been realised.[140] Indeed, the Commission itself recognised this in 2004, concluding that the Cardiff process had, to date, brought "*mixed results*":

> "*As many of the "low hanging fruits" of integration have already been picked, future efforts to reverse persisting unsustainable trends will need to focus increasingly on structural reforms, which may generate tensions with established interest groups in the sectors concerned. In addition, action at national level is needed to deliver on the commitments made at the Union level, as in many areas Community competence is limited.*"[141]

In order to do better, the Commission recommended more consistency in application, more political commitment, better implementation and review and clearer priorities. The renewed SDS adopted by the Council in June 2006 also made clear that the EU institutions' work in implementing the integration principle is far from over, prescribing

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[137] See, for example, the UK's sustainable development policy, outlined at http://www.sustainable-development.gov.uk/. Similarly, a new pilot ministry dealing with sustainability issues ("le ministère de l'Ecologie, du Développement et de l'Aménagement durables") was created in France in July 2007.

[138] See the report of the Guardian, December 22, 2007.

[139] See, for example, Unfried, Review of Lenschow, *Environmental Policy Integration: Greening Sectoral Policies in Europe* (2004) 13(3) RECIEL 352, who gives the example of the actions of British Prime Minister Blair, German Chancellor Schröder and French President Chirac in 2003, in urging the Commission to ease the regulatory burden on the chemicals industry in the context of finalising the REACH regime.

[140] See, for example, Dhondt, *Integration of Environmental Protection into other EC policies* (Groningen, Europa Law Publishing, 2003), who takes the examples of the Community's Common Agricultural Policy, Common Transport Policy and energy policy; and the Report of the UK House of Commons Environmental Audit Committee, which warned that, "*the [EU's] sectoral integration strategies produced to date have been bland statements of intent suggesting little action or timetable for action.*" Environmental Audit Committee, *First Report. EU Policy and the Environment: An Agenda for the Helsinki Summit*. Report and Proceedings of the Committee, together with Minutes of Evidence and Appendices, HC 44, House of Commons, Session 1999/2000, p. vi.

[141] European Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final, 3.

improved internal policy coordination between the different sectors dealt with by the institutions.[142]

From a policy perspective, therefore, one might argue that, as with the sustainability goal, the most important practical effect of the integration principle in policy-making to date has been primarily procedural: policy-makers are, via impact assessments, required to demonstrate that they have at least considered the sustainability implications of their proposals (and, as part of this, whether the proposal complies with the integration principle). Nonetheless, as discussed above, from a legal perspective, the ECJ shown itself to be willing to invoke the integration principle in a number of contexts and in situations of conflict. The potential relevance of the integration principle to competition policy will be discussed in detail in Chapter 6.

Should the Treaty of Lisbon enter into force, there is an argument that the force of the environmental integration principle will be diluted given the insertion within the "provisions having general application" section of other integration clauses (for example on discrimination and equality). The better view, however, would seem to be that the very different wording of these clauses serves to distinguish them, and the consequences flowing from them, from present Article 6 EC.[143]

[142] Though the General Affairs Council "*should ensure the horizontal coordination of the EU SDS*", the other Council formations "*should verify implementation in their respective areas of responsibility*." Council conclusions, doc. No. 10117/06 of June 9, 2006.

[143] See, for example, Article 5b TFEU: "*In defining and implementing its policies and activities, the Union shall aim to combat discrimination based on sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation*" (emphasis added).

Chapter 3: Forms of Environmental Regulation: Direct Regulation and Market-Based Instruments

1. Introduction

Having examined the legal framework set out in the Treaty for the EU's environmental policy, focusing on the most important aspects of this policy for our purposes - sustainable development and the Article 6 EC integration principle - we now turn to the question: How can the aims of the EU's environmental policy most effectively be achieved? What regulatory techniques are available to the EU in achieving its environmental policy aims, and what are the merits and demerits of these techniques? The aim of this Chapter is to outline these techniques - the regulatory "toolbox" - and to explore and explain the significant increase in the use of "economic" or "market-based" instruments of environmental regulation in recent years. This shift has, as will be demonstrated later, important implications for the interface between environmental and competition policy.

2. The distinction between direct regulation and economic instruments and how regulators decide which instrument to use[1]

A variety of regulatory options exists in environmental policy, which for the purposes of this research may usefully be divided into two general categories.[2]

The first is "direct" regulation, otherwise known as "command and control" regulation. Essentially, such regulation involves a state-prescribed "command" backed by the state's authority to impose a negative sanction, the "control".[3] In the environmental sphere, therefore, command and control regulation normally entails the adoption of standards by the state or its environmental protection bodies, which standards are enforced by public authorities and/or private persons via the courts. In this regulatory scenario, public authorities clearly play a central role - setting the standards and enforcing them. Direct regulation is often characterised by the use of permits (otherwise known as licensing or authorisation) systems, or (exceptionally) complete prohibition (for example, of an activity or substance). Enforcement techniques differ by jurisdiction, but may involve national courts, via the imposition of civil or criminal penalties (as is normal, for example in the UK), and/or non-judicial public enforcement agencies, via the imposition of "civil" or "administrative" penalties or the revocation of licences granted.

The second category of environmental regulatory technique is the use of "economic" instruments, otherwise known as "incentive"- or "market"-based instruments, to protect the environment. As will be seen below, the essential feature of these instruments is that the market is used to provide incentives to guide behaviour towards an environmentally-

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[1] On environmental regulatory techniques, see Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), 154 – 170, Lee, *EU Environmental Law: Challenges, Change and Decision-Making* (Oxford, Hart, 2005), Chapter 7, Ackerman and Stewart, "Reforming Environmental Law" (1985) 37 Stanford Law Review 1333, Stewart, "The Importance of Law and Economics for European Environmental Law", (2002) Yearbook of European Environmental Law 856, Galizzi, "Economic Instruments as Tools for the Protection of the International Environment", 6 European Environmental Law Review 155 (1997).

[2] Some authors adopt slightly different methods of categorisation, or would differ on the precise definition and scope of each category. See, for example, the Commission Communication on Impact Assessment COM (2002) 276 final.

[3] See, for example, Abbot, "Environmental Command Regulation" in Richardson and Wood (eds.) *Environmental Law for Sustainability* (Oxford, Hart, 2006).

favourable outcome, for instance by "internalising" environmental costs which would otherwise be treated as external (and so could lead to market failure).[4] Economic instruments came into vogue in EU environmental policy in the 1990s sparked by a similar rise in interest in the US, which had been provoked at least in part by Ackerman and Stewart's landmark 1985 article "Reforming Environmental Law."[5] In contrast to command and control regulation, market-based regulatory techniques rely heavily on the actions of market players - i.e., not public, but private bodies. For this reason the huge increase in their use at EU level (though command and control techniques still predominate) may be viewed as forming part of a wider shift from "government" to "governance", as will be discussed below.

A variety of factors may play a part in a regulator's choice of which instrument is best for controlling a specific type of pollution. These include:[6]

- Cost effectiveness (i.e., whether the instrument attains the target at the least cost, ideally by equalising the marginal cost of abatement of all firms involved in pollution control);
- Long-run effects (i.e., whether the effect of the instrument remains constant, strengthens or weakens over time);
- Dynamic efficiency (i.e., whether the instrument creates continuous incentives to improve production in ways that reduce pollution);
- Ancillary benefits, such as "double dividends" (where revenues from, for example, environmental taxes go towards reducing other distortionary taxes);
- Equity (i.e., the implications which the instrument has for distribution of wealth);
- Dependability (i.e., can the instrument be relied upon to achieve the target);
- Flexibility (i.e., can the instrument be adapted quickly to deal with changed conditions, information or targets);
- Costs of use under uncertainty (i.e., are the efficiency losses considerable if used with incorrect information);
- Information requirements (i.e., the amount of information which the instrument requires, and the cost of acquiring this information if the regulators do not already possess it).
- The impact which the choice of instrument may have on competitiveness, for instance of a region or state.[7] Competitiveness in this sense has a number of aspects: for example, it

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[4] As expressed by a Commission-convened Working Group of Member State Experts on the Use of Economic and Fiscal Instruments in EC Environmental Policy back in 1991, "*Economic instruments affect through the market mechanism costs and benefits of alternative actions open to economic agents, with the effect of influencing behaviour in a way which is favourable for the environment*." Commission of the European Communities, 1990. *Report of the Working Group of Experts from the Member States on the Use of Economic Instruments in EC Environmental Policy* (Brussels, Directorate-General Environment, Nuclear Safety and Civil Protection, 455. See (1991) 14 Boston College International and Comparative Law Review 447.

[5] Ackerman and Stewart, "Reforming Environmental Law" (1985) 37 Stanford Law Review 1333

[6] See Perman, Ma, McGilvray and Common, *Natural Resources and Environmental Economics* (3rd ed., Essex, Pearson Education Limited, 2003), 202-205; and Baumol and Oates, *The Theory of Environmental Policy: Exernalities, Public Outlays and the Quality of Life* (2nd ed., Englewood Cliffs, NJ, Prentice-Hall 1988).

may refer to competitiveness of the businesses hit by the tax compared to other businesses; or, more broadly, the macroeconomic competitiveness of the regulatory regime in comparison to other jurisdictions (regulatory competition). The use of certain environmental instruments has widely been viewed as having a negative effect in terms of regulatory competition (with direct regulation and environmental taxation being examples of instruments which may arguably dissuade investment and thus reduce a jurisdiction's international competitiveness).[8] Equally, however, the competitiveness issue can be viewed from the opposite perspective: ambitious environmental standards may ultimately benefit, rather than hinder, companies' competitiveness – by, *inter alia*, giving them a "headstart" and allowing them to corner emerging markets in environmental technologies; or even by "insulating" EU firms from foreign competition.[9]

The instrument ultimately chosen in a given situation by the regulator depends, to a large extent, on what weight the regulator chooses to give to these (and possibly other) criteria. Clearly, no one instrument is "best" for all types of pollution.

3. Direct regulatory techniques in Community environmental law

a. Background

For centuries, "environmental law" did not exist as a discrete body of regulation in most present EU Member State. Rather, issues which would now be viewed as environmental were left to be dealt with by private law alone, primarily via the law of non-contractual liability (tort) and property law.[10] Gradually, however, it became evident - with the onset of the industrial age - that this approach was not sufficient. By the 1970s, separate bodies of regulatory rules began to emerge in Community Member States, laying down public law standards of environmental protection to be observed by citizens and to be enforced by public authorities - i.e., using the technique of direct regulation. As we have seen in Chapter 2, this tendency was mirrored at Community level by the gradual development of Community environmental law, beginning in the 1960s with the regulation of hazardous

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[7] See further, Gunningham, Grabosky and Sinclair, *Smart Regulation: Designing Environmental Policy* (Oxford, Clarendon Press, 1998). Under "public choice" theories, a final factor in the regulator's choice may be whether the instrument can be used to grant a benefit to any pressure groups which may be exerting political pressure: see Chapter 7.

[8] See, for example, OECD, *Environmental taxes and competitiveness: An overview of issues, policy options and research needs* (COM/ENV/EPOC/DAFFE/CFA(2001)90/FINAL) (Paris, OECD, 2003). Some commentators, however, dispute the influence of a state's environmental policy on firms' location decisions: see, for example, Ulph and Valentini, "Environmental Regulation, Multinational Companies and International Competitiveness", in Welfens (ed.), *Internationalization of the Economy and Environmental Policy Options* (Berlin, Springer, 2001), at 25.

[9] See, for example, Porter and van der Linde, "Toward a New Conception of the Environment-Competitiveness Relationship", Journal of Economic Perspectives, 9(4), Fall 1995, 97; speech of Commissioner Dimas of November 9, 2006, "Environment and Industry, How ambitious environmental standards can promote business competitiveness in Europe?" (SPEECH/06/676); and speech of Commissioner Verheugen, "Sustainability and Competitiveness", June 12, 2006 (SPEECH/06/371).

[10] A classic example in UK tort law is the rule of private nuisance in *Rylands v. Fletcher (1868)*, L.R. 3 H.L. 330; [1861–73] All E.R., laying down the rule that, "*the person who for his own purpose brings on his lands […] anything likely to do mischief if it escapes, must keep it at his peril and is prima facie answerable for all the damage which is the natural consequence of its escape.*" Per Blackburn J. See also *Cambridge Water Co Ltd v Eastern Counties Leather plc* [1994] 2 AC 264.

substances, and followed in the 1970s with legislation regulating a wide range of environmental issues using directly regulatory techniques.[11]

Direct regulation remains the primary regulatory tool of Community environmental policy. It is characterised by what Dryzek has termed "*administrative rationalism*":[12] a reliance on the (presumed) good sense and good information of (government) bureaucrats to set the right environmental standards, and on public resources to enforce them.[13]

b. Principal forms of Community environmental direct regulation

Community environmental direct regulation may be, broadly, divided into four main categories.[14]

A first type is the establishment of environmental quality standards. These set down (maximum) permitted levels of pollution or environmental interference. They may be set for a given environment (e.g., a habitat designated as a "Special Area of Conservation" under the Habitats Directive)[15] or environmental medium (e.g., water, air), which may in turn be subdivided by geographic location (e.g., ground water, surface water).[16] In the present state of environmental policy, some interference or pollution is normally permitted - i.e., "zero-tolerance" policies are rare, reflecting the balance currently thought appropriate between economic growth and environmental protection, and a recognition that human activity inevitably causes a certain amount of pollution or damage to our environment.[17] Instead, a "threshold of intolerability" is selected by the rule-maker.[18] In exceptional cases, however, little or no environmental interference is permitted. This may be appropriate, for example, in the biodiversity area: for instance, particularly ecologically important sites may need to be kept free from interference, or endangered species may need absolute protection by the law.[19]

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[11] See, for example, Directive 75/442 on waste OJ 1975 L 194/23 and Directive 79/409 on the conservation of wild birds OJ 1979 L 103/1.

[12] Dryzek, *The Politics of the Earth: Environmental Discourses* (Oxford, Oxford University Press, 1997), 79.

[13] Another way of characterising direct regulation is as "substantive" law - whereby governments lay down detailed, value-based substantive programmes and rules - in contrast to "formal" private law (private law, such as tort and property law), and "reflexive" law (which is aimed at provoking self-reflection and self-correction by those regulated, instead of using commands). See Abbot, "Environmental Command Regulation" in Richardson and Wood (eds.) *Environmental Law for Sustainability* (Oxford, Hart, 2006), 63 – 64. She draws in this regard on the work of Gunther Teubner, "Substantive and Reflexive Elements in Modern Law" (1983) 17 Law and Society Review 239.

[14] See Abbot, *ibid,* 64. These categories are not set in stone. Contrast, for example, Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), 155, and Lubbe-Wolff, "Efficient Environmental Legislation – On Different Philosophies of Pollution Control in Europe" (2001) 13 Journal of Environmental Law 79, 80.

[15] Directive 92/43 on the conservation of natural habitats and of wild fauna and flora OJ 1992 L 206/7.

[16] See, for example, Directive 2000/60 establishing a framework for Community action in the field of water policy OJ 2000 L 327/1.

[17] See Sands, note 14 above, at 156.

[18] Examples from Community law include the Community's rules on the quality of drinking water, which lay down microbiological and chemical parameters which must not be exceeded by drinking water at the point of entry into Member States' domestic distribution systems: see Directive 80/778 relating to the quality of water intended for human consumption OJ 1980 L 229/11.

[19] In Community law, examples include the "Annex A" species of the Community's Regulation on endangered species trade in which is only authorised in exceptional circumstances, and Council Regulation 338/97 on the protection of species of wild fauna and flora by regulating trade therein OJ 1997 L 61/1 (the Basic Regulation).

A second type of environmental direct regulation is the establishment of product-specific standards - for example, standards establishing maximum levels of pollutants to be used in the manufacture of a product, or specifying the permitted design, marketing or use of a product.[20]

A third type of environmental direct regulation is the establishment of emission standards, which set maximum levels for pollutants emitted from installations, activities or products.[21]

A fourth and final type of environmental direct regulation is the use of process, or technical, standards – by which is meant requiring the use of a particular technology, technique, or practice in carrying out a (normally industrial) activity, or in the design of an installation.[22]

A common way of effecting each of these categories is by making the particular polluting activity subject to a non-transferable permit (otherwise known as a licence or authorisation). Permitting is not, however, a technique specific to direct regulation, as will be seen when we examine the Community's emissions trading scheme, which is based around the idea of transferable permits. Equally, permitting is not the only enforcement method available for classic direct regulation; legislators may also simply rely on direct enforcement by environmental or other enforcement agencies.[23]

Going beyond this basic categorisation, two important current trends in Community direct environmental regulation can be identified.

First, there is a major trend at present towards what is termed "flexibility" in direct regulation: that is to say, the use of broad, "framework"-style Directives, leaving Member States much discretion on how to implement the objectives of the Directive in a manner appropriate to the specific environmental conditions of their country (or indeed allowing them to differentiate per locality). This contrasts with the tendency in the 1970s and 1980s for Community legislation to impose fixed minimum standards for the Community as a whole, leaving little discretion to Member States to take local environmental conditions into account, or to use different instruments, in implementation. This movement, which was particularly evident in the Community's Fifth Environmental Action Programme, has been attributed by some to the need for more effective environmental legislation, as well as concerns about the EU's international competitiveness.[24] One of the trailblazers of this trend is the Integrated Pollution Prevention and Control (IPPC) Directive, which represents regulatory "flexibility" as to the permit conditions containing installations' emissions limit

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Clearly, the effectiveness of even a complete ban on interference turns on the extent to which it is properly enforced.

[20] Community law examples include Community rules specifying how certain chemicals which are particularly hazardous for the environment should be packaged, labelled and used (see Directive 67/548 on the classification, labelling and packaging of dangerous substances [1967] OJ 196/1 and the new REACH Regulation, Regulation 1907/2006, OJ 2006 L 396/1.

[21] An example in the Community context is Directive 96/61 on integration pollution prevention and pollution control OJ 1996 OJ L 257/26 (now Directive 2008/1 OJ 2008 L 24/8). Operators of industrial installations covered by Annex I of the IPPC Directive (around 50,000 at present, according to the Commission) are required to obtain an authorisation (environmental permit) from the authorities in the Member States. See also, Directive 2000/76 on the incineration of waste OJ 2000 L 332/91.

[22] Examples in the Community context are Directive 2006/12 on waste OJ 2006 L 114/9 and Directive 91/689 on hazardous waste OJ 1991 L 377/20.

[23] See Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 141.

[24] See, for example, Macrory and Turner, "Participatory Rights, Transboundary Environmental Governance and the Law" 39 (2002) CML Rev 489, 358.

values. Rather than setting the permit conditions and emission limit values out in Community legislation at a specified, fixed and uniform level for Community-wide application, they are set via the decision of Member States' licensing authorities, in conjunction with the installation, on what represents the "Best Available Technology" (BAT) in the industry at the time.[25]

Second, there is a trend towards "proceduralisation" of direct regulation: that is to say, the use of direct regulation not directly to set down substantive standards (i.e., to establish "substantive law" in the sense used above), but rather to establish procedures aimed at evaluating the effects of regulatory or administrative action on the environment. These procedures may be purely internal, such as the Commission's own requirement to carry out an Impact Assessment for each major policy proposal, evaluating its compatibility with the sustainable development concept (although these are subsequently published).[26] Alternatively, they may include external elements, such as provision for the participation of interested third parties (whether from industry, environmental interest groups, or the general public) in the regulatory process.[27] In this scenario, proceduralisation achieves a dual aim: demonstrating expressly to the public that the final decision represents the culmination of a thorough reasoning process, in which the regulator has taken all relevant environmental factors into account, as well as, increasing the democratic credentials of the ultimate decision taken.

c. Some merits and demerits of direct regulation

Direct regulation is well-suited to certain areas of environmental regulation: in particular, setting pollution limits for specific installations (e.g., large industrial installations as covered by the IPPC Directive). It has the benefit of enabling very specific limits to be prescribed per industry, while still leaving some scope for flexibility via the adaptation of regulatory requirements to local conditions. This is particularly evident with the new, more flexible approach to standard-setting using BAT standards, as adopted in the IPPC Directive. It is also, however, to be seen in more traditional direct regulation - an example being emissions standards, which, although prescribing the ultimate maximum emissions from an installation or product, do not prescribe the way in which the standard must be achieved.

Further, it is generally accepted that direct regulation is the only way of protecting certain especially precious natural resources – e.g., to preserve biodiversity, endangered species, or special habitats. Market mechanisms and private law rights are insufficient to achieve such protection: as the "beneficiaries" of such resources (humanity as a whole) cannot easily be

[25] Directive 96/61on integration pollution prevention and pollution control OJ 1996 OJ L 257/26 (now Directive 2008/1 OJ 2008 L 24/8). Under the IPPC Directive, BAT is determined after a Commission-organised exchange of information between experts from the EU Member States, industry and environmental organisations, which exchange of information results in the adoption and publication by the Commission of "BAT Reference Documents" (BREFs). In addition, licensing authorities have flexibility, in determining permit conditions, to take into account the technical characteristics of the installation, its geographical location and local environmental conditions.

[26] Commission Communication on Impact Assessment, COM (2002) 276 final.

[27] See, for example, the Environmental Impact Assessment Directive (Directive 85/337 OJ 1985 L 175/40, as amended, which includes the possibilities for the "*public concerned*" to express an opinion on the project and the participation of administrative bodies dealing with nature protection.

charged with the cost of protecting them, insufficient market incentives exist for the owners or managers of these resources to preserve them.[28]

Direct regulation also has legal certainty and transparency advantages. From the perspective of those trying to comply with the legislation - e.g., industry - the requirements to be met by direct regulation are normally relatively clear and certain (though, where standards are more flexible – as with Best Available Technology standards – requirements become less certain). From the general public's perspective, direct regulation lays down a (more or less) precise, visible and consistent standard to be met by industry (or whatever party at which the legislation is directed), thus (potentially) increasing public confidence in governmental efforts to improve environmental standards.[29]

Nonetheless, one can identify numerous disadvantages with direct regulatory methods. We will confine ourselves in this Chapter to six potential problems with the direct regulatory technique.

i. Time lag

The first can be called the "time lag" problem, which stems from the fact that, with traditional direct regulation, standards are fixed by the regulator at given points in time. Though more or less frequent revisions to the standards may be built into the system, even the most ambitious revision program will likely fail to keep up with technical innovations in the industry, or indeed to changes in environmental or economic conditions. Indeed, one of the benefits of traditional direct regulation - certainty for industry - would be compromised if the standards set were to change too frequently. As a result, direct regulation may disincentivise innovation: industry has little incentive to develop more cost-effective, efficient methods of reducing pollution if this would mean going beyond their legal obligations under the applicable standard set down by law.[30]

A related disadvantage of direct regulation focuses on traditional permit systems. As mentioned above, such permit systems form one of the primary means of implementing standards imposed on significant polluters by direct regulation, in industries such as chemicals, power generation and waste managements. Where permits are given out for free - as is normally the case - installations have no incentive to reduce pollution to below the permitted level. Nor, as traditional permits are non-transferable, are installations incentivised to lower their pollution in order to be able to sell (part of) their permitted amount for profit. This leads us to one of the points of contrast between traditional direct regulation permits and the Community's Emissions Trading Scheme, discussed in detail in Chapter 4.

ii. Information deficit and regulatory costs

A second disadvantage of direct regulation may be termed the "information deficit" problem: governments often do not know what type of regulation, or which standards, are best for an industry. Rather, it is industry, not regulators, which has the "best" information

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[28] See further, the discussion of environmental externalities and the "tragedy of the commons" scenario discussed in Chapter 8.

[29] See Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 14, at 145-6.

[30] See *contra*, however, Porter and van der Linde, "Toward a New Conception of the Environment-Competitiveness Relationship", Journal of Economic Perspectives, 9(4), Fall 1995, 97.

which would be necessary to set effective and efficient standards. This rigidity may lead to a risk of over- or under-regulation (for example, in the case of anti-pollution regulation, new pollutants may appear frequently, which can only later be taken into account if using a traditional standard-setting mechanism). In addition, that information which regulators can obtain is costly to gather, meaning that standard-setting is a relatively costly means of regulating. These additional costs for regulators, added to the extra costs for those regulated entailed by complying with permits which may not, in fact, contain optimal conditions for environmental protection, mean that direct regulation can be an unduly costly affair (whether compared to other regulatory methods with similar results; or compared to the benefits of the legislation).[31]

The drive towards "flexibility", mentioned above, is an attempt to remedy each of these problems. Many, however, consider this drive – in particular its star player, the BAT technique – to be at best a qualified success. Though the BAT approach certainly helps to solve problems of information deficit, with industry providing much of the information required to regulate, it cannot, for example, realistically enable continuous reassessment of what amounts to "best available technology" (as demanded in order properly to deal with the time lag problem).

iii. Dependence on enforcement

A third, and major, disadvantage of direct environmental regulation is that its effectiveness necessarily depends on effective enforcement - which in turn depends on the government's resources and enforcement policy of the day. It is fair to describe enforcement of environmental law as the Achilles Heel of contemporary Community environmental policy (though, of course, it is not a problem specific to Community or environmental law).[32] As the Community has no "environmental enforcement agency" - proposals to this effect made by some commentators have been vociferously rejected by Member States wary of encroachment on what they perceive as their sovereignty territory - Community direct regulation is dependent for effectiveness on a combination of variables, or conditions of effectiveness. In particular, the effectiveness of such direct regulation depends on:

- Member States' enforcement authorities' taking action against individual non-complying operators. Such enforcement may be via administrative tools of enforcement (such as withdrawing a permit, or imposing administrative penalties), or via criminal law tools of enforcement. In each case, as the ECJ has long held, the starting point is, in principle, national procedural autonomy: Member States are free to choose how to penalise breaches of Community law, subject to the principles of equivalence (remedies must be equivalent to those for comparable breaches of national law) and effectiveness (remedies must not render the enforcement of Community rights impossible or excessively difficult).[33] However, a certain (limited) amount of harmonisation of remedies has taken

[31] This may to some extent be remedied by the use of "bespoke" permits, the conditions of which are tailored to the individual operator. The downside of such permits is, however, that costs to the regulator are increased by the cost of negotiating the bespoke permit. See further, Holder and Lee, *Environmental Protection, Law and Policy* (2nd ed., Cambridge, Cambridge University Press, 2007).

[32] See, for example, Lee, *EU Environmental Law: Challenges, Change and Decision-Making* (Oxford, Hart, 2005 and Farber, "Taking Slippage Seriously: Noncompliance and Creative Compliance in Environmental Law" (1999) 23 Harvard Environmental Law Review 297.

[33] See, for example, Case 199/82 *San Giorgio* [1983] ECR 3595.

place at Community level.[34] The most notable recent example is the agreement on the text of a Directive partially to harmonise remedies by requiring Member States to establish criminal sanctions for certain serious environmental offences in May 2008 by the European Parliament and the Council, following the ECJ's *Environmental Criminal Penalties* judgment of October 2007.[35] Nonetheless, it by no means follows from the creation of a criminal offence on the books of national criminal law that Member States' prosecutors will have the time, resources, or inclination, to pursue all or most of such offences.

- The enforcement of Community law (or an implementing national law) by private parties through their national courts. However, this faces a number of potential problems. First, certain Member States employ restrictive standing rules for "diffuse" environmental interest claims, some of which require proof of a "sufficient interest" or "right" at stake.[36] Environmental claims are notoriously difficult to categorise as traditional rights-based private law claims. Second, broader problems of access to justice often exist, in particular as regards funding. These tend to be a particular issue for environmental claims, due essentially to "tragedy of the commons"[37] reasoning, i.e., individuals do not generally have an economic interest in bringing cases to protect public environmental resources.[38] As a result, private environmental enforcement of Community law does not at present play a major role in most Member States.

- Article 226 EC and Article 228 EC actions brought by the Commission against Member States for failure to fulfil their Treaty obligations. Again, this is dependent on finite Commission resources.[39] Further, there is a risk that Member States will ignore a Court

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[34] See, for example, Article 16(3) of Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community OJ 2003 L 275/32 and Articles 5 and 6 of Directive 2004/35 on environmental liability with regard to the prevention and remedying of environmental damage OJ 2004 L 143/56.

[35] See Case C-176/03 *Commission* v *Council* [2005] ECR I-7879 and Case C-440/05 *Commission v Council (Ship-Source Pollution)*, judgment of October 23, 2007, not yet reported, and the legislative resolution of the European Parliament of May 21, 2008 on the proposal for a directive of the European Parliament and of the Council on the protection of the environment through criminal law (COM(2007)0051 – C6-0063/2007 – 2007/0022(COD)) and the Press Release of the Council of May 21, 2008.

[36] This is also, of course, a major problem in actions brought by environmental interest groups against Community institutions before the Court of First Instance: see, for example, Case T-585/93 *Stichting Greenpeace Council (Greenpeace International) and Others v Commission* [1995] ECR II-2205. However, the ECJ has to a certain extent encouraged the reliance on Community environmental law by individuals before national courts in cases such as Case C-201/02 *Wells* [2004] ECR I-723 and Case C-72/95 *Kraaijeveld* [1996] ECR I-5403, where it interpreted its doctrine that Directives cannot be relied upon in national courts by individuals against other individuals (i.e., do not have horizontal direct effect) in a restrictive manner.

[37] See Hardin, The Tragedy of the Commons, 162 Sci. 1243 (1968).

[38] Note, however, the relevance of the Aarhus convention (UNECE Convention of June 25, 1998 on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters) to this area, one of the pillars of which is the requirement of sufficient access to justice in environmental matters. This is implemented in the EU, in this regard, by Directive 2003/35/EC providing for public participation in respect of the drawing up of certain plans and programmes relating to the environment OJ 2003 L 157/17.

[39] This problem has, however, to some extent been alleviated by the acceptance of the doctrine of "general and persistent breach" by the ECJ – a doctrine which holds that, where the Commission has adduced evidence of a "*systemic and consistent*" tolerance of breaches of Community environmental law up to the reasoned opinion, showing "*sufficient*" proof of a general and persistent breach by the Member State, the burden of proof shifts onto the Member State to show that it complied with Community law. See Case C-494/01 *Commission v Ireland*

ruling against them: while Article 226 EC judgments were given more "teeth" by the Treaty of Maastricht's introduction of Article 228(2) EC (providing for the possibility of bringing a new action for the imposition of penalty payments or fines where a Member State has failed to comply with a Court ruling),[40] certain Member States continue to be tardy in complying.[41] Nonetheless, environmental enforcement constitutes a significant proportion of the ECJ's workload, which hands down an average of one judgment per week on environmental matters.[42]

In sum, the enforcement of Community direct environmental regulation is at present essentially dependent on the policy priorities and resources of the Commission, on the one hand, and Member States' authorities, on the other. Neither can hope to have enough resources to achieve anything close to "full" enforcement, nor is anything close to this being achieved at present.[43] As a result, it is fair to say that, at present, standards set by direct regulation give a false sense of security as to the state of the European environment.

iv. Regulatory "capture"

A fourth disadvantage of direct regulation is what is known as the "capture" phenomenon: in setting standards, regulators are susceptible to "capture" by well-funded interest groups, i.e., the procurement of favourable regimes or opt-outs for their particular group, or even just the use of data which are acceptable to one interest group (but not necessarily another). This well-documented[44] phenomenon poses major problems for the democratic credentials of the resulting legislation. Such problems of democratic legitimacy are further reinforced by the fact, mentioned above, that prioritisation of enforcement is largely a matter of discretion for the enforcer (whether the Commission or national enforcement bodies): there is no "litmus test" defining which non-compliance cases are pursued and which are treated more leniently. To a certain extent, this is remedied by the "proceduralisation" trend in Community environmental law, also discussed above, insofar as impact assessments enhance transparency and (sometimes) allow for public participation. However, even in this scenario, regulators inevitably have discretion as to how and to what extent they take the public's comments or contributions into account in making the final decision.

v. Diffuse source pollution

Fifth, while direct regulation can be very effective in pursuing single-source pollution problems (e.g., controlling emissions from particular industrial installations), it is not always suitable for tackling environmental harms caused by diffuse, generalised sources. A good

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[2005] ECR I-3331, which concerned twelve separate complaints, which were dealt with together in a single case via this doctrine.

[40] Article 228(2) EC has been used on numerous occasions in environmental cases: see, for example, Case C-387/97 *Commission v Greece* [2000] ECR I-5047 and Case C-278/01 *Commission v Spain* [2003] ECR I-4947.

[41] For example, at the year-end of 2004, 81 environmental judgments had not been complied with from that year: Seventh Annual Survey of the Implementation and Enforcement of Community Environmental Law 2005, SEC (2006) 1143, Commission Staff Working Paper.

[42] See further, Jacobs, "The Role of the European Court of Justice in the Protection of the Environment" Journal of Environmental Law 18 (2006) 185.

[43] See Seventh Annual Survey of the Implementation and Enforcement of Community Environmental Law 2005, SEC (2006) 1143, Commission Staff Working Paper.

[44] See, for example, the large body of "public choice" theory commentary, such as Makkai and Braithwaite, "In and Out of the Revolving Door: Making Sense of Regulatory Capture" (1995) 1 Journal of Public Policy 61 and, for an economic perspective, Buchanan and Tullock, "Polluters' profits and political response: direct controls versus taxes", The American Economic Review, 65(1) 401 (1975). See further, Chapter 7.

example is climate change, which is caused by carbon dioxide emissions from a multitude of sources, some natural, some human-made. It would be impossible for one body - or even numerous bodies - to gather information on and regulate all of these sources and enforce this regulation. Another, broader, example is the environmental harm, seen in a globalised manner, caused by the habits of consumers in general - i.e., the inherent, global effect on the environment of purchase-driven, capitalist society. Taking the Community's Waste Strategy as an illustration, while recycling targets and making waste-disposal operators subject to licence may limit environmental damage to some extent, clearly the underlying problem for this strategy is the level of consumption in the first place. For this reason, reduction in consumption is priority number one of the Community's waste policy, with re-use and control of waste processing appearing further down the list of priorities.[45]

vi. Fragmentation of approach

A sixth, related disadvantage is the tendency of direct regulation techniques, in pursuing single-source pollution problems, to adopt a (medium-, industry- or installation-) fragmented approach, rather than an "internally" integrated approach looking at the total effects on the environment of, for example, a particular installation. This is one of the main issues which the novel approach of the IPPC Directive seeks to address - by using a permitting technique which is not confined to a single medium (e.g., water, air), but which covers a plant's emissions into a variety of different media. This approach represents what is known as "internal" integration - the integration of different media-specific approaches to environmental regulation (in contrast to Article 6 EC's external integration of environmental considerations into non-environmental policy areas).

d. Conclusion: the limits of direct regulation

In sum, direct regulation has clearly, in many respects, treated the Community very well as a regulatory technique for environmental problems; but it has its limits. Moroever, European regulators are becoming acutely aware of this. The view of Sir John Harman, Chairman of the UK's Environment Agency, is illustrative:

> *"[Direct regulation] has a long successful history of substantial benefit for people and the environment. Great smogs are a thing of the past. Our air, rivers, beaches and drinking water are the cleanest they have been since before the industrial revolution. But regulators, like society as a whole, face new challenges, and must adapt to them…[C]lassic environmental regulation has proved a powerful force for good over the last century, but the times they are a-changing. The world is more complex, attitudes and expectations have shifted, and our regulatory model must respond. The acid test is the environmental outcome of our regulatory activity."*[46]

To a certain extent, the Community has reached a plateau in the effectiveness of direct regulatory techniques in its environmental policy.[47] Landmark Community legislation has, from the 1970s onwards, been passed in those areas which lend themselves naturally to this

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[45] See, for example, Commission Communication, "Taking sustainable use of resources forward - A Thematic Strategy on the prevention and recycling of waste" COM (2005) 666 final.

[46] Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 141.

[47] See, more generally, Dryzek, *The Politics of the Earth: Environmental Discourses* (Oxford, Oxford University Press, 1997), 418, who notes that, "…*the administrative state may be running out of steam in the environmental arena, or experiencing diminishing returns to effort. This would accord with experience in other policy areas such as crime, public health, industrial development, and education. It is relatively easy to achieve substantial initial gains, because the relatively easy and most visible problems will be attacked first. It is very hard to show sustained improvement on any dimension once these initial gains have been made (though occasionally a technological breakthrough may allow more substantial change).*"

form of regulation - such as biodiversity regulation, the regulation of waste and the regulation of particular dangerous substances. Since the beginning of the 1990s, however, the pace of such legislative activity has slowed. With most of the obvious candidates for direct regulation covered, and some of the disadvantages of direct regulation becoming evident - in particular, its tendency to disincentivise innovation and investment in new, greener technologies - the Community began in earnest to look for alternative, more efficient regulatory tools. Certain of these tools (in particular, regulation using BAT standards) have been a success, but a limited one. It is in this context that the emergence of market-based instruments, and the recent significant increase in their popularity, must be viewed.

4. Market-based instruments in Community environmental policy

As already mentioned, "economic", "incentive-" or "market"-based instruments essentially work by using market mechanisms to create incentives for actors to change their behaviour.[48] This category of instrument, which has grown increasingly popular in the EU since the 1990s, is hailed by some commentators as a (partial) solution to many of the problems associated with direct regulation, such as the problems of stifling of innovation, the information deficit, and the relatively high cost of direct regulation.[49]

a. The development of market-based instruments

i. Theoretical origins

The origins of the much of the current "wave" of environmental economic instruments can be traced back to the hugely influential "Law and Economics" movement.[50] In the environmental context, this movement has found expression in instruments and principles which seek to adopt an economic solution to the problem that many environmental resources amount to "public goods" in the economic sense. By this is meant resources characterised, first, by lack of "rivalry" or "nondiminishability" (i.e., one agent's consumption is not at the expense of another's consumption) and second, by lack of excludability (i.e., agents cannot be prevented by other agents from using the resource). Where resources fall within this category, this generally leads to inefficient outcomes, preventing the "invisible hand" of the market mechanism from functioning properly. Where the public good is an environmental resource, Hardin's celebrated "tragedy of the commons" argument posits that this can lead to overexploitation of the resource.[51] In economic terms, another way of putting this is that environmental damage is, traditionally, viewed as a negative externality; that is, a situation where one actor's production or consumption decisions have an unintentional negative impact on another's utility or profit, for which no compensation is made.[52] This means that, in the absence of corrective policy, the operation of the market will result in more pollution being produced than efficiency

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[48] Perman, Ma, McGilvray and Common, note 6 above, at 217.

[49] See, for example, OECD, *Evaluating economic instruments* (Paris, OECD, 1998).

[50] Though tracing its roots back to Jeremy Bentham, has flourished in the US and is epitomised by the writings of academics such as Ronald Coase, Guido Calabresi, Richard Posner and, in the environmental field, Richard Revesz and Richard Stewart. For an overview of Law and Economics thinking, see Posner, Economic Analysis of Law and Stewart, "The Importance of Law and Economics for European Environmental Law", (2002) 2 Yearbook of European Environmental Law 1.

[51] Hardin, "The Tragedy of the Commons" 162 Sci. 1243 (1968), taking its name from the fact that, historically, resources such as pastureland and fisheries were owned in common.

[52] See, Perman et al, note 6 above, at 134 and Frank, *Microeconomics and Behaviour* (6th ed., New York, McGraw-Hill/Irwin, 2006), at 607.

requires (i.e., market failure), because market actors do not have to pay for the cost to society of their pollution.

Environmental economic instruments aim to tackle this problem by "internalising" negative environmental externalities into market actors' decision-making processes. This is normally achieved by placing a price on pollution – whether this price is decided upon by the State (in the case of environmental charges and taxes) or by market operators themselves (in the case of tradable permit systems). Alternatively, some economic instruments work by ensuring that environmentally-friendlier market operators have, more generally, a market advantage (for example, voluntary agreements). Each of these instruments is discussed in Chapter 4. As the common thread in these approaches is the use of market mechanisms to incentivise environmentally-friendlier behaviour, economic instruments are, in principle at least, an obvious choice for proponents of sustainable development: in theory, they provide an economically efficient, welfare-maximising way of achieving environmental goals.

ii. Development in international, EU and Member State policy

Driven by the failure of many types of direct regulation successfully to improve environmental conditions, the movement towards employing economic instruments to "use" the market to attain better environmental results has essentially developed since the beginning of the 1990s at international, Community and Member State levels.

At international level, the use of economic instruments has been championed, in particular by the OECD since the 1990s.[53] An example is the Declaration of the 1992 UN Rio Conference, Principle 16 of which proclaimed,

> "*National authorities should endeavour to promote the internalisation of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution with due regard to the public interest and without distorting international trade and investment.*"

This was followed by the UN Framework Convention on Climate Change in 1992, Article 4(2)(e) of which requires developed country contracting parties to "*coordinate as appropriate with other such Parties, relevant economic and administrative instruments developed to achieve the objective of the Convention.*" Article 4(2)(e) in turn laid the foundation for the 1997 Kyoto Protocol which, in authorizing certain greenhouse gas emissions trading arrangements, set the scene at international level for one of the most important economic instruments in use today - tradable permit systems, discussed below.

At Community level, the move towards the use of economic instruments also began at the beginning of the 1990s. Thus, the Commission proposed the first international environmental tax in 1992 which, though it never got through the Council, would have levied a tax on certain fossil fuel products on the basis of carbon dioxide emissions and energy content.[54] The Community's Fifth Environmental Action Programme (EAP), "Towards Sustainability", represented a major shift of environmental instruments into the regulatory "spotlight". One of the principal "themes and priorities" of this EAP was

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[53] One of the first formal references at UN level to the benefits of economic instruments is to be found in the Ministerial Declaration of the Second World Climate Conference held in Geneva in 1990, cited in Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003), at 154.

[54] Commission Proposal for a Council Directive Introducing a Tax on Carbon Dioxide Emissions and Energy, COM (92) 226 final.

"*Broadening the Range of Instruments*" used in Community environmental law. This was dealt with in Chapter 7 of the EAP, which states that,

> "*In order to bring about substantial changes in current trends and practices and to involve all sectors of society, in a spirit of shared responsibility, a broader mix of "instruments" needs to be developed and applied. Environmental policy will rest on four main sets of instruments: regulatory instruments, market-based instruments (including economic and fiscal instruments and voluntary agreements), horizontal supporting instruments (research, information, education etc) and financial support mechanisms.*"[55]

The EAP went on to identify five particular types of economic instrument on which the Community would focus: charges and levies, fiscal incentives, state aids, environmental auditing and environmental liability.[56] Tradable permits were mentioned as an "*alternative*" to these instruments, to be studied in further depth.[57] This approach was combined with accentuation of the Article 6 EC integration principle, discussed in Chapter 2 above. Indeed, the use of economic instruments has often gone hand-in-hand with emphasis on the integration principle and sustainable development at the Community policy-making level, being recommended in the Commission's 2001 Sustainable Development Strategy[58] and its 2004 Stocktaking of the Cardiff Process.[59] In furtherance of this objective, a wide number of Community measures were taken between 1993 and 2003, the most important of which are discussed below. The current, Sixth, Environmental Action Programme of the Community continues the emphasis on a market-based approach to environmental regulation, including the need for policy integration in pursuit of sustainability as one of its "*strategic approaches*".[60] The approach is also evident in the Commission's 2005 Review of the Community's Sustainable Development Strategy[61] and, most obviously, in the Commission Green Paper of March 2007 dedicated to the topic of market-based instruments in

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[55] Fifth Environmental Action Programme, "Towards Sustainable Development" OJ 1993 C 138/1, 68. Article 3 of the 1998 Review of the Fifth EAP confirmed this general focus. This Article provides that, *"The Community will develop, apply or otherwise encourage a broader mix of instruments in order to bring about substantial changes in current trends and practices in sustainable development, taking account of the subsidiarity principle. 1. In relation to the development, at an appropriate level, of effective market-based and other economic instruments as a means of implementing policy, special attention will be given to: (a) environmental accounting; (b) examining constraints on the introduction of economic instruments and identifying possible solutions; (c) the use of environmental charges; (d) identifying subsidy schemes which adversely affect sustainable production and consumption practices with a view to their reform; (e) encouraging the application of the concept of environmental liability at Member State level; (f) voluntary agreements which pursue environmental objectives while respecting competition rules; (g) encouraging the use of fiscal instruments to achieve environmental objectives, inter alia by considering possible legislative initiatives in this area during the course of the Programme and continuing the study of the potential wider benefits of such instruments, notably in the context of the general economic objectives of the Community, such as employment, competitiveness and growth…."*

[56] *Ibid*, 71 – 72.

[57] *Ibid,* 71.

[58] Commission, "A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development" COM (2001) 264 final, at 7.

[59] Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final.

[60] Decision 1600/2002 laying down the Sixth Community Environmental Action Programme OJ 2002 L 242/1, Preamble, recitals 13 – 14 and Article 2(3) and Article 3(5).

[61] "The 2005 Review of the EU sustainable development strategy: initial stocktaking and future orientations" COM (2005) 3, one of the key strategies of which was to get "*prices and incentives right*".

environmental policy, where the Commission states that, "…*market-based instruments and fiscal policies in general will play a decisive role in delivering the EU's policy objectives*."[62]

At Member State level, varying degrees of enthusiasm about economic instruments still persist, with Member States holding better environmental records generally tending to be the first to use such instruments. Early examples were Sweden (with its espousal of environmental taxation) and Denmark and Germany (with their deposit-refund systems). More recently, the UK has embraced economic environmental instruments firmly, introducing a Landfill Tax in 1996 and its own voluntary national tradable permits scheme for carbon dioxide equivalent emissions in 2002, which was the world's first economy-wide greenhouse gas emissions trading scheme.[63]

b. Some merits and demerits of market-based instruments[64]

The huge increase in the popularity of environmental economic instruments begs the question: Why are environmental regulators turning to the market?

i. Advantages of market-based instruments

There are four main categories of advantage which economic instruments, considered in general, enjoy in contrast to direct regulation.

1. Internalisation of externalities

As we have seen, failure to achieve such internalisation is a major defect with direct regulation, meaning that regulators try to "second-guess" the costs of pollution, and that the burden is placed on government agencies to enforce environmental policy, despite having insufficient resources to do so. By internalising externalities, thus remedying market failure at the micro level - "*bringing the environment into the boardroom*"[65] - the idea is that use of economic instruments not only increases the effectiveness of environmental protection policy, but also achieves a more "just" outcome as, consistently with the polluter pays principle, those actors which cause environmental damage are the ones charged with paying the price for it (rather than the burden of remedying the damage falling on society as a whole).

2. Cost-effectiveness

Second, economic instruments can often be more cost-effective than direct regulation, achieving an environmental aim (a societal "benefit") at the least "cost" to society. This is often because the regulated party has the best information to be able to choose whichever

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[62] Green Paper on market-based instruments for environmental and related policy purposes, COM (2007) 140 final, at 2. In this Green Paper, the Commission has, *inter alia*, mooted the establishment of a "market-based instruments" forum to stimulate exchanges of Member States' experience, and raised the question of applying a market-based instrument to emissions in the maritime sector.

[63] See further, http://www.defra.gov.uk/environment/climatechange/trading/uk/index.htm. For a database of economic environmental instruments in use in the EEA at present, maintained by the OECD and European Environment Agency, see http://www2.oecd.org/ecoinst/queries/index.htm.

[64] See further, for example, Ackerman and Stewart, "Reforming Environmental Law" (1985) 37 Stanford Law Review 1333, Stewart, "The Importance of Law and Economics for European Environmental Law" (2002) 2 Yearbook of European Environmental Law 1, Galizzi, "Economic instruments as tools for the protection of the international environment" (1997) European Environmental Law Review 155, Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45).

[65] Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 141, at 147.

way of achieving a given environmental result is least costly, giving in-built flexibility to the process. In contrast to command and control regulation, therefore, polluters who can reduce pollution more cheaply than other polluters have an incentive to do so flowing from market-based instruments.[66] In addition, economic instruments may be cost effective because of the reduced amounts spent on enforcement - in comparison to enforcement-heavy direct regulatory methods.[67]

3. Fewer problems of time lag and informational deficiency

Third, from an informational perspective, the use of economic instruments can be seen as avoiding the "time lag" problem which faces regulators using direct regulation: market actors are better placed to know what the best and most efficient technology is at present, and to develop such technology to gain a market advantage. The use of economic instruments thus provides market actors with an ongoing incentive to develop new technology by putting a price on pollution. This results in what economists term "dynamic efficiency benefits", whereby the market's incentive structure operates to reward successful environmentally friendly behaviour.[68] Moreover, the use of economic instruments avoids the undesirable "uniformity" of legislation and informational difficulties so often a hallmark of direct regulation. As a result, in situations of uncertainty - where firms' marginal abatement costs are not known with accuracy to the regulator, as is very often the case in the environmental context - market-based instruments by and large achieve the most cost-efficient results.

4. More democratic

Fourth, economic instruments are viewed by some as more "democratic", as decisions to act are in principle taken not by the regulator, but by individual market players. By thus increasing participation, such instruments form part of a broader transition which can be dubbed a movement from "government" to "governance" - i.e., the movement from one or more centralised regulators to include a broader base of involved and informed non-governmental participants in environmental performance.[69] This makes a lot of sense from a practical perspective, given the major enforcement and informational problems with which, as we have seen, direct regulation is faced - in particular at Community level, in the absence of any Community environmental "police force" on the ground - and fits well with the subsidiarity principle. More broadly, it also alleviates the problem of "capture" of the regulator by interest groups, which, as we have seen, may pose problems for the legitimacy and effectiveness of direct regulation.

ii. Disadvantages of market-based instruments

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[66] Perman, Ma, McGilvray and Common, note 6 above, at 234, summarising the conclusions of Tietenberg, Economic instruments for environmental regulation, Oxford Review of Economic Policy 6(1), 17 (1990).

[67] See the studies simulating the effects of policies using economic instruments in reducing air pollution in different areas of the United States; a review of the results from 11 of them found that, on average, the cost of achieving a given environmental objective through command and control policies was six times higher than for cost-minimising instruments such as emission taxes and tradable permits: OECD Observer, "Do Economic Instruments Help the Environment"? (Paris, OECD, 1997).

[68] See Perman et al, note 6 above, at 236.

[69] See further, Holder and Lee, *Environmental Protection, Law and Policy* (2nd ed., Cambridge, Cambridge University Press, 2007, 164 – 167.

Economic instruments also have their disadvantages, which may be grouped into four general categories.

1. Market failure

First, the market does not always work properly, which may mean that environmental goods are priced wrongly. This is usually due to flaws in the way in which the market is set up in the first place. For instance, there may be informational difficulties in setting the price of such goods where this must be set centrally, as with environmental taxes; or, in a market for tradable permits, where the market is flooded with permits; or where there are insufficient players on the market. In addition, the market structure is simply not suitable for certain environmental aims, with the preservation of the biodiversity of protected or endangered species being a good example. Short of giving property rights over certain species or habitats to individual legal or natural persons (which many people would find unacceptable for such resources), there are few ways in which the costs of damage to such unique resources can properly be valued and "charged" to those who damage them.[70] Sunstein has termed this the idea of "*incommensurability*": where the loss of a resource would mean losing something unique and qualitatively distinctive.[71]

2. Ethical problems

Second, many "deep green" thinkers have difficulty with the very idea of putting a price on environmental goods, which effectively can be seen as giving a right to damage such goods to those who can afford to pay for it (in contrast to direct regulation, where it is possible, at least ostensibly, to prevent damage occurring at all). In a similar sense to the positions of "strong sustainability" we looked at in Chapter 2, they have a problem with the very idea that environmental protection should be allowed to depend on purely economic choices made in the market, using a cost-benefit analysis to maximise individual "welfare". They criticise such "*economic rationalism*" as reducing the importance of the environment to its usefulness as an input to the economy: the right to pollute can be bought like any other commodity, thus potentially removing any stigma which might otherwise attach to polluting activities.[72]

3. Democratic concerns

Third, some critics have participation concerns about economic instruments, in that they reserve the right to participate in actions affecting the environment to economic (market)

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[70] See, however, the Commission in its Green Paper on market-based instruments for environmental and related policy purposes, COM (2007) 140 final, which explicitly rejects the idea that such instruments may never be appropriate to protect biodiversity. It gives the examples of imposing charges and fees for hunting and fishing permits; and granting subsidies under the Common Agricultural Policy to compensate landowners for undertaking environmental improvements to their land. A further example taken by the Commission is the US-developed instrument of "habitat banking", whereby a region sets a target for how much land it wants to keep for wildlife conservation, then leaves it up to the free market to find the most cost-effective way of achieving this goal. If a developer wants to destroy valuable habitat, it must purchase a permit to do so from someone who has created a piece of valuable habitat elsewhere. See further, Press Release of the European Science Foundation of October 12, 2007, "Buying and selling habitats to help wildlife". Note, however, that the Commission does not suggest that market instruments are appropriate to ensure protection of rare or endangered species.

[71] Sunstein, "Two Conceptions of Irreversible Environmental Harm", Chicago, John M. Olin Law & Economics Working Paper No. 407 of May 2008.

[72] See further, for example, Dryzek, *The Politics of the Earth: Environmental Discourses* (Oxford, Oxford University Press, 1997), 118.

actors, which have vested interests in growth and profit.[73] Linked to this concern are criticisms related to distribution, which argue that the very nature of many market-based instruments means that lower-income persons will inevitably be at a disadvantage in a market context: only those who can afford to pollute will continue to be able to do so.[74]

4. Certain costs are inevitable

Fourth, it is not the case that economic instruments can work without any regulatory framework; rather, they require a certain amount of supervision by regulators and the setting of the broad framework for their operation. This clearly entails a certain amount of cost, albeit not as much as for direct regulation. Taking emissions trading as an example once again, clearly a huge amount of organisation and supervision are involved in setting up the markets, distributing the emissions allowances, and making sure that allowances are not exceeded (and if they are, penalising this).

In sum, it is clear that economic instruments in themselves cannot provide all the regulatory answers, and need to be used in combination with - not to replace - direct regulation. In cases where direct regulation is particularly effective - e.g., regulation of "point-source" pollution from large industrial installations, particularly involving more damaging pollutants, or regulation of biodiversity - direct regulation is often a better choice than market-based instruments.[75] Nonetheless, in a substantial variety of scenarios, market-based instruments offer a more efficient and more effective means of achieving environmental protection goals. The next Chapter takes a closer look at the functioning of three of the economic instruments which, it will be argued, are of most relevance to Community competition policy: environmental taxation, tradable permit systems and voluntary agreements.

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[73] See, for example, Krämer, "Thirty years of EC environmental law: perspectives and prospectives" (2000) Yearbook of European Environmental Law 155, 185: "*Community environmental law cannot be developed without Community environmental lawyers…Placing this law into the hands exclusively of administrations or, worse, vested interest groups, could have disastrous effects on the law, as it could become placebo law.*"

[74] Johnson, "Economics v. equity: do market-based environmental reforms exacerbate environmental injustice?" 56 Wash. & Lee L. Rev. 111 (1999), at 118.

[75] Green Paper on market-based instruments for environmental and related policy purposes, COM (2007) 140 final, at 3.

Chapter 4: Focus on Market-based Instruments most Relevant to Community Competition Policy

This Chapter focuses on the three most instruments of most relevance to competition policy analysis: (1) Environmental state subsidies, including environmental taxes and other forms of state subsidy; (2) Tradable permit schemes, and especially the Community's Emissions Trading Scheme; and (3) Regulatory reliance on voluntary initiatives, such as voluntary agreements or other initiatives undertaken under the auspices of "corporate social responsibility". The Chapter concludes with a section introducing some implications of trends in environmental regulation for the Community's competition policy, which leads into the discussion of this competition policy in Parts II and III.

1. State subsidies and taxes

a. Development and usage

The taxation of pollution and the grant of state subsidies on pollution abatement are among the most commonly-used, and oldest,[1] forms of environmental instrument.

In the case of environmental taxes, their rationale is essentially that increasing the price of environmentally harmful products or activities via imposing a tax or charge will internalise the product's or activity's environmental cost, by sending out a price signal which will influence market actors' decision-making. In this way, decisions taken in the market will reflect all relevant costs, rather than just the producer's private costs, meaning that the profit-maximising pollution level will be the same as the socially efficient level.[2] This solution to the "tragedy of the commons" problem has, since first formally proposed by the economist Arthur Pigou early in the 20th century,[3] become classic (though Pigou's concept of an environmental tax has attracted numerous critics in the interim, one of the most prominent being Ronald H. Coase).[4] A further potential reason for using charges or taxation as an instrument is to raise finance for the government (whether for governmental environmental activities or otherwise). Often, however, due to public pressure and the wish to minimise obstacles to economic growth, green taxes are intended to be "fiscally neutral" – i.e., another existing tax is reduced or removed when the green tax is introduced.[5]

Examples of environmental charges and taxes currently in use at the Community level are few.[6] This is due mainly to the reluctance of Member States to allow the Community to

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[1] France, for example, has had a charge for water effluent in place since the late 1960s. Some distinguish a charge from a tax on the basis of the destination of the proceeds (in the case of a charge, the proceeds go for environmental purposes only; in the case of a tax, the proceeds go into the general public "pot"), though this distinction is not universally adopted. See, Sands, *Principles of International Environmental Law* (2nd ed., Cambridge, Cambridge University Press, 2003, at 161.

[2] See Perman, Ma, McGilvray and Common, *Natural Resources and Environmental Economics* (3rd ed., Essex, Pearson Education Limited, 2003), at 218. Perman et al note that, from an economic perspective, it will be profitable for firms to reduce pollution as long as their marginal abatement costs are less than the value of the tax rate per unit of pollution: *ibid.*

[3] See Pigou, *The Economics of Welfare* (London, Macmillan & Co., 1932), 183: hence the appellation "Pigouvian taxes."

[4] Coase, The Problem of Social Cost, 3 J. L. & Econ. 1 (1960).

[5] In the UK, for example, fiscal neutrality of green taxation is the explicit goal. See Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 141.

[6] See generally, Commission Communication on environmental taxes and charges in the Single Market, COM (97) 9 final.

legislate on fiscal matters, which is still subject to unanimity of voting under the legal bases for indirect taxation (Article 93 EC – i.e., taxation not collected directly from the taxpayer, such as VAT) and direct taxation (Article 94 EC – i.e., taxation collected directly from the taxpayer, such as income tax). One of the key areas in which proposals have been made for Community-level environmental taxation is the taxation of energy and energy products. As mentioned above, the Commission's 1992 proposal of a carbon tax never got past the Council.[7] In 2003, however, a Directive on an Energy Tax was passed, imposing a very limited tax on energy products.[8] The Commission is currently considering revisions to the Energy Tax Directive, including dividing the Community minimum levels of taxation into separate energy and environmental elements, meaning separate taxes at national level in the form of an energy tax and an environmental (emissions) tax.[9] In its Green Paper of March 2007 on market-based instruments, the Commission raised the issue of increasing the number of environmental taxes at Community level; for example, imposing a harmonised landfill tax with EU-wide minimum rates.[10] In addition, Commissioner Dimas has, informally, suggested that Community environmental taxes might be appropriate in areas such as water pricing, sustainable waste management, the reduction of local air pollution and habitat banking.[11]

At the Member State level, a large number environmental charges and taxes have, as mentioned above, been in use in certain Member States for many years. In 2006, revenues from environmental taxes in the EU represented 2.6% of GDP.[12] Examples include charges

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[7] Commission Proposal for a Council Directive Introducing a Tax on Carbon Dioxide Emissions and Energy, COM (92) 226 final. The proposal would have harmonised tax on certain fossil fuel products, with tax being levied on the basis of carbon dioxide emissions (at a rate of three dollars per barrel) and energy content - though levying of the tax would have been dependent on the adoption of similar measures by the OECD. It is interesting to note that similarly, across the Atlantic, a 1993 proposal from Clinton for an energy tax failed.

[8] Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity OJ 2003 L 36/31. The Directive extended the concept of Community-imposed minimum tax rates in the energy sector - which had only ever applied to mineral oils - to coal, natural gas and electricity. However, a number of very important sectors are exempted from the Directive, including electricity producers and the air and fisheries sectors. Member States may, however, choose to tax energy products (including electricity) "*for reasons of environmental policy*" and, conversely, may give a partial or full exemption for certain areas seen as environmentally-friendly, such as biofuels or energy products used in buses, rail and trams. See further, Case C-226/07 *Flughafen Köln/Bonn*, judgment of the ECJ of July 17, 2008.

[9] See Green Paper on market-based instruments for environmental and related policy purposes, COM (2007) 140 final, at 7. A further example of a - sectoral - environmental tax adopted at Community level is the Eurovignette Directive, Directive 1999/62/EC on the charging of heavy goods vehicles for the use of certain infrastructures, OJ 1999 L 187/42, as amended. Further, the Commission has included in its proposal for passenger car related taxes the introduction of a carbon dioxide-dependent element in the tax base of annual circulation and registration taxes. Proposal for a Council Directive of 5 July 2005 on passenger car related taxes, COM (2005) 261.

[10] Green Paper on market-based instruments for environment and related policy purposes, *ibid.*

[11] See Reuters report of March 19, 2007, available at http://www.reuters.com/article/environmentNews/idUSL1958084220070319. The Commission has, for example, stated that it will propose cuts to the VAT rate on environmentally-friendly products as part of its wider overhaul of reduced VAT rates to be tabled in 2008, following a Franco-British proposal of November 2007. See, for example, EU Observer, "EU capitals set for clash over taxes", November 14, 2007.

[12] Eurostat, News Release 92/2008 of June 26, 2008. See also Johansson and Schmidt-Faber, "Environmental Taxes in the European Union 1980-2001: first signs of a relative "green tax shift", Statistics in focus: Environment and Energy (Theme 8 – 9/2003, Eurostat), who note that environmental tax revenues for the EU Member States in 2001 amounted to €280 billion (2.7% of GDP), or more than four times the 1980 figure. See also OECD, *Evaluating economic instruments* (Paris, OECD, 1998).

for water use;[13] charges on waste discharge;[14] air pollution charges and taxes;[15] noise charges; user charges for the cost of collection and treatment services; product charges for products which pollute when manufactured, consumed or disposed of;[16] taxes on modes of transport which are perceived as less environmentally friendly;[17] and taxes on energy, such as on carbon- or sulphur-based fuels, going further than Directive 2003/96,[18] or on certain methods of producing energy.[19] 73% of the revenue generated from EU environmental taxes in 2006 was sourced from energy taxes.

A related environmental economic instrument is the grant of State subsidies to certain firms or sectors on environmental grounds. These may take the form of grants, preferable loan conditions, or tax breaks for environmentally-superior products.[20] The Commission has placed a good deal of emphasis on the importance of subsidies in achieving environmental goals, indicating in its Green Paper on market-based instruments its belief that environmental subsidies may be "*particularly relevant*" as an instrument to achieve the EU's goal of reducing greenhouse gas emissions by at least 20% by 2020 and the binding target of 20% renewables of energy production by 2020.[21]

Clearly, the major issue for present purposes regarding environmental taxes and subsidies is the extent to which they are compatible with the Community's State aid rules. This is discussed in detail in Chapter 15.

b. Merits and demerits of environmental taxation and subsidies

One of the main virtues of environmental taxation is its simplicity: in contrast to the point-source nature of direct regulation, tax is a relatively easy way of sending price signals with a view to changing behaviour more generally. As an instrument, taxation has a number of potential advantages. First, it can be applied across-the-board - rather than primarily to large installations, as is sometimes the case for direct regulation due to enforcement costs. As a result, taxation has the potential to reach smaller firms and individuals which are hard and costly to regulate individually. Taxes and charges thus often have the advantage of being easier to administer than other (non-price based) economic instruments, such as tradable permits. Second, in the case of installations subject to other environmental standards,

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[13] While some Member States have long imposed such charges, the number so doing has increased following Directive 2000/60 establishing a framework for Community action in the field of water policy OJ 2000 L 327/1, by which Member States must introduce by 2010 water-pricing policies which encourage efficient water use, in particular so that water users bear the costs of such usage - including external environmental and resource costs - under the polluter pays principle.

[14] For example, the UK's landfill tax.

[15] For example, France's charge on sulphur oxide emissions; Sweden's charge on nitrogen oxide emissions and carbon dioxide emissions; or the UK's climate change levy for IPPC installations.

[16] For example, taxes on fertilizers, pesticides, batteries, packaging or plastic bags - such as the tax on plastic bags in Ireland.

[17] For example, Swedish taxes on air tickets and motor vehicles.

[18] For example, the Swedish taxes on electricity consumption and electricity production.

[19] For example, the Swedish taxes on hydro and nuclear forms of energy production.

[20] Certain subsidies - for example, those providing grants or exemptions from environmental taxes to particularly "dirty" industries hardest hit by environmental standards – can, however, have the undesirable long-run effect of increasing the size of the targeted industry through increasing their income.

[21] Green Paper on market-based instruments for environmental and related policy purposes, note 9 above, at 5. Note that the 10% target for biofuels proposed in that Green Paper has since been revised, in light of concerns that this would exacerbate the global food crisis, with MEPs voting on July 7, 2008 to reduce the target to 4% by 2015.

taxation can provide an incentive for those regulated to do better than the standard, and thus to innovate - an incentive which, as discussed, is often lacking where standards alone are used.[22] Third, taxes may raise revenue which can be invested back into environmentally-friendly technologies and the like. Alternatively, such revenue may be channelled into reducing other distortionary taxes in the economy, thus providing what some economists term a "double dividend".[23] In general, taxation works best when there is an alternative, cleaner option to which firms or individuals can switch; where (relatively small) price signals will have an effect on market behaviour; and where it is not necessary to have a lot of exemptions to the system, so that it can stay simple.

There are, however, a number of disadvantages pertaining to use of taxes and charges as an instrument of environmental protection.

First, though the concept of "internalising externalities" via adding a Pigouvian tax makes sense in theory, in practice it is extremely difficult to estimate the correct "value" of the particular externality. As a result, it is very difficult to set the tax at a level which will be effective in incentivising environmentally-friendly behaviour, without being excessive (as a tax set too high will, just as a tax set too low, lead to inefficiencies).[24]

Second, as increases in taxation are generally unpopular, environmental tax legislation may be littered with exemptions for certain sectors, or goods, from the taxation scheme, often due to political compromise and lobbying. To this extent, the taxation approach is thus still susceptible to being criticised on grounds that legislators may be "captured", just as we saw in the case of direct regulation. Indeed, the EU's own Energy Tax Directive of 2003 is a good illustration of this phenomenon.[25] This has the potential to compromise severely the effectiveness of environmental taxation regimes.

Third, taxation may, depending on the design of the tax system, raise issues of distribution and justice. If the same type of basic consumer goods or activities are subject to equal amounts of environmental tax - which makes sense from an environmental perspective - this will impact more severely on the lowest earners in society, meaning that, in the case of taxes on essentials (such as energy) environmental taxes have the potential to be regressive rather than redistributive.[26]

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[22] See, for example, Hemmelskamp and Leone, "Do Environmental Taxes and Standards Induce Innovation?", in Welfens (ed.), *Internationalization of the Economy and Environmental Policy Options* (Berlin, Springer, 2001).

[23] See, for example, Backhaus, "The Law and Economics of Environmental Taxation: When should the Ecotax kick in? 19 Int'l Rev. L. & Econ. 117 (1999).

[24] An example is the UK's Landfill tax, introduced in 1996, which it is now acknowledged did not succeed in changing consumer behaviour because it was set at too low a level. See, for a proposed solution to this issue, Backhaus, "The Law and Economics of Environmental Taxation: When should the Ecotax kick in?" 19 Int'l Rev. L. & Econ. 117 (1999), who favours ecological taxation via a tax credit on personal or corporate income taxes on certifications of an ecological improvement scheme. See also, OECD Observer, "Integrating Environment and Economy" (Paris, OECD 1997).

[25] Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity, note 8 above. See, on the damage to effectiveness caused by routine and widespread exemptions from environmental tax regimes, Ekins and Speck, "Competitiveness and Exemptions from Environmental Taxes in Europe", Environmental and Resource Economics 13, 369 (1999).

[26] See OECD, *Evaluating economic instruments*, note 12 above, and the Commission's Green Paper on market-based instruments, note 10 above, at 5. See also, Hamm, "Die Ökosteuer - eine ordnungspolitische Fehlleistung" ORDO Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft (Stuttgart, Lucius & Lucius, 2001) 1.

Fourth, taxation is a rather blunt instrument for achieving environmental goals: it does not ensure environmental outcomes; and it may take a long time (if it ever happens) before individuals' behaviour changes. As a price-based instrument, the environmental outcome is not, therefore, as certain as in the case of instruments which place a definite quantitative "cap" on pollution (such as cap-and-trade tradable permit schemes, discussed below).[27] Further, such behaviour may revert immediately back to the environmentally-unfriendly stance should the tax be removed. This means that the environmentally-beneficial effects are dependent on the vagaries of politics - a new administration may simply abolish the tax.[28] More fundamentally, without changing peoples' underlying attitudes and beliefs about the aims of the tax, environmental taxes may result in people going to great lengths to avoid the tax, whether legally or illegally.[29] A classic example is charges for removing and processing domestic refuse: without belief in the need for proper and environmentally-friendly refuse disposal, such charges may be counterproductive, resulting in illegal dumping ("fly tipping") in the countryside (as, for example, has been a major problem in Ireland).[30]

2. Tradable permits

a. Concept

The second form of economic instrument of potential relevance to competition analysis is the tradable permit. In its simplest meaning, this indicates the creation of a regime whereby polluters are granted (or sold) a limited number of pollution rights; should they pollute less than allowed by their permit, they may sell the excess to other polluters. In this way, tradable permit schemes can minimise costs, by encouraging firms which would find it costly to reduce their emissions to purchase the right to pollute from firms for which the cost is lower. In principle, such schemes can allow for economic development to be reconciled with environmental protection, by allowing new industrial activities in the area covered by the scheme without increasing the total volume of emissions from that area.[31] One of the most common uses of tradable permit schemes at present is trading in emissions allowances - i.e., permits to emit certain pollutants, often shortened to "emissions trading schemes".[32] Emission trading schemes may be divided into two categories: "cap and trade" ("absolute" regimes) or "baseline and credit" systems ("relative" regimes).[33]

"Cap and trade" regimes generally set a total "cap" or absolute maximum quantity of emissions (measured over a specified period of time) on all emissions from the sources

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[27] See further, Green Paper on market-based instruments, *ibid,* at 4.

[28] See Dobson, *Citizenship and the Environment* (Oxford, Oxford University Press, 2003), 3 – 4.

[29] Moreover, some economists argue that the obligation imposed by environmental taxes may lead to motivational "*crowding-out effects*": that is, citizens who would otherwise have been motivated to undertake voluntary environmentally beneficial actions, for instance out of public spiritedness, may feel less inclined to do so when coerced by taxes. See Grepperud, "Environmental voluntary behaviour and crowding-out effects: regulation or laissez-faire?" Eur J Law Econ (2007) 23: 135-149.

[30] See, Report of the Irish Environmental Protection Agency, *The Nature and Extent of Unauthorised Waste Activity in Ireland* (Wexford, EPA, 2005), available at www.epa.ie.

[31] See OECD, *Evaluating economic instruments*, note 12 above.

[32] Note, however, that the term emission trading scheme is misleading, as trading takes place not in the emissions themselves, but in the allowances to emit the pollutant(s) covered by the scheme.

[33] Relative and absolute systems have, on occasion, been linked together – as was the case with the UK's greenhouse gas allowance (absolute) trading regime, which allowed trading with sectors which had negotiated Climate Change Agreements with the government and which had relative targets. See Lefevere, "Greenhouse Gas Emission Allowance Trading in the EU: A Background" (2003) Yearbook of European Environmental Law 149, 159 and 161.

covered by the regime. This quantity is then allocated as individual "allowances", either free of charge or by auction - a process which, in effect, creates new transferable property rights. After the allocation, sources can either choose to reduce their emissions and sell the excess, or increase their emissions and buy others' excess allowances. These choices are made on the basis of the market price of the allowances and the "marginal costs" of the emissions reductions for that source - i.e., the cost to the source of reducing pollution by one unit, as compared to the cost to the source of purchasing the necessary allowance. Sources have the possibility, therefore, of acting in the most cost-effective manner. Such trading systems have a fixed compliance period, at the end of which sources must be able to show that they have sufficient allowances to cover their actual emissions. In addition, the cap may be reduced over time, to improve environmental quality. Examples of current "cap and trade" systems are the scheme envisaged by the Kyoto Protocol and the Community's Emissions Trading Scheme (ETS), both of which are discussed in further detail below.

In contrast, "baseline and credit" systems have relative targets: no total "cap" of emissions is fixed; rather, a relative target is set by defining a "baseline". The baseline is usually expressed in terms of the source's emissions efficiency compared to its activity. Unlike cap and trade regimes, however, allowances are not allocated up-front, but when a source demonstrates that it is performing better than its baseline. The idea is, however, that (as with cap and trade systems) sources which can reduce their emissions more cheaply than the market price for allowances will do so, and sources for which reduction is more expensive than the market price for allowances will purchase extra allowances. However, due to the relative targets in baseline and credit systems, they do not give the same certainty of environmental outcome which cap and trade systems have in principle (though as we will see, not always in practice). Conversely, many installations prefer relative targets, as any increase in production can be countered by increasing efficiency via, for example, installing less polluting equipment, thus increasing efficiency without penalising production activity.[34]

Overall, typical components of a tradable permit scheme are: a binding (absolute or relative) target; a unit of trade (for emissions trading, normally one tonne of carbon dioxide equivalent); a system for distributing allowances to participants; and a compliance period, at the end of which participants must have enough allowances to cover their emissions, failing which they are subject to a penalty.[35]

b. Development and usage internationally[36]

One of the first emissions trading schemes widely recognised as successful was the United States' sulphur dioxide emissions trading scheme, brought in by the 1990 amendments to the Clean Air Act and which subsequently inspired the Kyoto Protocol and the EU's ETS.[37]

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[34] A number of Member States – including Germany, the Netherlands and the UK – had, prior to the Community's ETS, negotiated relative (voluntary) target emissions agreements with industry. See Barth and Dette, "The Integration of Voluntary Agreements into Existing Legal Systems" (2001) 1 Environmental Law Network International Review 20. Likewise, the Netherlands' domestic nitrous oxides trading scheme is also a relative scheme, setting a relative target in amounts of nitrogen oxide emissions per unit of energy consumed.

[35] See Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 141.

[36] On this, see Freestone and Streck (eds.), *Legal Aspects of Implementing the Kyoto Protocol Mechanisms* (Oxford, Oxford University Press, 2005). On potential design(s) of international emissions trading systems, see OECD, *Markets for Tradeable CO2 Emission Quotas: Principles and Practice* (Paris, OECD, 1995).

[37] For a recent description of the US's two main trading regimes, see Schwarze and Zapfel, "Sulfur Allowance Trading and the Regional Clean Air Incentives Market: A Comparative Design Analysis of Two Major Cap-and-Trade Permit Programs?" (2000) 17 Environmental and Resource Economics 279. See also, the US's

The US's scheme followed much academic debate in the US about the merits of tradable permits, including an influential 1985 article by Bruce Ackerman and Richard Stewart advocating a reform of environmental law by the use of tradable permit schemes. As they saw it, the US's then-reliance on direct environmental regulation "*wastes tens of billions of dollars every year, misdirects resources, stifles innovation, and spawns massive and often counter productive litigation*…" The introduction of an emissions trading scheme would, by incentivising those polluters with lowest marginal abatement costs to clean up their act, "*at one stroke, cure many of the basic flaws of the existing command-and-control regulatory systems.*"[38] They were proven right: the US's switch to a tradable permit scheme for sulphur dioxide emissions reduced such emissions by 50% over ten years.

At international level, by far the most important example of an emissions trading system at present is that set up by the 1997 Kyoto Protocol. This followed Article 4(2) of the UN's 1992 Framework Convention on Climate Change (UNFCC), which allowed developed country contracting parties and other Annex I parties to implement policies and measures in mitigation of climate change required under that provision "*jointly with other parties*". This was subject to decisions taken by the conference of the UNFCC parties at its first session "*regarding criteria for joint implementation.*"[39] The 1992 Framework Convention gave no details as to the mechanics of such joint implementation: this came with the 1997 Kyoto Protocol.[40]

The Kyoto Protocol works as follows. Annex B to the Protocol sets per-country targets for the reduction of greenhouse gas emissions for all developed countries (Framework Convention "Annex I" parties) from 2008 – 2012 (the "first commitment period"). These targets or "caps" are based on a percentage of the country's 1990 greenhouse gas emissions. Developing countries, however, were not made subject to any "cap" on greenhouse gas emissions. By Article 4 of the Protocol, a group of developed countries may form a "bubble", allowing them to agree on a single reduction target applicable to them and to then redistribute this target among members of the group. The EU has chosen to use such a bubble mechanism: its target as a region is that aggregate emissions of a "basket" of six greenhouse gases must be reduced by 8% over 2008 – 2012 compared to 1990 emissions

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proposed Climate Security Act, which would have instituted a cap and trade scheme whereby the federal government would set an overall limit on emissions; and the Regional Greenhouse Gas Initiative in the North East of the US, which is an agreement among ten north eastern states to cut emissions from power plants by 10% between 2009 and 2018. Emissions will be capped from January 1st, 2009. On June 6, 2008, the Climate Security Act failed to gain enough votes to continue in the US Senate. See The Economist, November 17, 2007, Clarke, "Summary of the Recently Departed Climate Security Act: A look at what's coming in US federal climate change law?" (2008) European Energy and Environmental Law Review 260 and Meckling, "Corporate Policy Preferences in the EU and US: Emissions Trading as the Climate Compromise?" 2 Carbon and Climate Law Review (2008) 171.

[38] Ackerman and Stewart, "Reforming Environmental Law" (1985) 37 Stanford Law Review 1333, at 1333 and 1341. See also, Gehring and Streck, "Emissions Trading: Lessons from SOx and NOx Emissions Allowance and Credit Systems: Legal Nature, Title, Transfer and Taxation of Emission Allowances and Credits 35 Environmental Law Reporter (2005) 10219.

[39] UN 1992 Framework Convention, Article 4(2)(a) and (d).

[40] In the negotiations running up to the Protocol, it was in fact a group led by the United States (under Clinton) which pushed for an emissions trading approach; this was opposed by the EU, which favoured a more command-and-control-inspired list of binding policies. See Lefevere, note 33 above, 154.

levels.[41] Should a group of countries fail to meet their target as members of the "bubble", however, each country is held to its individual Annex B requirement.

Three flexible mechanisms are detailed in the Protocol, each forms of emissions trading, as means of achieving the targets. These are: (1) Joint Implementation (JI) (Article 6); (2) The Clean Development Mechanism (CDM) (Article 12); and (3) International Emissions Trading (IET) (Article 17).

- **JI and CDM.** These are "project-based" mechanisms, which allow countries, rather than reducing emissions at "home", to invest in emission reduction or sequestration projects in other countries in order to reach their target. Credits - which are termed "Emission Reduction Units" (ERUs) for JI and "Certified Emission Reductions" (CERs) for CDM - are granted by comparing the actual emissions of such projects with the emissions which would have occurred had the investment not taken place (the "baseline" emissions). In the case of JI projects, these take place in developed countries, while CDM projects take place in developing countries;

- **IET.** This is the true emissions trading mechanism provided for by the Kyoto Protocol, inserted practically at the last moment (the last night) of negotiations after much pressure from the US and other countries, and despite the Community's resistance. As a result, the details of the mechanism are not established in the Protocol itself.[42] Annex B (developed country) parties may avail of emissions trading to meet their targets. However, "*any such trading shall be supplemental to domestic actions for the purpose of meeting quantified emission limitation and reduction commitments*" under the Protocol. Meat was added to the bones of the IET with the adoption of the Marrakech Accords in 2002. In the run-up to Marrakech, it was agreed that domestic action shall constitute a "*significant element*" of developed countries' action to meet their targets.[43]

In addition, it was expressly agreed that non-state entities could participate in Article 17 IET - which had not been clear from the text of that provision - under the responsibility of the country which authorised them to do so. As a result, Kyoto, as specified by Marrakech, left the door open for individual countries or regions to decide upon a system whereby non-state actors could participate in emissions trading. The EU's 2003 Directive on an Emissions Trading Scheme represented the first such regional system. In the interim, certain Member States - in particular, the UK and Denmark - adopted their own, national, emissions trading systems.

The Kyoto Protocol was implemented on behalf of the Community by Decision 2002/358, which confirmed the EU's use of the JI bubble system set out in Article 4 of the Protocol.[44] The actual quantity of emissions (in tonnes of carbon dioxide equivalent) allocated to the Community and its Member States under the Protocol's first commitment period was established in Decision 2006/944.[45] In a flurry of activity and declarations at the beginning of 2007 (which coincided with the review of the Community's Energy Policy), the

[41] By 2006, the EU-15's emissions had dropped by 2.7% below the base year: see Commission press release of June 18, 2008 IP/08/965.

[42] Article 17 of which provides that the parties, "…*shall define the relevant principles, modalities, rules and guidelines, in particular for verification, reporting and accountability for emissions trading.*"

[43] See the Bonn Agreements of 2001, on what is known as the "supplementarity" issue.

[44] See Article 2 of Decision 2002/358 OJ 2002 L 130/1.

[45] Decision 2006/944 OJ 2006 L 358/87.

Commission issued a Communication making explicit its view that, globally, climate change must at all costs be kept to a maximum of two degrees increase above pre-industrial levels.[46] This was endorsed by the European Council in its Brussels summit of March 2007.[47]

c. The EU's Emissions Trading Scheme (ETS)[48]

Though emissions trading schemes had existed prior to the EU ETS at national level,[49] the EU ETS went far beyond their scope. It has justifiably been described as "*the largest experiment to date with the creation of regulatory property*."[50] The speed at which the transition was made to a Community-wide trading scheme was remarkable - particularly in view of the Member States' differing obligations under the Kyoto Protocol and their differing views on the importance of combating climate change.[51] Most commentators would likely have agreed with Point Carbon's view in September 2001 that the having a Community-wide

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[46] See Commission Communication, "Limiting Global Climate Change to 2 degrees Celcius: the way ahead for 2020 and beyond" COM (2007) 2 final.

[47] The Spring 2007 European Council also agreed on a non-binding goal of "*a 30% reduction in greenhouse gas emissions by 2020 compared to 1990 as [the EU's] contribution to a global and comprehensive agreement for the period beyond 2012, provided that other developed countries commit themselves to comparable emission reductions and economically more advanced developing countries to contributing adequately according to their responsibilities and respective capabilities.*" Presidency Conclusions 7224/07 CONCL/1. Such commitment on the part of other developed countries and advanced developing countries has not yet been forthcoming.

[48] A multitude of literature has sprung up on this. See, for example, Lefevere, "Greenhouse Gas Emission Allowance Trading in the EU: A Background" (2003) Yearbook of European Environmental Law 149, Peeters, "Emissions Trading as a New Dimension to European Environmental Law: The Political Agreement of the European Council on Greenhouse Gas Allowance trading" (2003) European Environmental Law Review 82, Mortensen, "The EU Emission Trading Directive" (2004) European Environmental Law Review 275, Pâques and Charneux, "Du Quota d'Émission de gaz à effet de serre" 3 (2004) Revue Européenne de droit de l'environnement 226, Pâques, "La directive 2003/87/CE et le système d'échange de quotas d'émission de gaz à effet de serre dans la Communauté européenne", Revue trimestrielle de droit européen 40(2) (2004) 250, Bazelmans, "De implementatie van Europese handel in emissierechten in Nederland" Milieu & Recht 31(4) (2004) 214, Kelly, "An Evaluation of the European Union's Emissions Trading Scheme in Practice" (2006) European Environmental Law Review 175, Ellerman and Buchner, "The European Union Emissions Trading Scheme: Origins, Allocation, and Early Results", Review of Environmental Economics and Policy 2007 1(1):66.

[49] Prior to the EU ETS scheme, there were some examples of emissions trading schemes in the EU, e.g., the UK's ETS, which started in 2002, ran until 2006, and combined a system whereby installations (voluntarily) accepted a cap in return for an incentive payment, with a baseline-and-credit system intended to assist businesses in reaching pollution reduction targets in the Climate Change Agreements that had been negotiated between industry and the government. See Dahlgreen, "Emissions Trading in the United Kingdom: The Greenhouse Gas Emissions Trading Scheme (Amendment) and National Emissions Inventory Regulations 2005 and the Greenhouse Gas Emissions Trading Regulations 2005" Enviro LR 8 2 (134); and Torre-Schaub, "La naissance d'un nouveau marché: le système britannique de commerce d'allocations d'emissions de gaz à effet de serre", Revue Internationale de Droit Economique (2004) 227. Others included: the Danish CO_2 trading system, which started in 1999, and was limited to the electricity utility sector; the Dutch program soliciting Joint Implementation (JI) or Clean Development Mechanism (CDM) project credits intended to promote the cost-effective achievement of the Netherlands' Kyoto obligations; and BP's voluntary emissions trading program imposing a greenhouse gas emissions limit (internal to the corporation) on its operating entities in many parts of the world. See further, Ellerman and Buchner, "The European Union Emissions Trading Scheme: Origins, Allocation, and Early Results", Review of Environmental Economics and Policy 2007 1(1):66.

[50] Anttonen, Mehling and Upston-Hooper, "Breathing Life into the Carbon Market: Legal Frameworks of Emissions Trading in Europe", (2007) European Environmental Law Review 96, at 97.

[51] Ellerman, Buchner and Carraro (eds.), *Allocation in the European Emissions Trading Scheme: Rights, Rents and Fairness* (Cambridge, Cambridge University Press, 2007), at 3.

trading scheme in place by 2005 was a "*low-probability scenario*."[52] Part of the reason why it was possible to bring in the ETS so swiftly was that, in contrast to the approach of many major US business interests, most significant EU business players did not oppose the concept of a trading scheme in principle.[53] The EU's scheme entered into force on January 1, 2005, initially providing for a pilot phase (Phase I) from 2005 – 2007, with Phase II corresponding to the first commitment period of Kyoto.

In terms of scope, to date the scheme only applies to carbon dioxide emissions from certain activities, listed in Annex I of the Directive (for example, certain energy activities and certain activities in the production and processing of ferrous metals and in the mineral industry).[54] This list corresponds to a significant extent to those installations covered by the IPPC Directive and means that the scheme at present covers approximately 12,000 installations comprising 45% of the EU's total carbon dioxide emissions. In July 2008, the European Parliament voted to include aviation activities within the ETS from 2012 onwards.[55] In Phase II, Member States may choose unilaterally to apply the ETS to other activities, installations and greenhouse gases, subject to Commission approval. The mechanism of the ETS is essentially as follows.

Grant of permits. National "competent authorities" grant greenhouse gas emission permits to installations, under Articles 5 and 6 of Directive 2003/87. These permits allow the installations to engage in one of the activities falling within the ETS's scope[56] and impose conditions of monitoring and reporting carbon dioxide emissions on installations. In addition, such permits include an obligation for the installation to surrender allowances equal to its total emissions in each calendar year, within four months of the end of that year.[57]

NAPs. Member States were obliged to draw up "National Allocation Plans" (NAPs) for Phases I and II in turn, which plans state the total quantity of allowances that the Member State intends to allocate from that period and how it proposes to allocate them. The plans "*shall be based on objective and transparent criteria, including those listed in Annex III, taking due account*

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[52] Point Carbon, The Carbon Market Analyst, September 2001, cited in Ellerman, Buchner and Carraro (eds.), *ibid*, at 3.

[53] Only two sectors successfully lobbied against being included in the ETS: the chemicals and aluminium sectors. See Meckling, "Corporate Policy Preferences in the EU and US: Emissions Trading as the Climate Compromise?" 2 Carbon and Climate Law Review (2008) 171 for an interesting historical analysis of changes in corporate approaches to emissions trading. A major opponent to the introduction of trading schemes was the Global Climate Coalition, a business group from which many (US and EU) firms withdrew in around 1996-1997.

[54] Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community OJ 2003 L 275/32 (the "ETS Directive"). The Commission has proposed that this be extended in Phase 3, for example, to ammonia and aluminium producers, and to nitrous oxide and perfluorocarbon gases: see Commission Proposal for a Directive to extend and improve the functioning of the EU ETS, COM (2008) 30 final.

[55] Airlines must cut their carbon dioxide emissions by 3% in 2012, and by 5% from 2013, with 85% of allowances being distributed by free allocation. See Commission's Proposal of December 2006 for a Directive amending Directive 2003/87 so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community, COM (2006) 818 final, an amended version of which was approved at second reading in the European Parliament.

[56] ETS Directive, Article 4.

[57] ETS Directive, Article 5.

of comments from the public".[58] Among the factors listed in Annex III are that the NAPs must not provide for more allowances to be issued than is consistent with the Member State's meeting its Kyoto obligations; and must deal with the possibility of new entry to the market (which may be difficult where Member States use a "grandfathering" system of allocation of allowances, explained below).[59] The NAPs are submitted to the Commission for approval, which must respond within three months. While the Commission was initially rather lenient towards Member States' plans (resulting in too many allowances being distributed by Member States, as discussed below), it has, following criticism, taken a more demanding approach.[60] Member States must base decisions to allocate individual allowances on their National Allocation Plan.[61]

Allocation of allowances. Member States must allocate allowances to emit one tonne of carbon dioxide equivalent (also known as "European Union Allowances" or "EUAs"). In doing so, Member States were obliged to allocate at least 95% of the allowances free of charge from 2005 – 2007; for 2008 – 2012, this figure was 90%. It is the allowances - and not the permits - which are tradable and valid for emissions during the period for which they are issued. Many Member States choose to allocate the free allowances on the basis of a "grandfathering" system - i.e., on the basis of the market incumbents' existing activities, the implications of which will be discussed below. However, importantly, decisions on allocation of allowances, "*shall be in accordance with the requirements of the Treaty, in particular Article 87 and 88 thereof*."[62] The Commission has issued guidance to Member States on allocating allowances.[63] When deciding upon allocation, Member States "*shall take into account the need to provide access to allowances for new entrants*."[64] The Commission in its 2003 Guidelines on Allocation listed three possible ways of allocating allowances to new entrants: a Member State may have new entrants buy all their allowances on the market, it may make use of the possibility to set aside some allowances for periodic auctioning, or it may foresee a reserve in the national allocation plan to issue allowances to new entrants free of charge.

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[58] ETS Directive, Article 9. See the template NAP with explanatory notes in the Commission's 2005 Communication on Further Guidance on Allocation Plans for the trading period 2008 – 2012 of the Emissions Trading Scheme COM (2005) 703 final.

[59] Article 11 and Annex III, ETS Directive. See the Commission 2005 Communication on Further Guidance on Allocation Plans for the trading period 2008 – 2012 of the Emissions Trading Scheme, *ibid*, and Commission Communication, "Building a global carbon market - Report pursuant to Article 30 of Directive 2003/87/EC" COM (2006) 676 final.

[60] Where a Member State's NAP is rejected, the Member State may appeal this rejection: see, e.g., Case T-374/04 *Germany v Commission*, judgment of November 7, 2007, not yet reported, where the Commission's rejections of the German Phase II NAP was partially annulled, and Case T-178/05 *UK v Commission* [2005] ECR II-4807, in which the CFI annulled the Commission's rejection of the UK's proposed amendment to its NAP for the first commitment period. See also, the Order of the Court in Case C-6/08 P *US Steel Košice v Commission*, in which the ECJ confirmed the CFI's ruling that a company whose allowances were reduced following the Commission's decision ordering Slovakia to reduce the total number of allowances allocated under its National Allocation Plan did not have standing to challenge this decision.

[61] Article 11(1) ETS.

[62] Article 11(3) ETS.

[63] Communication from the Commission on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87, COM/2003/830 final and Communication on Further Guidance on Allocation Plans for the trading period 2008 – 2012 of the Emissions Trading Scheme, note 59 above.

[64] Article 11(3), ETS Directive.

The holding of allowances is not limited to operators of installations. Article 19 of the ETS Directive provides that "*any person may hold allowances*", meaning that allowances may be purchased by third parties.[65]

Pooling. By Article 28, Member States may allow operators of installations to form a "pool" of installations from the same activity for Phase I and/or 2 of the ETS, on application to the competent authority. In this case, the operators must nominate a trustee to "take over" the individual operators' ETS responsibilities – i.e., to be issued with the total allowances for the group, to be responsible for surrendering allowances, to be liable to penalties in the event of failure to do this etc. Should a Member State be minded to allow such a pool, it must notify the Commission, which may within three months reject an application, giving reasons. Any penalty which the trustee fails to pay falls to be paid by the constituent individual members of the pool.

Monitoring and enforcement. Installations subject to permits are, along with Member States, responsible for monitoring emissions. They are guided in this respect by the Commission's Guidelines 2004/156, which build on the principles for monitoring and reporting set out in Annex IV to the ETS.[66] Should an operator fail, in the period 2005-2007, to surrender sufficient allowances by April 30 of each year to cover its emissions the previous year, it is liable to a penalty per tonne of carbon dioxide equivalent emitted of €40. This penalty must increase to €100 per tonne in the ETS's second period. Importantly, payment of the penalty does not release the operator from the obligation to surrender allowances for those excess emissions in the next year. Further, Member States "*shall ensure publication*" of the names of operators in breach. Subject to these "harmonising" provisions, penalties for infringement are for the Member States to decide upon, though they must be effective, proportionate and dissuasive.[67]

Trading. Member States must also establish national registries to ensure correct accounting and trading in allowances[68] (though the Commission also maintains a separate "central administrator" to maintain a transaction log of the transfer of allowances), and must submit an annual report on the functioning of the system to the Commission.[69] Member States' registries, and the EU's transaction log, are to be connected to the UN's international carbon credit registry from December 2008,[70] which will mean that carbon credits issued under Kyoto's Clean Development Mechanism can be transferred to Member States' registries.

Linkage. Specific provision is made in the 2003 Directive for the interaction of the ETS with the IPPC regime, providing that IPPC permits should not include an emission limit value for ETS-covered gases "*unless it is necessary to ensure that no significant local pollution is caused.*"[71] In addition, Directive 2004/101 links the ETS with the Kyoto Protocol's project mechanisms (JI and CDM), by allowing operators to use not only ETS allowances (as

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[65] For example, hedge funds or even – in principle – environmental groups who wish to "decommission" allowances to reduce pollution, though lack of funds makes this unlikely.

[66] See Article 15 and Annex V, ETS Directive.

[67] Article 16 ETS Directive.

[68] See Regulation 2216/2004 for a standardised and secured system of registries OJ 2004 L 386/1.

[69] Article 21, ETS Directive.

[70] See Commission press release of August 6, 2008, "Emissions Trading; Commission to connect EU with UN carbon credit registry before December" IP/08/1246.

[71] Article 26, ETS Directive (i.e., to avoid the occurrence of the "hot spot" phenomenon, by which a large amount of pollution accumulates in a locality).

distributed by Member States pursuant to their National Allocation Plan) but also JI and CDM credits (ERUs and CERs) as allowances to be surrendered in order to satisfy their ETS obligations.[72] Member States were to specify in their National Allocation Plans the percentage of ERUs and CERs which each installation can use to satisfy their ETS obligations.[73] Further, provision is made in Article 25 of the Directive for the linkage of the ETS with other greenhouse gas emissions trading schemes, via the conclusion of agreements with other developed countries ("Annex B" Kyoto countries) providing for the mutual recognition of allowances between the schemes, though this has not taken place as yet. In October 2007, the EU's ETS was extended to the EEA countries, Norway, Liechtenstein, and Iceland.[74]

The future. The Commission is considering the extension of the scope of the ETS in a variety of ways, including gases and installations/activities covered.[75] It is also considering linking the ETS with third countries' national or sub-national emissions trading schemes,[76] and other fine-tuning of the scheme.[77] More fundamentally, in its January 2008 proposals to revamp the ETS, the Commission has put forward the idea of implementing a single EU-wide cap after 2012 and harmonising criteria for granting allowances, with a major increase in auctioning allowances.[78] This would mean that Member States would no longer have to produce NAPs, as allowances would effectively be granted according to objective criteria set at Community level. A further possibility which has been mooted by, *inter alia,* French president Sarkozy and Commission president Barroso, is the introduction of "carbon tariffs" on imports from countries which have not signed up to international climate change obligations (which could include, for instance, the United States and China), in order that EU firms are not placed at a disadvantage by the ETS's emissions caps.[79]

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[72] See further, Bazelmans, "De koppeling van CDM en JI aan het Europese emissiehandelssyteem", Nederlands tijdschrift voor Europees recht 6 (2004) 151.

[73] See Decision 2006/780 on avoiding double counting of greenhouse gas emission reductions under the Community emissions trading scheme for project activities under the Kyoto Protocol OJ 2006 L 316/12, which requires Member States to ensure that no ERUs or CERs are issued for emission reductions from installations which participate in the ETS, and Langrock and Sterk, "The Developing Market for CERs: Current Status and Challenges Ahead" JEEPL 2(2005) 101.

[74] See Decision 146/2007 of the EEA Joint Committee, not yet published in the OJ.

[75] See Commission Communication, "Building a global carbon market - Report pursuant to Article 30 of Directive 2003/87/EC" COM (2006) 676, Commission Proposal for a Directive to extend and improve the functioning of the EU ETS, COM (2008) 30 (proposal to extend to ammonia and aluminium producers, and to nitrous oxide and perfluorocarbon gases), and Commission proposal for a Directive on the geological storage of carbon dioxide, COM (2008) 18.

[76] The primary potential partners (i.e., who have trading schemes in place for at least part of the territory) are Canada, Japan, Australia, New Zealand and Switzerland, as well as the US state California. See Mace and Anderson, "Transnational Aspects of a Linked Carbon Market" 2 Carbon and Climate Law Review (2008) 190 and, further, the launch of the International Carbon Action Partnership (ICAP) in October 2007, an international forum for governments and public authorities involved in emissions trading systems.

[77] For example, in its Green Paper on market-based instruments for environmental and related policy purposes, COM (2007) 140 final, the Commission raised the possibility of fine-tuning the boundaries between the 2003 Energy Taxation Directive, discussed above, and the EU's ETS, to avoid overlap between the two systems while minimising "loopholes" whereby certain operators might fall outside both schemes.

[78] Commission Proposal for a Directive to extend and improve the functioning of the EU ETS, COM (2008) 30 final.

[79] See the speech of Commission president Barroso of January 21, 2008, "Europe's climate change opportunity", SPEECH/08/26 and Financial Times, "Sarkozy warns China of carbon tariffs", November 27, 2007.

d. Merits and demerits of tradable permit systems

Tradable permit systems may, depending on their design, have a variety of advantages. First, they are potentially economically efficient, in that they can in principle achieve environmental protection while ensuring that allowances end up with those who value them most. Participants can choose whether or not it is cost-effective for them to achieve lower emissions than the quantity of allowances allocated (and sell the excess), and they can make their choice on their own terms (i.e., they can choose the timing of pollution, and where improvements should be made, themselves). As such, they represent a "least-cost" solution to achieving environmental aims: those who can improve their environmental performance at the least cost will do so. In economists' terms, this means that overall pollution abatement costs decrease.[80] Second, as with most economic instruments, tradable permits thus provide incentives to improve environmental performance, while offering the possibility of offsetting investment costs in new technology and potentially providing firms which do so with a competitive advantage. As such, the schemes turn the "burden" of reducing pollution into an opportunity to gain a market advantage, thus increasing overall environmental benefits compared to traditional command and control techniques.[81]

Realisation of these benefits, however, is contingent on the correct set-up and smooth functioning of the market. Thus, tradable permit systems work best where: there are in fact different options for firms, such that it is open to them to choose which one is most cost-effective for them; where the environmentally beneficial outcome can be accurately measured and is binding (something which is easier to achieve with "cap-and-trade" rather than relative target schemes); where the number of participants is relatively high and varied (i.e., the market is fairly liquid), so that comparative cost advantages can be realised; in "cap-and-trade" schemes, where the cap is set at a level which will in fact achieve environmental protection; where allocation of allowances is done accurately, so as to remain within the limit of the cap; and where accurate verification and monitoring of emissions is possible (i.e., the gases being traded must be susceptible to accurate measurement, and suitable, trustworthy bodies must be entrusted with the task).

Even if these requirements are satisfied, certain problems remain with use of a tradable permit system. Some, such as ethical and distributional concerns, are common to all or most economic instruments, and have been considered above. More particularly, use of a relative target (as many national systems do) does not guarantee environmental protection, for the reasons outlined earlier.[82] Further, even with cap-and-trade systems, the overall nature of the "cap" (i.e., the fact that the cap merely sets a limit on the total amount of emissions from the overall area covered by the scheme) may entail the occurrence of "hot spots" – i.e., high pollution occurring in a localised area. As long as this does not push the area as a whole over the limit of the cap, cap-and-trade systems do not preclude such an outcome.

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[80] Thus, for example, one of the leading US economic commentators on market based instruments, Tietenberg, concluded in 1992 that the US sulphur dioxide emissions trading scheme had unquestionably and substantially reduced the costs of complying with the US Clean Air Act, with an accumulated capital saving of over $10 billion (in addition to the recurrent savings in operating costs). Tietenberg, in Markandya and Richardson (eds) *The Earthscan Reader in Environmental Economics* (London, Earthscan, 1992).

[81] *Ibid.*

[82] See, *contra*, Peeter, Weishaar and de Cendra, "A Governance Perspective on the Choice between "Cap and Trade" and "Credit and Trade" for an Emissions Trading Regime (2007) European Environmental Law Review 191, who advocate use of a relative cap system (credit and trade) for the EU's ETS.

In the case of the EU ETS, however, the method of distributing allowances has proven to be, at least initially, the most serious problem threatening the effectiveness of the scheme.[83] As outlined above, the EU's ETS opted to require Member States to distribute at least 95% of allowances for free in Phase I and at least 90% in Phase II. In Phase I, however, only four governments chose to exercise the auctioning option: Denmark, Hungary, Lithuania, and Ireland, for a proposed 5%, 2.5%, 1.5%, and 0.75% of their respective totals (though in the end Denmark and Lithuania failed to carry out any auctions).[84] EU-wide, only 0.12% of total allowances were ultimately auctioned.

Member States' over-allocation of free allowances in Phase I proved to be a major flaw in the ETS's operation during this period.[85] This was likely done in an attempt to give their industries a competitive advantage over other Member States' industries, or simply because they were not willing to accept possible (short-to-medium term) stagnation of growth of their national industries as a result of limiting allowances. The problem stemmed at least partly from the fact that data on the level of emissions per installation were simply not available to the requisite degree of accuracy at the beginning of the EU ETS.[86]

The release of the 2005 emissions data in April and May 2006 revealed that the number of allowances distributed to installations in 2005 exceeded those installations' emissions by about eighty million tons, or about 4% of the total EU cap. This meant the market was flooded with allowances and prices dropped significantly towards the end of Phase I (from a starting trading price of €6). This is clearly demonstrated by the following Figure, which shows a sudden flooding of the market with allowances in April 2006, causing the price to dip by over €20, followed by a drop in price from September 2006 onwards due to the fact that installations could not "carry over" Phase I allowances for use in Phase II.

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[83] See, Rousseaux, "L'allocation des quotas d'émission de gaz à effet de serre: un aspect determinant du future marché européen" 484 Revue du Marché commun et de l'Union européenne (2005) 31 and Ellerman, Buchner and Carraro (eds.), *Allocation in the European Emissions Trading Scheme: Rights, Rents and Fairness* (Cambridge, Cambridge University Press, 2007.

[84] Ireland also ultimately auctioned that part of its New Entrant Reserve which it had not used up at the end of Phase I, which amounted to 1.05% of its total allocations. For the EU ETS as a whole, with an average annual allocation of almost 2.2 billion EUAs, slightly less than three million EUAs-or 0.13 percent-were, in 2007, designated for auctioning (though this was subject to a potential small increase where countries chose to dispose of any allowances remaining in their new entrant reserves.) See Ellerman and Buchner, "The European Union Emissions Trading Scheme: Origins, Allocation, and Early Results", Review of Environmental Economics and Policy 2007 1(1):66 and

[85] See Commissioner Dimas, SPEECH/07/265, "Improving environmental quality through carbon trading": *"The credibility of emission trading in Europe, but also worldwide, hinges on our capacity to rectify [the over allocation of CO2 quotas] for the second trading period*." CO2 emissions from installations participating in the ETS increased by 0.3% in 2006 - compared to the 3% growth in EU GDP. This was welcomed by Commissioner Dimas, who commented that it was "*very encouraging to see that the mechanics of the EU ETS are working well…*" (See Commission press release, "Emissions trading: strong compliance in 2006, emissions decoupled from economic growth", IP/07/776).

[86] See Ellerman and Buchner, "The European Union Emissions Trading Scheme: Origins, Allocation, and Early Results", Review of Environmental Economics and Policy 2007 1(1):66.

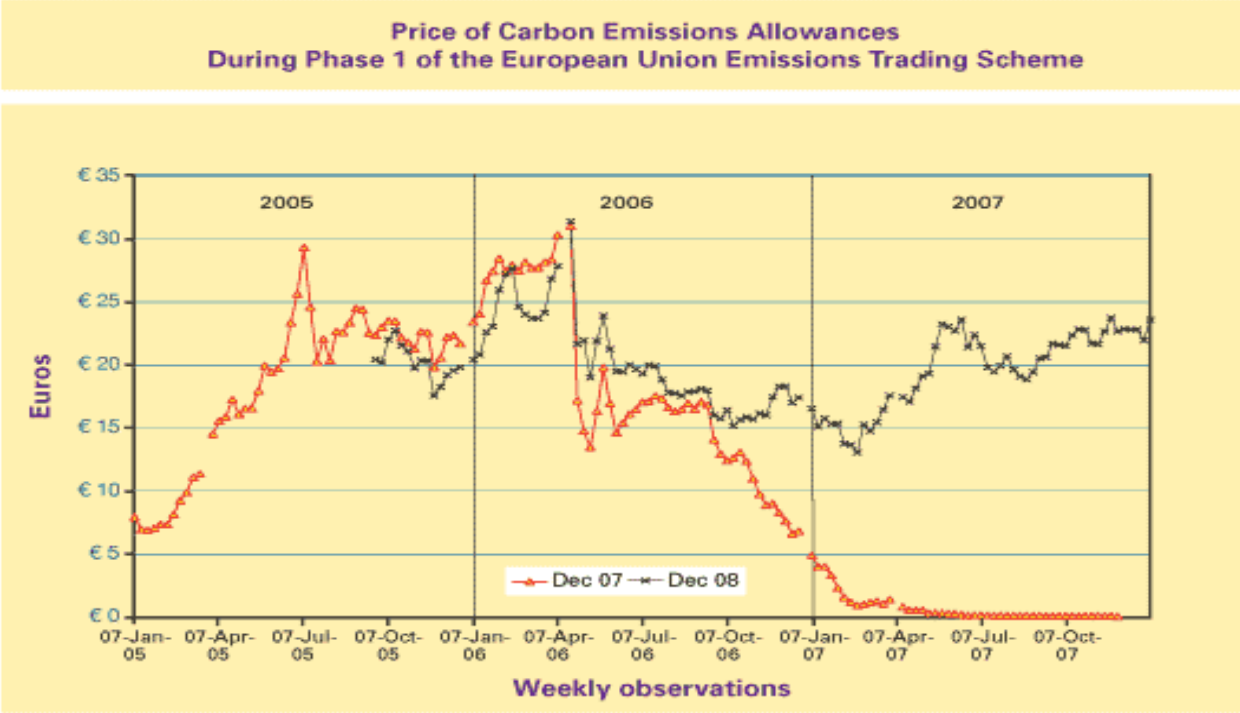

Figure 1: Performance of the ETS Carbon Market

Source: MIT Energy Institute

Key: *Red curve - prices for Phase 1 allowances (i.e. which could be used up to December 2007)*

Black curve - prices for future Phase II allowances

By July 2008, however, the price of Phase II allowances had risen to €29.33. Some market analysts predicted an eventual rise to €45,[87] based partly on business' reactions to the Commission's proposals of January 2008. The rise in price of EUAs had a direct effect on business with, for example, the leading polluter in the UK - a coal-fired power station - blaming carbon prices as being one of the factors behind a significant drop in profits in the first half of 2008. In a bid to reduce carbon emissions (and thus increase profits), the power station has announced a deal to develop a biomass co-firing facility.[88] Though such examples illustrate the potential effectiveness of the EU's ETS,[89] EUA price levels have not remained consistently high, dropping to €14 by December 2008.

In addition to the problems associated with over-allocation of EUAs, the "grandfathering" method of allocating EUAs itself raises serious issues for new entrants, the competition difficulties which are discussed in Part III. Moreover, the fact that most EUAs are allocated

[87] See IDEAcarbon's Summer 2008 Global Carbon Report.

[88] See the report of BusinessGreen.com of August 5, 2008, "Drax blames carbon price for falling profits".

[89] Indeed, it is fair to regard the fact that overall carbon dioxide emissions from ETS businesses increased by just 0.68% in 2007 (in comparison to GDP growth of 2.8%) as a sign of the (belated and limited) success of the ETS in its first phase. See Commissioner Dimas' (rather optimistic) conclusion that emissions "*would most likely have been significantly higher without the EU ETS"* Commission press release of May 23, 2008, IP/08/787.

for free, with resultant "windfall profits" for installations which sell off freely-allocated allowances, causes evident distributional concerns. Auctioning allowances is a perceived solution to some of these problems. Accordingly, the Commission has encouraged Member States to use the possibility of auctioning 10% of the allowances in Phase II as far as possible, emphasising that this can raise revenue to fund the administrative costs of the ETS and can go towards purchasing ERUs or CERs to meet Member States' Kyoto allowances. Evidently, however, Member States remain free to ignore this encouragement – and most have, due presumably once again to fears of placing their domestic industries at a competitive disadvantage by increasing operational costs. Nonetheless, many more governments have chosen in Phase II to exercise the option to auction allowances, including Germany, the United Kingdom, the Netherlands and Italy for a proposed 9%, 7%, 4% and 5.7% of their respective totals. This means that almost 4% of EUAs are proposed to be auctioned in this phase – still a small figure, but a significant increase compared to Phase I. The Commission's intention that this trend should continue are clear: in its January 2008 proposals, the Commission envisages that free allocation will diminish considerably in importance from Phase III onwards.[90]

3. Voluntary Environmental Agreements

A third market-based environmental instrument relevant to competition policy is the use of "voluntary agreements" and similar voluntary initiatives on the part of firms. Numerous types of corporate voluntary initiatives to protect the environment are currently in use within the EU, all of which can fairly be categorised as falling under the broad (and lately rather fashionable) umbrella phenomenon of "Corporate Social Responsibility" (CSR).[91] The Commission has defined CSR as,

> "*a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis...It is about enterprises deciding to go beyond minimum legal requirements and obligations stemming from collective agreements in order to address societal needs… In Europe, the promotion of CSR reflects the need to defend common values and increase the sense of solidarity and cohesion.*"[92]

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[90] Commission Proposal for a Directive to extend and improve the functioning of the EU ETS, COM (2008) 30 final.

[91] See Lyon and Maxwell, *Corporate Environmentalism and Public Policy* (Cambridge, Cambridge University Press, 2004) (who describe corporate environmentalism as "*the most notable trend in environmental policy since the 1990s*"), Bergkamp, "Corporate Governance and Social Responsibility: A New Sustainability Paradigm" (2002) European Environmental Law Review 136, Vironneau-Georges, "Le débat sur la responsabilité sociale des enterprises (RSE) à nouveau sur l'agenda politique européen?" (2008) Revue du Marché common et de l'Union européenne 393, and De Schutter, "Corporate Social Responsibility European Style" (2008) 14(2) European Law Journal 203.

[92] Communication on Corporate Social Responsibility, "Implementing the Partnership for Growth and Jobs: Making Europe a pole of excellence on CSR" COM (2006) 136 final, and Communication from the Commission concerning Corporate Social Responsibility: A business contribution to Sustainable Development COM (2002) 347 final.

The CSR concept has awakened massive interest in policy-makers at national,[93] Community and international level,[94] who have latched onto it eagerly as fitting perfectly with the goals of "sustainable development" and "integration" – i.e., as a way of combining growth and enterprise with environmental protection. At the EU level, the Commission has stated its ambition to make the Community a "*pole of excellence*" in CSR and that "*CSR matters to each and every European, since it represents an aspect of the European social model.*"[95] The current attention being paid to CSR by policy-makers within the EU is reflected by the decision to make it one of the priorities of the 2008 French presidency of the Council.[96]

a. The rationale behind corporate environmentalism: why would businesses voluntarily be green?

The validity of the CSR concept is hotly disputed - to an even greater degree than the sustainability principle. Many view CSR as little more than a cosmetic exercise, with little ultimate practical effect on the behaviour of businesses. Indeed, it is argued, this ineffectualness is a good thing: it is inherent in the model of capitalism that firms compete between themselves to make money, and this is what managers are accountable to shareholders for. It is not legitimate - and indeed may breach managers' duties to shareholders - for the former voluntarily to try to achieve other goals at the same time. The "*triple bottom line*" which the UN and the Commission advocate - aiming not just to make money, but also to protect the environment and to improve social justice - distracts attention from ultimate managerial duties.[97]

This criticism can be averted if, and insofar as, CSR - and corporate voluntary environmental initiatives in particular - can be shown to be good for business, rather than amounting to philanthropy. This approach, rooted in "environmental realism", is part of the reason why many "deep Greens" are inherently against voluntary corporate approaches. Nonetheless, it is an approach adopted by many policy-makers in practice, including EU policy-makers. A good example is the message of the EU's Environmental Commissioner, Commissioner Dimas, that,

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[93] Within the EU, particularly within the Nordic countries, the Netherlands, Spain, and France. In France, for example, much attention was given to CSR in the context of the *Grenelle de l'environnement* launched in July 2007 by the French government as a forum for discussion between the State and representatives of civil society, resulting in the proposal of a variety of measures. See Vironneau-Georges, "Le débat sur la responsabilité sociale des enterprises (RSE) à nouveau sur l'agenda politique européen?" (2008) Revue du Marché common et de l'Union européenne 393.

[94] See, for example, the "Global Partnership" approach taken in the UN's Johannesburg Conference of 2002, Chapter 3. For a sceptical view, however, see Naomi Klein in The Guardian, 'The Summit that couldn't save itself', September 4, 2002: "*…post-Enron, it's hard to believe that companies can be trusted to keep their own books, let alone save the world. And unlike a decade ago, the economic model of laissez-faire development is being rejected by popular movements around the world.*"

[95] Communication on Corporate Social Responsibility, "Implementing the Partnership for Growth and Jobs: Making Europe a pole of excellence on CSR", note 92 above. The Commission has backed the launch of a European Alliance on CSR, a political process to increase the uptake of CSR amongst European enterprises.

[96] Vironneau-Georges, "Le débat sur la responsabilité sociale des enterprises (RSE) à nouveau sur l'agenda politique européen?" (2008) Revue du Marché common et de l'Union européenne 393. See also, the 2008 launch of the "Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan" by the Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions COM (2008) 397/3.

[97] See, for example, The Economist, January 22nd, 2005 "The good company".

> *"[e]xpecting individual businesses to be moral or to care about the greater economic good is missing the point. The bottom line for companies is their own profit…The real reason why the world's top companies are going green is because it makes excellent business sense. And I am pleased that this is the case because it is the best guarantee that this is a trend that will last."*[98]

There are a variety of reasons why it might make business sense for a firm to act in an environmentally responsible manner.

First, consumers may prefer purchasing certain products from firms perceived as "green". Equally, taking the broader stakeholder analysis, potential investors may prefer to invest in firms which are perceived as being "green" - either out of moral conviction, or - increasingly - following advice warning of the likely rise in environmental standards in the future.[99] In turn, a good corporate image may increase staff motivation and help recruit the best employees. Inversely, being shown to engage in environmentally-unfriendly practices can be damaging to business.[100]

Second, firms may voluntarily engage in environmentally-beneficial activities because it will help them develop cutting-edge environmentally-friendly technology, which will give them an edge on the market - i.e., the "first-mover" advantage.[101] The EU is casting itself as a market leader in this respect. In 2006, EU eco-industries accounted for around one third of the global markets, and exports were growing at around 8% a year.[102]

Third, firms may be keen to take action to reduce environmental costs, such as energy costs or the costs of cleaning up pollution. Such clean-up costs may in turn flow, for instance, from environmental standards or other environmental instruments.

Fourth, firms might choose voluntary environmental initiatives to avoid regulation - and the concomitant costs of compliance, potential inefficiency, and loss of control over the applicable standard and regime. In many instances, the wish to anticipate government policy changes and influence law-making may be the primary motivation for businesses in entering into voluntary initiatives. Where an environmental problem has not yet been addressed by government, firms invest resources into voluntary environmental initiatives as a tactic to reduce oversight by regulators.[103] Moreover, empirical economic research suggests that this

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[98] Speech of Commissioner Dimas of November 9, 2006, "Environment and Industry, How ambitious environmental standards can promote business competitiveness in Europe?" (SPEECH/06/676). Thus, for example, in a survey carried out by KPMG, 74% of those companies who engaged in corporate responsibility reporting in 2005 stated that they did so for economic reasons: KPMG 2005 Corporate Responsibility Survey, available at www.kpmg.nl.

[99] See, for example, the report of the Financial Times, "Investors warned over cost of greenhouse gas", June 13, 2005, citing a Carbon 1000 report from Henderson Global Investors.

[100] For example, many importers of tropical wood have been forced to ensure that their wares are certified after the move of many large retailers, such as Home Deport, IKEA and B&Q, to promise not to sell products made with uncertified wood. See The Economist, Special report on the logging trade, March 25, 2006.

[101] See the Report commissioned for the Commission in 1999 on the importance of the eco-industry export market, available at http://ec.europa.eu/environment/enveco/industry_employment/pdf/eco.pdf and Porter and van der Linde, "Toward a New Conception of the Environment-Competitiveness Relationship", Journal of Economic Perspectives, 9(4), Fall 1995, 97 (who argue that such innovation promotes dynamic efficiency in the market, which, in their contention, has replaced static efficiency as a new paradigm of international competitiveness).

[102] See the speech of Commissioner Dimas of November 9, 2006, "Environment and Industry, How ambitious environmental standards can promote business competitiveness in Europe?" (SPEECH/06/676).

[103] In this way, CSR can become "*a codeword for abandoning to market mechanisms certain questions which might otherwise be the target of regulatory approaches"* (De Schutter, "Corporate Social Responsibility European Style" (2008) 14(2)

may be a tactic that works[104] and can lead to lower abatement costs.[105] One high-profile EU example of such incentives in action was the choice of the EU car industry to enter into agreements on emissions standards, which was essentially made to avert the regulation of the matter at EU level - an attempt which ultimately ended in failure in 2007, when the Commission lost patience and put forward a proposal to legislate on the matter due to the failure of the voluntary initiative.[106] In other instances, government itself may (whether formally or informally) be the instigator of voluntary agreements, with the aim of encouraging industry to cooperate in setting and achieving environmental goals.

b. Types of voluntary corporate initiative

Voluntary environmental agreements. "Environmental agreements" - voluntary agreements between firms which supplement regulatory requirements - are an increasingly popular voluntary initiative. There is no universally accepted definition of an "environmental agreement", though evidently the notion of "agreement" necessarily implies that the measures can be distinguished from unilateral environmental initiatives made by a single undertaking. The definition used by the Commission in 2002 Communication on Environmental Agreements is a useful starting point:

> "*Environmental agreements at Community level are those by which stakeholders undertake to achieve pollution abatement, as defined in environmental law, or environmental objectives set out in Article 174 EC.*"[107]

Environmental agreements may be grouped into two categories. The first is self-regulation, where the agreement is put in place solely by market actors, on a voluntary basis. Such agreements are normally made between undertakings. They may be in the form of binding agreements[108] or "gentlemen's agreements".[109] Very often, self-regulation agreements contain reporting and monitoring provisions, to give some level of assurance to public authorities that the agreement is effective and credible. At EU level, the Commission has expressed its approval for this form of agreement, stating that it may "*consider it preferable not*

European Law Journal 203, at 204). See also, Lyon and Maxwell, *Corporate Environmentalism and Public Policy* (Cambridge, Cambridge University Press, 2004), who analyse the company-regulator relationship from a game theory perspective.

[104] See, for example, Decker, "Corporate Environmentalism and Environmental Statutory Permitting" 46 J.L. & Econ. 103.

[105] See, for example, Conrad, "Voluntary Environmental Agreements vs. Emission Taxes in Strategic Trade Models" Environmental and Resource Economics 19, 361 (2001).

[106] Proposal for a Regulation of the European Parliament and of the Council setting emission performance standards for new passenger cars as part of the Community's integrated approach to reduce CO2 emissions from light-duty vehicles COM (2007) 856 final.

[107] Communication on Environmental Agreements, COM (2002) 412 final. This definition was also used by the Commission in its Horizontal Cooperation Guidelines OJ 2001 C 3/2, at point 179. Interestingly, the Commission fails to mention the concept of co-regulatory covenants involving government used in certain Member States, such as the Netherlands, in the Horizontal Cooperation Guidelines, seeming far more comfortable with the concept of agreements between private operators. See also the elements listed in De Clercq., Bracke, Baeke, Ameels. And Seyad, *Het gebruik van vrijwillige instrumenten bij de realisatie van duurzame ontwikkeling – Module 2: Vrijwillige milieubeleidsovereenkomsten* (Gent, Universiteit Gent, 2001), at 2-3.

[108] Common in, e.g., Germany, Austria, Belgium, France and the United Kingdom. See Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45).

[109] Common in, e.g., Netherlands and Portugal. See Rehbinder, *ibid.*

to make a legislative proposal where agreements of this kind already exist and can be useful to achieve the objectives set out in the Treaty."[110]

The second form of environmental agreement is co-regulation. This indicates a situation where the legislator or regulator establishes the key elements of the regulation - which may, for instance, include the regulatory objectives, the deadlines and mechanisms relating to implementation, methods of monitoring the application of the legislation and any sanctions which are necessary to guarantee the legal certainty of the legislation[111] - and the firms subsequently agree on the means of implementing it. The technique is common in the US, where it is often known as the "public voluntary programme" technique. As such, these voluntary agreements still have - to a greater or lesser extent - some element of regulatory input. Co-regulation may take the form, for example of contracts concluded between the government/administration and industry, as is common in the Netherlands.

In a report of 1999, the OECD identified a total of 312 environmental agreements concluded in the EU Member States.[112] At EU level, the Commission has signalled its cautious approval and encouragement of the use of environmental agreements in Communications of 1996 and 2002. It was by no means clear prior to these Communications that the Commission would adopt such a position: in fact, it had previously seemed to hold a negative attitude to voluntary agreements.[113] In its 2002 Communication, it indicated that it would take the following criteria into account when assessing whether use of environmental agreements is appropriate in a given situation:

- Does the environmental agreement deliver an increased level of protection of the environment?
- Is the agreement cost-effective for the Community institutions' administration (for example, in reducing monitoring costs)?
- Are the parties concerned representative?
- Are the objectives of the agreement set in clear and unambiguous terms?
- Has civil society - industry, environmental NGOs, and civil society in a broad sense - been informed of the agreement?
- Does the agreement contain a well-designed monitoring system?
- Is the agreement compatible with the goal of sustainable development?
- Are the incentives provided by the agreement compatible with other factors and incentives present, such as market pressure, taxes and national legislation?

The Commission concludes by stating that it "*wishes to encourage the preparation of voluntary environmental actions as well as environmental agreements at Community level, over a wide range of*

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[110] Communication on Environmental Agreements, note 107 above, at 5.
[111] *Ibid.*
[112] OECD, *Voluntary Approaches for Environmental Policy - an Assessment* (Paris, OECD, 1999).
[113] See Van Calster and Dekeletaere, in Orts and Deketelaere, *Environmental Contracts: Comparative Approaches to Regulatory Innovation in the United States and Europe* (The Hague, Kluwer, 2001), who describe the negative comments made about the concept of voluntary agreements by the then-Commissioner of the environment directorate-general prior to adoption of the 1996 Communication.

sectors…"[114] It has formally recognised voluntary agreements on a number of occasions. The normal course of action is for the Commission to adopt a Recommendation confirming the content of the industry's engagement, or simply acknowledging the environmental agreement by exchange of letters.[115] The Commission has stressed, however, that such action can "*never*" mean that it forgoes its right of initiative.[116] In some cases, a Recommendation may be accompanied by a monitoring Decision. The Commission first adopted such a Recommendation in 1989, regarding an engagement by the aerosol industry to limit use of CFCs to products where they were absolutely essential. This resulted in a Council Resolution followed by three specific Commission Recommendations addressed to aerosol manufacturers, foam plastic producers, and the refrigeration and air-conditioning sector. The approach has been followed on a variety of other occasions.[117]

At a national level, certain Member States have far more experience in the use of environmental agreements than others.

The Netherlands, for example, has long had an explicit government policy of using voluntary environmental agreements and has the most extensive experience with regulatory agreements of all the Member States.[118] Initially, gentlemen's agreements were used, with a movement in more recent years towards binding contracts. The Dutch Ministry of Housing, Land-use Planning and the Environment is normally a party to these contracts, which are subject to the participation of the public and intervention of the Dutch Parliament.[119] The Dutch government has published official guidelines for agreements (*aanwijzingen voor convenanten*), which cover topics such as when the use of an environmental agreement is appropriate,

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[114] Communication on Environmental Agreements, note 107 above, at 13.

[115] See further, Schnabl, "The Evolution of Environmental Agreements at the Level of the European Union", in Croci (ed.), *The Handbook of Environmental Agreements* (Berlin, Springer, 2005), which contains an annex of all of the environmental agreements approved by the Commission up until 2004.

[116] Communication on Environmental Agreements, note 107 above, at 5.

[117] See, for example, the recommendations issued acknowledging a voluntary agreement on the labelling of detergents in 1989 (Commission Recommendation 89/542/EEC OJ 1989 L 291/55), and the recommendations acknowledging voluntary agreements between associations of European, Japanese and Korean car manufacturers on the reduction of carbon dioxide emissions from passenger cars (Commission Recommendation 1999/125 OJ 1999 L 40/49, Commission Recommendation 2000/303 OJ 2000 L 100/45 and Commission Recommendation 2000/304 OJ 2000 L 100/57). As discussed above, the latter are now intended by the Commission to be replaced by formal "direct" regulation - to the consternation, in particular, of certain German car makers: Proposal for a Regulation of the European Parliament and of the Council setting emission performance standards for new passenger cars as part of the Community's integrated approach to reduce CO2 emissions from light-duty vehicles COM (2007) 856 final.

[118] See further, Bressers and De Bruijn, ""Environmental Voluntary Agreements in the Dutch Context" in Croci (ed.), *The Handbook of Environmental Agreements* (Berlin, Springer, 2005); Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45). One of the principles of the Dutch First Environmental Policy Plan (NEPP) in 1989 was the idea of "internalisation", whereby target sectors would agree with the state on the policy options and voluntarily assume a fair share of pollution reduction, and would then draw up their own plans for meeting the required goals through self-regulation: see Liefferink and Mol, "A Comparative Analysis of Joint Environmental Policy-making", in Mol, Lauber and Liefferink (eds), *The Voluntary Approach to Environmental Policy: Joined Environmental Policy-making in Europe* (Oxford, Oxford University Press, 2000), at 205.

[119] *Ibid.* Examples of agreements concluded include the "Basic Metals Covenant" concluded between the Foundation for Primary Metals industry and competent public authorities (in particular, the Ministry for Housing, Land-use planning and the Environment), whereby participating firms signed up to cut a wide range of emissions as well as waste, radiation, noise and odours. Industry "targets" are translated into requirements for individual firms through a "Company Environmental Plan", negotiated between individual firms and the competent authorities. The Covenant is open to be signed by all firms in the industry.

which parties are eligible to conclude agreements, and which type of clauses parties should consider including in agreements.[120] The guidelines make clear that all agreements concluded must comply, *inter alia*, with Community law.[121]

An excellent example of the Dutch system in action is its implementation, until recently, of the Community's successive Packaging Directives by means of environmental agreements on packaging. Initially concluded in 1991, new versions of these environmental agreements (*convenanten verpakkingen)* was concluded in 1997 and 2002 under the auspices of the Dutch legislation implementing the applicable Directive on packaging and packaging waste, the aim being that the Directive's requirements would be achieved by means of the agreements, in conjunction with ministerial regulation.[122] Article 2 of the 1997 Dutch Ministerial Regulation on Packaging and Packaging Waste provided that the producer or importer is exempted from a number of the Regulation's obligations if it is party to a *convenant* containing (at the least) binding provisions covering the obligations flowing from the Directive.[123] Importantly, the fact that the agreements applied in conjunction with the relevant Dutch legislation meant that free-riders under the agreements were still bound to comply with certain minimum legislative standards.[124] The environmental agreements were private law contracts, hence enforceable by parties to the contract in case of breach, and were published in the Dutch official journal (the *Staatscourant*) as well as notified to the European Commission. As such, they constitute a good illustration of binding voluntary agreements, complete with monitoring provisions. Though, since 2006, the Dutch system has changed from relying on environmental agreements, to placing the Directive's re-use and recycling obligations on individual producers or importers,[125] the Dutch were undoubtedly pioneers in using binding voluntary agreements in this way, and their system has been influential in subsequent systems developed in other states.[126]

Voluntary agreements are also relatively common in Germany where, like the Netherlands, the German Federal government has adopted a policy of favouring self-regulation in environmental matters. In Germany, the most prevalent form of self-regulation in environmental policy consists in "self-commitments" – unilateral declarations of firms or industry representative bodies. Such self-commitments do not take the form of formal

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120 *Aanwijzingen voor convenanten*, Staatscourant 2003, nr. 18/pag. 9.

121 See Guidelines 9 (an agreement shall not contravene national or international law) and 23 (in case of doubt about the compatibility of an agreement with Community law, the proposed agreement should be shown to the Commission).

122 See, for example, implementing Directive 94/62 on packaging and packaging waste OJ 1994 L 365/10, the 1997 Dutch Ministerial Regulation on Packaging and Packaging Waste (*Ministeriële Regeling Verpakkingen en Verpakkingsafval)* Staatscourant 1997, nr. 125/pag. 14. Environmental agreements were concluded between government and industry in 1991, 1997 and 2002 (*convenanten verpakkingen I-III*). See *Besluit beheer verpakkingen en papier en carton* (decision on the management of packaging, paper and cardboard) of April 7, 2005 and Vogelaar, "Verpakkingen en verpakkingsafval: de richtlijn 94/62/EEG en haar tenuitvoerlegging in Nederland" in Deketelaere and Wiggers-Rust, *Actualiteiten Europees Milieurecht*, Brugge, Die Keure, 1997, 95.

123 See Vogelaar, *ibid,* at 103 and 116.

124 See Seerden in Orts and Deketelaere, *Environmental Contracts: Comparative Approaches to Regulatory Innovation in the United States and Europe* (The Hague, Kluwer, 2001).

125 See the Besluit Beheer Verpakkingen en Papier en Karton of March 24, 2005, implementing Directive 2004/12 OJ L 47/26.

126 See further, the discussion of the French, German, Austrian and UK approaches in Chapter 10.

agreements, but are normally concluded after discussions with the competent authorities, who in turn often recognise the commitments informally (for example, via a press release).[127]

Voluntary agreements have also been used in Denmark, Flanders and the UK, albeit in widely differing ways. In the cases of Flanders and Denmark, legislation has been passed setting out a framework for binding voluntary agreements. In each case, the provisions have been little used by industry to date, and thus have not enjoyed the success seen, for example, in the Netherlands.[128] In Denmark, a provision on binding agreements was included in the Danish Environmental Protection Act in 1991.[129] In Flanders, legislation was passed in 1994, providing that voluntary agreements must be concluded in the form of a contract between representatives for the sector at issue which have been given an express mandate to negotiate on behalf of the sector. Each draft contract is published in the official journal and public bodies must be consulted.[130] In the UK, some of the principal examples of voluntary environmental agreements are the "Climate Change" Agreements signed in 2001 between the UK government and 48 sectoral associations in the industrial, commercial and public sectors.[131]

An interesting question is why the use of voluntary agreements between Member States diverges so greatly. It is not possible to pinpoint a single reason for this divergence; rather, the answer seems to lie in an assortment of factors, including the variable stringency and reach of national environmental policies, the commitment of the national government to deregulation, and the political and administrative culture of a country. In general, it would seem that Member States where the political decision-making culture tends to be more

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[127] See further, Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45). An example is the 1995 declaration of the Federation of German industry on Global Warming Prevention made between 16 industrial organisations representing major parts of German industry, by which Germany industry committed to reduce their CO2 emissions or energy consumption by 20% by 2005. For a critical analysis, see Morgenstern and Pizer, "How Well Do Voluntary Environmental Agreements Really Work?" (2007) 164 Resources 23.

[128] This may be due to differences in the level of encouragement given by the government to enter into negotiated agreements (high level of encouragement in the Netherlands), differences in the design of the legislative provisions (more flexibility in the Netherlands), and/or differences in the industrial and consumer cultures in these countries. See further, Bracke, Albrecht and De Clercq, "The use of negotiated environmental agreements: from gentlemen's agreements to binding contracts", Working Paper 2006/415, Universiteit Gent, Faculteit Economie en Bedrijfskunde, who argue that increased emphasis on enforcement of agreements and penalisation of breach deters industry from entering into the voluntary agreement in the first place, and De Clercq., Bracke, Baeke, Ameels. And Seyad, *Het gebruik van vrijwillige instrumenten bij de realisatie van duurzame ontwikkeling – Module 2: Vrijwillige milieubeleidsovereenkomsten* (Gent, Universiteit Gent, 2001).

[129] See, for example, the Danish voluntary agreements on energy efficiency first entered into in 1996, as part of a set of "green" taxes being imposed on industry, discussed in Liefferink and Mol, "A Comparative Analysis of Joint Environmental Policy-making", in Mol, Lauber and Liefferink (eds), *The Voluntary Approach to Environmental Policy: Joined Environmental Policy-making in Europe* (Oxford, Oxford University Press, 2000).

[130] See further, De Clercq., Bracke, Baeke, Ameels. And Seyad, *Het gebruik van vrijwillige instrumenten bij de realisatie van duurzame ontwikkeling – Module 2: Vrijwillige milieubeleidsovereenkomsten* (Gent, Universiteit Gent, 2001).

[131]The agreements formed part of a policy mix including an energy tax, climate change levy and emissions trading system. Under the agreements, energy intensive business users can receive up to an 80% reduction in the amount of climate change levy they have to pay, in return for meeting energy efficiency or carbon saving targets. Such agreements cover around 12,000 sites representing around 44% of UK industry. See http://www.defra.gov.uk/environment/climatechange/uk/business/ccl/index.htm and Morgenstern and Pizer, "How Well Do Voluntary Environmental Agreements Really Work?" (2007) 164 Resources 23.

consensus-based generally favour voluntary environmental agreements, whereas countries favouring more legalistic processes tend to prefer command and control regulation.[132]

Two further specific types of corporate voluntary initiative bear individual mention. These may, or may not, take the form of voluntary agreements between firms.

Voluntary environmental management standards. The first is the use of eco-management standards in accounting, auditing and reporting. This aims at increasing the information available to corporate stakeholders on a firm's environmental performance and is thus at least in part motivated by the desire, discussed above, to achieve beneficial corporate publicity and improve the corporation's image. A firm's decision to participate in an environmental management initiative may be purely unilateral, or may involve agreeing on a framework for environmental management standards with other firms. In the US, commentators have gone so far as to describe the voluntary environmental management movement as the "*third phase*" in the evolution of environmental policy - following initial phases of command and control regulation and market-based approaches.[133]

At international level, a relatively successful framework for environmental reporting has developed in the form of non-binding guidelines issued by the "Global Reporting Initiative" (GRI), which was launched in 1997 by the "Ceres" group of investors and environmental organisations.[134] The GRI standards are now used by 1200 firms worldwide and have been hailed as the *de facto* industry standard, with 40% of firms which engaged in corporate responsibility reporting in 2005 using these standards.[135] The ultimate aim is to build the GRI guidelines into an international reporting framework which is as widely accepted as the International Financial Reporting Standards (IFRS). Additional initiatives exist for particular types of environmental information - in particular, information on the carbon dioxide being emitted by individual firms.[136] In 2005, according to a survey carried out by KPMG, 52% of the world's 250 largest firms produced separate corporate responsibility reports (which include environmental information); whereas 64% included corporate responsibility information in their general financial reports.[137]

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[132] See Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45), who refers to "*the value system of society*" as playing an important role.

[133] See, e.g., Case, "Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective" 76 U. Colo. L. Rev. 379 (2005), at 384.

[134] By the end of the decade, 35% of the world's 250 largest companies voluntarily produced formal corporate environmental reports, many of them based on GRI guidelines. *Ibid*, at 389.

[135] See further, http://www.ceres.org/ceres/, KPMG 2005 Corporate Responsibility Survey, available at www.kpmg.nl and http://www.globalreporting.org/Home (GRI home page).

[136] The Carbon Disclosure Project - a voluntary, not-for-profit body - is the largest provider of such information, covering 2,400 companies' emissions in 2007. See http://www.cdproject.net/. This Project was set up and is run by a large group of institutional investors, with an estimated $41 trillion under management, and is aimed *inter alia* at informing these investors - and the general public, as the information collected is freely available - of the climate change performance and risks associated with individual companies.

[137] KPMG 2005 Corporate Responsibility Survey, available at www.kpmg.nl. The greatest incidence of participation in corporate responsibility reporting within the EU is in the UK, with 71% of its top 100 companies participating.

The EU has a voluntary environmental audit and management scheme (EMAS), the framework for which is provided for by legislation (now Regulation 761/2001).[138] In order to be registered under EMAS, an undertaking must:

- Conduct an environmental review of its activities, products and services in accordance with the requirements set out in the EMAS Regulation;
- Have environmental auditing carried out in accordance with the requirements set out in the EMAS Regulation;
- Prepare an "*environmental statement*", which pays "*particular attention to the results achieved by an organisation against its environmental objectives…*";
- Have the above three steps verified to make sure that they meet the Regulation's requirements; and
- Forward the validated environmental statement to the Member States's competent authority and, after registration, make it publicly available.[139]

As such, EMAS is more about procedure and public information than definite environmental standards. In particular, no single reporting framework is mandated by EMAS; thus, EMAS-reporting firms may use various performance indicators, and are not required to use (for example) the GRI's indicators. EMAS is expressly without prejudice to other Community or national law, though Member States "*should consider*" how EMAS registration may be taken into account in implementing environmental legislation "*in order to avoid unnecessary duplication of effort by both organisations and competent enforcement authorities*."[140]

Voluntary eco-labelling. A second common type of corporate voluntary initiative is voluntary eco-labelling, i.e., labelling a product with a standardised sign indicating that it is (more) environmentally friendly. Voluntary eco-labels are, by their nature, not unilateral initiatives: the framework for the eco-label may be set up by the State or, in some cases, by a group of firms or private actors. A plethora of labels exists at national level in Member States.[141] Some rely on a framework set up by the State to a greater or lesser extent - for

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[138] Regulation 761/2001 OJ 2001 L 114/1. A framework for environmental reporting has developed at international level. Non-binding guidelines have been issued by a body named the "Global Reporting Initiative" (GRI), launched in 1997 by the "Ceres" group of investors and environmental organisations. In 2005, according to a survey carried out by KPMG, 52% of the 250 largest companies produced separate corporate responsibility reports (which include environmental information), whereas 64% included corporate responsibility information in their general financial reports. See also, the accounting directive Directive 2006/46 OJ 2006 L 224/1, which encourages firms falling within its scope to include environmental information in their annual report (though there is no obligation to report on non-financial matters, contrary to the Commission's original proposal); and the proposed revision to the EMAS Directive annexed to the Commission Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, on the Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan COM (2008) 397/3.

[139] EMAS Regulation, Article 3. The environmental statement "*shall be presented in a clear and coherent manner in printed form for those who have no other means of obtaining this information*": EMAS Regulation, Annex III.

[140] EMAS Regulation, Article 10.

[141] Examples of national eco-labels include: The Blue Angel (Germany), The Green Spot (Austria), NF-Environnement (France), Umweltzeichen Bäume" (Austria), Miliukeur (Netherlands), AENOR-Media ambiante (Spain), The Soil Association Organic Standards (UK) and the White Swan (Iceland, Norway, Sweden and Finland). See further, Lavallée and Bartenstein, "La regulation et l'harmonisation internationale des programmes d'écolabels sur les produits et les services" (2004) Revue Internationale de Droit Économique 47.

example, the organic food label of the Red Ø in Denmark, the AMA food label in Austria, or the Milieukeur EKO label in the Netherlands. Others are wholly private initiatives - for example, the organic EKO label in the Netherlands.[142] The principal such regulation at Community level is the Community's Eco-Label Regulation. Like EMAS, it is wholly voluntary.[143] Certain products are excluded from the system, including hazardous chemicals, food, drink and pharmaceuticals. Applicant manufacturers must apply to the relevant national competent authority to be awarded the EU's "flower" eco-label. Although the Eco-Label Regulation sets out broad criteria for the award, detailed requirements are developed through the Community Eco-Labelling Board, composed of national competent authorities and a "consultation forum" comprising a "*balanced participation of all relevant interested parties concerned with that product group*."[144]

Other, product-specific, EU labelling measures co-exist with the Flower label, some of which are mandatory, some voluntary. An example of a mandatory measure is the energy class rating system, introduced in 1994, which identifies refrigerators, freezers and other household equipment which are particularly economical in terms of electricity consumption.[145] Similar initiatives have been undertaken for buildings (on a voluntary basis), with "energy efficiency certificates" being awarded for energy-efficient structures.[146] The Commission has announced a review of these measures aiming at a more integrated approach, in order to exploit "*potential synergies between the different instruments.*"[147]

c. Merits and demerits of corporate voluntary initiatives

Used wisely, voluntary initiatives may result in more commitment and enhanced environmental standards than regulation simply imposed from "above".[148] Though they are not appropriate for all situations, and generally do not receive a good press, they may reach

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142 Liefferink and Mol, "A Comparative Analysis of Joint Environmental Policy-making", in Mol, Lauber and Liefferink (eds), The Voluntary Approach Environmental Policy: Joined Environmental Policy-making in Europe (Oxford, Oxford University Press, 2000).

143 Regulation 1980/2000 on a revised eco-label award scheme OJ 2000 L 237/1, Article 1. The objective of the EU eco-label is "*to promote products which have the potential to reduce negative environmental impacts, as compared with the other products in the same product group, thus contributing to the efficient use of resources and a high level of environmental protection. This objective shall be pursued through the provision of guidance and accurate, non-deceptive and scientifically based information to consumers on such products*." See also, the proposed revision to the eco-label Directive annexed to the Commission Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, on the Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan COM (2008) 397/3.

144 *Ibid*, Article 15. Grant of the eco-label can have further consequences: for example, when granted to an energy-using product, the eco-label means that the product is considered to comply with Directive 2005/32 on the eco-design of energy-using products OJ 2005 L 191/29, as amended.

145 Ratings range from A++ rating to G. See Directive 92/75 on the indication by labelling and standard product information of the consumption of energy and other resources by household appliances OJ 1992 L/297/16. See also, Directive 2005/32 establishing a framework for the setting of ecodesign requirements for energy-using products OJ 2005 L 101/29 and Regulation 106/2008 on a Community energy efficiency labelling programme for office equipment OJ 2008 L 39/1.

146 See further, the Commission's Green Paper on Energy Efficiency (COM (2005) 265 final).

147 Commission Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, on the Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan COM (2008) 397/3, at 3.

148 In the Commission's words, "*It is clear…that environmental agreements can bring qualitative benefits such as consensus building; broader sharing of information; awareness raising among enterprises; and improving environmental management in businesses.*" Communication on Environmental Agreements, note 107 above, at 4.

parts of the economy which direct regulation fails to reach.[149] In this way, regulators can make use of what Thaler and Sunstein term the "nudge" effect: rather than expressly commanding companies to behave in a certain manner, regulators become "choice architects", ensuring that the regulatory framework incentivises, or nudges, companies voluntarily to act in an environmentally friendlier manner.[150]

In the case of voluntary agreements, these work best where regulators have a "stick" to hold over the participating firms (normally the threat of bringing in heavier-touch regulation), and a small number of relatively large firms wish to participate (thus enabling the regulator to keep an eye on standards).[151] Voluntary agreements allow firms to decide on the means of achieving outcomes - which in principle constitutes a major advantage, as firms are better placed than regulators to know the most cost-effective way to achieve a given environmental outcome. (More controversially, self-regulatory voluntary agreements often allow firms to decide on what the outcomes themselves should be.) In addition, voluntary agreements allows firms swiftly to adapt to what are often complex, fast-changing environmental issues in the marketplace, thus beating "time lag" problems, and can alleviate the need for (detailed) regulation, which cuts enforcement and compliance costs alike. Such advantages have led countries like the Netherlands to reject the possibility of providing a detailed legislative framework for environmental agreements, such as exists in Denmark, on the basis that this could result in the loss of the benefits of flexibility of the voluntary agreements approach.

Empirical research on the beneficial effects of voluntary agreements for the level of environmental protection has been limited to date. However, conclusions have so far been mixed. In a survey of environmental agreements used in various EU Member States and in the US, the Environmental Law Network Institute concluded that, in the majority of cases, voluntary agreements contribute to a higher level of environmental protection than would exist without the agreement.[152] Others, however, have concluded that the effectiveness of voluntary agreements depends on the type of pollution which firms are trying to tackle: in the case of climate change or carbon reduction goals, voluntary agreements are, it is argued, less effective, because of the non-localised nature of such pollution.[153]

Aside from any benefits in the level of environmental protection as such, voluntary environmental initiatives may have other advantages. In particular, voluntary management initiatives and voluntary participation in eco-labels have clear environmental "democracy" benefits, in that they increase transparency, access to environmental information and participation (not only by participating firms, but also by consumers purchasing eco-

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[149] See Harman, "Environmental Regulation in the 21st Century" (2004) 6 Environmental Law Review 141, 149.
[150] Thaler and Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness* (New Haven, Yale University Press, 2008).
[151] See the list of conditions compiled by UNICE in 1995 in order for voluntary environmental agreements to be successful: clearly defined goals; a transparent negotiating process; involvement of top management in the sector; discouragement of free riders; and the presence of measures to encourage participation such as tax breaks and the threat of stricter legislation in the absence of compliance. See further, Van Calster and Dekeletaere, in Orts and Deketelaere, *Environmental Contracts: Comparative Approaches to Regulatory Innovation in the United States and Europe* (The Hague, Kluwer, 2001).
[152] Environmental Law Network International (ed.), *Environmental Agreements: The role and effect of environmental agreements in environmental policies* (London, Cameron May, 1998), at 6.1.
[153] Morgenstern and Pizer, "How Well Do Voluntary Environmental Agreements Really Work?" (2007) 164 Resources 23.

friendlier products), in line with the goals of the Aarhus convention.[154] In turn, the availability of information has been shown to improve environmental protection levels and the effectiveness of environmental standards, through providing people with the knowledge on which to take action - whether market action (choosing/refusing to purchase a product) or otherwise.[155]

In contrast, the first, and principal, disadvantage with voluntary initiatives of all genres lies in their very essence: they are by definition not compulsory. Moreover, in the case of voluntary agreements, they are often not binding and thus are unenforceable. As such, their effectiveness in terms of environmental outcome is not guaranteed, meaning they cannot be used for immediately serious environmental risks. This problem can be seen for practically all types of voluntary initiative - from voluntary agreements whose targets are not respected by participants (such as occurred with the EU car emissions agreement), to eco-management and audit schemes and certain eco-labels which have had a very low participation rate to date.[156] Clearly, therefore, voluntary initiatives are not normally appropriate for use to tackle localised grave environmental risks.[157]

Similarly, in the case of voluntary environmental management initiatives, the flexibility inherent in such initiatives, while a major advantage to firms, can also critically damage their effectiveness, both in raising standards of environmental protection and in increasing the "green" profile of the firm. Empirically, there is conflicting evidence on whether environmental management schemes actually improve environmental quality.[158] This was confirmed by the Community's interim review of the EMAS regulation in 2005, where praise for EMAS was mixed.[159] In terms of public perception, the success of the publication of an environmental report by firms, or the inclusion of an environmental section in the annual or financial report, depends on the reliability of the information and whether consumers and/or shareholders will find it convincing. Rather, more cynical members of the public may well suspect that a report amounts to "greenwash", reflecting only the aspects of

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[154] The Aarhus goals apply here, however, by extension only, as Aarhus does not as such cover private bodies (save when private bodies are performing public functions under the control of a public body): Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Maters, done at Aarhus on June 25, 1998, Article 2(2)(c).

[155] See, for a law and economics perspective, Kennedy, Laplante and Maxwell, "Pollution Policy: The Role for Publicly Provided Information" 26 J. Envtl. Econ. & Mgmt 31 (1994). The authors conclude that social welfare is indeed improved in such cases by the provision of information to the public, insofar as the consumption of the polluting product does decrease.

[156] Freeman, Pierce and Dodd, *Environmentalism and the New Logic of Business* (Oxford, Oxford University Press, 2000).

[157] See likewise, Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45): "…*self-regulation as a rule cannot - or at least should not - be used for the prevention of clearly unacceptable risk, but, rather, in areas where environmental risks or resource consumption below the level of unacceptability shall be reduced for precautionary reasons*." See likewise, Eickhof, "Selbstverpflichtungen im Bereich des Umweltschutzes" (2004) ORDO 269.

[158] The REMAS project showed that evidence collected by a survey of 500 companies participating in such schemes from 2002 – 2006 demonstrated improved environmental performance. See www.remas.info.

[159] See the EVER report, "Evaluation of EMAS and the Eco-label for their Revision", December 26, 2005, available at http://ec.europa.eu/environment/emas/index_en.htm: "*EMAS-registered organisations find that it is a useful tool for improving environmental performance both in the short and long term. They perceive their performance as better than that of other organisations, although most quantitative studies have not been able to confirm this…EMAS is not generally seen as a benchmark. Little more than 60% of the interviewed companies and stakeholders think that EMAS is regarded and used as 'best practice'…*"

environmental performance which the undertaking is willing to reveal, obscuring or omitting negative information. The EU's EMAS system fails to solve this problem, insofar as it fails to require firms to abide by a single set of environmental indicators. As a result, *inter* alia, of these failings, EMAS currently suffers from very low participation rates.[160] One hopes that the revision of the EMAS scheme announced by the Commission in 2008 will improve its effectiveness.[161]

In contrast, voluntary participation in eco-labels seems, thus far, to show greater potential to achieve concrete improvements in environmental performance. The success of a given eco-label depends, however, on the extent of corporate participation in the label, as well as on consumers' awareness of and trust in the label - each of which can vary considerably per label. In the case of the EU's Eco-Label, the results have - in contrast to the results of EMAS - been relatively positive. In its 2005 review of the Eco-Label Regulation, the Commission concluded that,

> "*the EU Eco-label is frequently able to actually produce…an improvement in environmental performance…[it] is also able to induce an improvement in the performance of other companies in the supply chain of the participants (e.g. providers of intermediate goods and services).*"[162]

Similarly, eco-labelling has been credited by the US Environmental Protection Agency with reducing volatile organic compound (VOC) emissions in Germany, and with increasing paper recycling in Korea.[163]

Second, certain voluntary initiatives are susceptible to the criticism that they are "undemocratic", in the narrow sense that they do not involve elected representatives or their agents. In particular, in the case of voluntary agreements which replace, or partially replace, legislation, this puts the decision of which environmental standard will be adopted into the hands of firms, rather than regulators (which normally removes the possibility for public participation and consultation in the run-up to setting the standard). This may ultimately result in a lower standard being set than would have occurred via direct regulation, and/or a failure to comply with standards due to lack of any penalty system.[164] Clearly, whether this is so depends the structure of the particular agreement: for instance, whether the task of setting the outcomes is left to participating firms (as with self-regulation) or regulators (as with many co-regulatory arrangements), and whether an effective monitoring system has been put in place.[165] Further, public participation in the process of negotiating and

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[160] See the table of participating firms in MEMO/08/513, "Questions and Answers on the Revision of the Eco-Management and Audit Scheme", Commission memo of July 16, 2008.

[161] See Commission Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, on the Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan COM (2008) 397/3.

[162] See the EVER report, note 159 above.

[163]"Economic Incentives for Pollution Control", US Environmental Protection Agency, Washington, DC (1999).

[164] Hansen argues that voluntary agreements may result in lower standards of environmental protection because environmental agreements place responsibility for environmental performance in the hands of corporations which may be less susceptible to influence by environmental NGOs. Hansen, "Aspects of the Political Economy of Environmental Voluntary Agreements" in Croci (ed.), *The Handbook of Environmental Agreements* (Berlin, Springer, 2005).

[165] Likewise, as Alberini and Segerson note, voluntary agreements backed by the credible threat of regulation are far more effective in terms of environmental outcome than agreements without such a threat. Alberini and Segerson, "Assessing Voluntary Programs to Improve Environmental Quality" Environmental and Resource Economics 22, 157 (2002), at 177. For these reasons, many commentators argue that CSR can only truly be

monitoring environmental agreements - as takes place in some Member States, such as the Netherlands - clearly increases the democratic credentials of such agreements.

A third criticism of voluntary initiatives is that they may not always make economic sense, depending on how they work in practice. For instance, where an industry (rather than individual polluters) is targeted by a voluntary agreement, there may be an incentive for some firms to "free ride": an undertaking may feel that, though there may be a risk of regulation if the industry as a whole fails to meet its goals, it can individually get away with not participating in the voluntary initiative.[166] Furthermore, the transactions costs of entering into ad hoc voluntary environmental agreements may mean that other (economic) instruments may prove more cost-effective in a given situation.[167]

In sum, voluntary initiatives have in some circumstances certain clear advantages in comparison to direct regulation and, in the right context, they may offer an important contribution to achieving a higher level of environmental protection. However, their use is not always appropriate - and even where in principle appropriate their success in achieving environmental protection goals (and, where relevant, environmental governance goals) depends on how the initiative is constructed and functions in practice. This qualified endorsement is also evident in the Commission's conclusion in its 2002 Communication on voluntary agreements that such agreements,

> "*are not an environmental panacea, nor will they be the optimal instrument in all circumstances, [but] they have a potentially valuable role to play in complementing - but not replacing - other policy instruments, notably legislation."*[168]

4. Implications of environmental regulation for competition policy: An introduction

Having looked at the most important trends in environmental regulation within the Community, what are the implications of these trends for competition policy? What, if any, significance does the increased use of economic environmental policy instruments have for competition policy? Prior to discussing the approach of competition law to environmental factors in Parts II and III, it is useful to introduce briefly some potential competition issues raised by environmental regulation in general, and by economic environmental instruments in particular.[169]

a. Potential competition problems raised by environmental regulation

First, the increase in the use of market-based instruments means that competition law may be applicable to large areas of environmental policy where, had direct regulation been used, it would not have applied. In the case of state subsidies, taxes and tradable permit schemes, this can occur via those areas of Community competition law applicable to State measures which restrict competition on a market - for example, Articles 86 and 87 EC. In the case of

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effective if grounded in a framework set by the legislator. See, for example, De Schutter, "Corporate Social Responsibility European Style" (2008) 14(2) European Law Journal 203, at 235.

[166] See further, Alberini and Segerson, "Assessing Voluntary Programs to Improve Environmental Quality" Environmental and Resource Economics 22, 157 (2002).

[167] See the conclusion of Environmental Law Network International (ed.), *Environmental Agreements: The role and effect of environmental agreements in environmental policies* (London, Cameron May, 1998), at 6.2 and Keeler, who criticises voluntary agreements on cost-effectiveness grounds in comparison to "cap and trade" tradable permit systems. Keeler, "Contract-based trading programs" Contemporary Economic Policy 22(4) 526 (2004).

[168] Communication on Environmental Agreements, note 107 above, at 4 and Alberini and Segerson, note 166.

[169] See generally, OECD, *Competition Policy and the Environment* (Paris, OECD, 1996).

voluntary agreements, it can occur via those areas of Community competition law applicable to private undertakings - for example, Articles 81 and 82 EC.

Second, and more broadly, environmental policy instruments can be relevant to competition analysis through raising barriers to entry into the market, which can in turn deter innovation.

This may occur through traditional "command-and-control" regulation via, for example, environmental regulation requiring expensive pollution control equipment to be added to new or existing plants, or requiring waste from certain products to be collected and disposed of free of charge.[170] Further, there may be a risk of environmental regulators being "captured" by incumbent firms, who may be able to manipulate regulatory outcomes so as to make new entry more difficult. In some cases, the barriers to entry created by environmental regulation may be so great that they indirectly lead to the creation or entrenchment of substantial market power on the market, which may in turn enable the abuse of market power to the detriment of consumers. For example, Member States may choose to grant only limited permits to operate on a market - such as a market for the recycling of waste - if they feel this is necessary due to the need to achieve a minimum scale of operation where costs of recycling are high. Undertakings granted such permits may as a result hold a position of dominance, which may in some cases be abused. For similar reasons, Member States may choose to grant exclusive rights to an undertaking performing a given environmental service, thus excluding all potential competitors.

Economic instruments may also increase barriers to entry, by putting a price on pollution emitted, thus increasing overall running costs in an industry. This may occur, for example, where Member States tax environmentally-unfriendly activities. It may also occur when Member States operate tradable permit systems to control pollution. For example, the use of "grandfathering" methods of allocation in emissions trading schemes may mean that new entrants into the market are subject to greater costs than incumbents. Similarly, the use of an auctioning system may raise barriers to entry, where, for example, a large incumbent undertaking can outbid potential rivals because it has greater resources at its disposal. In addition, voluntary instruments may raise barriers to entry where, for example, firms agree on industry standards via voluntary agreement, which standards are very difficult or impossible for new entrants to attain. Similarly, participation in voluntary eco-labels may become a *de facto* requirement in order for a product to be stocked by retailers.[171] More generally, the time involved in going through the process of obtaining a permit (whether a

[170]See, for instance, for an analysis of the barriers to entry created by the EU's Directive 2002/96 on Waste Electric and Electronic Equipment OJ 2003 L 37/24, Mock and Perino, "Wasting Innovation: barriers to entry and European regulation on waste electronic equipment" Eur J Law Econ (2008) 26:1-10, who criticise the fact that the Directive requires the costs of disposing of "historical waste" (products sold before August 13, 2005) to be shared proportionately among producers in proportion to their current market shares - meaning that new entrants to the market effectively have to subsidise the disposal of their competitors' products.

[171] See, for instance, Grolleau, Ibanez and Mzoughi, "Industrialists hand in hand with environmentalists: how eco-labeling schemes can help firms to raise rivals' costs" Eur J Law Econ (2007) 24: 215-236, who conclude that eco-labelling schemes can provide firms with a legitimate way to disadvantage rivals, frequently foreign rivals, by defining distinct product categories to prevent competitors from differentiating their products; and defining eco-label criteria and monitoring procedures to increase competitors' costs. A good example is the EU's eco-label scheme for copy paper, which has led to complaints by US paper importers that it amounts to a severe trade barrier, as retailers in some EU countries refuse to allocate substantial shelf space to non-labelled products: *ibid,* 224.

tradable permit or traditional permit) may, in some circumstances, constitute a barrier to entry.

Third, environmental regulation may sometimes facilitate collusion between undertakings. This may arise, for example, where environmental regulation limits the number of competitors on a market - for example, by restricting the number of permits which may be issued. It may make it easier for competitors to keep an eye on each other or, for example, to share out markets among each other. It may also arise where environmental regulation facilitates the sharing of information between competitors, as, for example, may occur under the auspices of coordination in the context of voluntary regulatory initiatives, such as voluntary agreements and voluntary standard-setting via eco-labels; or even by close cooperation between undertakings on a pollution control scheme. Such fora in principle present opportunities for competitors to meet and discuss a range of commercially sensitive topics, whether related to the environmental matter at hand (e.g., product planning of environmentally-friendlier products) or by way of "spill-over" from the interaction.[172]

b. Potential competition benefits of environmental regulation

It is not all bad news. It would be wrong to ignore the potential competitive up-side of environmental regulation. For instance, environmental regulation can create markets. This can occur directly or indirectly. Directly, for example, by the creation of markets for tradable permits. Indirectly, for example, where the use of economic instruments, by placing a price on pollution, incentivises the development of new technologies for pollution abatement - thus adding to the dynamism of the market.

More generally, the development of consumer preferences for environmentally-friendlier goods, as witnessed by the rise in voluntary environmental initiatives discussed above, may lead to an additional factor on which firms can compete, which may in turn lead to market expansion and, ultimately, to the emergence of new, separate markets for environmentally-friendly goods.

[172] See, for instance, Commission decision of September 3, 2004, COMP/E-1/38.069 *Copper Plumbing Tubes*, at point 152; Commission decision of December 5, 2001 *Citric Acid* OJ 2002 L 239/18, at point 92; Commission decision of December 11, 2001 *Zinc Phosphate* OJ 2003 L 153/1; Commission decision of November 30, 2005 COMP/38354 *Industrial bags*, point 385.

Part II - A Perspective from Competition Theory

This Part considers the relevance of environmental factors from the perspective of competition theory. Chapter 5 examines the goals of EU competition law and the approaches taken by the leading schools of competition thought to the role of non-economic factors in competition analysis. Chapters 6 to 8 focus on environmental factors, and consider whether, as a normative matter, such factors ought to be excluded from competition analysis. These Chapters set out three theoretical arguments why this should not be so, and propose a theoretical framework for when and how such considerations should be taken into account in Community competition law enforcement.

Chapter 5: Theoretical Foundations - The Goals of Community Competition Policy and its Approach to Non-Economic Factors

1. Introduction

In order to understand what role environmental factors can or should play in EU competition policy, an essential first step is to return to the vexed question: What can we say are the goals of Community competition law at present? It is one of the curiosities of Community competition policy that there is - still - no consensus on the answer to this question.[1] To structure our consideration of this issue, the first section of this Chapter revisits briefly some important models of competition thought, considering their views about the goals of competition policy, the extent of their influence on Community competition policy, and their approaches to the relevance of environmental protection in competition policy. These models are often referred to as "schools" of competition theory - the Ordoliberal, Harvard, Chicago and post-Chicago schools, a practice which, for ease of reference, will be continued here.[2] In the light of this discussion, the second section considers some examples of the relevance of non-economic goals, other than environmental protection, to Community competition policy to date. It will be concluded that Community competition policy at present is based on, and has been influenced by, a blend of competition theories. The "European School", if one wishes to call it that, might be described as a mixture of Harvard School and Chicago School approaches, set in a broader framework heavily influenced by ordoliberalism. This will form the backdrop to the consideration in Chapters 6-8 of the role environmental factors should, from a theoretical perspective, play in Community competition policy.

2. Four important schools of competition theory, their influence on Community competition policy, and their approaches to the role of environmental protection

a. Ordoliberalism[3]

Overview. Ordoliberalism is far more than a theory of competition: it is an overarching vision of the role which the economy should play in society. It originated in the University of Freiburg, Germany in the 1930s, founded by the economist Walter Eucken

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[1] Rein Wesseling, for instance, wrote in 2000 that Community antitrust policy is characterised by a "*fundamental ambivalence*" as to its goals (Wesseling, *The Modernisation of EC Antitrust Law* (Oxford, Hart, 2000), 96). Writing in 2002, Roger Van den Bergh went further, concluding that, *"[t]here has never been a comprehensive discussion about the goals of EC competition law…*" (Van den Bergh, "The difficult reception of economic analysis in European competition law", in Cucinotta, Pardolesi and Van den Bergh (eds.), *Post-Chicago Developments in Antitrust Law* (Cheltenham, Edward Elgar, 2002), at 36).

[2] Any attempt to group a variety of views into a "school" often leads to (not quite accurate) generalisations. Though effort will be made below to specify particularly important divergent views within the same "school", some generalisations certainly remain as this is not the juncture for an exhaustive account of individual school members' views. Nonetheless, it is submitted that the exercise is an instructive one, in suggesting potential influences for the current and future approaches of EU competition policy to environmental factors.

[3] For accounts of ordoliberal theory, see Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford, Clarendon Press, 1998), ch. VII, Gerber, "Constitutionalizing the Economy: German Neo-liberalism, Competition Law and the "New" Europe" (1994) 42(1) American Journal of Comparative Law 25, Lemke, "'The birth of bio-politics': Michel Foucault's lecture at the Collège de France on neo-liberal governmentality" (2001) 30(2) Economy and Society 190, Sally, "Ordoliberalism and the Social Market; Classical Political Economy from Germany (1996) 1(2) New Political Economy 233, Streit and Wohlgemuth, "The market economy and the State: Hayekian and ordoliberal conceptions" Diskussionsbeitrag 06-97, Max-Planck-Institut zur Erforschung von Wirtschaftssystemen (1997), Vanberg, "The Freiburg School: Walter Eucken and Ordoliberalism", Freiburg Discussion Papers on Constitutional Economics 04/11, Walter Eucken Institut (2004) and Walter Eucken's major work on economic policy, *Grundsätze der Wirtschaftspolitik* (Principles of economic policy) (7th ed., Tübingen, Mohr Siebeck, 2004).

and lawyer Franz Böhm, who were later joined by the lawyer Hans Grossmann-Doerth. This "Freiburg School" sought to find a third way between the Scylla and Charybdis of Nazi totalitarianism and communism. Their solution was grounded in liberalism, but with a twist. They agreed with classical liberal theory that economic freedom and a competitive economic system were crucial for both economic prosperity and for political freedom. However, they rejected classical *laissez-faire* liberalism, with its belief in a minimal role for the state. Rather, their "neo-liberal" vision was of a competitive market embedded in a constitutional framework, which would serve to guard against competitive distortions, to ensure the equitable distribution of resources in society, and to prevent undue government intervention in the market. This combination of liberalism and *Ordnung* (loosely translatable as "order")[4] resulted in the Freiburg School's *Wirtschaftsverfassungspolitik* (constitutional economic policy), by which the state's role was to set the "rules of the game" in which Adam Smith's "invisible hand" could function. The resultant competitive order (*Wettbewerbsordnung*), constituted and regulated by a "policy of order" (*Ordnungspolitik*), would be compatible with the *Rechtsstaat* - the state based on the rule of law. In contrast to *laissez-faire* liberalism, thus, the Ordoliberals believed that the free market order could not exist spontaneously in the absence of government. Rather, it could only exist within the framework of an economic constitution which must be "*consciously shaped*",[5] carefully cultivated and protected by the state. The construction and cultivation of this framework necessarily involved political choices "*as to how the economic life of the nation is to be structured.*"[6]

Eucken's *Ordnungspolitik* was based on eight "constitutive" principles and four "regulative" principles.[7] The constitutive principles, which formed the fundamental principles establishing the form of a market economy, included the principles of price stability, open markets, private property, freedom of contract, and legal responsibility for one's own acts. In turn, the role of the regulative principles was to ensure the effectiveness of the constitutive principles. The most important regulative principle was the principle of creating and maintaining competition policy, which Böhm described as "*the moral backbone of a free profit-based economy.*"[8] From the ordoliberal perspective, the aim of competition was the restriction of private economic power, and the prevention of the harmful effects flowing from such power - a view based in part on the conviction that the existence of powerful cartels in Germany in the 1930s had helped Hitler remain in power. This distrust of private economic power, and the accompanying emphasis on economic freedom as a fundamental right, meant that anti-monopoly law was central to ordoliberal competition policy. In their view, monopolies should be prohibited or, where they already existed, abolished. Where abolition was not possible, the conduct of monopolies should be controlled so that they behaved "as if" they were subject to

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[4] Eucken distinguished between two types of "order": the order of any society where ordinary economic transactions take place, and the normative ideal of *Ordo,* which he defined as the order that "corresponds to reason or to the nature of men": Eucken, *Grundsätze der Wirtschaftspolitik* (Principles of economic policy) (7th ed., Tübingen, Mohr Siebeck, 2004), 372. The *Ordo* concept thus has its origins in natural law theory, a line tracing from the philosophies of antiquity to Saint Augustine onwards. See Sally, "Ordoliberalism and the Social Market; Classical Political Economy from Germany (1996) 1(2) New Political Economy 233.

[5] Eucken, *The Foundations of Economics - History and Theory in the Analysis of Economic Reality* (Berlin, Springer, 1992), at 314.

[6] See Böhm, Eucken and Grossmann-Doerth, "The Ordo Manifesto of 1936" in Peacock and Willgerodt (eds) *Germany's Social Market Economy: Origins and Evolution* (London, Macmillan, 1989), at 24.

[7] See further, Sally, "Ordoliberalism and the Social Market; Classical Political Economy from Germany (1996) 1(2) New Political Economy 233.

[8] Böhm, "The non-state ("natural") laws inherent in a competitive economy, in Stützel et al (eds.) *Standard Texts on the Social Market Economy* (Stuttgart, Fischer, 1982), at 110.

competition - i.e., as if they did not enjoy monopoly power.[9] Ultimately, the aim was to achieve what the ordoliberals termed "performance" competition (*Leistungswettbewerb*): competition on the merits to provide better products and services for consumers.[10] This would be achieved when a state of "complete competition" (*vollständiger Wettbewerb*) was reached - that is, where no firm in the market had the power to coerce other firms in that market. Moreover, in order to avoid what would in modern public choice theory be termed the "capture" of enforcers via lobbying, and to ensure the maintenance of the *Rechtsstaat*, the ordoliberals required competition law to be enforced by an independent competition office, subject to review by the courts.

The ordoliberal emphasis on freedom of competition, and distrust of market power, is still evident in what has been termed the Austrian school of economics, as epitomised by writers such as Erich Hoppmann - though, as his compatriot Hayek had before him, Hoppmann rejects the ordoliberals' view of the role of the state as overly interventionist.[11]

More broadly, going beyond ordoliberalism *per se*, ordoliberal ideas in turn inspired the concept of the "social market economy" (*Soziale Marktwirtschaft*), a phrase coined by the economist Alfred Müller-Armack in 1946. The model of the social market economy was essentially in agreement with most aspects of ordoliberal theory, but placed greater emphasis on the equitable distribution of the benefits of a market economy throughout society.[12] Thus, Müller-Armack envisaged the use of the free market to produce the required amount of wealth, which could then be redistributed according to the requirements of social justice.[13] This model was a core concept in the foundational period of the Federal Republic of Germany, espoused by Ludwig Erhard as economics minister from 1949-1964 and subsequently as chancellor from 1964-1966.

Ordoliberal ideas had a major influence in early Community economic policy, including in Community competition law.[14] Their importance was due partly to the fact that, when the Treaty of Rome was being drawn up in 1955 and 1956, Germany was on the verge of completing the legislative process for its own national competition law which ultimately came into force on the same day as the Treaty of Rome.[15] Thus, the structure of present

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[9] The notion of requiring monopolists to behave "as if" subject to competition is widely considered to be one of the weakest elements of ordoliberal theory, as it is a standard which seems virtually impossible to measure and enforce.

[10] This was contrasted with *Berhinderungswettbewerb,* or competing by means of hindering the activities of other producers on the market. See Eucken, *Grundsätze der Wirtschaftspolitik* (Principles of economic policy) (7th ed., Tübingen, Mohr Siebeck, 2004), at 43 and 329.

[11] See further, Van den Bergh and Camesasca, *European Competition Law and Economics: a Comparative Perspective* (London, Sweet & Maxwell, 2006).

[12] See Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford, Clarendon Press, 1998), at 237 and Sally, "Ordoliberalism and the Social Market; Classical Political Economy from Germany (1996) 1(2) New Political Economy 233.

[13] See Ebner, "The intellectual foundations of the social market economy: Theory, policy and implications for European integration" (2006) 33(3) Journal of Economic Studies 206 and Joerges and Rödl, "'Social Market Economy' as Europe's Social Model?" EUI Working Paper LAW No. 2004/8 (2004).

[14] See Hildebrand, *The Role of Economic Analysis in the EC Competition Rules* (2nd ed., The Hague, Kluwer, 2002), at 10, who describes the Freiburg School as the "*academic cradle of EC competition law*."

[15] See Weitbrecht, "From Freiburg to Chicago and beyond - the first 50 years of European Competition law" European Competition Law Review (2008) 81, who notes that the fact that the Rome Treaty, unlike the European Coal and Steel Treaty, did not include rules on merger control was probably also due to the German influence, as Germany had concluded that for its own national competition law it did not need substantive merger control provisions (in the end, these were not brought in until 1973). Nonetheless, the Treaty of Rome's competition provisions were certainly inspired by those of the European Coal and Steel Community Treaty, and in particular its Articles 65 (on restrictive agreements) and 66(7) (on abuse of

Articles 81 and 82 EC reflects ordoliberal thought, with a very broadly-worded prohibition of restrictive agreements (Article 81(1)), subject to justification (Article 81(3)), and a prohibition of "abuse" of a dominant position (Article 82) reminiscent of the "as if" standard for monopolists discussed above.[16] Moreover, Walter Hallstein, the first President of the European Commission, was closely associated with ordoliberalism, as was Hans von der Groeben, one of the two principal drafters of the Spaak Report (on which the original Treaty of Rome was based) and the first competition Commissioner. In addition, the director-general of the Commission's competition directorate has traditionally been German (a tradition which was broken with the appointment of Philip Lowe in 2002).

Despite this undoubted initial influence, ordoliberal competition theory has, for the moment, to a certain extent gone out of fashion at EU level.[17] In particular, the Freiburg emphasis on the right to economic freedom, and its suspicion of market power, has led to its association with favouring (even less efficient) "competitors" over the goal of "competition".[18] Ordoliberal theory was also associated with a very wide definition of the scope of Community competition law, meaning at times that innocuous contractual provisions fell under the Article 81(1) prohibition even if they had no anti-competitive economic effects[19] - an approach now abandoned in particular in the area of vertical agreements. Nonetheless, ordoliberal ideas still permeate much of EU economic policy, and have recently been emphasised in the rise to prominence of the "social market economy" concept in the EU context, with the Lisbon Treaty explicitly including working towards a "*highly competitive social market economy*" among the EU's goals.[20]

Role of environmental factors. It is not entirely clear from their writings what role the fathers of ordoliberalism would have attributed to environmental factors in competition policy. Nonetheless, there are, in the present author's, view significant grounds for concluding that a strict separation of environmental and "pure" economic efficiency grounds is inconsistent with the ordoliberal vision.

In the first place, it is fundamental to the ordoliberal viewpoint that an "integrated policy perspective" (*Ganzheitsbetrachtung*) must be adopted by regulators, by which is meant that each individual economic decision had to be seen as part of the greater "*blueprint*" of the economic constitution.[21] Implementation of the *Ordnungspolitik* necessitates a

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dominant position). In turn, the inclusion of these provisions in the ECSC Treaty was arguably due to Jean Monnet, who wrote in his *Mémoires* that such inclusion constituted "*une innovation fondamentale en Europe, et l'importante legislation antitrust qui règne sur le marché commun trouve son origine dans ces quelques lignes pour lesquelles je ne regrette pas de m'être battu quatre mois durant*" (Monnet, *Mémoires* (Paris, Fayard, 1976), 413.

16 See further, Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford, Clarendon Press, 1998).

17 See, for instance, Monti *EC Competition Law* (Cambridge, Cambridge University Press, 2007), at 24. Faull and Nikpay (eds.), The EC Law of Competition (2nd ed., Oxford, Oxford University Press, 2007), a book written by officials and ex-officials of the Commission's competition directorate-general, omit ordoliberalism entirely from their discussion of competition theory. Clearly, the mere fact that ordoliberalism might have been the economic model best reflecting the intentions of the Treaty authors themselves at the time of drafting the Treaty does not, in itself, mean that an ordoliberal interpretation of the Treaty provisions should now be preferred: an "intention"-based interpretative technique has rarely been used in the context of the EC Treaty, due *inter alia* to the absence of *travaux préparatoires* for the Treaty of Rome and the preference for systematic interpretation.

18 A criticism with which the Community has repeatedly been faced, in particular in cases of conflict with the US Federal Trade Commission in cases like *GE/Honeywell* OJ 2004 L 48/1.

19 See, for example, early cases such as Case 56/65 *Société Technique Minière* [1966] ECR 235.

20 See Article 3(3) of the Treaty on European Union. This was retained from the EU's failed European Constitution, which tasked the Union in Article I-3 with working for a social market economy.

21 See Gerber, "Constitutionalizing the Economy: German Neo-liberalism, Competition Law and the "New" Europe" (1994) 42(1) American Journal of Comparative Law 25, at 48 and Eucken, *Grundsätze der*

comprehensive, holistic approach to the community's legal, political and economic systems. For instance, Eucken rejected the notion of "functional" economic theory, whereby thinking is divided per policy area (agricultural policy, monetary policy, employment policy, etc). Such a functional approach, he felt, ignores the interaction between policy areas *inter se* within the economic order, and ignores the effects of one policy decision on other policy areas and on the economic order as a whole.[22] In turn, the economic order is interdependent with the other orders within society.[23] Such reasoning requires the rejection of a narrow compartmentalisation between the aims and decisions of competition policy and those of other policies in the broader economic order, including environmental policy. Thus, Eucken warned that, standing alone, competition law would be of little or no value.[24]

This aspect of the ordoliberal approach resounds strongly, it is submitted, with the argument - taken up in Chapter 6 - that certain non-economic factors should play a role in Community competition policy due to the systematic structure of the EC Treaty itself. Article 2 EC, which sets out the objectives of the Community, includes the establishment of a common market and the achievement of a high level of competitiveness within the Community among these objectives; Article 3(1)(g) EC provides that this is to be achieved by running "*a system ensuring that competition in the internal market is not distorted*", of which the competition provisions specified in Title VI, Chapter 1 EC form part. However, Article 2 EC makes clear that this goal is only one of many for the Community and, as is well-known, sets down no hierarchy between those goals. Rather, the EC Treaty should be viewed as a system, with ambiguous provisions being interpreted in the light of this system and of the Community's overall goals.[25] This "teleological" approach is famously consistently espoused by the Community Courts when interpreting Community law. The competition field has been no exception. Classic examples of judgments in which the ECJ has interpreted the competition provisions in the light of the overall scheme of the Treaty, and its wider aims set out in Article 2 EC, include *Walt Wilhelm* and *Continental Can*.[26]

Second, the ordoliberal effort to define a new relationship between law, the economy and society was based in part at a rejection of the legal positivism of Germany in the 1920s, and its acceptance that legislation was the sole source of law - to the exclusion of fundamental values and common aims.[27] Rather, the ordoliberal approach is that such

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Wirtschaftspolitik (Principles of economic policy) (7th ed., Tübingen, Mohr Siebeck, 2004), at 304. This integration imperative has had a major influence on the structure of German governmental departments, with virtually all departments dealing with the economy having "principles sections" (*Grundsatzabteilungen*) to ensure that individual policy decisions make sense in the broader economic policy context: Gerber, "Constitutionalizing the Economy: German Neo-liberalism, Competition Law and the "New" Europe" (1994) 42(1) American Journal of Comparative Law 25, at 68.

22 See further, Sally, "Ordoliberalism and the Social Market; Classical Political Economy from Germany (1996) 1(2) New Political Economy 233. This integration imperative is still evident in the writings of present ordoliberal theorists: see, for instance, Oberender and Zerth, "Soziale Ziele und marktwirtschaftliches Gesundheitswesen - schlußendlich kein Gegensatz! Anmerkungen zum Spannungsfeld von Wettbewerbspolitik und Sozialrecht" ORDO Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft (Stuttgart, Lucius & Lucius, 2006) 262.

23 Eucken, *Grundsätze der Wirtschaftspolitik* (Principles of economic policy) (7th ed., Tübingen, Mohr Siebeck, 2004), pp. 9, 11, 14.

24 Gerber, "Constitutionalizing the Economy: German Neo-liberalism, Competition Law and the "New" Europe" (1994) 42(1) American Journal of Comparative Law 25, at 57.

25 See, for instance, Giorgio Monti, who writes that, *"[i]nterrelationship among policy areas is a defining feature of the EC."* Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057, at 1093.

26 Case 14/68 *Walt Wilhem* [1969] ECR 1, Case 6/72 *Continental Can* [1973] ECR 215.

27 See, for example, Böhm, *Ordnung der Wirtschaft als geschichtliche Aufgabe und rechtsshöpferische Leistung* (Stuttgart, Kohlhammer, 1937), at ix-xii.

fundamental values were inherent to the economic constitution upon which the market economy, and competition, were based. Indeed, the choice of a community's economic constitution is, in itself, a political decision which should be based on that community's values. Moreover, no attempt should be made to hide the values upon which the economic constitution is based: they should be clearly and easily identifiable.[28] One of Eucken's associates writes of Eucken that,

> *"The battle that he waged…for a free order for the economy and the society did not emerge from economic theory. It was a battle for the eternal truths of humanity. For him, the economic theory was only a means to develop an "Ordnung" that was to liberate those values from their threatened encirclement by chaotic, anarchic, collectivistic and, finally, neo-liberal forces."*[29]

It follows, it is submitted, that <u>if</u> the value of environmental protection is considered to be fundamental to the economic constitution of a given community, an ordoliberal reading would conclude that decisions made in the area of competition policy should take environmental policy factors into account. It will be argued in the following Chapter that, in the EU context, environmental protection indeed constitutes one of the fundamental values of the Treaty of Rome, a Treaty which represents what ordoliberals would term the EU's "economic constitution".[30]

<u>Third</u>, looking more broadly at the concept of a social market economy, it is possible to argue that environmental protection can form part of the concept of a social market economy, depending on the community at issue. This argument has been made forcefully by Fikentscher,[31] who argues in the German context that, without protection or respect for the environment,

> "*the necessary conditions are not fulfilled for a the preservation of a free and social economic value system…The protection of the environment forms an integral part of the social aspect of our free market system."*[32]

In his view, a healthy environment forms part of the framework conditions necessary in order for a social market economy to function, as it is a pre-condition to all economic activity. Chapter 8 returns to the economics of this argument, amplifying it in the specific context of competition policy. However, the observation should be made at this stage that while, post-Lisbon, working towards a social market economy will constitute one of the EU's goals, it is not at all evident what that concept means in the EU (rather than nation-state) context, given the EU's limited social policy competences at present.[33] As a result, in the EU context, we must limit ourselves to the proposition that, <u>insofar as</u>

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[28] See Streit and Wohlgemuth, "The market economy and the State: Hayekian and ordoliberal conceptions" Diskussionsbeitrag 06-97, Max-Planck-Institut zur Erforschung von Wirtschaftssystemen (1997), at 14.

[29] Miksch, "Walter Eucken" (1950) 4 Kyklos 279, cited in Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford, Clarendon Press, 1998), at 240. Neo-liberal is probably used here in the sense of untrammelled free market liberalism as espoused, for instance, by Hayek. See also, Streit and Wohlgemuth, "The market economy and the State: Hayekian and ordoliberal conceptions" Diskussionsbeitrag 06-97, Max-Planck-Institut zur Erforschung von Wirtschaftssystemen (1997)

[30] See, considering the Treaty of Rome to be the EU's economic constitution, Gerber, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (Oxford, Clarendon Press, 1998), at 264, Joerges and Rödl, "'Social Market Economy' as Europe's Social Model?" EUI Working Paper LAW No. 2004/8 (2004) and Zuleeg, Die Wirtschaftsverfassung der Europäischen Gemeinschaften" in *Wirtschaftspolitische und Gesellschaftspolitische Ordnungsprobleme der Europäischen Gemeinschaft* 73 (Würzburg, Schriftenreihe des Arbeitskreises Europäische Integration, 1978).

[31] Fikentscher, "An Environment-Conscious Constituted Market Economy" in *Freiheit als Aufgabe* (Tübingen, Mohr Siebeck, 1997), at 12.

[32] *Ibid,* at 14.

[33] See Joerges and Rödl, "'Social Market Economy' as Europe's Social Model?" EUI Working Paper LAW No. 2004/8 (2004), who conclude that this addition to the EU's goals will likely have little significance in practice.

the EU is working towards social market economy, environmental protection should be seen as a constituent part of that goal.

b. The Harvard School

Overview. A second important model of competition theory is that developed by a group of theorists such as Edward Mason and Joe Bain of Harvard University, which has since become known as the "Harvard School". This School emphasises the importance of the attributes of markets in competition analysis: in particular, the causal links between market structure, market conduct or behaviour, and market results or performance (the "Structure-Conduct-Performance" or "SCP" analysis). SCP analysis was originally central to Industrial Organisation (IO) theory, though its importance has diminished in modern IO theory, which tends to focus on "new industrial organization" ideas based on developing industry-specific models of firm behaviour.[34] In essence, the theory holds that the structure of a market has a major influence on market actors' conduct on that market, and ultimately on the performance of that market. As a result, the competitive inquiry is centred on market structure, focusing on questions such as:

- What are the economic characteristics of the product? Is it a consumer or producer good, and is it differentiated or standardised?
- How concentrated is the market? How easy it is to enter the market? High market concentration and barriers to entry are viewed as damaging under the Harvard School approach. In this respect, Harvard School theory resembles ordoliberal competition theory.
- What are the conditions of demand? How many buyers are there in the market and how well do buyers know the product's characteristics?
- What are the distribution channels for the product?

The goal of antitrust policy was not to achieve the unattainable state of "perfect" competition, but rather to attain a level of "workable" competition, a standard based on compliance with a range of criteria formulated to judge whether an industry is competitive.[35] Moreover, in a similar way to ordoliberalism, antitrust policy was viewed as an integral part of general economic policy strategy, meaning that it could be used as an instrument in achieving broader societal goals.[36] Thus, non-economic goals were included within the legitimate goals of antitrust policy.[37] Market performance should be evaluated on a number of different levels: how resources are allocated among different market actors; stability of employment; and - importantly, and in contrast to Chicago School theorists - whether the distribution of income is equitable. In this analysis, antitrust policy was a means of ensuring the fairness of business conduct.[38] Where market performance is considered unacceptable on the basis of these criteria, government interference in private markets may be justified.[39]

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[34] See Church and Ware, *Industrial Organization: A Strategic Approach* (Boston etc, McGraw-Hill, 1st ed., 2005), at 10, and Hildebrand, note 14 above, at 126.

[35] See the criteria formulated by Scherer and Ross, *Industrial Market Structure and Economic Performance* (3rd ed., Boston, Houghton Mifflin, 1990), at 5.

[36] See Budzinski, "Monoculture versus diversity in competition economics" (2008) 32 Cambridge Journal of Economics 295, at 299 and Van den Bergh and Camesasca, *European Competition Law and Economics: a Comparative Perspective* (London, Sweet & Maxwell, 2006), at 31.

[37] See, for instance, Kaysen and Turner, *Antitrust Policy: An Economic and Legal Analysis* (Cambridge, Harvard University Press, 1959).

[38] *Ibid.*

[39] *Ibid,* and see Hildebrand, note 14 above, at 128.

Harvard School thinking has had considerable influence on EU and US competition policies. In the US, its heyday is generally considered to have been the period up to the 1970s, when Chicago School ideas rose to prominence. Nonetheless, some US commentators such as Einer Elhauge view many of the US Supreme Court's recent judgments as siding with the Harvard School in cases where the Chicago and Harvard School approaches are in conflict:[40]

> *"when it comes to actual conclusions, the [the US Supreme Court] has been much more comfortable with the moderate prescriptions of the Harvard School than with the radical revolution advocated by the Chicago School."*[41]

In the EU, Harvard School thinking has retained a far greater degree of influence than in the US, and it would be fair to say that it remains one of the principal lodestars of EU competition policy.[42] The Harvard School's emphasis on market structure and its suspicion of highly concentrated markets is still evident in EU competition policy (for instance, in the continued relevance of the Herfindahl-Hirschmann Index - the sum of the squares of the market share of all firms in the market - to EU competition analysis). Moreover, the concept of "workable competition", with its inherent ambiguity, necessarily leaves room for a large amount of administrative discretion in enforcing competition law, which is clearly present in the EU context. Indeed, the ECJ in *Metro I* expressly referred to "workable competition" as an appropriate way of achieving the goals of the EC Treaty, though it is unclear whether the Court intended this to be understood in the specific sense of economic theory.[43]

Nonetheless, the Harvard approach has not been accepted wholesale within the EU. For instance, the Commission's recent indications that it may accept "efficiencies" defences in the Article 82 EC and mergers areas are at odds with a pure Harvard approach, illustrating the increased influence of Chicago School ideas. Moreover, EU policy has traditionally been seen as rejecting the notion that analysis of the market structure alone could be a sufficient basis for competition decisions; rather, the structure must be examined along with firms' conduct and the (likely) negative effects flowing from such conduct.[44] It is interesting to contrast this with the Commission's submission to the CFI in *British Airways* that,

> *"Article 82 EC does not require it to be demonstrated that the conduct in question had any actual or direct effect on consumers. Competition law concentrates upon protecting the market structure from artificial distortions because by doing so the interests of the consumer in the medium to long term are best protected."*[45]

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[40] See Elhauge, "Which Antitrust School Drives Recent U.S. Supreme Court Decisions?" Competition Policy International 3 (2007) 2, at 59. See further, Van den Bergh and Camesasca, *European Competition Law and Economics: a Comparative Perspective* (London, Sweet & Maxwell, 2006), at 33 ("*the competition law of the European Union can best be described as a piecemeal policy which aims at workable competition in the common market*").

[41] Elhauge, *ibid,* at 77.

[42] See, to this effect, Hildebrand, "The European School in EC Competition Law" (2002) 25(1) World Competition 3 and Van den Bergh and Camesasca, *European Competition Law and Economics: a Comparative Perspective* (London, Sweet & Maxwell, 2006), at 34.

[43] Case 26/76 *Metro I* [1976] ECR 1875.

[44] See, for instance, Peeperkorn and Verouden in Faull and Nikpay (eds.), The EC Law of Competition (2nd ed., Oxford, Oxford University Press, 2007), at 1.17.

[45] Case T-219/99 *British Airways* [2003] ECR II-5917, at para 264.

Though the CFI ultimately decided the issue using (potential) effects based-reasoning,[46] the submission provides a striking example of the continued influence of Harvard-style reasoning within the Commission.

Role of environmental factors. As discussed above, the Harvard School did not view competition policy as a policy area which could, or should, be separated from the broader, overarching economic policy which a society adopted to achieve its goals. Rather, competition policy could validly be used to achieve other societal goals, including non-economic goals such as employment stability and redistribution. It follows that - just as was concluded above for ordoliberalism - there is no reason of principle why, on a Harvard School approach, environmental factors should be excluded from competition analysis. Moreover, if environmental protection were found to be one of the fundamental goals of a given society - as, Chapter 6 will argue, is the case for the EU - it is submitted that a Harvard School analysis would at the very least allow, and potentially require, this to be taken into account in that society's competition law.

c. The Chicago School

Overview. The third school of competition theory we will consider emerged in the 1970s in the US, as represented by thinkers such as Aaron Director, Robert Bork, George Stigler and Richard Posner. The "Chicago School" approach - so called because espoused by much of the economics faculty of the University of Chicago at that time, though this is no longer the case now - was revolutionary, rejecting much of the accepted wisdom in antitrust thinking up to that time. It had four key features.[47]

First, the Chicago School authors viewed neo-classical microeconomics, and in particular price theory and the presumption of profit maximisation, as the core of antitrust. The economic concept of consumer welfare was the exclusive goal of antitrust. Consumer welfare was defined in terms of economic - allocative and productive - efficiency, as follows:

- Allocative efficiency exists where, in conditions of perfect competition, consumers can obtain the goods or services they need at the price which they are willing to pay, meaning that resources are allocated exactly according to their wishes. Under conditions of perfect competition, allocative efficiency is ensured because price and marginal cost are equal.[48]
- Productive efficiency exists where, in conditions of perfect competition, goods and services are produced at the lowest cost possible, meaning that as little of society's resources are used as possible in the production process.[49] For example, firms with

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[46] *Ibid,* para 293: "*BA cannot accuse the Commission of failing to demonstrate that its practices produced an exclusionary effect. In the first place, for the purposes of establishing an infringement of Article 82 EC, it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in that respect to demonstrate that the abusive conduct of the undertaking in a dominant position tends to restrict competition, or, in other words, that the conduct is capable of having, or likely to have, such an effect.*" On appeal, the Commission (understandably) supported the CFI's formulation of the effects-based threshold: see Case C-95/04 P *British Airways v Commission* [2007] ECR I-2331, para 95.

[47] See, in general, Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York, Basic Books, 1978, 1993 reprint with new introduction and epilogue); Posner, *Antitrust Law* (Chicago, University of Chicago Press, 1976).

[48] See Bishop and Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (2nd ed., London, Sweet & Maxwell, 2002), 2.17.

[49] Thus Bishop and Walker, *ibid,* write, "*In perfect competition, economic profits for efficient firms are zero and so inefficient firms must lose money. Perfect competition leads to firms being productively efficient because the pursuit of the maximum possible profits given firms an incentive to reduce costs as far as possible and, unlike in many other models of competition, firms that do not have costs as low as their rivals will exit the market due to losses.*" 2.16.

too much market power may be productively inefficient, whether due to X-inefficiency (a lack of competition in an industry giving rise to inefficient costs levels) or rent-seeking behaviour (the cost of creating and retaining market power).

In Chicago School analysis, markets would ideally be Pareto efficient – where nobody can be made better off without making someone worse off. Recognising that this is virtually impossible to achieve in practice, however, the more attainable goal of Kaldor-Hicks efficiency is often used, holding that a scenario is more efficient if it is possible for the "winners" in the competitive process to compensate the losers and still be better off themselves. From a Chicago School viewpoint,

> *"The antitrust laws…have only one legitimate goal, and that goal can be derived as rigorously as any theorem in economics….the only legitimate goal of American antitrust law is the maximization of consumer welfare…"*[50]

Consumer welfare, in this sense, is at its greatest when society's economic resources are allocated so that consumers can satisfy their wants as fully as technological constraints permit.[51] Bork gives four reasons why maximising consumer welfare should be the sole goal of antitrust:

- It would enhance predictability in the courts and would avoid arbitrary or anti-consumer rulings;[52]
- It would place "intensely *political and legislative decisions*" in the legislature's hands instead of in the courts' hands;
- It therefore maintains the integrity of the legislative process; and
- It would avoid "*unreal economic distinctions*" to which antitrust courts trying to "*avoid the appearance of complete subjectivism*" would be driven.[53] As a result, the efficiency of the outcome of competition is key, and not (as with ordoliberalism and the Harvard School) the protection of the process of competition or reducing market concentration.

Second, Chicago School commentators criticised the interventionism of the US anti-trust authorities at the time, stressing the efficiency rationales behind vertical restraints and vertical mergers in particular.[54] They questioned the Harvard School's Structure-Conduct-Performance thesis, which in their view gave too much importance to market structure, concentration and barriers to entry. Moreover, they harshly criticised the tendency in the US at the time to favour producers, or competitors, over consumers. In Bork's case, for instance, one of his primary concerns was to disprove the "theories" of certain US commentators (and some judges) by which competition law should also aim at protecting competitors in a competitive process and ensuring "fragmentation" of the system of industrial organization (what he terms "*small-firm*" welfare).[55] In his view, this

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[50] Bork, note 47, at 51. Thus, the task of antitrust is essentially to "*improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare.*" Bork, note 47 above, at 90-91. Consumer welfare is generally indicated by the amount of consumer surplus, that is, the aggregate measure of the surplus of all consumers, indicated by the difference between the consumer's valuation of the good considered (or his willingness to pay for it) and the actual price (see Hildebrand, note 14 above).

[51] Bork, *ibid,* at 429.

[52] Bork, *ibid,* at 82.

[53] Bork, *ibid,* at 85.

[54] Thus, Bork complains in 1978 that the "*modern condition*" of antitrust exhibited "*the paradox of great popularity and vigorous enforcement coupled with internal contradiction and intellectual decadence*" (Bork, *ibid*, at 309). See also, Posner, "The Chicago School of Antitrust Analysis" 127 U. Pa. L. Rev. (1979) 925.

[55] Bork, *ibid,* at 54.

required judges to perform a task that lay outside their remit: the balancing of conflicts between producer and consumer welfare, which would mean balancing of policy goals.[56] In his view, this went against the principle of legal certainty and defeated the intent of the drafters of the Sherman Act, as this was a matter for the legislature alone.[57] Further, it could often result in judgments which damaged consumer welfare.[58]

Third, an important element of the Chicago School approach is that competition policy should be insulated from all non-economic or ethical concerns. As long as efficiency is achieved, the question whether the distribution of resources is equitable within society or not is irrelevant to competition policy (again, in contrast to the ordoliberal and Harvard School approaches). It is then up to government, insofar as it wishes to do so, to redistribute wealth using regulation such as taxation. Thus, Bork writes that,

> *"consumer welfare…has no sumptuary or ethical component, but permits consumers to define by their expression of wants in the marketplace what things they regard as wealth…."*[59]

Thus, while competition policy may perhaps be viewed as guaranteeing *ex ante* equity (i.e., that firms have the same chances in the marketplace on a level playing field), it should never be concerned with *ex post* equity (equity in the outcome of the market mechanism). As soon as one moves away from efficiency analysis, the economist is not qualified to pronounce on which solution is "better" or "worse".[60]

A final element of Chicago School thinking was that the market should be left to its own devices, without state intervention, to function on the basis of what Stigler called the "*survival of the fittest*" - an approach which has been termed "*Economic Darwinism*".[61] The role of the State should be confined to providing a minimum legal framework in which competition can take place. In this regard, Chicago School thinking was deregulatory and, politically, very conservative.[62]

In the US, the Chicago School became almost immediately influential in the debate on the goals of competition policy, and led to significant judgments by the US Supreme Court such as the landmark *GTE-Sylvania* judgment of 1977, in which the Supreme Court decided that non-price vertical restraints should be subject to a rule of reason.[63] By the 1980s, the US Department of Justice seemed to consider efficiency as the exclusive goal of antitrust.[64] One can, for instance, see the influence of Chicago School thinking in US

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[56] He argued that, "*the case-by-case resolution of [conflicts between producer and consumer welfare] is the great difficulty in any approach that leaves conflicting policy goals in the hands of judges.*" Bork, *ibid,* at 46.

[57] Bork, *ibid,* at 79: "*the case law provides no guide whatever for judging…trade-offs*" between values.

[58] "*…because [antitrust] pretends to one objective while frequently accomplishing its opposite, and because it too often forwards trends dangerous to our form of government and society, a great deal of antitrust is not even respectable as politics.*" Bork, *ibid,* at 418. Similarly, Posner emphasises that, "*the protection of small business - whatever its intrinsic merit - cannot be attained within the framework of antitrust principles and procedures.*" Posner, *Antitrust Law* (Chicago, University of Chicago Press, 1976), at 4.

[59] Bork, *ibid,* at 429.

[60] See, for example, Harberger, "Three Basic Postulates for Applied Welfare Economics: An Interpretive Essay" 9 J Econ Lit (1971) 785, at 785, who argues that welfare outcomes, "*may be exceedingly important, perhaps the dominant factors governing any policy decision, but they are not part of the package of expertise that distinguishes the professional economist from the rest of humanity. And that is why we cannot be expected to reach a professional consensus concerning them.*"

[61] Hildebrand, note 14 above, at 145.

[62] Antitrust should focus on the following types of behaviour: (1) The suppression of competition by horizontal agreement; (2) Horizontal mergers creating very large market shares; and (3) Deliberate predation in order to drive rivals from the market, or prevent or delay rivals' entry, or discipline existing rivals. Bork, note 47 above.

[63] 433. U.S. 36 (1977).

[64] See Hovenkamp, "Antitrust Policy after Chicago" 84 Mich L Rev 213, at 223.

merger policy, such as the 1997 Merger Guidelines' recognition of efficiencies which can flow from bigger firms.[65]

In the EU, Chicago School thinking has had less obvious influence, though this has arguably increased in recent years. For instance, the original broad scope of the competition rules adopted by the ECJ in early cases such as *Consten & Grundig* and *Société Technique Minière*, in which the concept of "restriction of competition" under Articles 81 and 82 EC was very broadly defined, would clearly have run contrary to a Chicago School, minimum-intervention, view of competition policy (though these judgments preceded the emergence of Chicago School theory).[66] A further illustration of non-"Chicago compliant" policy is the EU's prohibition on absolute territorial restraints in vertical distributorship agreements, which Chicago scholars might sometimes view as justifiable in order to avoid "free riding" by the distributor.[67] In contrast, the Commission's recent implication that non-economic goals may not be relevant to Article 81(3) EC analysis,[68] and its recognition that efficiencies may play a role in Article 82 EC and merger analysis, illustrate that the Chicago School has indeed had some influence across the Atlantic.[69]

Though it is true that the Commission has explicitly moved towards a more "economic" (less formalistic) approach to competition policy,[70] it would be simplistic to view this in itself as implying a move towards the Chicago School. Though the Chicago School approach is certainly economics-based, so too are other competition models, such as the ordoliberal model we examined above.[71] More fundamentally, it is true that there are many statements by the Commission, its Commissioners and officials, and the Community courts describing consumer welfare as a key goal of competition policy. An example is the judgment of the CFI in *GlaxoSmithKline,* holding that,

> *"the objective of Article 81(1) is to "prevent undertakings, by restricting competition between themselves or with third parties, from reducing the welfare of the final consumer of the products in question…"*[72]

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[65] See the Horizontal Merger Guidelines issued by the US Department of Justice and the Federal Trade Commission on April 2, 1992, revised version of April 8, 1997 and Van den Bergh and Camesasca, *European Competition Law and Economics: a Comparative Perspective* (London, Sweet & Maxwell, 2006), at 48.

[66] Joined Cases 56 & 58/64 *Consten & Grundig* [1966] ECR 299, Case 56/65 *Société Technique Minière* [1966] ECR 235. Note that some place the beginning of the "economisation" process even earlier. See, for example, Weitbrecht, "From Freiburg to Chicago and beyond - the first 50 years of European Competition law" European Competition Law Review (2008) 81, at 85, who argues that the process began after the enactment of the first Merger Regulation.

[67] See Regulation 2790/1999 OJ 1999 L 336/21 and Van den Bergh and Camesasca, *European Competition Law and Economics: a Comparative Perspective* (London, Sweet & Maxwell, 2006), at 49.

[68] Guidelines on the application of Article 81(3) of the Treaty OJ 2004 C 101/97.

[69] On which, see Chapters 12 and 13.

[70] Key examples of the change are the adoption of the vertical antitrust guidelines and vertical block exemption regulations at the end of the 1990s (Regulation 2790/1999 OJ 1999 L 336/21 and Guidelines on Vertical Restraints OJ 2000 C 291/1), the appointment of a Chief Economist, assisted by a team of industrial economists, within DG Competition, and the launch of a review of Article 82 EC, aimed at making competition analysis under this provision more economic (DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005). In his farewell speech of October 28, 2004, Commissioner Monti concluded that "*a major trend of [his] mandate has been to ensure that competition policy is fully compatible with economic learning.*"

[71] See likewise, Budzinski, "Monoculture versus diversity in competition economics" (2008) 32 Cambridge Journal of Economics 295.

[72] Case T-168/01 *GlaxoSmithKline* [2006] ECR II-2969, para 118 (currently under appeal as Joined Cases C-501, 513, 515 and 519/06 P). See also, for example, the classic definition of abuse under Article 82 EC given in cases such as Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, discussed further in Chapter 12; in the context of Article 81 EC, Joined Cases T-213/01 and T-214/01 *Österreichische*

Similarly, the Commission, in its 2004 Guidelines on the application of Articles 81 and 82 of the EC Treaty to technology transfer agreements, observed that,

> *"[t]he aim of Article 81 as a whole is to protect competition on the market with a view to promoting consumer welfare and an efficient allocation of resources…"*[73]

It would be wrong, however, to deduce from such statements that this implies a narrow, Chicago School view of competition policy. In the first place, while they certainly imply a more economic, efficiency-based view of competition policy, they do not imply agreement with the range of very specific beliefs held by the Chicago School as described above. In the second place, it may unduly presumptuous to suppose that the concept of consumer welfare in such statements is, in the absence of specification, intended to refer to the narrow technical meaning ascribed to it by Chicago School theorists (i.e., maximising allocative and productive efficiency), rather than a more general meaning.[74] Moreover, in the case of the Commission, it has exhibited no great consistency in describing the goal of Community competition policy as that of consumer welfare.[75]

More generally, in the academic field, reasoning inspired by Chicago-style analysis has led certain EU commentators to reject the legitimacy of any goals other than that of economic efficiency to Community competition policy. The leading exponent of this

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Postsparkasse and Bank für Arbeit und Wirtschaft v *Commission* [2006] ECR II-1601, para 115; and the statement by Mr Justice Fennelly (formerly Advocate General at the ECJ), "*The entire aim and object of competition law is consumer welfare*", judgment of the Irish Supreme Court in *The Competition Authority v O'Regan* [2007] IESC 22, at para 106.

[73] Guidelines on Technology Transfer OJ 2004 C 101/2. A further example is the 1996 Green Paper on Vertical Restraints, where the Commission stated that, "*the interest of the consumer is at the heart of competition policy. Effective competition is the best guarantee for consumers to be able to buy good quality products at the lowest possible prices*" (COM (96) 721 final, para 54), and the speeches of then Competition Commissioner, Mario Monti describing the promotion of consumer welfare as lying "*at the heart*" of his mandate (see, for instance, his speeches of October 22, 2004 and October 28, 2004). See also, the speech of Director General Philip Lowe at the St Gallen Competition Law Forum, "Preserving and Promoting Competition: a European Response", "*…competition is not an end in itself, but an instrument for achieving public interest objectives, notably consumer welfare."*

[74] Some economists, however, conclude from statements such as these (as well as, for instance, the wording of Article 81(3) EC) that Community competition policy values consumer over producer welfare, and thus does not (in contrast to many US commentators) adopt a "total welfare" efficiency analysis. See, for instance, Motta, *Competition Policy: Theory and Practice* (Cambridge, Cambridge University Press, 2004), at 20, and Bishop and Walker, "*Economists have traditionally focused on social welfare. They do not make a value judgement between consumers and producers and so treat €1 of gain to either group as being of equal value…However, it is clear that EC competition law does not treat consumer welfare and producer welfare as being of equal importance. Consumer welfare is valued above producer welfare, although this is nowhere made explicit in EC law…*" Bishop and Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (2nd ed., London, Sweet & Maxwell, 2002), 2.22. See, in contrast, for example, Carlton and Perloff's definition of consumer welfare (from a US perspective) as the sum of consumer surplus (amount above price paid that consumer would willingly spend, if necessary, to consume the units purchased) and producer surplus (the largest amount that could be subtracted from suppliers' revenue and yet supplier would still willingly produce): Carlton and Perloff, *Modern Industrial Organisation* (4th ed., Essex, Addison Wesley, 2004).

[75] See, for instance, the Commission's submission to the CFI in Case T-219/99 *British Airways* [2003] ECR II-5917, discussed above in the context of Harvard School theory, and the Commission's XXIX Report on Competition Policy, 1999 (Brussels, Commission of the European Communities 2000), at 6: "*The first objective of competition policy is the maintenance of competitive markets. Competition policy serves as an instrument to encourage industrial efficiency, the optimal allocation of resources, technical progress and the flexibility to adjust to a changing environment*." It is interesting to note that Neelie Kroes has not been explicit about what she sees as the goals of competition policy, preferring to characterise her approach as "pragmatic" rather than "ideological", as she stated in a 2006 speech to the Fordham Competition Law Conference: "*I am not interested in having competition for the sake of it. I am not interested in taking ideological stances concerning policy agendas. My priority is policy measures that are sound, pragmatic, and really work in real life, modern solutions which match up to the challenges of today's market place*" (SPEECH/06/499).

view is Giuliano Amato in his eloquent 1997 book, *Antitrust and the Bounds of Power*.[76] As with the Chicago School theorists discussed above, Amato argues that competition law works best when purely economic factors are taken into account: the job of taking other, broader, considerations into account is one for the legislator alone. His main argument for this conclusion is that, if competition authorities attempt to carry out this function – for which they are not qualified - it will skew their decisions, leading to an economically inefficient outcome, and amounting to an usurpation of legislative duties.[77] In Amato's view, Community competition goals are inextricably influenced by those of the US regime, which he sees as the "*genetic origin of antitrust law*."[78] In his view,

> "*no criticism, on the theoretical or academic level, has succeeded in dismantling the Chicago School*."[79]

Sharply criticising cases in which the Commission and Courts have seemed to take non-economic factors into account, such as industrial policy in cases like *ENI/Montedison*,[80] as well as the Community authorities' tendency to over-regulate dominant firms via Article 82 EC, he pleads that antitrust should be "*liberalised*" from objectives extraneous to it, and in particular from industrial policy and regional policy.[81] To aid this result, in his view, an independent Community antitrust body should be created, as the Commission constitutes a "*structurally political body*."[82]

The issues raised by Amato - in particular, the proper role of Community competition enforcers and the relationship between the US and EU competition regimes - go to the core of the present research and will be revisited in detail over the course of the next three Chapters. However, two initial remarks can be made.

First, Amato's position on the role of non-economic factors in Community competition policy is explicitly aspirational. Amato himself admits that his belief in a "pure", efficiency-focused competition policy does not accord with the reality of Community competition practice to date. This is undoubtedly true, and the final part of this chapter gives further illustrations of situations where non-economic factors have been taken into account in Community competition practice. Similarly, Amato's vision of the creation of an "independent" Community antitrust body does not represent present reality, but rather an ideal situation if, as he proposes, Community competition policy were to become purely efficiency-focused.

Second, Amato's position is clearly strongly influenced by his belief that US and Community competition policies are ultimately very similar in their make-up and goals.

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[76] Amato, *Antitrust and the Bounds of Power* (Oxford, Hart, 1997). See also, the discussion of Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), in Chapter 6 and, for instance, Maks, "The "New" Horizontal Agreements Approach in the EU: An "Economic" Assessment" (2002) 37(1) Intereconomics 28.

[77] Thus, for example, the economist Roger Van den Bergh comments that, *"[t]he goal of market integration continues to put a heavy mortgage on European competition law; in terms of quality, the price to pay is inconsistencies and possibly even perverse effects"*: "The difficult reception of economic analysis in European competition law" in Cucinotta, Pardolesi and Van den Bergh (eds.), *Post-Chicago Developments in Antitrust Law* (Cheltenham, Edward Elgar, 2002), at 37.

[78] Amato, note 76 above, 2, though he admits that *"[t]he European story appears radically different in its development*," (*ibid*, at 39), being founded on the Freiburg School (*ibid*, at 41): in his view, the Freiburg School represented "*the absolute need to give a solid institutional framework for the competitive economy to prevent both the formation of [private] power and the creation with it, by linking up with public power, of a conglomerate that could engender tragedies like the one Germany was then living through*."

[79] *Ibid*, at 24.

[80] *ENI/Montedison* OJ 1987 L 5/13.

[81] Amato, note 76 above, at 117.

[82] *Ibid,* at 124.

Though it is true that some similarities exist between the US and Community approaches, it has been argued above that fundamental differences persist between them, both of design and aim. Most fundamentally, from a systematic perspective the Community's competition rules form part of the EC Treaty, meaning that the goals of the Community's competition policy are embedded in those of the Treaty itself - a framework most certainly not present in the case of US competition policy. Further, from a legal perspective, the wording and structure of Articles 81 and 82 EC differ considerably from those of the relevant US Statutes (principally, the Sherman Act and the Robinson-Patman Act), and the US has no real equivalent of Articles 86 and 87 EC (i.e., dealing with anti-competitive State measures such as State aid and exclusive rights). This is important because, as we have seen, Chicago School writers such as Bork grounded much of their criticism of pre-1970s case law on the premise that this case law had gone against the intention of the drafters of the Sherman Act.[83] Ultimately, it is submitted, Community competition policy (at least at present) rests on a different mixture of competition theories - a different "blueprint" - than US antitrust policy.

Role of environmental factors. The Chicago School approach to the role of environmental factors in antitrust policy is *prima facie* clear: it has none. As discussed above, one of the tenets of Chicago School theory is that factors unrelated to economic efficiency should be excluded from antitrust analysis. The fact that such exclusion might be unethical, or run counter to societal values, is irrelevant to Chicago School theorists: it is the role of the legislature, not antitrust, to deal with these issues. It follows that, unless environmental factors are viewed as forming part of the efficiency goal - a question considered in Chapter 8 - Chicago School theory holds that they must be excluded from antitrust analysis.

d. The Post Chicago School(s)

Overview. The fourth and final wave of competition theory which we will consider is what has come to be known as "post-Chicago" theory - a heading which groups together post-1970s thinkers who have taken issue with the Chicago School's approach on a variety of different grounds. As such, it is more accurate to speak of post-Chicago "schools" of thought, rather than a single "school". Some of these writers seek to argue that, despite the apparent dominance of the Chicago School in the US, it "*just as its predecessors, is mortal.*"[84] Others (those commenting from what Hovenkamp terms "inside" the model) accept the fundamental premises of the Chicago School approach, but seek to add certain qualifications to its economic model. As it is not possible here to detail all post-Chicago criticisms, we will confine ourselves to the most relevant criticisms in assessing the role of environmental factors in competition policy.

A first criticism is that, even if one accepts the basic premises of the Chicago School - for instance, that efficiency is the sole goal of antitrust - Chicago School theory is too simplistic. For example, it oversimplifies the concept of efficiency, in focusing only on allocative and productive efficiency. This overly static approach ignores dynamic efficiency, which should also be included in the measure of welfare. Dynamic efficiency refers to what Schumpeter famously termed the process of "*creative destruction*", in which innovative activities lead to new markets, new industries and the death of old markets and industries.[85] In this perspective, monopolies may at times be necessary to ensure that

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[83] Bork, note 47 above, at 405.

[84] See Hovenkamp, "Antitrust Policy after Chicago" 84 Mich L Rev 213, at 215 and Hovenkamp in Cucinotta, Pardolesi and Van den Bergh (eds.), *Post-Chicago Developments in Antitrust Law* (Cheltenham, Edward Elgar, 2002), who describes post-Chicago views as "*another swing in antitrust's ideological pendulum.*"

[85] See Schumpeter, *Capitalism, Socialism and Democracy* (New York, Harper, 1975).

firms engage in risky innovative activities, which ultimately benefit consumers - for instance, investing in the R&D necessary to discover new drugs in the pharmaceutical industry.

A second criticism from inside the model is that the Chicago School model ignores the importance of strategic behaviour - that is, behaviour designed to reduce the attractiveness of competitors' offers. [86] Thus, one of the innovations of post-Chicago theory was to emphasise the potential danger of raising rivals' costs via strategic behaviour such as litigating against non-dominant competitors. In this way, in Harvard School terminology, market conduct can in fact influence market structure (in contrast to the Harvard School model holding that structure influences conduct).

A third post-Chicago development has been the development of "contestable market" theory, which criticise the traditional Chicago School approach as paying insufficient attention to the role of potential competition. In this analysis, market structure becomes virtually irrelevant in a perfectly contestable market, defined as one with no entry or exit costs.[87] This means that the focus of competition law becomes not concentration as such, but rather tackling the erection of barriers to entry by private undertakings or by the state.

Fourth, more broadly, many criticise the Chicago School's simplified economic models as of limited usefulness in tackling the economic complexities of the real world, without being capable of coping with dynamic market realities.[88] The Chicago School approach is, it is argued, too theoretical, relying too heavily on economic theory, rather than facts, to decide cases.[89] Indeed, this criticism has been levied at economic, efficiency-based approaches to competition policy in general, on the basis that it may often be wholly impractical, for instance, for a court or competition authority solely to concern itself with maximising efficiency, as they may lack the information which might enable them to assess which solution is more "efficient". This criticism bears close resemblance to an argument sometimes made in favour of excluding all consideration of non-economic factors in Community competition policy, which is that including such factors in competition analysis infringes the principles of legal certainty and justiciability.[90] In reality, it is evident that focusing purely on efficiency goals in competition analysis may pose equally difficult problems of justiciability.

Fifth, many commentators have rejected the notion that antitrust can ever be made wholly apolitical.[91] They argue that placing efficiency at the heart of antitrust is, in itself,

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[86] Hovenkamp, "Antitrust Policy after Chicago" 84 Mich L Rev 213, at 261.

[87] See, for instance, Baumol, "Contestable Markets: an uprising in the theory of industry structure" 72 AER 1 (1982).

[88] See, Hovenkamp in Cucinotta, Pardolesi and Van den Bergh (eds.), *Post-Chicago Developments in Antitrust Law* (Cheltenham, Edward Elgar, 2002), at 5 and Fox, "The Battle for the Soul of Antitrust" 75 Cal L Rev 917.

[89] See, for example, Hovenkamp, *ibid*, at 4: "*post-Chicago" antitrust…has relatively less confidence in markets as such, is more fearful of strategic anticompetitive behaviour by dominant firms, and has a significantly restored faith in the efficacy of government intervention*."

[90] Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), at 7: "*the extent to which non-efficiency goals trump efficiency is a constitutional question external to competition law that ultimately requires resolution at the constitutional level.*" Balancing Treaty goals within the competition provisions would mean that these provisions would become "*non-justiciable*". See also, Maks, "The "New" Horizontal Agreements Approach in the EU: An "Economic" Assessment" (2002) 37(1) Intereconomics 28, "*…it might be a proper choice for competition policy to concentrate on its traditional core business and not to bungle around with environmental externalities in an ineffective way such that its core task of maintaining workable competition is hampered."*

[91] Fox, "The Modernization of Antirust: A New Equilibrium" 66 Cornell L Rev 1140 (1981), Sullivan, "Economics and More Humanistic Disciplines: what are the Sources of Wisdom for Antitrust?" 125 U Pa

a fundamentally political exercise.[92] Moreover, many reject the notion that the sole concern of antitrust should be that an economically efficient outcome be achieved. As such, they take issue not only with the specific Chicago School approach, but more broadly with the economic, efficiency-based approach to competition analysis in general. In the US, for instance, Fox and Sullivan have argued that antitrust should protect the competitive process, with antitrust laws setting "fair rules of the game".[93] Indeed, Hovenkamp rejects the very idea that efficiency concerns can be separated from distributional concerns, as the efficient allocation of resources in any given society is "*substantially a function of the way that society's wealth is distributed initially.*"[94]

Role of environmental factors. It will be clear from the above that it is impossible to identify any one single approach to environmental factors from a "post-Chicago" perspective. The fundamental distinction in this regard is between what we have termed post-Chicago commentators "inside" the economic efficiency model, and those "outside" the model. In the former case, as the premise of maximising efficiency is accepted, environmental factors can only be relevant insofar as they form part of efficiency analysis (or insofar as they form part of one of the post-Chicago additions to efficiency analysis, such as dynamic competition or the theory of contestable markets). In the latter case, however, the notion of an exclusive economic efficiency goal is rejected, meaning that *prima facie* environmental protection may, depending on its importance as a societal goal, legitimately play a role in competition law.

3. Some examples of the relevance of non-economic goals to Community competition policy to date

It has been argued above that current Community competition policy displays attributes of a mixture of theoretical models, combining elements of the Chicago School with Harvard School and ordoliberal influences. Although economic welfare and efficiency comprise important goals of Community competition policy, there is little evidence of an exclusive focus on economic efficiency. As Budzinski puts it, Community competition policy is not based on a "*monoculture*", but rather on a constantly evolving diversity in competition economics.[95] Consistently with this, there are numerous examples where "non-economic" goals (i.e., goals other than economic efficiency in the narrow sense) have played a part in the application to date of Community competition law by the Commission, the Community courts, and national courts and competition authorities.[96]

L Rev 1214 (1977); Pitofsky, "The Political Content of Antitrust" 127 U Pa L Rev 1051 (1979). See also, for example, Lande, "Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust" 58 Antitrust L. J. (1989) 631. In the EU, context, see generally Chapter 6 and, for instance, Mortelmans, "Towards Convergence in the Application of the Rules on Free Movement and on Competition?" 38 CML Rev (2001) 613 and Vogelaar, "Modernisation of EC Competition Law, Economy and Horizontal Cooperation between Undertakings" (2002) 37(1) Intereconomics 19.

92 See, for instance, Pitofsky, The Political Content of Antitrust 127 U Pa L Rev 1051 (1979) and Hovenkamp, "Antitrust Policy after Chicago" 84 Mich L Rev 213. More recently, writers such as Fred McChesney have argued, in the context of the US system and using public choice theory, that it is unavoidable that politics affect antitrust enforcement: "Public Choice: Do Politics Corrupt Antitrust Enforcement? Economics versus politics in antitrust" 23 Harv J L & Pub Pol'y 111 and 133 (1999). He reasons that, in the US, antitrust enforcement is the responsibility of the state attorney general - who is normally an elected official, and thus can be "captured".

93 Fox and Sullivan, "Antitrust - Retrospective and Perspective: Where Are We Coming From? Where Are We Going?" 62 NYU L Rev 936, at 959.

94 Hovenkamp, "Antitrust Policy after Chicago" 84 Mich L Rev 213, at 247.

95 Budzinski, "Monoculture versus diversity in competition economics" (2008) 32 Cambridge Journal of Economics 295.

96 Whish, for example, comments that, *"[i]n reality…many different policy objectives have been pursued in the name of [Community] competition law, some of which are not rooted in notions of consumer welfare in the technical sense, and some of*

Market Integration. The goal of achieving greater integration within the single market has undoubtedly played an important role in Community competition policy.[97] Clearly, the Community competition regime differs fundamentally from the US regime and national competition regimes insofar as one of the primary goals of the EC Treaty (and thus, on a systematic analysis, the competition rules) is to prevent barriers to the achievement and functioning of a single market - a goal which does not necessarily follow from the narrow goal of achieving economic efficiency.[98] Thus, Article 2 EC provides that,

> *"the Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities…"*

In this respect, the competition rules act as a complement to the Community's rules on free movement - in particular Article 28 EC - which seek to prevent the maintenance of barriers to trade via Member State rules or practices. The Community's "antitrust" rules – i.e., Articles 81 and 82 EC – aim at preventing such barriers from being maintained by private agreements; while the Community's State aid rules prevent the use of State subsidies, which could similarly hamper the achievement of an integrated market by, for example, hindering imports from or artificially buoying exports to other Member States.[99]

The Community courts and the Commission have frequently confirmed the relevance of the market integration goal to competition analysis. Thus, for instance, in its XXVth Report on Competition Policy, the Commission observed that,

> *"[a]n essential aim of European competition policy is to ensure that the completion of the internal market brings consumers and the European economy as a whole all the benefits of a Community-wide market."*[100]

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which are plainly inimical to the pursuit of allocative and productive efficiency…There is no single, unifying policy which binds EC…law together: there is no simple premise from which decisions flow through the application of logic alone. In particular, competition policy does not exist in a vacuum: it is an expression of the current values and aims of society and is as susceptible to change as political thinking generally" (Whish, *Competition Law* (5th ed., London, Butterworths, 2003) at 17). See also, Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), 160 who recognises that the Court has, in fact, taken certain non-economic considerations into account in the past, but argues that this was only done due to political stagnation at the time in other areas of Community policy, and that the use of the teleological approach can be justified, if at all, only in times of political stagnation or emergency. See also, the speech of Director General Philip Lowe at the St Gallen Competition Law Forum, "Preserving and Promoting Competition: a European Response", "*…competition is not an end in itself, but an instrument for achieving public interest objectives, notably consumer welfare."*

97 See Motta, note 74 above, Bishop and Walker, note 48 above, Hildebrand, note 14 above.

98 The single market imperative may, however, contribute to greater economic efficiency in some cases, however, as firms in isolated markets may not be able to exploit efficiency advantages as minimum efficient scale may greater exceed national demand: See Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), at 13.

99 In this sense, Pescatore writes that, *"the first objective of the competition rules is to contribute to establishing and maintaining a single market in the Community and to preventing the re-erection of economic barriers by private agreements"* (Pescatore - Public and Private Aspects of Community Competition Law (1987) 10 Fordham Int'l L. J. 373). See also, the XXIX Report on Competition Policy, where the Commission stated its view that the second objective of Community competition policy "*is the single market objective. An internal market is an essential condition for the development of an efficient and competition industry.*" Commission, XXIX Report on Competition Policy, 1999 (Brussels, Commission of the European Communities 2000), at 6.

100 At 23. See also, Guidelines on Vertical Restraints OJ 2000 C 291/1 at 7. Some commentators have raised the possibility that, with the decentralisation of enforcement of Community competition law brought by Regulation 1/2003, the single market imperative will lose force, being applied by national competition authorities not used to taking account of market integration - though if this were to happen, the Commission would likely "reclaim" such cases and/or the Community courts would be called on ultimately to resolve the matter. See Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81*

This approach was epitomised by, amongst others, the ECJ's *Consten & Grundig* judgment, in which it held that - irrespective of whether they were efficient - market-partitioning vertical restraints were illegal under Article 81 EC.[101] To a certain extent, the major progress made to date in achieving the single market, has led the Commission to place less emphasis in recent years on the market integration goal in the competition policy context.[102] Nonetheless, both the ECJ and the Commission continue to place considerable emphasis on the market integration function of Community competition law. A recent example is the *Sot. Lelos* judgment where the ECJ held that, in view of the Treaty's goal of achieving market integration, market-partitioning practices of a dominant undertaking aimed at avoiding parallel exports between Member States amount, in principle, to an abuse.[103]

Industrial policy. Possibly the most controversial potential non-economic goal of them all, the interrelation between industrial policy and Community competition policy has long been dogged by controversy. In the past, certain goals of industrial policy have, on occasion, been accepted as valid objectives even in the context of the Community's competition rules, one of many examples being the treatment of agreements to reduce structural overcapacity.[104] Indeed, the very idea of State aid - which, though in principle prohibited, may be exempt under the conditions of Article 87(3) EC - is itself an embodiment of industrial policy.[105] However, Commissioner Monti and Commissioner Kroes have each, on their successive watches, fervently denied that, where industrial

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(Oxford, Oxford University Press, 2006), at 21 and Wesseling, "The Draft Regulation Modernising the Competition Rules: The Commission is married to one idea" 26 EL Rev 357.

[101] Joined Cases 56 & 58/64 *Consten & Grundig* [1966] ECR 299. See, similarly, for instance, Case C-234/89 *Delimitis* [1991] ECR I-935, Case 161/84 *Pronuptia* [1986] ECR 353, Case T-77/92 *Parker Pen* [1994] ECR II-549, Case C-551/03 P *General Motors* [2006] ECR I-3173. See, however, Case T-168/01 *GlaxoSmithKline* [2006] ECR II-2969 (under appeal as Joined Cases C-501, 513, 515 and 519/06), where the CFI held that, in the specific context of the pharmaceutical sector where regulation largely protects medicine prices from the full force of supply and demand, it cannot be presumed that an arrangement limiting parallel trade will have a negative effect on competition such that it should be viewed as having the object of restricting competition. See further below, Chapter 10.

[102] An example is the Commission's White Paper on Modernisation, which comments, "*At the beginning, the focus of [competition policy's] activity was on establishing rules on restrictive practices interfering directly with the goal of market integration…The Commission has now come to concentrate more on ensuring effective competition by detecting and stopping cross-border cartels and maintaining competitive market structures…*"COM (99) 101 final, point 8 of the summary. See the conclusion of Röller and Stehmann, former Chief Economist and member of the Chief Economist's team at DG Competition respectively: "*With progress made toward realisation of the internal market, the relative importance of the market integration goal has declined. As a result, policy statements today stress efficiency, consumer welfare, and competitiveness.*" Röller and Stehmann, "The Year 2005 at DG Competition: The Trend towards a More Effects-Based Approach" 29(4) Review of Industrial Organization (2006) 281. See also, Baquero Cruz, who criticises this tendency on the basis that competition law forms part of the "economic constitutional law" of the Community, which is aimed at market integration and achieving the single market - a goal which has not yet fully been achieved: Baquero Cruz, *Between Competition and Free Movement: The Economic Constitutional Law of the European Community* (Oxford, Hart, 2002).

[103] Joined Cases C-468/06 to C-478/06 *Sot. Lelos kai Sia*, judgment of September 16, 2008. In so holding, the ECJ upheld, *inter alia*, the Commission's argument that the refusal by an undertaking in a dominant position to supply medicinal products to wholesalers with the aim of restricting parallel trade constitutes in principle an abuse of a dominant position under Article 82 EC: see para 32 of the judgment.

[104] See, for example, *BPCL/ICI* OJ 1984 L 212/1, *ENI/Montedison* OJ 1987 L 5/13. Commissioner Van Miert was a vocal proponent of the position that non-economic factors cannot be "taken out" of Community competition policy. Writing in 1995 during his mandate, he observed, "*Competition policy can be seen rather as one instrument among others, which fosters the achievement of the Community's basic objectives. The Community's competition policy does not operate in a vacuum. It must take into account its effects on other areas of the Commission action, such as industrial, regional, social and environmental policies…Competition policy, in turn, plays a role in the preparation and introduction of other policies*" (1995) "An Active Competition Policy or Economic Growth" in Frontier-Free Europe, Monthly Newsletter, European Commission, Luxembourg, June 1995, at 1

[105] See further, Chapter 15.

policy amounts to industrial protectionism, it can ever play a role in Community competition policy.[106] In so doing, the Commissioners have clashed swords repeatedly with major European leaders - as well as other Commissioners, such as present Commissioner for Enterprise, Günter Verheugen.

A recent example is the clash with French president Sarkozy over his insistence on the removal from the text of the Lisbon Treaty, signed on December 13, 2007, of the reference to "*free and undistorted competition*" as an activity of the EU (which had been included as Article I-3(2) of the Constitutional Treaty). This was done with a view to protecting national "champions".[107] Although Commissioner Kroes and other high-level Commission officials have - naturally - sought to play down the significance of this change as being pure semantics,[108] there is a risk that the competition *acquis* will be weakened by this development, in combination with the excision of present Art. 3(1)(g) from the Lisbon text and given the Community courts' use of teleological interpretation.[109] Nonetheless, this risk should not be exaggerated, particularly as Article 119 of the Treaty on the Functioning of the European Union specifies that the Union's economic policy is to be conducted "*in accordance with the principle of an open market economy with free competition.*"[110]

Sectoral policies: transport; energy; agriculture. Community competition policy has traditionally been applied to certain sectors in a qualified manner. This is so for reasons of policy (unrelated to economic efficiency) and due to their perceived special features, leading in many cases to specific Community secondary legislation regulating the extent of the application of the competition rules. In some cases, the trend is for such sectors to be brought gradually back into the application of the general competition rules (subject to the existence of specific secondary legislation).[111] Special treatment is, however, given to the agricultural sector, due to the important role of market organisations.[112] This position was originally enshrined in Regulation 26, as replaced by

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[106] See, for instance, the speech of Commissioner Kroes at the Fordham Competition Law conference of 2006: "*the answer to the challenges faced by industry in today's globalising economy is not to seek to shield industry from the forces of competition, but to put in place the conditions which will allow industry to flourish in an increasingly competitive environment. [I]t is time to put old-fashioned industrial protectionism to bed, and instead to develop a modern, proactive industrial policy which embraces change and paves the way for our future competitiveness.*" (SPEECH/06/499).

[107] See, for example, the report of June 25, 2007 of the EU Observer, "Sarkozy claims "competition" victory at summit" and the press release of M. Sarkozy at the time: "[*W]e have obtained a major reorientation on the objectives of the Union. Competition is no longer an objective of the Union or an end in itself, but a means to serve the internal market…* "

[108] See, for example, the letter of June 27, 2007 to the Financial Times from Mr Michel Petite, the Director General of the European Commission's Legal Service, in which he rejected the arguments of Financial Times columnist Wolfgang Munchau that the removal of the competition principle from the then-Reform Treaty threatened the status of competition in the single market.

[109] Riley, "The EU Reform Treaty and the Competition Protocol: undermining EC competition law" (2007) European Competition Law Review 703. See also, Drijber, "Het Hervormingsverdrag van de EU: stap vooruit of stap achteruit?" (2007) 5/6 Markt en Mededinging 131.

[110] See also, the Protocol to the Treaties on European Union and on the Functioning of the European Union on the internal market and competition, which states that "*the internal market as set out in Article 3 of the Treaty on European Union includes a system ensuring that competition is not distorted."*

[111] The transport and the energy sectors are good examples. Though Regulation 141 (OJ Spec. Ed. 1959-1962 291) originally exempted the transport sector as a whole from the application of Regulation 17, Regulation 1017/68 applying the rules of competition to road, rail and inland waterway (OJ Spec. Ed. 1968 302) limited its scope to maritime and air transport. Regulation 1/2003 OJ 2003 L 1/1, the successor to Regulation 17, applies to all types of transport, repealing Regulation 141 and amending *inter alia* Regulation 1017/68.

[112] Article 36 EC provides that, "The provisions of the chapter relating to rules on competition shall apply to production of and trade in agricultural products only to the extent determined by the Council." See further, Elhauge and Geradin, *Global Competition Law and Economics* (Oxford, Hart, 2007), at 51.

Regulation 1184/2006, and is evident in the way in which the Court has applied competition law to the agricultural undertakings.[113]

The protection of intellectual property. The goal of protecting certain intellectual property rights is evident in some areas of Community competition policy. An inherent tension exists between patent law and competition law, essentially because the latter aims at protecting competition, while the former creates monopolies which aim at eliminating competition to reward innovation. Courts and regulators, therefore, must reconcile the tension as best they can by determining whether the benefit to innovation resulting from a given restraint offsets any anti-competitive effect.[114] The approach presumes that patent and other intellectual property rights merit special treatment compared to other property rights. An evident result of this approach in the Community context is the Block Exemption on Technology Transfer and the accompanying Guidelines on the application of Articles 81 and 82 of the EC Treaty to technology transfer agreements.[115]

Defence. Although, in principle, the EC competition rules apply to the defence industry, Article 296 EC provides that Member States may refuse to disclose information if this could run "*contrary to the essential interests of [their] security*". Further, Member States may take measures which are considered "*necessary for the protection of the essential interests of [their] security which are connected with the production of or trade in arms, munitions and war material.*" As a result, where Member States can show that the application of the competition rules would run counter to their security interests, such application may be limited.[116]

Redistribution? It is arguable - though a highly controversial proposition - that the dispersal of economic power and the redistribution of wealth - the promotion of economic equity - may be viewed as a further goal of Community competition policy. For instance, it might be argued that, to the extent that Community competition policy favours consumer welfare over producer welfare in Article 81(3) EC, it can be viewed as having certain redistributive objectives.[117] As discussed above, such an interpretation would rely on the Harvard School and ordoliberal influences in Community competition policy, but would be anathema to those adopting a Chicago School analysis.

Other "lateral" policies. In a number of cases, the Community courts and Commission have, explicitly or implicitly, taken special account of a variety of "lateral" Community policies in applying competition law. These cases will be discussed in detail in Part III's Chapters dealing with the specific areas of Community competition law. Such policy areas include social policy, employment policy,[118] health policy, and cultural

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[113] Regulation 26 applying certain rules of competition to the production of and trade in agricultural products OJ 1962 30/993, Regulation 1184/2006 applying certain rules of competition to the production of and trade in agricultural products OJ 2006 L 214/7. Examples of the Court's approach here are the judgments in Case C-137/00 *Milk Marque* [2003] ECR I-7975 and Joined Cases T-217/03 and 245/03 *FNCBV* [2006] ECR II-4987.

[114] Elhauge and Geradin, *Global Competition Law and Economics* (Oxford, Hart, 2007), 191, citing Kaplow, "The Patent-Antitrust Intersection: A Reappraisal (1984) 97 Harv L Rev 1813.

[115] Regulation 772/2004 OJ 2004 L 123/11 and Guidelines on Technology Transfer OJ 2004 C 101/2. This could, however, be viewed as coming within the goals of "economic efficiency" in its post-Chicago, Schumpterian sense of encouraging dynamic efficiency, and thus not to amount to a "non-economic" goal.

[116] However, Article 296 EC is specified only to apply to products intended for "*specifically military purposes.*"

[117] See further, Chapter 11.

[118] Se the cross-sectional clause in the Treaty, Article 127(2) EC, "*The objective of a high level of employment shall be taken into consideration in the formulation and implementation of Community policies and initiatives.*"

policy.[119] They also include areas such as sport, in which the Community has not traditionally been viewed as having a "policy" as such.[120]

Having thus identified the mixture of competition theories underlying present Community competition policy and their approaches to environmental factors, and having identified the relevance of a range of non-economic factors to Community competition practice, we turn now to consider the specific case of environmental protection, and what role it should play in Community competition analysis.

[119] See Psychogiopolou, "EC Competition Law and Cultural Diversity: The Case of the Cinema, Music and Book Publishing Industries" 30(6) EL Rev (2005) 83 and Mayer-Robitaille, "Le statut ambivalent au regard de la politique communautaire de concurrence des accords de nature culturelle et des aides d'Etat relatives à la culture" (2004) 40(3) RTD eur 477.

[120] See, however, the Lisbon Treaty, which gives the EU coordinating competence in the area of sport.

Chapter 6: Should Environmental Goals Play a Role in Community Competition Policy? Theoretical Perspectives I: A Systematic Argument

1. Introduction

This Chapter, and the following two Chapters, shift to a normative perspective, assessing the merits of the theoretical arguments for and against taking environmental protection considerations into account in Community competition policy. They focus on what are, it is submitted, the three best arguments why environmental protection goals should play a role in Community competition policy. These arguments will, respectively, be grounded in reasoning based on the system of the Treaty and its underlying principles (the "systematic" argument, Chapter 6), on governance theory (the "governance" argument, Chapter 7) and on economic theory (the "economic" argument, Chapter 8). The conclusion will be that these arguments are convincing, and should inform any application of Community competition law to environmentally-relevant issues. This conclusion is important for Part III, which considers the application of the specific Treaty competition provisions in practice.

2. The Systematic Argument

The first argument that Community competition policy should take environmental considerations into account returns to a theme touched upon already: the idea that the Treaty should be viewed as a coherent "system." In essence, this argument holds that, where possible and where Treaty provisions are sufficiently open-textured to be open to interpretation, they should be interpreted so as to help, and not hinder, the Community's other policy objectives.[1] This approach holds, it is argued, in interpreting Community competition law just as in interpreting the rest of Community law.[2] Applied to the intersection between competition and environmental policies, this argument can be divided into two limbs. The first is environment-specific, based on Article 6 EC. The second is more general, based on the systematic links between the EC Treaty's competition and free movement provisions.

i. The Meaning of Article 6 EC

As we saw in Chapter 2, this Article - also known as the "integration principle" - provides that,

> *"Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities…in particular with a view to promoting sustainable development."*[3]

In itself, a systematic approach would not, without more, allow a conclusion on which Treaty policy should get priority in case of conflict. Indeed, as we have seen, Article 2 EC itself lays down no hierarchy between the Community's objectives. The crucial question is whether, in the case of environmental protection, the presence of Article 6 EC in the Treaty changes matters.

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[1] See, for example, Pescatore, *The Law of Integration* (Leiden, Sijthoff, 1974), at 41, who writes that, "*the structure of the European Community and its law form a system, that is to say, a structured, organised and finalised whole. The Community thus benefits from the resources and the dynamics of the system…*" See also, Vedder, *Competition Law and Environmental Protection in Europe: Towards Sustainability?* (Groningen, Europa Law Publishing, 2003).

[2] See, for example, Wesseling, The Modernisation of EC Antitrust Law (Oxford, Hart 2000), at 4: "*Interpretations of Community substantive law generally, and of EC antitrust law in particular, are interrelated and dependent upon institutional, procedural, political and economic aspects of the system.*"

[3] This will become Article 11 TFEU under the Lisbon Treaty.

Status of Article 6 EC. As discussed in Part I, the integration principle forms one of the - substantive - pillars of the EU's goal of sustainable development. As we saw there, it has been implemented (at least in principle) at all levels of EU decision-making, including at European Council, Council of Ministers and Commission level. However, the precise status of Article 6 EC - and, in particular, whether it constitutes a formal "general principle" of Community law - is not specified in the EC Treaty. Though one might be forgiven for concluding that it constitutes such a general principle due to its post-Amsterdam positioning in Part I of the EC Treaty (headed "Principles"), such positioning is clearly not in itself sufficient to determine the matter, which is ultimately for the Community courts alone to decide.

In this regard, the jurisprudence of the Community courts to date confirms, it is submitted, that Article 6 EC should be considered as a general principle of Community law.[4] In particular, in common with other such general principles, Article 6 EC has been relied upon as a tool in interpreting Treaty provisions as well as secondary Community law,[5] as a limitation on the scope and exercise of the Community's competence (for instance, in legal basis case law),[6] and as a limitation on, and justification for, Member States' actions within the scope of Community law (for instance, in free movement of goods case law).[7] Indeed, this general principle could arguably be viewed as flowing not just from Article 6 EC, also from the national "constitutional traditions" oft cited by the Court as a source of general principles, with many Member States according constitutional status to the environmental protection.[8] Admittedly, the mere qualification of Article 6 EC as a general principle of Community law does not, in itself, allow a comprehensive definition of its effect in the Community legal order: the *Mangold* judgment, in particular, has led to much uncertainty about whether general principles of Community law (in that case, the "general principle" of non-discrimination on grounds of age) have horizontal direct effect.[9] Nonetheless, the

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[4] See further, Dhondt, *Integration of Environmental Protection into other EC policies* (Groningen, Europa Law Publishing, 2003), Wasmeier, "The integration of environmental protection as a general rule for interpreting Community law" (2001) CML Rev 159.

[5] See, for example, the Opinion of AG Kokott, Case C-304/01 *Spain v Commission* [2004] ECR I-7655 (interpretation of fisheries legislation); Joined Cases T-74/00 etc *Artegodan* [2002] ECR II-4945 (precautionary principle), Opinion of AG Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769 (polluter pays principle). See also, the Opinion of AG Alber in Case C-444/00 *Mayer Parry Recycling* [2003] ECR I-6163.

[6] Case C-300/89 *Commission v Council (Titanium Dioxide)* [1991] ECR I-2867, paras 22 – 24. See analogously, Case C-17/90 *Pinaud Wieger* [1991] ECR I-5253 (confirming a similar approach towards the common transport policy) and *Opinion 2/00* [2001] ECR I-9713, where the Court confirmed that Article 6 EC was "*in full harmony*" with the *Titanium Dioxide* doctrine, and Case C-336/00 *Huber* [2002] ECR I-7699. See also, the Opinion of AG Kokott in Case C-94/03 *Commission v Council (Rotterdam Convention)* [2006] ECR I-1 and the Opinion of AG Geelhoed in Case C-161/04 *Austria v Parliament and Council* [2006] ECR I-7183 who concluded that, in cases of manifest disregard of environmental interests, Article 6 EC should function as a standard of review of the legality of Community legislation.

[7] Case C-379/98 *PreussenElektra* [2001] ECR I-2099, Case C-2/90 *Commission v Belgium* [1992] ECR I-4431, Case C-320/03 *Commission v Austria (Inn Valley)* [2005] ECR I-9871.

[8] Thus, a number of Member States have "general principles" of environmental protection in their constitutions. See, for example, the Opinion of AG Léger in Case C-227/02 *Wood Trading* [2004] ECR I-11957, who refers to Belgium, Greece, Spain, Finland and Hungary in this regard, as well as to the Charter for the Environment recently attached to the French Constitution; and the Opinion of AG Ruiz-Jarabo Colomer in Case C-176/03 *Commission* v *Council* [2005] ECR I-7879.

[9] Case C-144/04 *Mangold* [2005] ECR I-9981 (in which the ECJ seemed, controversially, to ascribe horizontal direct effect to the general principle of non-discrimination on grounds of age, though it had not previously been clear that general principles could have such an effect).

ECJ's jurisprudence demonstrates that the effects of Article 6 EC in the Community legal order clearly go beyond the programmatic,[10] entailing,

> "*an obligation on the part of the Community institutions to take due account of ecological interests in policy areas outside that of environmental protection* stricto sensu."[11]

On any natural interpretation, there is no reason why Article 6 EC should not apply to Community competition policy in the same way as any other Community policy, and indeed the Commission is of the view that it does so apply.[12]

Application of Article 6 EC in practice. Though Article 6 EC's status as a general principle of Community law may be relatively clear, its application in practice is, as we saw in Chapter 2, not at all so. From a legal and policy perspective, the principle as defined in the Treaty suffers from evident indeterminacy. This is not merely due to the uncertainty of meaning of Article 6 EC itself.[13] A far greater problem is that neither Article 6 EC, nor its subsequent application by the Community institutions, offers an answer to the glaring question raised by its wording: in the case of irresolvable conflict between environmental objectives and the objectives of another Community policy, which takes priority?[14] In order to evaluate the potential practical relevance of the integration principle to Community competition policy, we need to establish a working hypothesis of the answer to the question: What instruction does the integration principle give to decision-makers?

On this issue, Dhondt has put forward a useful distinction between three potential meanings of "integration" in this context:

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[10] The nature of Article 6 EC has been described by Advocate General Jacobs as "*not merely programmatic but [imposing] legal obligations*". Jacobs, "The Role of the European Court of Justice in the Protection of the Environment" Journal of Environmental Law 18 (2006) 185.

[11] Opinion of AG Geelhoed in Case C-161/04 *Austria v Parliament and Council* [2006] ECR I-7183, paras 50-60.

[12] See, for example, the speech of Jean-François Pons, "European competition policy for the recycling markets", Speech of September 20, 2001, "*Community law provides that environmental considerations must be integrated into all other Community policies. This includes European competition policy*". See also, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, discussed further in Chapters 10-12.

[13] The Treaty offers no definition as such of "environmental protection requirements", but most commentators agree that this refers to the Article 174(1) EC environmental policy objectives, as well as the Article 174(2) EC environmental principles, which seems reasonable. See further, Jans and Vedder, *European Environmental Law* (Groningen, Europa, 2008); Borràs Pentinat, "The Process of the Integration of Environmental Protection into Other European Union Policies" in Fajardo de Castillo *et al* (eds.), *Strengthening European Environmental Law in an Enlarged Union* (Aachen, Shaker 2004), at 29; Dhondt, note 4 above.

[14] See further, Alves, "La Protection intégrée de l'environnement en droit communautaire", Revue juridique de l'environnement, 2/2003 p. 1 and Nollkaemper, "Environmental Policy integration: greening sectoral policies in Europe - Three conceptions of the integration principle in international environmental law" in Lenschow (ed.), *Environmental Policy Integration: Greening Sectoral Policies in Europe* (London, Earthscan 2002).

Possibility 1. A "weak interpretation", where the obligation to integrate environmental protection requirements is merely an obligation to take these requirements into account, leaving decision-makers with a broad discretion as to whether or not to adjust their policies to those requirements in practice;

Possibility 2. A "strong interpretation", where the principle requires decision-makers to pursue environmental objectives in a systematic way alongside the specific sectoral objectives of each discrete policy area and, where several policy options are available, policy making should choose the most environmentally friendly option. In other words, environmental protection requirements must be observed in defining and implementing Community policies.[15]

Possibility 3. A "very strong interpretation", where environmental requirements should be applied at all times in priority to all other potentially conflicting objectives. This is reminiscent of the economic concept of "strong sustainability", a version of the sustainable development goal which we considered in Part I.

Dhondt concludes that, in her view, the second interpretation - the "strong interpretation" - should be preferred over the two others, as it is the only interpretation which achieves the aim of effectively integrating environmental requirements into all other Community policies in a systematic and proportionate manner. Not all commentators agree. Wasmeier, for example, seems to espouse a stronger interpretation - more akin to Possibility 3 - arguing that,

> *"…in any case where a conflict between the Community's economic and environmental objectives arises, the interests involved must be reconciled insofar as possible, in accordance with the principle that all Community purposes and interests set out in Article 2 are of equal value…Strictly speaking, if [a Community measure has an environmental impact], it must be either positive or neutral. Essentially, the Community cannot adopt any measures that lead to deterioration of the quality of the environment."*[16]

Similarly, applying this reasoning to competition law, Giorgio Monti argues that Article 6 EC means that environmental protection is "*normatively superior to the core values of EC competition law*" and so "*may thereby act as a "trump" to justify even anticompetitive environmental agreements if these are necessary to safeguard the environment.*"[17]

Like Wasmeier, Monti and Dhondt, the present author would argue that Possibility 1 should be rejected (i.e., the idea that environmental considerations should merely be "taken into account" in taking policy decisions in all areas). It is interesting to note that, were Possibility 1 to be accepted, the Community's present practice of carrying out impact assessments (i.e., achieving compliance with the integration principle via procedural means, discussed in Chapter 2), could be considered to be largely sufficient to comply with the requirements of the integration principle and sustainable development. It is submitted, however, that to accept this version of integration would be wrong from a systematic perspective - in particular given sustainable development's status as one of the core aims of the Treaties, and

[15] Dhondt, note 4 above.
[16] Wasmeier, note 4 above, at 160.
[17] Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057, at 1078.

Article 6 EC's status as a general principle of Community law.[18] Rather, the *effet utile* of Article 6 EC, as a component of a core aim of the Community and of the Union, demands that the provision be interpreted in a broad manner - meaning substantive integration, rather than reliance on the primarily procedural tool of impact assessments.

Equally, like Dhondt, the present author would reject Possibility 3 (i.e., the idea that environmental requirements should be applied at all times in priority to all other potentially conflicting objectives). This would mean that environmental protection would become a kind of an absolute "trump" card, akin, perhaps, to certain fundamental human rights. It would mean that, where a decision-maker is faced with a conflict between environmental and other (economic) goals, he or she must always prefer the environmental goal. This view, it is submitted, goes too far, and goes beyond the wording of Article 6 EC and indeed beyond the very concept of "sustainable development" itself, on which Article 6 EC is premised. Though, as we saw in Part I, the meaning of sustainable development is rather indeterminate, what is at least clear is that it attempts to find a middle ground or "win-win" solution between economic and environmental concerns, rather than viewing one as "trumping" the other.[19] In this sense, an analogy might be made with the *Viking* and *Laval* cases, which concerned the balance between national labour policies - in particular, the right to strike - and Community internal market law. In those cases, one argument made was that the right to take collective action constituted a fundamental right, protected by many national constitutions, and thus should fall outside the scope of Community internal market law. These arguments were rejected by the Court, which held that, though protection of fundamental rights could constitute a valid justification for restrictions of free movement - where proportionate - it could not remove the restriction from the scope of the internal market altogether.[20]

This leaves us with the middle ground of Possibility 2 - i.e., the idea that environmental protection requirements must, as a matter of obligation, be observed in defining and implementing Community policies and, where a number of different policy choices are possible, the choice most consistent with environmental protection should be preferred. In common with Dhondt, the present author believes that this interpretation of Article 6 EC is the "best fit", in the sense described by Dworkin,[21] with the scheme and system of the EC Treaty. This, it is submitted, is sufficient for any situation where there is no real conflict between environmental and competition objectives, or where any apparent conflict is resolvable.

However, it does not take us far enough: it fails to provide us with a useful answer to our initial question: in the case of irresolvable conflict between environmental objectives and objectives of another Community policy, which takes priority? The principle of Community

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[18] See Articles 2 EC and EU, and Wasmeier, note 4 above, 164. See, by analogy, the ECJ's classic reasoning in Case 26/62 *Van Gend en Loos* [1963] ECR 1, in which the ECJ examined the nature, scheme and wording of the Treaty in concluding that present Article 25 EC has direct effect.

[19] Nor does it follow from the presence of environmental protection objectives in the Charter of Fundamental Rights. Clearly, the Charter goes beyond "core" fundamental rights, which are viewed by some commentators as trumping other interests, and includes broader policy directives, in particular certain broad economic and social rights which are not found in the European Convention of Human Rights.

[20] Case C-438/05 *Viking* [2007] ECR I-10779 and Case C-341/05 *Laval* [2007] ECR I-11767. The Court's approach follows that in, for instance, Case C-36/02 *Omega* [2004] ECR I-9609.

[21] See Dworkin, *Taking Rights Seriously* (Cambridge, Harvard University Press, 1977) and Dworkin, *Law's Empire* (London, Fontana 1986), discussed further in Chapter 7.

law which provides us with a potential solution to this question is a general principle of Community law: the principle of proportionality.[22] This is the classic means, integral to the system of the Treaty and codified by the Treaty of Maastricht in Article 5(3) EC, of reconciling the Treaty's potentially conflicting policy goals. As is well known, the two-limbed formula typically used by the ECJ in, for example, free movement cases,[23] as well as cases seeking to annul Community measures for breach of a general principle of Community law,[24] is that an impugned measure is "proportionate" (and thus acceptable) where: (1) the measure is suitable (or "apt") to achieve a legitimate aim under the Treaty (the "suitability" test); and (2) the measure is the least restrictive of the conflicting Community goal as is possible (the "necessity" test).

This takes us to the final stage in the analysis: What concrete instruction does the integration principle, then, give to competition authorities (whether national competition authorities or the Commission) and courts applying Community competition law? It is submitted that, applying the systematic logic developed above as to the meaning of the integration principle, the best answer to this question is as follows:

[22] See likewise, Vedder, note 1 above, Wasmeier, note 4 above.
[23] See, for example, Joined Cases 133-136/85 *Rau* [1986] ECR I-2289. See further, Barnard, *The Substantive Law of the EU* (Oxford, Oxford University Press, 2007).
[24] See, for example, Joined Cases 154 and 155/04 *Alliance for Natural Health* [2005] ECR I-6451.

1. As a procedural matter, where environmental considerations could be relevant to a case, the question whether they should be taken into account must be considered in coming to a decision.
2. Where there is, on their wording, no scope at all for interpreting the Treaty competition provisions in a way that favours environmental protection, the integration principle is not relevant. This is because, as a principle of Community law, it can only be used as a tool of interpretation insofar as a provision is sufficiently open-textured.[25] One (obvious) outcome of this conclusion is that, where behaviour is environmentally damaging but does not restrict competition, it cannot be sanctioned by the Treaty competition rules where these expressly only apply to competitive restrictions.
3. Where it is possible to interpret the Treaty competition provisions in a way that favours environmental protection, and there is no conflict with the goals of competition policy, the Treaty provisions must always be interpreted in that manner.
4. Where it is possible to interpret the Treaty competition provisions in a way that favours environmental protection, and there is a conflict with the goals of competition policy, then the proportionality principle applies. That is to say, where a (private or State) measure is suitable to achieve the Community's environmental policy objectives, and there is no way of achieving these objectives that is less restrictive of competition, the measure should be allowed under Community competition law.[26]

Figure 1: Working hypothesis of the practical implications of the Article 6 EC integration principle in the context of Community competition law

These four points form our "working hypothesis" on the implications of Article 6 EC, to be applied concretely in Part III in the context of the specific Treaty competition rules.

ii. The Systematic Links between Competition Policy and Free Movement Policy

The second limb to what we have termed the "systematic" argument may be called an "internal comparative" approach: the argument that, as competition policy and free movement of goods policy form part of the Community's internal market law, they do and should, to a certain extent, converge in their aims and complement each other. This argument has three distinct aspects.

The first is inspired by ordoliberal economic theory. As discussed in Chapter 5, from an ordoliberal perspective, Community competition policy can only be understood in the context of the Community's broader economic policy: regulators must adopt a *Ganzheitsbetrachtung* (integrated policy perspective), viewing each individual economic

[25] See by analogy cases such as Case C-105/03 *Pupino* [2005] ECR I-5285, which makes clear that such interpretative requirements (in that case, in the context of the doctrine of indirect effect) cannot require a judge to interpret *contra legem*. See also, Winter, "On the effectiveness of the EC administration: the case of environmental protection" 33 CML Rev (1996) 689, at 700.

[26] See Steenbergen, "Proportionality in Competition Law and Policy" (2008) 35(3) Legal Issues of Economic Integration 259, at 266, who argues that, when assessing the relationship between competition policy and other EU policies, the Courts apply a "*somewhat diluted*" indispensability test. The application of the proportionality principle in practice in environment-related cases will be dealt with in detail in Part III.

decision as part of the greater economic constitution.[27] Recognition of the effects of one policy decision on other policy areas and on the economic order as a whole is fundamental to ordoliberalism's *Ordnungspolitik*.[28] This approach, by its nature, sees competition law and internal market law as complementary elements forming part of the same system of economic constitutional law. Similarly, Baquero Cruz has argued forcefully that the competition and free movement rules, as the "*oldest layer of the Community constitution*", should "*not be seen as isolated and independent groups of norms, but rather as inextricably linked in a functional sense.*"[29] In a manner reminiscent of the post-Chicago criticism of Eleanor Fox in the US,[30] he criticises a "*growing tendency among competition specialists to treat their topic in a highly technical way, as distinct from the economic constitutional law of the Community*".[31] As part of the same overarching body of economic constitutional law, therefore, the two sets of rules should be considered to have the same ultimate aims, though with some differences of application - such as their personal scope and the presence of the *de minimis* rule in competition law, which does not apply in free movement law.

The second aspect to the systematic link between the Community's competition and free movement policies is based on empirical observation of current trends in the case law of the Community courts. As Mortelmans has noted, and as will be discussed further in Part III, there is a trend towards convergence between the areas of free movement and competition in the case law of the Community courts, though they have not yet adopted a systematic approach to such convergence.[32] He points, first of all, to convergence in the scope of the basic Treaty prohibitions of restrictions to free movement and competition, citing, *inter alia*, examples of case law in which the ECJ took a similar approach to the scope of the Article 81

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[27] See Eucken, *Grundsätze der Wirtschaftspolitik* (Principles of economic policy) (7th ed., Tübingen, Mohr Siebeck, 2004), at 304, and the discussion in Chapter 5.

[28] See further, Sally, "Ordoliberalism and the Social Market; Classical Political Economy from Germany (1996) 1(2) New Political Economy 233.

[29] "*As the law now stands…the competition rules contained in the Treaty have a constitutional status and may be interpreted as shaping a law of economic liberty from restraints of competition and abuses of private economic power, not only a law of economic efficiency*…." Baquero Cruz, Between Competition and Free Movement: The Economic Constitutional Law of the European Community (Oxford, Hart, 2002), at 1. See also, Hervouët, "La dérive de l'Union européenne: de l'objectif de l'Union entre les peuples à celui de la concurrence" (2008) 514 Revue du Marché commun et de l'Union européenne 9, who argues that competition has always, in the scheme of the Treaty, merely constituted a means to attain the EU's broader objectives, namely increasing the well-being of its people.

[30] On which, see Chapter 5.

[31] He refers *inter alia* to the Spaak report, by which the inclusion of competition rules was expressly aimed at preventing private undertakings from re-erecting the barriers to trade that would fall as a consequence of the free movement rules. See the Spaak Report, at 16: "*Des règles de concurrence qui s'imposent aux enterprises sont donc nécessares pour éviter que les doubles prix aient le même effet que des droits de douane, qu'un dumping mette en danger des productions économiquement saines, que la répartition des marchés se substitute à leur cloisonnement*."

[32] Mortelmans, "Towards Convergence in the Application of the Rules on Free Movement and on Competition?" 38 CML Rev (2001) 613. See also, however, Gyselen, The Emerging Interface between Competition Policy and Environmental Policy in the EC, in Cameron, Demaret and Geradin (eds.), *Trade and the Environment: The Search for Balance* (London, Cameron May, 1994), at 242 and Stuyck, "Libre circulation et concurrence: les deux piliers du Marché commun" in *Mélanges en homage à Michel Waelbroeck* (Brussels, Bruylant, 1999), at 1478. He notes that the Court almost had the opportunity to develop a systematic approach in Case 2/91 *Meng* [1993] ECR I-5751, in which, in considering the application of Articles 3(1)(g), 10 and 81 EC to actions of public authorities which restrict competition, it had asked the intervening parties whether such public authorities should be able to rely on the justifications set out in Article 81(3) or, alternatively, the mandatory requirements of public interest in Articles 28 and 49 EC. The matter did not ultimately have to be decided, however, as there was no violation of Articles 3(1)(g), 10 and 81 EC on the facts. See further, Chapter 14.

EC prohibition as it famously adopted in *Cassis de Dijon* regarding the scope of the Article 28 EC prohibition on restrictions to free movement of goods.[33] In addition, he notes a convergence in the permissible "exceptions" to the competition and free movement rules: "economic" justifications have been accepted for restrictions of free movement,[34] and "non-economic" justifications have been accepted for restrictions of competition.[35] Further, he notes that the Court has accepted (in, for example, *Bosman*)[36] that private parties may rely on justifications of public policy, public security or public health to justify a prohibition on the free movement of workers, and that both private parties and the State may rely on Article 86(2) as a justification for breach of the competition rules.[37] His conclusion is that such convergence is necessary to avoid distortions of competition,[38] though full convergence is not desirable due to the still-relevant distinction between public interests (*imperium*) and private interests (*dominium*).[39]

A third aspect to the argument for convergence in the Community's competition and free movement policies is that the line between state action and private action is a fine one, meaning that the approach to economic behaviour should ideally not depend on the status of the actor - i.e., whether the actor is a state body or a private undertaking. This approach draws, *inter alia*, on Hayek's view that,

> *"it seems unwise to draw a sharp distinction between economic and political autonomy, for it is difficult to distinguish economic action from political action…"*[40]

This point should be seen in the broader current political context, where many Member States are choosing to "devolve" what would formerly have been viewed as public functions to private undertakings. In such instances, cases are increasingly being argued before the Community courts on competition and free movement points.[41] As private undertakings are essentially performing the same functions as previously performed by the State, it would seem logical that they should be able to rely on similar Treaty derogations when performing such functions - albeit with perhaps greater deference being paid (for instance in assessing proportionality) to those policy choices made by Member States enjoying greater democratic legitimacy and accountability than private actions.[42] As a result, the standard of legality for

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[33] Case 120/78 *Rewe-Zentrale AG (Cassis de Dijon)* [1979] ECR 649. See, for example, Joined Cases C-51/96 and C-191/97 *Deliège* [2000] ECR I-2549, Case 26/76 *Metro I* [1977] ECR 1875 and Case 161/84 *Pronuptia* [1986] ECR 353 and Mortelmans, note 32 above, 627-630.

[34] See, for example, Case 72/83 *Campus Oil* [1984] ECR 2727 and Case C-158/96 *Kohll* [1998] ECR I-1931. One might also include examples from the Court's case law on direct taxation, such as Case C-204/90 *Bachmann* [1992] ECR I-249.

[35] Citing cases such as Case C-360/92 P *Netbook agreement* [1995] ECR I-23 (culture), as well as examples from the sports and environmental fields.

[36] Case C-415/93 *Bosman* [1995] ECR I-4921.

[37] Though the manner in which the justification may apply differs: see Mortelmans, note 32 above, at 645 and Chapter 14.

[38] *Ibid,* at 648. Further, the trend will be buoyed by "cross-cutting" policy integration clauses such as Article 6 EC and ability of national courts to deal with free movement and competition cases in "one go" given their post-Regulation 1/2003 power to apply Article 81(3).

[39] *Ibid,* at 649.

[40] Hayek, *The Constitution of Liberty* (Chicago, University of Chicago Press, 1960).

[41] See, for example, Case C-415/93 *Bosman* [1995] ECR I-4921, Case C-379/98 *PreussenElektra* [2001] ECR I-2099.

[42] See, for example, Mortelmans, note 32 above. See *contra*, however (in the context of Article 82 EC) Albors-Llorens, "The role of objective justification and efficiencies in Article 82 EC" 44 (2007) CML Rev 1727, who emphasises that the competition rules and free movement rules differ, because achieving the single market is

the competition and free movement provisions should be viewed as what Gyselen has termed a "*seamless web*", in view, *inter alia*, of the deregulation of formerly public activities to private undertakings, blurring the traditional public-private divide.[43] Such blurring provides a convincing rationale for what Baquero Cruz has termed the "privatisation" of the free movement rules (e.g., the finding in cases such as *Walrave and Koch* that certain of the free movement rules have horizontal direct effect) and the "publicisation" of the competition rules (e.g., the *INNO* line of cases by which Member States may breach Articles 81 and 82, read in conjunction with Articles 3(1)(g) and 10 EC).[44]

It is worth noting that environmental protection is a prime example where, as we have seen in Part I, economic, "market-based" instruments are increasingly being used in environmental policy. As we have seen, this forms part of a shift in environmental governance, away from State-source measures towards governance "*through the workings of the marketplace*."[45] In this context, as Vogelaar has noted, the argument for convergence in approach between Community "public" and "private" law is particularly pertinent.[46]

To conclude, the implications of this argument, based on convergence between Community free movement and competition law, bring us squarely back to the conclusions reached above on the significance of the Article 6 EC integration principle.[47] Clearly, as discussed in Part I, environmental protection has been recognised by the ECJ on numerous occasions as a potential acceptable justification for Member State measures restricting free movement, under the *Cassis de Dijon* formula. Likewise, as we also saw in Part I, the Court has in cases such as *PreussenElektra* and *Walloon Waste* accepted (albeit not explicitly) that environmental considerations may justify distinctly applicable measures, where normally only express Article 30 EC derogations would suffice.[48] According to the logic of the present argument, this militates against any exclusion of environmental considerations from the application of Community competition law. Moreover, as the proportionality principle is key in how the ECJ resolves conflicts between policy goals in the context of the free movement provisions,

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the sole aim of the latter, whereas it is just one aim of the former (along with the aim of ensuring effective competition), and Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006).

[43] Gyselen, note 32 above, at 242.

[44] Baquero Cruz, note 29 above; Case 36/74 *Walrave and Koch* [1974] ECR 1405, Case 13/77 *INNO v ATAB* [1977] ECR 2115. Though Article 28 EC is essentially addressed to States and Articles 81 and 82 EC to private undertakings, Article 28 EC can now also apply to restrictions created by private actors (see, e.g., Case C-265/95 *Commission v France* [1997] ECR I-6959 ("French farmers") - though ultimately it is still the State which may be found liable, albeit for the actions of private undertakings) and States can now be found liable for infringement of Articles 81 and 82 under the *INNO* doctrine. See, further, Chapter 14 below.

[45] See, for example, Cafaggi, "Gouvernance et Responsabilité des Régulateurs privés" Revue Internationale de Droit Économique (2005) 111.

[46] Vogelaar, "Towards an Improved Integration of EC Environmental Policy and EC Competition Policy: An Interim Report" in 1994 Fordham Corp. L. Inst. (B. Hawk ed. 1995) 529, at 534. He notes that, while state measures with environmental aims must satisfy Articles 28, 29 or 87 EC, private measures with environmental aims must satisfy Articles 81 and 82 EC. Vogelaar concludes that, in each of these areas, "*the degree of legal acceptability of the measures taken hinges on the concept of "proportionality" or "reasonableness". The measures adopted, be they public or private, should be proportional to the objective pursued.*"

[47] See, *contra,* for example, Odudu, note 42 above, at 167 who characterises the use of a teleological approach as a "Trojan horse", citing Wesseling, *The Modernisation of EC Antitrust Law* (Oxford, Hart 2000), at 34-50 and 61-64 (though on closer analysis, Wesseling's argument is in fact that non-economic factors may indeed be relevant to competition analysis overall).

[48] Case C-379/98 *PreussenElektra* [2001] ECR I-2099, Case C-2/90 *Commission v Belgium* [1992] ECR I-4431. This is further discussed in Chapter 7 *infra.*

the present argument adds further force to the validity of our the working hypothesis on the implications of Article 6 EC in Community competition policy, set out at Figure 1 above.

Chapter 7: Theoretical Perspectives II - A Governance Argument

1. Introduction

A second argument that goes against the view that environmental considerations should not be taken into account in Community competition policy is that, from a governance perspective, any attempt to draw a "bright line" separating the two areas would be inefficient, unrealistic, and would infringe the principles of good governance, detracting from the effectiveness and ultimately the legitimacy of Community law. After outlining the thrust of this argument, this section goes on to apply the argument to the three primary levels of Community competition law enforcement: (1) the Commission; (2) the Community Courts; and (3) national authorities applying - post-Regulation 1/2003 - Community competition law, including national administrative competition authorities and national courts.

2. Outline of the argument

The argument can be divided into two limbs. First, as a matter of principle, for governance to be efficient and effective, action across Community policy spheres should interlink and be coherent. This is fundamental to good governance. Moreover, in the specific context of environmental protection goals, the coherence imperative is even stronger, because it is laid down explicitly in the Treaty in the form of the sustainable development principle and, as part of this, the integration principle discussed in the previous Chapter. Second, in practice, the position that environmental considerations should be excluded from the analysis in Community competition enforcement is unrealistic and unlikely to be achieved. As a result, any push to exclude them from competition analysis is undesirable, as it would inevitably lead to problems of legal certainty.

a. Coherence of Policy Action as a Requirement of Good Governance

The first limb of the governance argument starts from a simple premise: that, in a system with multiple policy objectives such as the EC Treaty, the goals of the system overall will be more efficiently and more effectively achieved where the governance of one part of the system takes the aims of another part of the system into account.

This is not a new approach at Community level.[1] In its 2001 White Paper on European Governance, which is the main (and one of the only) policy documents setting out the Commission's approach to EU governance,[2] the Commission identifies the principles of "*effectiveness*" and "*coherence*" of Community policies as two of the fundamental five principles

[1] See further, Lamy, "Europe and the future of economic governance" JCMS 42(1) (2004) 5, who identifies three functions of economic governance: implementing underlying values; efficiency, and legitimacy. He also points to the problems of "*interlinkages*" in the context of "*single issue*" institutions. See also, Van Gerven, *The European Union: A Polity Of States and Peoples* (Oxford, Hart, 2005), who identifies integrity and effectiveness as the guiding principles of good governance, and Kadelbach, "European Administrative Law and the Law of a Europeanized Administration" in Joerges and Dehousse (eds.), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press, 2002).

[2] COM (2001) 428 final. It defines governance as the "*rules, processes and behaviour that affect the way in which powers are exercised at European level*" White Paper, at 8. See further, Wincott, "Looking forward or harking back? The Commission and the reform of governance in the European Union" 39(5) Journal of Common Market Studies 897, and Jachtenfuchs, "The Governance Approach to European Integration" 39(2) JCMS (2001) 245, who defines governance as "*the intentional regulation of social relationships and the underlying conflicts by reliable and durable means and institutions, instead of the direct use of power and violence*" or, more simply, "*the ability to make collectively binding decisions*" (at 246).

of good governance within the EU - along with openness, participation, and accountability.[3] The Commission describes the aim of effectiveness of Community policies as follows:

> *"Policies must be effective and timely, delivering what is needed on the basis of clear objectives, an evaluation of future impact and, where available, of past experience…"*[4]

Most importantly for the present analysis, the aim of coherence of Community policies is thus described:

> *"Policies and action must be coherent and easily understood. The need for coherence in the Union is increasing: the range of tasks has grown; enlargement will increase diversity; challenges such as climate and demographic change cross the boundaries of the sectoral policies on which the Union has been built; regional and local authorities are increasingly involved in EU policies. Coherence requires political leadership and a strong responsibility on the part of the Institutions to ensure a consistent approach within a complex system."*[5]

Thus, the Commission states that one of its principal aims is to "*reinforce attempts to ensure policy coherence.*"[6] Though the Commission points to cross-cutting policy initiatives which have helped, identifying in particular the Göteborg strategy for sustainable development launched by the European Council in 2001, it concludes that,

> *"more needs to be done. The Institutions and the Member States must work together to set out an overall policy strategy. For this purpose, they should already refocus the Union's policies and adapt the way the Institutions work under the existing Treaties."*[7]

More broadly, it is evident that increasing the effectiveness, efficiency and coherence of the Community's policies will, in addition to enhancing the effective attainment of the EU's substantive policy goals, increase the output legitimacy of EU's decisions – i.e., the extent to which EU decisions are accepted as legitimate and sound, for instance by EU citizens. Community institutions which do not "talk to each other", producing conflicting policies and decisions, will not help in the EU's continuing quest for acceptance by its public. Similarly, any attempt to construct the Community's internal market policies (including its competition policy) in isolation from the wider social and environmental context in which they are embedded will face major issues of output legitimacy.[8]

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[3] *Ibid,* at 10.

[4] *Ibid,* at 10.

[5] *Ibid,* at 10.

[6] *Ibid,* at 6. In particular, it observes that, "*the step by step integration, which has characterised the Union's development, has tended to slice policies into sectoral strands with different objectives and different tools: over time the capacity to ensure the coherence has diminished. The current working methods of the Institutions and the relations with the Member States prevent them from showing the necessary leadership.*"

[7] *Ibid,* at 28.

[8] See, for example, Everson, "The Crisis of Indeterminacy: An "Equitable" Law of "Deliberative" European Market Administration?" in Joerges and Dehousse (eds.), *Good Governance in Europe's Integrated Market* (Oxford, Oxford University Press, 2002), at 232: "*Few markets…can operate in full isolation from the wider society in which they are embedded. The European market is no exception…In an uncertain post-national political setting, the ability of the European market administration and its law to respond to the social will largely determine its long-term success or otherwise in the absence of on-going political direction, the "technocratic" needs must be administratively balanced against the "ethical", whilst the "economically rational" must be weighed against social demands within the administrative process.*" She concludes that, "*the sum total of the process of European market integration is…the emergence of a "market" that does not stand in isolation from the social and political processes of the Member States and Community, but which is, instead, "embedded" within those processes…*" *Ibid*, at 240.

In the environmental sphere, the importance of coherence of policy objectives is clearly provided for explicitly by the principles of sustainable development and Article 6 EC integration, and is thus given special force. The drive for good governance thus ties in neatly with the EU's Sustainable Development Strategy, as well as with the Cardiff process implementing the Article 6 EC integration principle, discussed in Part I.[9] It is fair to conclude that the sustainability and integration principles require, if they are to be taken seriously, a sea change in the sectoral paradigm of Community governance.[10]

b. A Realist's Perspective

The second limb in the governance argument can be outlined more briefly. Shifting away from a normative perspective, it holds that, even if one were to accept that it would be better in theory for Community competition law enforcers to ignore environmental considerations, it would be unrealistic to expect this to happen (consistently) in practice. Further, such a lack of consistency would lead to legal certainty problems. This argument has most force, as we see below, as regards enforcement of Community competition law by the Community courts and national courts (and, to a certain extent, national administrative competition authorities), as they may very well neither be minded, nor used, to applying competition provisions in a way that excludes non-economic factors. It has less force in the case of DG Competition of the Commission, as a specialised technocratic body which has, subject to the review of the Community courts, a relatively high degree of autonomy in its approach to enforcement. However, as discussed below, it may be possible, using public choice theory, to arrive at a similar conclusion for the Commission.

3. Applying Governance Analysis to the Commission

a. Good governance analysis

As already discussed, the Commission has itself - at least on paper - been one of the main driving forces in formulating EU policy on good governance (via its White Paper), as well as on implementing sustainable development (via the EU's Sustainable Development Strategy) and the Article 6 EC integration principle (via various Communications and the institution of impact assessments, for example). Far from intimating that it, as an institution, would be excluded from the application of these principles, the Commission has, in these documents, liked to portray itself as leading by example.

Nonetheless, it is undeniable that, in practice and as the number, size and remit of the Commission's Directorates General has increased tremendously over the past years, the interlinkage between its policies has proved increasingly problematic. It is often very difficult for one arm to know what the other arm is up to. This problem was one of the issues targeted by the push for Commission Reform which took place during the Prodi Commission, following the collapse of the Santer Commission. This push resulted in a

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[9] As mentioned in Part I, policy implementation of these processes include the development of bilateral integration strategies and programmes for a wide number of Council formations; the publication of a 1998 Commission Communication "Partnership for Integration" (COM(98) 333); the 2004 undertaking of the Commission to carry out an annual stocktaking of the progress of the Cardiff process; and the more general undertaking in the EU's SDS that the Commission will carry out impact assessments as to environmental impacts when proposing major policy measures. See European Commission, "Integration of Environmental Considerations into other Policy Areas – a Stocktaking of the Cardiff Process" COM (2004) 394 final.

[10] See Alves, "La Protection intégrée de l'environnement en droit communautaire" Revue juridique de l'environnement, 2/2003 p. 1, who refers to a "*renovation de la gouvernance communautaire*."

White Paper on Reforming the Commission in 2000,[11] based on four guiding principles - efficiency, accountability, service and transparency - and subsequent reform and progress updates in 2003 and 2005 (the Kinnock reforms). The need for greater internal coordination between Directorates General was a priority from the beginning for the Prodi Commission. A paper entitled "Closer Internal Coordination", presented at the inaugural meeting of the Prodi Commission in Aartselaar, 1999, notes that,

> *"closer internal coordination is necessary to ensure the consistency and effectiveness of the Commission's action, together with the high quality of its initiatives. Recourse should be had to internal coordination as early as possible so as to avoid technical trade-offs at Chefs de cabinet meetings…"*[12]

The paper proposed that the competent department of the Commission should be primarily responsible for internal coordination on policy matters, supplemented by the Secretariat General.[13] During his tenure as Secretary-General, David Williamson made significant efforts to tighten up the programming of activities and improve co-ordination among DGs.[14]

These steps taken within the Commission represent at least a partial acknowledgement of the dire need to improve internal policy coordination between Directorates General of the Commission.[15] These difficulties may be termed difficulties of horizontal internal integration within the Commission.[16] The deepening and broadening of European integration has increased the policy areas in which the Commission is active, leading to greater specialisation and fragmentation of approach. Such horizontal integration problems are likely to increase as the size of directorates-general, and their policy remits, grow. Metcalfe comments,

> "*for an organization whose business is integration, the Commission is embarrassingly poorly integrated. It lacks the capacities to contain rivalries and jurisdictional disputes among DGs.*"[17]

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[11] COM (2000) 200.

[12] Available (though untitled) at http://ec.europa.eu/reform/pdf/coordin_en.pdf, at 1. On the success of the Kinnock reforms, see Kassim, "'Mission impossible' but mission accomplished: the Kinnock reforms and the European Commission (2008) 15(5) Journal of European Public Policy 648.

[13] *Ibid*, at 2: the Secretariat General's position, "*recognised by the departments and the Commissioners' offices, enables it to have a good overview, to stand back a little from the issues it addresses and to act in complete neutrality*…"

[14] See Metcalfe, "Reforming the Commission: Will Organizational Efficiency Produce Effective Governance?" Journal of Common Market Studies 38(5) (2000) 817.

[15] See, for example, Hofmann and Türk, *EU Administrative Governance* (Cheltenham, Edward Elgar, 2006), who note the poor coordination between the 24 Directorates-General (at 24); Sand, "Understanding the New Forms of Governance: Mutually Interdependent, Reflexive, Destabilised and Competing Institutions" 4(3) European Law Journal (1998) 271, who refers to a "*thick interdependency*" between different policy areas.

[16] The goal of improving horizontal internal integration might be distinguished from the goal of improving vertical internal integration, which refers to improving linkages within the Commission between the staff of the Directorates-General and the Commissioners themselves, and the goal of improving vertical external integration, which refers to improving linkages between the Commission and national bodies who are also involved in implementing a given area of Community policy, forming a "network" with the Commission. See Hofmann and Türk, "The Development of Integrated Administration in the EU and its Consequences" 13(2) European Law Journal (2007) 253. The enforcement of Articles 81 and 82 EC is, post-Regulation 1/2003, a good example of a movement towards vertical external integration in this sense. This goal may equally refer to improving linkages "upstream" between the Commission and the Council.

[17] He refers in this regard to a report on "Designing Tomorrow's Commission" which was presented to the Prodi Commission in 1999 (the "DECODE" report) as demonstrating the deficiencies of internal co-ordination and the way in which the workloads associated with co-ordination have grown in recent years. Metcalfe concludes that the diversification in the Commission's responsibilities demands better co-ordination in order to ensure coherence and consistency of policy areas - which is lacking at present within the Commission.

Considerable efforts have been made in recent years to increase horizontal coordination within the Commission.[18] However, the continued lack of integration is partly a function of the very structure of the Commission, comprising large and relatively separate directorates-general. As Christiansen comments, some of the difficulty in horizontal internal policy coordination within the Commission is a function of the sheer physical distance between directorates-general, leading to problems in communication between Commissioners and their cabinets.[19]

The fact that, as a formal matter, the Commission acts as a collegiate body provides little answer to these criticisms. In practice, in the vast majority of cases - save perhaps certain high-profile matters or matters of particular importance for a given Member State - Commissioners with another portfolio will not challenge the proposal of their colleague. The equilibrium between Commissioners, and their "strategy" in this regard, may be viewed from a game theory perspective: Damien Neven, currently Chief Economist at DG Competition, has observed that there exists an "*equilibrium of mutual deterrence*" between Commissioners, meaning that instances where recommendations from the competition Commissioner have not been followed by the College are rare.[20]

These problems of fragmentation clearly have the potential to damage the effectiveness of the attainment of EU policy goals across the board, especially those goals - including environmental protection - where a sectoral approach will be ineffective.[21] Two conclusions may, it is submitted, be drawn from this. First, were DG competition to refuse to take any environmental protection requirements into account in applying Community competition law, this would simply aggravate the existing problem of internal policy incoherence - a problem which the Commission has been striving to eliminate. Second, this would breach the Commission's own principles of good governance, as well as the Treaty principles of sustainable development and Article 6 EC integration.

One can imagine that, in response to this conclusion, it might be argued that DG Competition is a "special case" within the directorates general of the Commission. Using Chicago School style analysis, it might be argued that, rather than acting as other directorates general, DG competition should be sectioned off as more akin to an independent competition agency, enforcing a separate, technical and economics-based area of law with no interlinkages with other Commission competences. It is submitted that, at present, this argument does not convince. In contrast to the wishes expressed by some, including Gordon Brown and Giuliano Amato, DG competition is not an independent agency at

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[18] See Schout and Jordan, "The European Union's governance ambitions and its administrative capacities" (2008) 15(7) Journal of European Public Policy 957, who observe that their interviews with Commission officials "*clearly show a drastic change from a traditionally hierarchical organization with little room for horizontal coordination into an organization that has become in a short span of time much more informal and open to internal and external coordination*" (at 969).

[19] "*Previously, meetings and informal conversations among members of different cabinets were a common part of the daily work routine as they could easily be arranged along the same corridor. Now, given that offices may be at the other end of town, meetings need to be organized in advance, and informal conversations have all but ceased*": Christiansen, "Intra-institutional politics and inter-institutional relations in the EU: towards coherent governance?" 8(5) Journal of European Public Policy (2001) 747.

[20] See Neven, "Competition Economics and Antitrust in Europe", Economic Policy 21(48) (2006) 741. He notes that these instances "*may be rare and the threat of being overturned may not be sufficiently strong to affect the behaviour of the inquisitors significantly (at least in the field of antitrust, state aids being possibly different).*"

[21] See more generally outside the EU context, Holder and Lee, *Environmental Protection, Law and Policy* (2nd ed., Cambridge, Cambridge University Press, 2007), at 167.

present, and is still very much part of the Commission.[22] This point raises the question, however, of the extent to which DG competition in reality - irrespective of its official role as part of the Commission - acts independently of the rest of the Commission, to which we now turn.

b. Realism analysis: A public choice approach

Even if, contrary to the above arguments, it were accepted in principle that the Commission should exclude environmental considerations in applying Community competition law, it is realistic to expect it to do so in practice? Though the realism argument is weakest in the case of the DG Competition, as a specialised, technocratic body relatively well-used (at least in recent years) to applying economic reasoning, it is nonetheless interesting to raise the possibility of applying to the Commission certain theories of public choice in bureaucracy. These theories adopt an economic approach to analysing human behaviour - in this case, the relevant behaviour being the decisional practice of DG Competition in applying the competition rules.[23]

A major plank in public choice theorists' analysis is the argument that politicians and bureaucrats have objectives which they attempt to maximise, such as - in the case of politicians - getting re-elected; or, in other cases, maximising their own influence and thus their own budget.[24] While this theory was initially applied to politicians alone, subsequent authors such as William Niskanen, have extended this reasoning to bureaucracies and the administrative side of the state - termed "agencies" - arguing that it would be naïve to "assume away" political influence at administrative level and to believe in a fully scientific administrative state, which administers rules wholly neutrally.[25] In the US context, for example, Niskanen argues that the increase in number and power of administrative bodies results from budget-maximizing behaviour by rational bureaucrats: agency administrators want "*a bigger budget, more employees, and more legal power.*"[26]

This premise leads some - though not all[27] - public choice theorists to espouse capture theory in analysing how bureaucracies work, a theory to which we have referred in discussing the merits and demerits of direct regulation in Part I. Thus, the so-called "economic theories of regulation" posit that rent-seeking interest groups "*secure agency-enabling legislation that provides those groups with private benefits while allocating costs (costs that often exceed the benefits) to*

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[22] See Gordon Brown's proposal reported in the Financial Times of April 20, 2005 and Amato, *Antitrust and the Bounds of Power* (Oxford, Hart, 1997). See also, C-D. Ehlermann, "Reflections on a European Cartel Office"(2005) 32 CML Rev 471.

[23] See further on public choice analysis, for example: Revesz, Federalism and Environmental Regulation: A Public Choice Analysis, 115 Harv. L. Rev. 553 (2001); Niskanen, *Bureaucracy and Representative Government* (Aldine, Atherton, 1971); Peltzman, Toward a More General Theory of Regulation, 19 J.L. & Econ. 211 (1976); George J. Stigler, The Theory of Economic Regulation, 2 J. Econ. & Mgmt. Sci. 3 (1971).

[24] See further, Lyon, "Environmental Governance: An Economic Perspective" Working Paper of the University of Michigan Frederick A. and Barbara M. Erb Institute for Global Sustainable Enterprise, September 2006, at 8.

[25] See Spence and Cross, "A Public Choice Case for the Administrative State" 89(1) Georgetown Law Journal (2000) 97 for a useful overview of literature on public choice theory applied to bureaucracies and the administration, and Niskanen, *Bureaucracy and Representative Government* (Aldine, Atherton, 1971).

[26] Spence and Cross, *ibid*, and Niskanen, *ibid.*

[27] See Spence and Cross, *ibid,* who discount the validity of capture theory.

the general public."[28] By this argument, bureaucratic action is driven by interest groups that form to advance their own agendas.

A further "limb" to public choice theory of potential relevance is the "principal-agent" model. Clearly, numerous varieties of this model exist, and it can be applied in a wide variety of contexts. One line of principal-agent theory of particular interest is that which seeks to demonstrate - again primarily in the US context - how politicians can, ultimately, control even apparently "independent" administrative agencies.[29] Under this analysis, politicians (or legislatures) should be viewed as the "principals" who may delegate their power to the administration and to whose wishes the administration (the "agent") may be more or less obedient. This can affect the outcome of the agent's decisions as, while agency bureaucrats will likely have ideological values which are consistent with the agency's mission (otherwise, they would not have applied to work there), "*politicians' values remain unconstrained by any particular institutional focus*".[30] Some theorists go further, arguing for a two-stage principal-agent analysis, whereby the politicians controlling the agencies (stage one of the analysis) are, in turn, controlled by voters' wishes (stage two of the analysis); hence, the administrative agency is, ultimately, heavily influenced by voters' preferences. Importantly, classic principal-agent theory recognises that the effectiveness of the principal's influence is, ultimately, dependent on the extent to which, in any given situation, the principal's and agent's aims converge or become aligned and the extent to which the principal can monitor the agent's activities.[31]

What, then, can we say is the potential relevance of public choice theory in analysing DG Competition's decisional practice and predicting how that will develop in the future? Does it militate towards a conclusion that, in reality, the Commission will, at least in some cases - whether explicitly or implicitly - take environmental considerations into account in applying competition law? Though the above discussion merely scratches the surface of the rich public choice literature, and space precludes an in-depth discussion of the field, the present author's preliminary conclusion is that, for the following reasons, public choice theory does not point "one way" on this issue.

To begin, some strands of the theory, if accepted, certainly tend towards the conclusion that it seems unrealistic to think that DG Competition ignores environmental considerations completely. The major example here is capture theory. Using this analysis, DG Competition is, each time it takes a decision where environmental concerns are potentially relevant, susceptible to "capture" by environmental interests. In the context of an individual case, these interests will, evidently, be represented primarily by the actor undertaking the environment-enhancing behaviour under review, who will by definition be defending this behaviour. In the case of private undertakings, however, it would not generally be correct to describe such undertakings as falling permanently within an "environmental interest group" - normally, undertakings are likely to choose to invoke environmental benefits in cases only when it suits them. In other words, most undertakings do not consistently engage in environmentally-beneficial behaviour. As discussed in Chapter 4, corporate environmental

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[28] See, Spence and Cross, *ibid,* and Stigler, note 23 above.

[29] See, for example, Matthew McCubbins et al., Administrative Procedures as Instruments of Political Control, 3 J.L. Econ. & Org. 243, 253-64 (1987), and additional literature cited in Spence and Cross, *ibid.*

[30] Spence and Cross, *ibid.*

[31] See, for instance, Church and Ware, *Industrial Organization: A Strategic Approach* (Boston etc, McGraw-Hill, 1st ed., 2005), at 772.

initiatives are often susceptible to the criticism that they represent "greenwash", and that apparently pro-environment policies may mask a less-publicised, dirtier reality.

In addition, one might conceivably apply a kind of modified principal-agent theory to the Commission's decisional calculus, again tending towards the conclusion that it is unrealistic to think that DG Competition ignores environmental considerations completely. Such an argument must, however, be viewed in light of the fact that, as Curtin notes, the standard principal-agent model of delegation, whereby administrative actors have been delegated power by political actors, and ultimately by citizens, is analytically inadequate when applied to the EU's evolving political system.[32] For instance, it is not possible to trace an unbroken chain of delegation stretching from EU voters to EU level administrative actors, including the Commission.[33]

Despite this lack of formal accountability in the Commission context, one can nonetheless formulate a modified two-stage principal-agent analysis in the competition field. Stage one of the analysis would be that DG Competition case-handlers are ultimately "controlled by" (i.e., subject to) the views of the Competition Commissioner and, more generally, to the College of Commissioners when the decision gets put to a vote. Stage two of the analysis would be that the Commissioners themselves, though not elected politicians, are influenced in taking competition decisions by the wishes of EU citizens, in two ways. First, the Commission is increasingly subject to a system of public democratic accountability to the European Parliament.[34] This accountability comprises, for instance, the asking of questions and establishment of committees of inquiry,[35] the supervisory role of the Ombudsman,[36] and the power to participate in the Commission's appointment and to censure the Commission.[37] Secondly, and more broadly, it is strongly arguable that Commissioners are, at least indirectly, influenced by the wishes of the electorate of the government who nominated them.[38] This "representational linkage" is not exhaustive: it is certainly the case that other interests also play a role, most importantly the general European interest, and the wish to champion the interests linked to their respective briefs.[39] Nonetheless, though information on voting patterns in the Commission is relatively limited, evidence suggests that national

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[32] Curtin, "Holding (Quasi-)Autonomous EU Administrative Actors to Public Account"(2007) 13(4) European Law Journal 523, at 525.

[33] *Ibid.*

[34] Curtin, note 32 above, at 540.

[35] Articles 193 and 194 EC, introduced by the Treaty of Maastricht.

[36] Article 195 EC.

[37] Articles 201 and 214(2) EC.

[38] Such broad influence from EU citizens would not, it is submitted, run contrary to Commissioners' overarching duty set out in Article 213(2) EC to be independent in the performance of their duties, and not to seek or take instructions from any other body. One might formerly also have made the argument that the practice of recruiting officials for senior posts within the Commission based on nationality, coupled with the presence within the Commission of "national experts" seconded to Brussels for some years, increases the influence of national governments (and thus, indirectly, their electorate) within the Commission. See, however, Curtin and Egeberg, "Tradition and Innovation: Europe's Accumulated Executive Order" West European Politics (2008) 31(4) 639, who conclude that national influence is becoming more limited within the Commission bureaucracy.

[39] See the empirical study of the decisional behaviour of the Prodi Commission carried out by Egeberg, "Executive politics as usual: role behaviour and conflict dimensions in the College of European Commissioners" (2006) 13(1) Journal of European Public Policy 1.

interests play a part on a relatively frequent basis in Commissioners' behaviour in College.[40] One reason for this may be that many Commissioners will seek to regain a prominent position in the national political sphere at the end of their mandate.[41] On these grounds, it is arguable that, if it were true that "voters" are, by and large, becoming increasingly pro-environment in their views, these views would have an influence on the Commissioners, including the Competition Commissioner. As noted above, however, classic principal-agent theory holds that the effectiveness of such influence would be dependent on the extent to which voters (via, for instance, the European Parliament) in fact monitor the Commission's activities, and the extent to which the voters' and Commissions' interests collide.

In contrast, other strands of public choice theory might tend to reinforce the view that it is realistic to think that the Commission would apply a pure efficiency-based approach. One might argue, for example, that by doing so, and by holding competition law out as a "special" area insulated from the various non-economic aims of the Community, DG Competition is cementing its own power and sphere of influence, such that no other DGs can fairly insist on having a say in its decisional practice. More generally, this argument would tie in with the view held by theorists such as Giandomenico Majone who see the EU as a regulatory state. In this analysis, bodies like the Commission - which he sees as an example of an "independent fourth branch of government" - are particularly well-suited to regulatory, efficiency-oriented policy-making, as opposed to redistributive policy-making. This is because efficiency-oriented policies only require a weak degree of democratic control, as they aim at Pareto-efficient solutions which are in everyone's interest; while redistributive policies, which make some people worse off and some better off, require a high degree of democratic legitimacy (which the Commission does not have).[42]

A further public choice argument going in this direction (and against principal-agent theory) is what has been termed the "agency drift" or "tunnel vision" argument made by scholars such as Anthony Downs, who maintains that the people who work for a given agency tend to be those who are ideologically committed to the agency's mission and who may therefore seek to advance that mission even at the expense of other goals preferred by the general public. Downs suggests that bureaucrats' views are,

> *"based upon a 'biased' or exaggerated view of the importance of their own positions 'in the cosmic scheme of things.'"*[43]

On this argument, any indirect "connection" between administrative agencies and voters is severed by the extent of agency bureaucrats' commitment to the agency's ideology.

In sum, no absolute conclusion is possible here, as delving further into public choice theory would go beyond the scope of the present research. Nonetheless, it is suggested that it is - at

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[40] *Ibid.* The existence, or at least the perception of the existence, of national influence, explains the concern of the Irish government to secure agreement on keeping one Commissioner per Member State in the European Council summit of December 11-12, 2008. See also, Wonka, "Technocratic and independent? The appointment of European Commissioners and its policy implications" (2007) 14(2) Journal of European Public Policy 169.

[41] Wonka, *ibid.*

[42] See, for example, Majone, "The European Community Between Social Policy and Social Regulation" 32(2) JCMS (1993) 153, and "The European Community: An "Independent Fourth Branch of Government" in Brüggemeier (ed.) *Verfassungen für ein ziviles Europa* (Baden-Baden, Nomos, 1994). See further, Jachtenfuchs, note 2 above.

[43] Downs, *Inside Bureaucracy* (Boston, Little, Brown, 1967), at 107.

the very least - arguable, on the basis of public choice theory, that the Commission is in practice unlikely wholly to exclude environmental factors from competition analysis.

4. Applying Governance Analysis to the Community Courts

Both of the governance arguments outlined above (coherence and realism) can, it is submitted, be applied with forceful effect to the Community Courts in carrying out their function as ultimate judicial arbiter on how the Community competition rules should be applied.

Clearly, the Community Courts are engaged in what can be called "governance" of the Community, as they evidently have the ability to make "*collectively binding decisions*" for the Community.[44] Given this, do, and should, the Community Courts seek to obey the principle of coherence – and, in particular, the environmental-specific sustainability and integration principles – in carrying out their role of "judicial" governance? We will consider this question using theories of coherence of law and judicial reasoning, applying these to the Community courts and taking practical examples from the Courts' own case law.

From the theoretical perspective, the obvious starting point here is the (non-EU specific) theories of "coherence of law" developed most famously by the Ronald Dworkin. As is well-known, in work such as *Law's Empire*, Dworkin argued that coherence, or "integrity", in legal adjudication was crucially important. Thus he writes,

> *"The adjudicative principle of integrity instructs judges to identify legal rights and duties, so far as possible, on the assumption that they were all created by a single author – the community personified – expressing a coherent conception of justice and fairness."*[45]

Under this perspective, judgments should "fit" with a set of principles which are already implicit in the coherent whole of the legal system. Thus Dworkin uses the now-famous metaphor of the chain novel to explain the judge's role receiving past "chapters" of the law to date and creating new chapters, in particular in "hard cases" where the law does not provide a solution, or provides contradictory answers. In hard cases, Dworkin argues, judges do not have unfettered discretion to decide what the law is; rather, they interpret existing chapters on the basis of the law's coherent conception of justice and fairness. Thus, integrity (i.e., coherence) is in itself a virtue of a legal system, alongside justice and fairness, and procedural due process.[46] Drawing on this approach to judicial reasoning, Bengoetxea, MacCormick and Morel Soriano argue that, in order for a court's judgment to be accepted, it must be justified, and coherent, in two senses. First, it must show internal justification, meaning that the judgment is justified "in law" (i.e., the legal provision being applied is valid

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[44] Viz. Jachtenfuchs, note 2 above, at 246; see also the White Paper on European Governance's definition of governance as the "rules, processes and behaviour that affect the way in which powers are exercised at European level".

[45] Dworkin, *Law's Empire* (London, Fontana 1986), at 225. It is important to note that others, such as Raz, dispute Dworkin's vision of law as integrity on the ground (amongst others) that it ignores the reality of moral pluralism. Coherence should not be an instrument to eliminate all value conflicts; rather, it is a "*mere by-product of the consistent application of a sound moral doctrine*." Raz, "The Relevance of Coherence" in *Raz, Ethics in the Public Domain: Essays in the Morality of Law and Politics* (Oxford, Clarendon, 1994) at 299. This sound moral doctrine does not instruct the judge to take the morally best ruling, but rather to take the decision which does not undermine the "*authority of the law*". Raz argues that, as law emerges from the activities of authoritative institutions, it is, in part, determined by politics, meaning that there is no reason to expect it to be coherent.

[46] See Dworkin, at 225 and see further, Morel Soriano, "A Modest Notion of Coherence in Legal Reasoning. A Model for the European Court of Justice" 16(3) Ratio Juris. (2003) 296, at 303.

within the legal system at issue, and it is possible to interpret the provision in the manner adopted in the judgment). Secondly, it must show external justification, meaning that the judgment is justified not only in law, but also is,

> *"ethically, politically, or ideologically acceptable…To say that the judgment is justified from an external point of view is to make a claim as to rational acceptability - the decision has respected formal reasons or discourse reasons - or even a claim as to material or substantive rightness - the decision is the right answer, not only in law but also in political morality."*[47]

Coherence in judicial reasoning has a number of advantages. Clearly, coherence in the sense of internal justification is beneficial from a practical perspective, making the legal system workable in practice and increasing the predictability of judicial decisions, thus promoting legal certainty.[48] Going beyond this, coherence in the sense of internal and external justification increase the legitimacy of a court's judgments, a factor which is particularly crucial in the case of the ECJ, as a court outside the state judicial system.

Applying these theories of coherence of law and of legal adjudication to the ECJ context, there is a strong argument that, in handing down judgments, judges in the Community Courts ought to, and do, strive to maintain the overall coherence of the Community legal system, based on the values which they view as inherent in that system. Those values, it is submitted, certainly include the Article 2 EC goals of sustainable development and a high level of environmental protection. The presence of the Article 6 EC integration principle – which, as has been argued above, the ECJ treats as a general principle of Community law – merely confirms, therefore, the judges' (pre-existent) duty to interpret Community law, including competition law, bearing the Community's environmental law in mind.[49]

Moreover, this coherence-based argument itself fits with extra-judicial statements by judges from the Community Courts on what they perceive their role to be. In this way, it is argued, the realist's perspective and the governance perspective each arrive at the same conclusion. A good example is the observation of David Edward, formerly the UK judge at the ECJ, who, in defending the ECJ against the criticism of judicial activism, surmised that,

> *"the judge's role cannot be confined to that of providing an technocratic literal interpretation of texts produced by others…In a system based on case law, the judge must proceed from one case to another*

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[47] Bengoetxea, MacCormick and Morel Soriano, "Integration and Integrity in the Legal Reasoning of the European Court of Justice" in de Búrca and Weiler (eds.) *The European Court of Justice* (Oxford, Oxford University Press, 2001).

[48] Morel Soriano, note 46 above, at 298. Indeed, one might even refer to Bork here as (unintentionally) representing an antecedent of Dworkin, insofar as he argues that, in interpreting the Sherman Act, the Courts should presume that the legislature intended that the law should be coherent: "There must surely be a canon of statutory construction holding that, other things being equal, courts should attribute to the legislature a policy intent which, because of the scope and nature of a body of law, makes that law effective in achieving its goals, renders the law internally consistent, and makes for ease of judicial administration." See *The Antitrust Paradox: A Policy at War with Itself* (New York, Basic Books, 1978, 1993 reprint with new introduction and epilogue), at 69.

[49] Clearly, there is an overlap in the reasoning here and that of the "systematic" argument above, which posited that the overall scheme of the Treaty leads to the conclusion that competition policy cannot ignore environmental considerations. However, the coherence argument differs, in that (1) it is specific to judicial reasoning; and (2) it does not necessarily confine itself to interpreting the wording of the Treaty itself, but seeks to identify broader values or ethics underlying the European legal order as a factor in coherence.

seeking, as points come up for decisions, to make the legal system consistent, coherent, workable, and effective."[50]

Similarly, former Advocate General Jacobs has observed extra-judicially, in the context of the growth in importance of environmental protection requirements as a Treaty goal, that,

"Legal rules, and especially treaty provisions which of their nature are more difficult to amend, should be interpreted, as far as possible, as a living and evolving text that needs to be adapted to a changing context."[51]

Does this argument itself fit the reality of the Courts' judicial practice? In the present author's view, the answer must be yes. Outside the environmental area, the Community courts are well-known for their use of "teleological", purpose-based interpretation: i.e., drawing from (the Courts' view of) the overall purpose of the provision at issue, placed in the broader context of the Treaty.[52] More particularly, the ECJ has displayed a definite coherence-based approach in environment-related cases. While the competition-specific cases will be discussed in detail in later Chapters, an excellent non-competition illustration is the ECJ's approach to environmental factors in the law of free movement of goods, which has been discussed briefly in Chapter 2. As mentioned there,[53] the ECJ has, in certain cases, accepted environmental justifications for what arguably amounted to distinctly applicable Member State measures which restrict the free movement of goods contrary to Article 28 EC. This is despite the fact that, according to its own case law, the only acceptable justifications for distinctly applicable measures are those set out in Article 30 EC (where environmental protection, as such, does not feature). Leading examples are the *Walloon Waste*, *Dusseldorp*, *Aher-Waggon*, *PreussenElektra* and, more recently, *Inn Valley* judgments.[54] These judgments, it is submitted, go against the grain of the Court's usual firm approach to distinctly applicable national measures and demonstrate the Court's wish to adopt an approach to interpreting Articles 28 and 30 EC which is coherent with the environmental goals of the Treaty, thus retaining the integrity of Community law. Thus, former Advocate General Jacobs writes that the *Walloon Waste* judgment - in which the Court accepted as justified a prohibition on the storage or dumping in Wallonia of waste originating in another Member State, or in a region of Belgium other than Wallonia – indicated,

"the lengths to which the ECJ was prepared to go to save what it regarded as an environmentally friendly measure, contrasting starkly with its generally very strict approach to restrictions on trade."[55]

Another shining example is the *PreussenElektra* judgment, which concerned a German law (the *Stromeinspeisungsgesetz*) obliging electricity supply undertakings to purchase the electricity produced from renewable sources of energy in their area of supply at a fixed, above-market price. The Court held this (clearly distinctly applicable) measure to be justified, reasoning on the basis of (a) the aim of the law, which was "*useful for protecting the environment in so far as it*

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[50] Edward, "Judicial Activism: Myth or Reality?" in Campbell and Voyatzi (eds.) *Legal Reasoning and Judicial Interpretation of European Law* (London, Trenton Publishing 1996), 29, at 66.

[51] Jacobs, "The Role of the European Court of Justice in the Protection of the Environment" Journal of Environmental Law 18 (2006) 185.

[52] Examples of this approach are plentiful, including the Court's classic *effet utile* reasoning in the early, foundational, cases of Community constitutional law, such as Case 26/62 *Van Gend en Loos* [1963] ECR 1.

[53] See further, for example Ziegler, *Trade and Environmental Law in the European Community* (Oxford, Oxford University Press, 1996).

[54] Case C-379/98 *PreussenElektra* [2001] ECR I-2099, Case C-2/90 *Commission v Belgium* [1992] ECR I-4431, Case C-320/03 *Commission v Austria (Inn Valley)* [2005] ECR I-9871.

[55] Jacobs, note 51 above.

contributes to the reduction in emissions of greenhouse gases which are amongst the main causes of climate change which the European Community and its Member States have pledged to combat" – a "*priority objective*" of the Community and its Member States;[56] (b) the relevance of the Article 6 EC integration principle, which it noted had been transferred by the Treaty of Amsterdam from Article 130r(2) to Part One of the Treaty, headed Principles;[57] and (c) the special "*nature*" of electricity, whereby "*once it has been allowed into the transmission or distribution system, it is difficult to determine its origin and in particular the source of energy from which it was produced*."[58]

For present purposes, we are not concerned with the failure of the Court to be open about accepting environmental protection considerations as a justification for distinctly applicable measures - though this failure is disappointing, confusing and intellectually rather dishonest.[59] Rather, what is important is that this judgment represents, it is argued, another example of the Court's desire to achieve coherence in the Community legal system – and, more particularly, to give effect (as it does explicitly) to the Article 6 EC integration principle. Thus, Jacobs concludes that the Treaty's post-Amsterdam legal framework has led the ECJ to take special account of environmental concerns in the context of free movement of goods, meaning that it is effectively,

> "*ready to accept any consequential effects on trade, however, severe, that may be caused by measures relating to environmental protection, if those measures are shown to pursue a genuine environmental aim and to constitute effective means to achieve that aim*."[60]

It is important to recognise, however, that there are potential counter-arguments to adopting a coherence-based approach to judicial reasoning in the context of the Community courts' application of the competition rules. Let us take two examples.

First, from a theoretical perspective, the coherence-based view contrasts with the (at least formerly) popular theories, taken from certain liberal intergovernmentalist branches of European integration theory, which take a highly realist approach to the Community courts. Wincott, for instance, argues that the ECJ acts as a "*cipher, or at best a weathervane*"[61] of Member States' own wishes, making the Court a "*tightly constrained agent of the member states, lacking the autonomy to make decisive independent interventions*."[62] Though there may be a hint of truth in this argument in some difficult constitutional cases,[63] the present author would forcefully dispute this approach as a realistic explanation of the Community courts' action overall.[64]

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[56] *PreussenElektra*, note 54 above, at paras 73-74.
[57] *Ibid,* para 76.
[58] An argument which the Court had essentially rejected in Case C-213/96 *Outokumpu* [1998] ECR I-1777 on Article 90 EC.
[59] See the Opinion of Advocate General Jacobs in *PreussenElektra*, note 54 above, and the Opinion of Advocate General Geelhoed in the *Inn Valley* case, note 54 above.
[60] Jacobs, note 51 above.
[61] See Wincott, "A Community of Law? "European" Law and Judicial Politics: The Court of Justice and Beyond" 35(1) Government and Opposition (2002) 3, at 6.
[62] Wincott, *ibid,* at 7.
[63] In such cases, as Timmermans observes, "*the Court will inevitably have to take into consideration the possible reception of its decisions in Member States when ruling on an issue*." Timmermans, "The European Union's judicial system" 41 CML Rev (2004) 393.
[64] See similarly, Bengoetxea, MacCormick and Morel Soriano, "Integration and Integrity in the Legal Reasoning of the European Court of Justice" in de Búrca and Weiler (eds.) *The European Court of Justice* (Oxford, Oxford University Press, 2001), at 82.

Secondly, and more practically, the scope of the Community courts' job in applying competition law depends on whether the matter at issue is an appeal of a Commission decision or (as will increasingly, under Regulation 1/2003, occur) a question on preliminary reference. While the ECJ is relatively unconstrained in its reasoning in the latter case (though subject of course to the questions posed), the CFI's role is necessarily more limited when exercising its judicial review function, and the ECJ's role in hearing appeals from the CFI's judgments is also limited. While this is of course true, in the case of the CFI, it is notable that, in recent groundbreaking judgments such as *Tetra Laval*, it has chosen to apply a more intensive standard of review than previously, refraining from a simple application of the traditional "manifest error of assessment" standard often used in judicial review. In *Tetra Laval,* for instance, the CFI famously held that,

> *"[w]hilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission's interpretation of information of an economic nature."*[65]

Evidently, the greater the scope of judicial jurisdiction in a given case, the more potential there is for judges to adopt a coherence-based approach to judicial reasoning in that case.

Thirdly, it might be argued that the Court of First Instance, as the relevant Community court with jurisdiction over appeals, is a more technocratic court than the Court of Justice itself, and is relatively "insulated" from concerns of coherence due to the fact that, at least at present,[66] much of its case load is taken up with relatively limited areas of Community law, and in particular competition cases. From a realist's perspective, therefore, it may arguably be more likely to ignore environmental factors than the ECJ, who deals on a daily basis with the whole gamut of Community law fields, including environmental policy. Put otherwise, the argument would be that, as the CFI's judges have to deal with Community environmental law on a less regular basis than those of the ECJ and may thus be less familiar with it, as a practical matter achieving coherence between Community environmental and competition law may not be foremost in their mind when deciding competition cases. While, again, there may be some truth to this argument, it does not detract from the fact that, in principle, the notion of coherence in judicial reasoning, as well as the requirements to interpret the Treaty systematically and in accordance with sustainability and the Article 6 EC obligation, apply to the CFI in precisely the same way as they do to the ECJ. Put otherwise, though the CFI might arguably be more likely to ignore environmental considerations in competition cases than the ECJ, it ought not to do so.

5. Applying Governance Analysis to National Courts and National Administrative Competition Authorities

The third and final "layer" of Community competition law enforcement is enforcement by national courts and national competition authorities (NCAs). As is well-known, since the entry into force of Regulation 1/2003 modernising the enforcement of Community

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[65] Case T-80/02 *Tetra Laval* [2002] ECR II-4519, para 39. Thus, in merger cases, the burden is on the Commission to prove using "*convincing*" evidence that "*in all likelihood*" the merger will have anti-competitive effects. Though the Commission appealed this judgment partly on the ground that the CFI had raised the standards, the ECJ confirmed the approach of the CFI, suggesting that the economic analysis should be "*plausible*": Case C-13/03 P *Tetra Laval* [2005] ECR I-1113. See further, Bay and Calzado, "*Tetra Laval II*: The Coming of Age of the Judicial Review of Merger Decisions" 28(4) World Competition (2005) 433.

[66] This would probably change if the possibility provided for by the Treaty of Nice for the CFI to have competence to deal with some preliminary references were to be implemented.

competition law, national courts and NCAs have had full power to apply Articles 81 and 82 EC: in particular, the Commission's former monopoly over taking decisions applying Article 81(3) EC has been abolished.[67] It is submitted that many of the governance arguments set out above apply forcefully to NCAs and national courts, for the following reasons.

NCAs. Beginning with NCAs, the first point to note here is the wide variety of types of NCA designated by the Member States. An important distinction in this regard is that between "monist" and "dualist" models of NCA.[68] "Monist" models consist of integrated independent administrative NCAs, which have full powers to hear, decide and impose penalties, subject to review by national courts. Examples include the German *Bundeskartellamt*, the Italian *Autorità garante della concorrenza e del commercio*, the Greek *Epitropi antagonismou*, the Dutch *Nederlandse Mededingingsautoriteit*, the Portugues *Autoridade da concorrência* and the UK Office of Fair Trading. In contrast, "dualist" models of NCA consist of, on the one hand, a body in charge of investigations and, on the other, a body with decision-making power, which may be administrative or judicial. Most Member States (as well as the US) have this model, including Austria, Belgium, Finland, France, Ireland,[69] Spain and Sweden.[70]

It is clear that, in principle, all NCAs enforcing Community competition law are bound by the same Community norms requiring coherence between Community competition and environmental policies as any other Community institution. As such, the "good governance" limb of the argument applies, it is submitted, with the same force to NCAs applying Community competition law as it applies to the Commission. However, the realist's side of the governance argument may, it is admitted, differ in force depending on the NCA at issue. One might imagine that, save perhaps in cases such as Ireland where the ordinary courts are designated NCAs, NCAs may not be as familiar with (Community or national) environmental policy as, for example, some general national courts which may deal with environmental law on a relatively regular basis. Further, some (though not necessarily all) NCAs are, of course, highly sophisticated in their economic analysis and well-used to applying competition economics, and hence would - if so minded - be in a position to apply a purely scientific, efficiency-based approach. Nonetheless, and certainly in the absence of specific guidance from the Commission on the relevance of environmental factors to Community competition analysis, there is no reason to think that they would be naturally inclined to adopt a "hard line" efficiency-based approach excluding such relevance *per se*. Moreover, the fact that some national competition laws expressly allow for account to be taken of environmental or other non-economic factors may well, it is submitted, result in spill-over in their analytical approach to the application of Community competition law.[71]

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[67] See Articles 1, 5 and 6 of Regulation 1/2003 OJ 2003 L 1/1.

[68] See Komninos, "Article 234 EC and national competition authorities in the era of decentralisation" EL Rev 29(1) (2004) 106, at 108.

[69] In Ireland, unusually, competition cases are dealt with by the ordinary courts – there is no specialised competition court – though there is a dedicated High Court judge in charge of a separate competition list.

[70] Komninos, note 68 above, at 109.

[71] See, for example, the Spanish, German and Finnish systems, and WT/WGTCP/W/172 6 July 2001 WTO Working Group on the Interaction between Trade And Competition Policy - exceptions, exemptions and exclusions contained in Members' Competition Legislation, which contains a list of those members where general public interest exemptions may be granted by Ministers. See, Boute, "Environmental Protection and EC Anti-Trust Law: The Commission's Approach for Packaging Waste Management Systems" RECIEL 15(2) (2006) 146, who holds the view that, "*it is very likely and even desirable that national courts and competition authorities will deviate from the Commission's approach [to] Article 81(3) in order to integrate environmental protection as such in their*

Part III discusses some specific examples of NCA approaches under national law to environmental factors.

National courts. In the case of national courts, governance arguments are even stronger.

First, as with NCAs, when enforcing Community competition law, these are bound by the above-described Community norms requiring coherence between Community competition and environmental policies.[72]

Second, from a realist's perspective, a distinction should be made between national courts acting as NCAs, discussed above, and national courts acting within their general jurisdiction, applying directly effective Community competition law. In the former case, such courts may be well-used to economic, efficiency-based argument (though, as noted above, this does not necessarily mean that they would be minded to exclude environmental considerations). In the latter case, however, it is submitted that such courts would be disinclined to ignore apparently relevant environmental considerations in favour of a purely economic analysis in competition cases. Rather, they will seek to apply their normal (coherence-based) means of interpretation and judicial reasoning.[73] Moreover, the sheer variety of such courts, and their physical distance from the Commission, in itself unavoidably dilutes the impact of any shift towards an exclusively efficiency-based approach in DG Competition - even if (which is disputed in the next Chapter) the implications of this approach is that environmental concerns are irrelevant to competition analysis. Such a movement, therefore, is bound not to carry the same force in, for example, a courtroom in Finland, Poland or Greece as it might have on Rue Joseph II in Brussels.[74]

Finally, though it is undeniable that national judges are unlikely to be as familiar with the overall "scheme" of Community law as, for example, the judges of the Community courts, this does not, it is submitted, lessen the force of the governance argument here. Rather, most national courts will be well-used to balancing environmental factors with other norms in the context of their national legal systems. This is particularly so where, as is the case in many Member States, environmental protection features in the national constitution.[75] As a

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assessment of restrictive practices. This will inevitably lead to a Community-wide uncoordinated application of anti-trust law" (at 159).

[72] Viz. Article 10 EC.

[73] See, by analogy, the wave of concern at the time of Regulation 1/2003 that national courts, unused to using economic analysis, would have difficulty in applying Article 81(3) EC: see Lenearts and Gerard, "Decentralisation of EC Competition Law Enforcement: Judges in the Frontline" World Competition 27(3) (2004) 31.

[74] Note, however, that Regulation 1/2003 provides for a possibility for Commission to file *amicus* briefs and for the NCAs to ask the Commission's or an economist's opinion possible. See, Lenaerts and Gerard, *ibid.* Due to the small number of environment-related competition cases decided by national courts to date, however, it is too early to conduct any empirical analysis of the approaches taken. See, for the few environment-related judgment to date reported on DG Competition's website of national court judgments, the judgment of the *Oberlandesgericht* of Düsseldorf of March 16, 2005 on recycling services for used glass – confidential version only (34 0 (Kart) 54/03 [VI – U (Kart) 39/03]), and the judgment of the *Landgericht* of Potsdam of September 23, 2004 on recycling/disposal services for used tyres of cars and trucks (51 0 204/03).

[75] See, for example, the Opinion of AG Léger in Case C-227/02 *Wood Trading* [2004] ECR I-11957, who refers to Belgium, Greece, Spain, Finland and Hungary in this regard; as well as to the Charter for the Environment recently attached to the French Constitution, and the Opinion of AG Ruiz-Jarabo Colomer in Case C-176/03 *Commission* v *Council* [2005] ECR I-7879, who noted the emergence in national constitutional traditions of, "*a right to enjoy an acceptable environment, not so much on the part of the individual as such, but as a member of a group, in which the individual shares common social interests*" (at para 53). He refers to Article 20a of the German Basic Law, Article

result, it is argued, the coherence arguments set out above in principle apply with equal force to national courts' reasoning as to that of the Community courts.[76]

45 of the Spanish Constitution, Article 66(1) of the Portuguese Constitution, Article 18(3) of Chapter II of the Swedish Law of 24 November 1994, Article 20 of the Finnish Charter of Government, Article 24(1) of the Greek constitution, and Article 21 of the Dutch constitution.

[76] The weight which different national courts might assign to environmental factors and competition factors will, of course, differ. This problem applies, however, to all aspects of Articles 81 and 82 EC, and is an unavoidable consequence of decentralisation of enforcement.

Chapter 8: Theoretical Perspectives III - An Economic Argument

The final argument to examine, in asking whether environmental considerations should be excluded from Community competition policy, is a microeconomic one. While the previous arguments have presumed (as is standard practice) that environmental considerations constitute "non-economic" factors, this section investigates the possibility of taking environmental considerations into account in the economic calculus of competition decisions, i.e., the possibility of achieving Article 6 EC integration within the framework of competition economics. It will conclude, after looking at the limits of the welfare concept and drawing on the theories and techniques of environmental and ecological economics, that - at least in some cases - this seems to be a real possibility. The implications of this conclusion, it is submitted, are that the current drive towards a more "economic approach" at the Commission should not necessarily mean the exclusion of environmental factors.

The section does not purport to engage in complex economic modelling, which would go beyond the scope of the present research; rather, its aims are far more modest: it seeks to apply some of the rich and multifarious literature on environmental economics in the context of Community competition policy. It is structured in five parts. First, it recalls the role traditionally attributed to the environment in neo-classical welfare economics; second, it looks at the limits of the concept of welfare (or "utility") as a goal of competition policy under standard neo-classical analysis; third, it examines the possibility of taking environmental considerations into account in measuring utility using the approach of environmental economics, and in particular the techniques of valuing environmental resources developed within that discipline; fourth, it examines the potential implications of the approach of a further economic discipline, ecological economics; finally, it asks whether these economic techniques can, and should, be applied in the context of Community competition policy.

1. Environment, the Market and the Concept of Externalities

Let us turn first to introduce the role which economics has traditionally given to the natural environment. A key element in examining this role is the notion of "environmental services", in the sense of the services provided by the environment to the economy.

a. The concept of environmental services

Our starting point here is that the environment and the economy are interdependent: economic activity takes place within the environment. It is clear, without delving too deeply into natural science, that the environment provides us, and our economy, with certain services. These services can be divided into four categories:[1]

- Providing inputs to production in the economy. Here, there is an important distinction between "stock" resources, where today's use has implications for tomorrow's availability (e.g., plant and animal populations and mineral deposits),[2] and "flow" resources, where this is not the case (e.g., solar radiation and wind and tide power). "Stock" resources may in turn be broken down into renewable and non-renewable resources;
- Acting as a receptacle or "sink" for the waste generated by the economy;

[1] Perman, Ma, McGilvray and Common, *Natural Resources and Environmental Economics* (3rd ed., Essex, Pearson Education Limited, 2003), at 18.
[2] Perman et al, *ibid,* at 11.

- Acting as an amenity service base, such as swimming at a beach, or viewing wild flora and fauna;
- Acting as a "life support" for humans, e.g., providing breathable air, a temperature in which we can survive, a certain amount of water, etc.

In the EU context, a 2007 report commissioned by DG Environment adopted a slightly different perspective, looking instead directly at the contributions the environment makes to the EU economy. It concluded that there were three main types of contribution:

(1) Activities where the environment is a primary natural resource or input into the economic process (agriculture, forestry, mining, electricity generation and water supply);

(2) Activities concerned with protection and management of the environment (waste recycling, pollution & sewage control and environmental management); and

(3) Activities dependent on environmental quality (environment related tourism).

The report concluded that, based on a definition of core environmental resources, environmental protection and management and environmental quality, the total turnover in the European economy which was linked to the environment was €405 billion along with 4.4 million jobs. On a broader definition of environmental resources - including, for example, environment-dependent areas such as agriculture - total direct turnover would be €3 trillion and 21 million direct jobs. In addition, the report concluded that broader links, such as biodiversity and ecosystem services, could not be measured statistically.[3]

b. The approach of classical economics to the environment[4]

Early classical economists, such as Adam Smith, envisaged an abundance of natural resources. As is well-known, Smith emphasised a deep-rooted belief in the efficacy of the market mechanism - the famous "invisible hand"[5] - as a fundamental organising principle of modern economics. This premise was built upon by Thomas Malthus, though Malthus believed that natural resources - and in particular land - were limited in availability and constituted important limits on economic growth. In Malthus's view, the fact that only a limited quantity of land was available meant that, ultimately, economic growth would stop and the economy would reach a stationary state - which, in his view, would be at a rather bleak subsistence level.[6] Though the approach was nuanced by David Ricardo, he agreed with the Malthusian conclusion that development would converge to a stationary or "steady" state, determined by the availability and use of land, on the basis that returns to land input would be diminishing.[7] John Stuart Mill added the

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[3] See "Links between the Environment, the Economy and Jobs", report of November 2007, available at http://ec.europa.eu/environment. On a global scale, in an article published in Nature in 1997, Costanza estimated the aggregate value of ecosystem services to total $16-54 trillion per year - whereas global Gross National Product was $18 trillion per year. See "The Value of the Word's Ecosystem Services and Natural Capital" 387 Nature 253 (1997).

[4] See further, Perman et al, note 1 above, ch. 1, and Kula, *A History of Environmental Economic thought* (London, Routledge, 1998).

[5] Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London, Methuen, 1776), Book IV, Ch. 2, at 477.

[6] See, for example, Malthus, *Essay on the Principle of Population* (London, Ward Lock, 1798).

[7] Ricardo, *Principles of Political Economy and Taxation* (London, Everyman, 1817, reprinted 1926), Book IV.

final "layer" to the approach of classical economics in this regard, by viewing the value of land not simply in terms of its agricultural and extractive uses, but also as a source of amenity values (e.g., the intrinsic beauty of the countryside). Mill writes, in an excerpt remarkably prescient of the modern conservation movement,

> *"There is room in the world, no doubt, and even in old countries, for a great increase in population, supposing the arts of life to go on improving, and capital to increase. But even if innocuous, I confess I see very little reason for desiring it…If the earth must lose that great portion of its pleasantness which it owes to things that the unlimited increase of wealth and population would extirpate from it, for the mere purpose of enabling it to support a larger, but not a happier or better population, I sincerely hope, for the sake of posterity, that they will be content to be stationary long before necessity compels them to it."*[8]

c. The approach of neo-classical economics to the environment and the concept of externalities[9]

With the movement in the 1870s to what has since come to be known as "neoclassical" economics, a new conception of value was adopted: value was determined in exchange, thus reflecting preferences and costs of production. As such, neo-classical economics was, at least initially, not concerned with the aggregate level of economic activity as had been the case with classical economic theory - i.e., the question whether or not there were "limits to growth" resulting from natural resources. Instead, neo-classical economics was more concerned with the structure of economic activity and its allocative efficiency.

It was Marshall who first came up with the notion of "externalities" as we know them in modern economics. Externalities can generally be defined as situations of market failure where the production or consumption decisions of one agent has an impact on another's utility, but no compensation is given for this. One of the most important "negative" externalities - where this impact takes the form of a decrease in utility - is, of course, environmental damage. In Marshall's analysis, externalities were left unpriced, as they were uncompensated. Later, as we saw in Chapter 3, Pigou added to this analysis by proposing that the state should take an interventionist stance to externalities such as environmental damage, by using taxation to "internalise" the externality into the price mechanism.[10] This was followed by the Coasian approach of market environmentalism based on property rights, which rejected taxation as a "solution" to externalities in favour of having well-defined property rights, so that individuals would negotiate payment which would induce those generating externalities to adjust their behaviour. Thus, for example, the solution to the externality of straying cattle which destroy crops growing on neighbouring land is to make the cattle owner liable for damage caused. This, Coase argued, was the socially optimal way of internalising (certain) externalities, as it avoided the problem that the state did not know what the optimal level of tax should be.[11]

"Environmental" economics may be defined as the study of problems caused by environmental externalities, and ways to remedy such market failure within the neo-classical economic model.[12] This is to be differentiated from "ecological" economics, which is concerned more broadly with the interdependence between the economic and

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[8] Mill, *Principles of Political Economy* (6th ed., New York, Augustus M. Kelly, 1865).

[9] See generally, Perman *et al*, note 1 above, and Kula, note 4 above.

[10] See further, Baumol and Oates, *The Theory of Environmental Policy: Externalities, Public Outlays and the Quality of Life* (2nd ed., Englewood Cliffs, NJ, Prentice-Hall 1988).

[11] Coase recognised, however, that the property rights approach works best where market transactions are costless.

[12] See, for example, Oates: "From Research to Policy: The Case of Environmental Economics" University of Illinois Law Review (2000) 135.

natural systems, and which rejects many of the axioms of neo-classical economics. The implications of each of these disciplines will be examined below.

2. The Concept of Consumer Welfare and its Limits

As we concluded in Chapter 5, an important goal of Community competition policy is maximising consumer welfare. To recap, consumer welfare was defined in terms of economic efficiency, with three dimensions to such efficiency, each present in the idyllic conditions of "perfect competition":

- Allocative efficiency where, in conditions of perfect competition, consumers can obtain the goods or services they need[13] at the price which they are willing to pay, meaning that resources are allocated exactly according to their wishes;
- Productive efficiency where, in conditions of perfect competition, goods and services are produced at the lowest cost possible, meaning that as little of society's resources are used as possible in the production process.
- Dynamic efficiency, which, moving away from the static perspective, takes into account the benefits of innovative activities which lead to new markets and new industries.

Consumer welfare is at its greatest when society's economic resources are allocated so that consumers are able to satisfy their wants "*as fully as technological constraints permit.*"[14] As we saw, in neo-classical economic theory, consumer welfare is generally indicated by the amount of "consumer surplus", that is, the aggregate measure of the surplus of all consumers, indicated by the difference between the consumer's valuation of the good considered (or his willingness to pay for it) and the actual price.[15] This "use-value" concept of consumer surplus, takes account of the price and quality of the good. Other factors relevant to consumer welfare include the amount of consumer choice in the market, and the amount of innovation in the market.[16] We also concluded that, though there is no definite consensus on the relevance of producer surplus in Community competition policy, the most widely-held view is that, in the Community context, consumer surplus is valued above producer surplus in this regard.

In practice, however, markets rarely, if ever, attain conditions of perfect competition, meaning that consumer welfare is not maximised. This occurs when a market is not operating efficiently in its allocative, productive and dynamic dimensions, resulting in the "deadweight loss" to society of consumer (and producer) surplus.[17] While this may occur for many reasons, including barriers to entry, information failures, or inefficient taxes, the reason which concerns us particularly in the present context is the presence of negative externalities, such as environmental damage.

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[13] "Allocation" of goods thus covers what goods are produced, in what quantities, which combinations of resource inputs, how outputs of goods are distributed, etc: see Perman *et al*, note 1 above.

[14] Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York, Basic Books, 1978, 1993 reprint with new introduction and epilogue), at 429.

[15] Hildebrand, *The Role of Economic Analysis in the EC Competition Rules* (2nd ed., The Hague, Kluwer, 2002). Consumer surplus is often measured by economists using a demand curve. See further, Willig, "Consumer Surplus without Apology" 66 American Economic Review (1976) 589; Stennek, "The expected consumer's surplus as a welfare measure" 73(2) Journal of Public Economics (1999) 265; and Schlee, "Expected consumer's surplus as an approximate welfare measure" 34 Economic Theory (2008) 127.

[16] See further, Lindsay, *The EC Merger Regulation: Substantive Issues* (London, Sweet & Maxwell 2006), at 1-003.

[17] See Carlton and Perloff, *Modern Industrial Organisation* (4th ed., Essex, Addison Wesley, 2004).

In principle, then, it is important to distinguish between two ways in which environmental considerations might be taken into account in evaluating whether consumer welfare - or "utility" - is maximised by a transaction or arrangement under review for compliance with Community competition law. First, it might be possible to value environmental benefits and take these into account in the evaluation of the likely effect of the transaction. Secondly, it might be possible to value environmental harm and take this into account in this evaluation.

How might this be done? This requires us to look more closely at the measurement of consumer welfare, and in particular consumer (and producer) surplus. Let us take, as our starting point the static, use-value definition of consumer surplus as the difference between the consumer's valuation of the good considered - normally measured by his willingness to pay for it - and the actual price. Using environmental economics techniques, it may be possible to incorporate the environmental benefits or detriments (which we will term the good's environmental "performance") into estimating the consumer's valuation of what he or she would be willing to pay for the good following a post-transaction change in environmental performance. Hence, an increase in the consumer's valuation or willingness-to-pay - through better environmental performance of the product - may mean that, even if actual prices increase slightly, consumer surplus nonetheless increases overall. Using the neo-classical terminology of rational choice theory, a consumer's expected utility preferences may be maximised by a situation where a product's environmental performance is higher.[18] This would occur, for example, if the value of the continued presence of essential environmental resources in the future were incorporated in the individual's utility function on an intertemporal analysis.[19]

In the context of integrating environmental considerations into Community competition law, however, this approach should, however, be limited in an important sense. As argued in Chapter 6, the limits of the integration obligation are reached where a transaction would lead to environmental damage but is not otherwise anti-competitive (i.e., does not otherwise decrease consumer welfare). For Community competition law to prohibit an activity in this situation would go beyond the scope of the competition laws as defined by the wording of the Treaty, which refers to the prohibition of practices which "restrict competition". Moreover, it would create a situation of unacceptable uncertainty. In practical terms, this means that, using an economic integration approach, Community competition enforcers should take into account: (1) post-transaction additions to or conservation of environmental resources (i.e., environmental benefits); and (2) post-transaction damage to the environment, but the latter only when competition is in any event restricted.[20]

In addition to this static use-value perspective to consumer welfare, it may also be possible to take environmental considerations into account in considering the dynamic

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[18] See, for example, Frank, *Microeconomics and Behaviour* (6th ed., New York, McGraw-Hill/Irwin, 2006), chapter 3 and at 78. Similarly, a decrease in a consumer's willingness-to-pay, where the environmental performance of a good decreases, might mean a decrease in consumer surplus, even where actual prices remain the same or fall.

[19] An alternative way of incorporating environmental performance in the utility function might be on the basis that a consumer's willingness-to-pay for an environmentally superior product might be greater if increased environmental awareness means that the consumer gains less pleasure from consuming a good where environmentally-friendlier substitutes are available. However, this seems a weaker position, as price remains a major factor in utility. For a model based on this hypothesis, see Conrad, "Price Competition and Product Differentiation When Consumers Care for the Environment" 31(1) Environmental and Resource Economics (2005) 1.

[20] In effect, this means that, in such cases, the damage to the environment will have little effect on the enforcer's decisions in the second category of case.

efficiency perspective. This is a narrower point, but may also be relevant depending on the competitive issue at hand: many environmentally-friendly products may be seen as "creating" markets, as the product of innovation, and as introducing another dimension of competition.[21] The potential of market creation in the EU context is illustrated by a 2002 report commissioned for DG Environment, which analysed the EU's "eco-industries" - defined as "activities which produce goods and services to measure, prevent, limit, minimise or correct environmental damage to water, air and soil" - as supplying (in 1999 values) € 183 bn of goods and services a year. As it is undisputed[22] that any dynamic efficiency benefits may be taken into account in environment-related cases, just as in other cases, dynamic efficiency will not be considered further in this section.

3. Measuring Consumer Surplus: An Environmental Economics Approach

How, then, might we measure consumers' own valuation of a product, or their willingness-to-pay, so as to take environmental performance into account? To answer this question, we can draw on the findings of environmental economists, who have tried to value environmental resources as a means of internalising environmental externalities.

At the outset, it must be recognised that environmental valuation is a very rapidly developing field, and a rather controversial one. This is so in two senses. First, environmental economists may disagree as to the best way of valuing the environment - which technique should best be used; and the ultimate figure arrived at. The second aspect to the controversy over environmental valuation is that some "deeper green" economists and non-economists reject the notion of putting prices on environmental resources at all, as this implies commensurability of natural and other capital. This view, consistent with the "strong sustainability" viewpoint discussed in Chapter 2, is the view taken by many ecological economists.

a. The approach of Cost-Benefit Analysis

Environmental economists have, since the 1970s, developed a number of methods of environmental valuation. These were originally developed for use in "cost benefit analysis" (CBA), so as to enable decisions to be taken, for example, on whether to go ahead with projects or legislation. CBA is inherently based on neo-classical welfare economics, as it is aimed at identifying "Potential Pareto Improvements" from projects (i.e., Kaldor-Hicks improvements).[23] In this context, environmental valuation is essentially premised on the "commodification" of the services provided by the environment, considered above, and their insertion into the utility and production functions of consumers and firms, respectively.[24]

Taking the cost of environmental benefits and damage into account, therefore, enables correction for market failure, resulting in what is termed an "environmental CBA (or

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[21] See further, Porter and Van der Linde 1995;and Alves, "La Protection intégrée de l'environnement en droit communautaire", Revue juridique de l'environnement, 2/2003 p. 1 ("*L'environnement n'est-il pas devenue "une nouvelle donne économique*"?).

[22] At least in the post-Chicago era: as considered in Chapter 5, the focus of the Chicago School approach was, at least originally, on static, rather than dynamic, efficiency.

[23] As already discussed, the Kaldor-Hicks criterion holds that, if the magnitude of the gains from moving from one state of the economy to another is greater than the magnitude of the losses, then social welfare is increased by making the move even if no actual compensation is made to the "losers". See further, Gowdy, "The revolution in welfare economics and its implications for environmental valuation and policy" 80(2) Land Economics (2004) 239, and Stavins, Wagner, and Wagner, cited in Gowdy, "[the Kaldor-Hicks criterion] is the fundamental foundation -- the normative justification -- for employing benefit-costs analysis, that is, for searching for policies that maximize the positive differences between benefits and costs."

[24] See Perman *et al* , note 1, at 400.

ECBA). In the first place, this requires measurement of the "environmental cost" (EC) of a project. This is often done by looking at the environmental benefits arising from not going ahead with a project. Four types of benefit may be identified:

(1) The "use value" of the service, arising from the actual or planned use of the service by an individual (e.g., for recreation);

(2) The "existence value" of the service, arising from knowing that the service exists and will continue to do so, even though the individual is not likely ever to use it;

(3) The "option value" of the service, arising from willingness of the individual to pay in order to guarantee that the service will be available for future use to him or her; and

(4) The "quasi-option value" of the service, arising from the individual's willingness to pay to avoid an irreversible commitment to development now, due to his or her expectation that, in the future, we will have greater knowledge of the implications of such development.[25]

The final three benefits are often called the "non use value" of the environmental service. An ECBA approach to the question whether a project should go ahead entails:[26]

- measuring the costs and benefits of the project, including the environmental costs and benefits. This is normally done on a net present value (NPV) basis, meaning that future costs and benefits are discounted;
- Where there is risk or uncertainty as to a cost or benefit actually transpiring, factoring this in. The difficulties inherent in risk and discounting are discussed further below.

b. Techniques of environmental valuation[27]

Following an environmental economics approach, valuing these benefits can be achieved by using techniques of "non-market valuation", which essentially try to ascertain what affected individuals collectively would be willing to pay if there were markets for environmental services.[28] There are two main approaches to estimating the monetary value of environmental damage for individuals.[29]

The first approach is indirect, which entails arriving at estimations from the observed behaviour of individuals in the context of commodities where, in contrast to environmental services, markets do exist.[30] Thus, if an improvement in water quality was followed by an increase in demand for fishing licences, one might try to use the observed increase in demand for licenses to put a value on the change in water quality.[31] One example of this method is the "travel cost method" (TCM), which attempts to measure the value placed by visitors on an amenity by the cost they incurred in travelling to get there. A further example might be observing the increase in the price of a house due to

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[25] Perman *et al*, *ibid,* at 402.
[26] Ackerman and Heinzerling, *Priceless: On Knowing the Price of Everything and the Value of Nothing* (New York, the New Press, 2004).
[27] See further, Perman *et al*, note 1 above and Gowdy, note 23 above.
[28] See Perman *et al*, note 1 above, at 373.
[29] Perman *et al*, *ibid,* at 402.
[30] See further, on the detailed economic techniques used to infer the monetary value of a change in the price, quality or quantity of a given environmental service, Perman *et al*, *ibid,* 403-409.
[31] See Perman *et al*, *ibid,* at 409.

its proximity to a beach. Environmental economists generally accept that such techniques can only be used to estimate the "use value" of environmental services.

The second approach of non-market valuation entails asking individuals questions directly about the affected environmental services. This approach can be used to estimate use and non-use values. An example of this method is the "contingent valuation method" (CVM), which involves asking a sample of the relevant population questions about what they would be willing to pay or give up to keep an environmental service, thus creating a surrogate or "shadow" price for the resource. This may be done on an existence value or option value basis.[32] While these techniques are more developed in the US, they are now increasingly being used in the EU, including in particular in Scandinavian countries. They have also been used by the Dutch, UK and German governments in making policy decisions.[33] Thus, Bonnieux and Rainelli give the example of the natural amenity value for visitors or potential visitors to the UK's Yorkshire Dales National Park being measured, via CVM techniques, on average at £24 per annum.[34] A further potential use of CVM techniques is in the difficult issue of valuing biodiversity, though this has not been hugely successful to date.

Such environmental valuation techniques are now beginning to become widespread and more accurate. Things have moved on since the Economist magazine wrote back in 1994 that,

> *"[i]f the environment is one of the world's bloodiest political battlefields, economics provides many of the weapons. Environmental lawsuits and regulatory debates would be starved of ammunition if economists did not lob their damage estimates into the fray. The trouble with these number wars is that the estimate's accuracy is often more akin to that of second-world-war bombers than precision guided missiles."*[35]

Just over ten years later, the same magazine reported a huge improvement in environmental valuation techniques, including a growing phenomenon of environmental entries appearing on firms' balance sheets,[36] putting cash values on environmental, ecosystem and ecological services.[37]

c. Difficulties with the approach: the intertemporal perspective and the problem of uncertainty

Prior to drawing any conclusions on the applicability of environmental valuation techniques in measuring consumer surplus for Community competition decisions, it is important to note the difficulties with the approach.

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[32] See Bonnieux and Rainelli, "Contingent Valuation Methodology and the EU Institutional Framework" and, on option value, see Sunstein, "Two Conceptions of Irreversible Environmental Harm", Chicago, John M. Olin Law & Economics Working Paper No. 407 of May 2008.

[33] *Ibid.* The Netherlands was the first country to use CV techniques in 1973, followed by the UK under Conservatives and Germany.

[34] Citing Willis and Garrod 1991 "Landscape Values: A Continent Valuation Approach and Case Study of the Yorkshire Dales National Park", ESRC Countryside Change Initiative, Working Paper 21, University of Newcastle upon Tyne.

[35] The Economist, December 3, 1994, at 106, quoted in Perman *et al*, note 1 above, at 399.

[36] The Economist, April 23rd 2005: "Are you being served?". This is also a phenomenon at macro-economic level. For example, in 2005, the World Bank published a report arguing that current measures of a country's economic welfare, such as gross national product, are inadequate as they ignore the value of a country's natural assets. See the Economist, "Greening the books", September 17, 2005

[37] This phenomenon, discussed in Chapter 4, is helped by informational improvements such as the publication by the World Bank every year of a book entitled the "Little Green Data Book", which acts as a benchmark in green accounting.

The most obvious difficulty is that of risk and uncertainty.[38] It is hard to estimate what a consumer would be willing to pay for an environmentally-friendlier product if the potential cost to the consumer of depleted natural resources from a more damaging product is unknown. Yet, this is often precisely the case in environmental matters. In particular, it is often unknown whether any given environmental damage is irreversible, or the point at which it becomes irreversible. For example, though one recent high-level report has estimated the global cost of biodiversity destruction at €2 trillion per year,[39] many economists hold the view that eco-system benefits and biodiversity cannot, at present, be valued to any degree of accuracy. This is due mainly to uncertainty difficulties; for example, removing or adding one species to an eco-system may affect other species and the overall integrity of the system in ways which cannot be predicted.[40]

To deal with this problem, environmental economists such as Weisbrod developed the benefit measures, to which reference was made above, of "option value" - the willingness of the individual to pay in order to guarantee that an environmental service will be available for future use to him or her - and "quasi-option value" - the individual's willingness to pay to avoid potentially irreversible commitments to development now. This branch of environmental economics is complex, using game theoretic approaches - "games against nature" - to try and predict which decisions consumers (or states) will make in situations of uncertainty.[41] However, some environmental economists have concluded that the best way to deal with such uncertainty is to adopt a "safe minimum standard of conservation" (SMS) of the environment, an extremely conservative rule whereby current gains, however large, are foregone in order to avoid future losses of an unknown, but presumed very large, size.[42] An alternative, and less conservative, standard, is a modified SMS whereby current gains are foregone in order to avoid future losses of an unknown, but presumed very large, size, unless this entails unacceptably large costs.[43]

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[38] See the distinction made by Knight in *Risk, Uncertainty and Profit* (New York, Houghton Mifflin, 1921), defining risky situations as those where the possible consequences of a decision can be completely enumerated and probabilities assigned to each possibility; and uncertain situations as those where the possible consequences of a decision can (or, in the case of "radical" uncertainty, cannot) be fully enumerated, but where the decision maker cannot assign probabilities. See further, Perman *et al*, note 1 above, at 445, Jensen, "Innovation, adoption and welfare under uncertainty" 40(2) Journal of Industrial Economics (1992) 173, and Lange, "A note on decisions under uncertainty: The impact of the choice of the welfare measure" 51(1) Theory and Decision (2001) 51.

[39] See the interim report on "The Economics of Ecosystems and Biodiversity", May 2008, commissioned by the EU and the German federal government by Mr Pavan Sukhdev of Deutsche Bank and presented to the Bonn meeting of the UN Convention on Biological Diversity, available at http://ec.europa.eu/environment/nature/biodiversity/economics/index_en.htm.

[40] See, for example, Dore and Webb, "Valuing Biodiversity: Reality or Mirage?" 86(1-2) Environmental Monitoring and Assessment (2003) 91 and the 2007 report prepared for the Commission, "Links between the Environment, the Economy and Jobs", report of November 2007, available at http://ec.europa.eu/environment.

[41] Thus, four possible decision rules in "games against nature" for the government are (a) the maximin rule, where government selects the strategy which maximises the minimum possible outcome (the "least-bad worst outcome", i.e., making the worst outcome as good as it can be); (b) the maximax rule, where government selects the strategy with the best of the best outcomes; (c) the minimax regret rule, where government chooses the strategy with the least amount of regret in case of failure; and (d) the assignment of subject probabilities by the government, which then adopts the strategy with the pay-off of the greatest value. See Perman *et al*, note 1 above, at 460-461 and Lange, "A note on decisions under uncertainty: The impact of the choice of the welfare measure" 51(1) Theory and Decision (2001) 51.

[42] Perman *et al*, note 1 above, at 462.

[43] *Ibid.* These standards bear similarities to the precautionary principle familiar to us from Community environmental policy.

A further difficulty in placing a value on future environmental damage, or benefits, is the necessity - according to some economists - of discounting utility that will (or might) only occur in the future. This requires the adoption of an intertemporal approach to efficiency in allocation, and is necessary, it is argued, because individuals as consumers are observed to require an incentive (e.g., the payment of interest) to postpone consumption - and hence utility (e.g., by saving).[44]

As with environmental valuation under uncertainty, discounting is a complex and controversial area, detailed discussion of which lies outside the scope of the present research.[45] The importance of making these points for present purposes lies in the difficulties they could raise for competition enforcers trying to estimate consumer surplus using the techniques of environmental economics. It is clear that such difficulties have significant implications for the administrability of any approach based on integrating environmental concerns into competition policy. More ecological economic approaches, however, deny the necessity to discount future utility of the environment in this way, distinguishing between the individual as consumer and the individual as citizen, and concluding that, as citizens, individuals may not wish to discount the future, given a commitment to future generations.[46]

A final difficulty with the above environmental valuation techniques is more general: the rejection of such techniques in sum or in part by economists who argue that some environmental resources are, quite simply, priceless.[47] The approach of ecological economics, which we turn briefly to look at now, is one such example.

4. Going Further? An Ecological Economics Approach

Since the 1980s, an additional branch of economics has emerged which rejects many of the tenets of neo-classical welfare economics, in favour of an approach based on the premise of interdependency between the natural and economic worlds - viewing the human economy as "*both a social system, and as one constrained by the biophysical world*".[48] This branch has come to be termed ecological economics, and has been fêted by its supporters as a veritable "*revolution*" in welfare economics:[49]

> *"…of all the conventional and heterodox schools of economic thought, ecological economics is the only one poised to address the problems of human survival in the coming centuries."*[50]

Ecological economics takes issue with the neo-classical assumption of self-interested, exogenous preferences, and in particular: (1) the theory of human behaviour embodied in the axioms of rational consumer choice and the individual as a selfish price-taker (*homo economicus*), with its goal of efficiency in utility maximisation in a Pareto-optimal

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44 Perman *et al*, *ibid,* at 68.

45 See Perman *et al*, *ibid,* at 67 onwards.

46 See the arguments of Sen, discussed under ecological economics below.

47 Ackerman and Heinzerling, *Priceless: On Knowing the Price of Everything and the Value of Nothing* (New York, the New Press, 2004).

48 Gowdy and Erickson, "The approach of ecological economics" Cambridge Journal of Economics 29 (2005) 207. The first issue of the publication Ecological Economics appeared in 1989. See further, Mayumi, "Reformulating the foundations of consumer choice theory and environmental valuation" 39 Ecological Economics (2001) 223, Costanza (ed.), *Ecological Economics: The Science and Management of Sustainability* (Columbia University Press, New York, 1991).

49 See Gowdy, "The revolution in welfare economics and its implications for environmental valuation and policy" 80(2) Land Economics (2004) 239.

50 Gowdy and Erickson, note 48 above.

equilibrium;[51] and (2) the theory of production based on the model of perfect competition, with its concomitant assumptions of firms' behaviour. These premises, ecological economists argue, are outdated, and should be replaced by modern behavioural models.[52] In particular, models of consumer choice should not be limited to choices in the market place, as this fails accurately to characterise human preferences.

Indeed, the model of a rational actor making decisions without a social or environmental context is itself disputed. Thus, many preferences for environmental features may be termed "lexicographic" - not subject to trade-offs at all.[53] Many ecological economists, drawing on the analysis of Amaryta Sen, rely on what Sen terms the "*fundamental dualism of persons*" in distinguishing between man acting as a consumer and as a citizen.[54] In this analysis, sympathy may be reflected in an individual's utility function: my utility may increase if a change improves another's lot. Further, using the concept of "commitment" - concern for others based on ethical principles - to the extent that I am committed to other(s), I may approve of a change though it reduces my own utility.[55] In this way, it is suggested, individuals may have multiple - and possibly conflicting - preference orderings, rather than just one.[56]

Moreover, ecological economists reject the very goal of achieving allocative efficiency in the marketplace. In particular, they argue that citizens often wish to achieve more than simply reaching the "optimal" level of pollution.[57] Indeed, they dispute the selection of allocative efficiency as a goal as based, in essence, on a value judgment rather than on any objective scientific justification.[58] In this respect, ecological economics rejects the approach of environmental economics, insofar as the latter focuses on valuing price externalities in the context of the neo-classical economic model (i.e., assigning a value to environmental resources in market exchange).[59] Similarly, ecological economists reject

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[51] See Stigler and Becker, "De Gustibus Non Est Disputandum" *The American Economic Review*, Vol. 67, No. 2 (Mar., 1977), 76. In terms of the axioms of consumer choice theory, ecological economics rejects the notion that tastes are not a matter of dispute.

[52] See Gowdy and Erickson, note 48 above, who argue that, "*Neoclassical theorists have by and large abandoned economic man and perfect competition; however, the policy recommendations of economists are still based on these outdated representations of human behaviour and commodity production…In new game theoretic and behavioural models of consumer behaviour Homo economicus is being out-competed by other special of economic actors…Likewise, the neoclassical theory of the firm as independent of historical time, space and the behaviour of other firms is being replaced by more realistic models…The heart of the neoclassical theory of the firm, profit maximisation, has failed the predictability test and is being replaced by more sophisticated models of cooperation and altruism.*"

[53] See Costanza, note 48 above.

[54] See further, Sen, *On Ethics and Economics* (Oxford, Blackwell, 1987) and Nyborg, "Homo Economicus and Homo Politicus: Interpretation and aggregation of environmental values" 42(3) Journal of Economic Behavior & Organization (2000) 305.

[55] See Perman *et al*, note 1 above.

[56] See Nyborg, note 54 above, "*This distinction between consumers and citizens seems to suggest that every individual may have two distinct and possibly conflicting preference orderings over social states, one associated with each role…*"

[57] See Verchick, "Feathers or Gold? A Civic Economics for Environmental Law" 25 Harv. Envtl. L. Rev. 95 (1995) at 117, who writes that, *"[w]hile acknowledging our use of nature's services, many citizens aspire to more than reaching the "optimal" level of pollution, or viewing nature as, to use Martin Heidegger's phrase, one "vast gasoline station." But the principle of economic efficiency will accept nothing less.*"

[58] See further, Gowdy and Erickson, note 48 above, at 217.

[59] Taking the example of climate change, neo-classical economics would hold that using society's scarce resources to moderate climate change would only be justified if this were to result in an increase in economic output overall and in the long run (after discounting for the valuing of a stable climate in the future), resulting in a Potential Pareto Improvement. From an ecological economist's perspective, however, this overriding focus on efficiency improvement is too simplistic, as it fails to take broader, ethical considerations into account.

the neo-classical assumption that future utility from environmental resources should be discounted.[60] In so doing, they rely on the precautionary principle.

If, however, environmental valuation techniques are to be used, ecological economists argue that such techniques should be broader. One of the leading writers in the area, Robert Costanza, has suggested that valuation techniques should be based on the contribution of the resource to the goals of:

(1) ensuring sustainability of human activities (which Costanza terms "whole system" fairness);

(2) Distributing resources fairly intergenerationally and between species (which he terms "Community" fairness); and

(3) Efficiently allocating resources, based on current individual preferences and estimates of what would be paid in a well-functioning market.[61]

In the case of goals (1) and (2) - sustainability and intergenerational fairness - the efficiency-based value of *homo economicus*, based on current, fixed individual preferences, would be rejected in favour of a wider, sustainability-based value. This value "*would require an assessment of the contribution to the ecological sustainability of the item in question*",[62] and would be connected to their physical, chemical, and biological role in the long-term functioning of the global system.

5. Can these techniques be applied to Community competition policy?

This Chapter set out to examine whether it is possible to integrate environmental considerations into the economic calculus of competition decisions. Having looked at two, very different, strands of economic thought which might enable us to do this - environmental economics and ecological economics - we turn now to ask whether these techniques can (realistically) be applied to Community competition policy.

Dealing first with ecological economics, it is the present author's view that the methods of this discipline cannot, in its current state of development, realistically be applied by competition enforcers. Ecological economics' wholesale rejection of the neo-classical model on which present competition policy is based necessitates that it offer a workable alternative to this model in order for the discipline to be applied by enforcers in practice. While the overall goals of the discipline are laudable - it attempts to translate the reality of the economy/environment interdependency into economic doctrine - its techniques are not, on the basis of the present research, sufficiently developed to offer such a workable alternative.

This is not, however, the case for the mature discipline of environmental economics. We have seen that, at present, it is fair to say that Community competition economics views a transaction's effect on consumer welfare as the preponderant factor in deciding whether the transaction is anti-competitive. This Chapter has argued that, in forecasting post-transaction consumer welfare, it is possible to take account of the beneficial post-transaction environmental performance of a product.[63] This can be done using environmental valuation techniques developed in the context of environmental cost-

[60] See, for example, Heinzerling, who finds that empirical studies do not suggest that most people believe present lives are any more valuable than future ones (107 Yale L J (1998) 1981 "Regulatory Cost of Mythic Proportions").

[61] See Costanza "Valuing the Earth: Reintegrating the Study of Humans and the Rest of Nature" in *"Managing the Earth" Linacre Lectures 2001* (Oxford, Oxford University Press, 2001) and Costanza, "Social Goals and the Valuation of Natural Capital" 86(1-2) Environmental Monitoring and Assessment (2003) 19.

[62] Costanza, 2003, *ibid.*

[63] This would be in addition to any dynamic efficiency benefits which the transaction may or may not have.

benefit analysis, a method long used by policy-makers in deciding whether to proceed with a given project. Put otherwise, if assessing the consumer welfare effects of an agreement or practice in a competition analysis, the product's beneficial post-transaction environmental performance can be factored into individuals' expected utility functions, to see whether the transaction would increase their utilities. Moreover, the Chapter has argued that this should be done, not just because of the Treaty's integration principle, but because the level of post-transaction consumer surplus is ultimately dependent on the level of remaining environmental resources.[64] For these reasons, it is concluded that, in cases where discrete economic efficiency analysis is made in a competition assessment (which, in practice, by no means occurs in all cases), environmental considerations can and should be taken into account in this assessment.[65] In effect, the result would be to internalise environmental externalities in competition analysis, within the measure of post-transaction consumer surplus.[66]

In the present research, space has not permitted going beyond the rudiments of environmental valuation, which is a huge field. Nonetheless, the Chapter has attempted to draw attention to two major difficulties with the above approach. The first is the difficulty in valuing post-transaction utility in situations of risk and uncertainty - which almost always apply in the context of environmental factors. The second is the difficulty of deciding on an appropriate rate of discount for future environmental benefits and damage. These difficulties, it is admitted, can make environmental valuation very complex in practice, and its results controversial. There is, therefore, an argument that using environmental valuation techniques in a competition enforcement context would make competition policy too uncertain, and thus unadministrable.[67] A further argument might be that competition policy cannot and does not adopt such a long-term approach to consumer welfare as environmental economics implies: rather, it is concerned - again, for reasons of administrability and predictability - with short- and medium-term effects on utility.

There are, it is submitted, two principal counter-arguments to these points.

Dealing first with the argument that competition policy cannot take a long-term approach, it is admitted that the requirement to analyse long-term harm (or benefits) makes a competition enforcer's job more difficult. It is easier to confine oneself to the short- and medium-term. Nonetheless, it is submitted that, in non-environmental

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64 See, likewise, Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057.

65 See also Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057, at 1075, who argues that, "the economic value of environmental assets is now just as relevant to consumer welfare as productive efficiency. Thus the definition of efficiency is widened to take into account an agreement's positive impact on sustainable development".

66 This would be consistent with the polluter pays principle, which the OECD and the Commission have stated is the key to integrating competition and environmental goals. See OECD, *Competition Policy and the Environment* (Paris, OECD, 1996), *"[The polluter pays principle] is in itself is consistent with competition policy to the extent that it remedies a market failure, internalising the pollution externality*" (at 5) and the paper from the EC Commission in that Report, which (at 77) states that the polluter pays principle is best way of internalising pollution costs and finding the best balance between competition and the environment. See also, Wasmeier, The integration of environmental protection as a general rule for interpreting Community law (2001) CMLRev 159, at 163.

67 A further potential argument, which was noted in Chapter 7 as a counter argument to our governance argument, is that, insofar as the suggested economic approach is not that used by the US competition enforcers at the moment, the divergence between the two regimes would, in itself, lead to a certain amount of inefficiency and extra cost for companies (see, e.g., Kolasky, Deputy Assistant Attorney General Antitrust Division US DOJ, "Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels" (2001)). However, as stated before, the possibility of such divergence is not in itself, in the present author's view, a good enough argument for maintaining the status quo in the EU.

contexts, the Commission and the Community Courts have not shied away from consideration of long-term effects. Obvious examples are merger decisions, where the Commission and the Courts have to engage in a prospective analysis of future events,[68] and the evaluation of potentially anti-competitive practices under Article 82 EC. Thus, Commissioner Kroes has, in the context of the ongoing review of Article 82 EC, observed that,

> *"[w]e need to take account not only of short term harm, but also medium and long term harm arising from the exclusion of competitors…We cannot just wash our hands of responsibility and say that competition law cannot or should not protect the consumer against negative medium to long term effects, just because it is difficult to assess."*[69]

Secondly, dealing with the more general concern about the administrability of competition law, it is, admittedly, undeniable that administrability, predictability and speed of decision-making are all important characteristics which a well-functioning competition regime should have. Clearly, the interest in maintaining such characteristics must be balanced against the interest in a competition enforcer arriving at the "right" answer in any given case. It is also admitted that the use of environmental valuation techniques can, depending on the case and on the level of detail entered into, be complex. However, it is argued that, in those cases where environmental valuation proves difficult, an approximation of the environmental benefit or detriment flowing from the transaction at issue would be a better solution than leaving environmental consequences out of the utility function altogether. Moreover, in practice, difficulties in valuing post-transaction consumer welfare abound in competition cases, and are of course not confined to environment-specific factors - an example being the difficulties in trying to place an exact value on the benefit of dynamic efficiencies in measuring welfare changes. More generally, it is submitted, it follows from the importance of the Article 6 EC integration principle within the system of the Treaty that administrability problems must be examined on a case-by-case basis and in a proportionate way. It would be disproportionate to invoke such problems in a blanket manner to justify ignoring environmental considerations across the board.[70]

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[68] See, for example, the judgment of the ECJ in *Tetra Laval II*, in which the Court recognised (at para 44) that the need to consider "*a lengthy period of time in the future*" increased the difficulties in a prospective analysis of the effects of a conglomerate merger. Case C-13/03 P *Tetra Laval* [2005] ECR I-1113.

[69] "Preliminary Thoughts on Policy Review of Article 82", speech at the Fordham Law Institute, September 23, 2005 (SPEECH/05/537). See also, the DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005.

[70] Note also that, since the "economisation" of the Commission via the increase in recent years in the number of economists in the Commission's staff, and the creation of the office of Chief Economist, there has been a large development in the complexity of economic theories used in the Commission's decisional practice. See further, Chapter 5.

Part III: A Perspective from Competition Practice

We turn now to the final stage of our analysis. In the previous Part, we examined the present goals of Community competition law and its approach to "non-economic" factors in principle (Chapter 5). We then examined, and accepted as convincing, three theoretical arguments - which we called the systematic argument, the governance argument and the economic argument - each of which concluded that environmental goals should, where possible, be taken into account in decision-making by competition law enforcers (Chapters 6-8).

This final Part applies these theoretical conclusions to the individual competition law rules: Articles 81, 82, 86 and 87 EC and the merger control rules. Its Chapters examine, first, the environment-related case law in these areas to date as an empirical matter and, second, the implications of the theoretical conclusions of Part II for these areas.

Chapter 9: Some Preliminary Issues - Definition of an Undertaking; Market Definition; Effect on Inter-State Trade

1. Introduction

This Chapter deals with the relevance of environmental factors to three concepts which are pertinent to more than one area of Community competition law. These are: (1) the definition of an undertaking; (2) market definition; and (3) effect on inter-state trade.

2. Relevance of Environmental Concerns to the Definition of an Undertaking

A first potential issue is the extent to which environmental actors fall within the definition of an "undertaking" within the meaning of Articles 81 and 82 EC. Clearly, actors falling outside this definition are not covered by Community antitrust law as such, though their activities may still in some cases give rise to a breach of the Treaty provisions by the state. It is well-established that the definition of an 'undertaking' covers,

> *"any entity engaged in an economic activity, regardless of the legal status of that entity and the way in which it is financed."*[1]

It is evident from the functional nature of this definition that it can include public bodies. Essentially, therefore, the test is whether the relevant activity consists in offering goods or services on a market - i.e., involves something that could, in principle, be carried out by a private entity for profit. In principle, therefore, this could include legal or natural persons offering environmental goods and services on a market. However, an activity may fall outside the definition of an undertaking where it involves the exercise of a task in the public interest forming one of the essential functions of the state. These two aspects of the concept of an undertaking, and their potential relevance in the environmental context, will be considered separately.

a. Does the activity consist in offering goods or services on a market?

The first criterion used by the ECJ in deciding whether a body qualifies as an "undertaking" is whether the activity consists in "*offering goods and services on a given market as an economic activity*".[2] This may be contrasted with activities undertaken on the basis of the principle of solidarity, where no "market" would exist. Examples of the Court's use of this approach are include cases in the area of social security, such as *Poucet & Pistre*,[3] *Albany*[4] and *Pavlov*;[5] and cases in the area of health, such as *FENIN*.[6] In particular, if participation in the activity in which the entity is engaged is compulsory, and/or the entity has little or no control over its costs of production or the price which it charges,

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[1] Case C-41/90 *Höfner and Elser* [1991] ECR I-1979, para 21, and Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK-Bundesverband and Others* [2004] ECR I-2493, para 46.

[2] See, for example, Case C-35/96 *Commission v Italy* [1998] ECR I-3851, para 36, Case C-180 & 184/98 *Pavlov* [2000] ECR I-6451 and Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089.

[3] In Joined Cases C-159-160/91 *Poucet and Pistre* [1993] ECR I-637 (French regional social security offices administering sickness and maternity insurance scheme and an old-age insurance scheme, set up under French law, were not undertakings).

[4] Case C-67/96 *Albany* [1999] ECR I-5751 (Dutch pension funds established by collective agreements in various industrial sectors, affiliation to which was required by Dutch law, were held to amount to undertakings).

[5] Joined Cases C-180 & 184/98 *Pavlov* [2000] ECR I-6451 (medical specialists, in deciding through their representative body to contribute to a compulsory supplementary pension fund, were acting as an undertaking).

[6] Case T-319/99 *FENIN* [2003] ECR II-357 (management bodies of the Spanish health system (SNS) were not acting as undertakings when purchasing from FENIN the medical goods and equipment which they require in order to provide free services to SNS members).

the Court is likely to take the view that its is an activity based on solidarity rather than being offered on a market basis. In making this analysis, the Court takes into account the extent to which the body bears the risk of its activities. The flip side to this is that, in order to be active on a "market", there must be (at least in theory) the potential for an entity to make profit from its activity.[7] In *Albany*, though the Court was not prepared to hold that the Dutch pension funds at issue fell outside the concept of an undertaking, it made clear that the social objective of the funds meant that the competition assessment was ultimately likely to be favourable.[8] The Court has confirmed that agricultural bodies and sporting bodies may qualify as undertakings, insofar as they are active in what can be called a "market".[9]

b. Is the activity in the public interest and one of the essential functions of the State?

The second aspect to the concept of an undertaking is that, if the body is performing a task which is in "*the public interest which forms part of the essential functions of the State*",[10] it does not qualify as an undertaking.[11] Thus, in *Calì & Figli*, anti-pollution surveillance in relation to loading and unloading of acetone products, which surveillance was carried out by a private company (SEPG) in the Port of Genoa set up by the public port authorities, did not qualify as an economic activity. This was on the ground that the surveillance constituted a task in the public interest, forming part of one of the "*essential functions of the state*"[12] in protecting the maritime environment. In the Court's view,

> *"Such surveillance is connected by its nature, its aim and the rules to which it is subject with the exercise of powers relating to the protection of the environment which are typically those of a public authority. It is not of an economic nature justifying the application of the Treaty rules on competition."*[13]

This meant that the situation did not fall under Article 82 EC. This was so despite the fact that the company's activities were financed by dues paid by port users – and not by the public authorities – as the levying of charges formed an "integral part" of SEPG's duties, and its tariffs were approved by the port authorities.[14] In so holding, the Court followed the Opinion of Advocate General Cosmas, who concluded that SEPG was "*run according to operating criteria that are not appropriate to a private undertaking.*"[15] As a result, the proceedings brought by the port user Diego Calì to challenge the monitoring dues demanded by SEPG on competition law grounds failed.[16]

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[7] See Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), 36-42.

[8] *Albany,* note 4 above, para 86: "*Undoubtedly, the pursuit of a social objective, the abovementioned manifestations of solidarity and restrictions or controls on investments made by the sectoral pension fund may render the service provided by the fund less competitive than comparable services rendered by insurance companies. Although such constraints do not prevent the activity engaged in by the fund from being regarded as an economic activity, they might justify the exclusive right of such a body to manage a supplementary pension scheme.*"

[9] See respectively, for example, Joined Cases T-217/03 and 245 *FNCBV* [2006] ECR II-4987 and Case T-193/02 *Piau* [2005] ECR II-209.

[10] Case C-343/95 *Calì & Figli* [1997] ECR I-1547, para 22.

[11] In his opinion in *FENIN*, Advocate General Maduro termed this a "comparative" criterion, as it requires a comparison between the activity at issue and activities which are capable of being carried out by a private undertaking. Opinion of AG Maduro in Case T-319/99 *FENIN* [2003] ECR II-357, paras 11-12.

[12] *Ibid.*

[13] *Ibid,* para 23.

[14] *Ibid,* para 24.

[15] *Ibid*, at 50.

[16] Contrast, for example, *Höfner and Elser*, note 1 above, where the Court held that the activity concerned - a public placement office, which had an exclusive right under domestic law to act as an employment agency

Likewise, bodies considered to be acting purely in the interest of public safety do not qualify as undertakings, as was the situation in the *Eurocontrol* case, concerning an international organisation responsible for air traffic control.[17] In contrast, in *Ambulanz Glöckner,* health organisations providing services on the market for emergency and ambulance services were held to be undertakings, because "*such activities have not always been, and are not necessarily, carried on by such organisations or by public authorities*."[18] More recently, in *Coname*, municipalities concluding concessions for the management of a public gas distribution service were held not to constitute undertakings, as they were acting in their capacity as public authorities; similarly, concessionaires entrusted with responsibility for a public service fell outside the scope of the undertaking concept.[19]

In addition, bodies who are acting purely in a regulatory role do not fall within the concept of an undertaking, insofar as such regulation is considered to have a social, and not an economic, objective. Examples are the *Meca-Medina*[20] case in the sporting context and the *AOK*[21] case in the health context. However, the scope of the "public interest" criterion in this context is interpreted narrowly. Thus, for example, in *Wouters*, the Court rejected the argument of the Dutch bar that its function as regulator of lawyers constituted an activity in the "public interest".[22]

c. Discussion

Applying these tests in the environmental context, the question is to what extent bodies supplying environmental goods and services may be viewed as "*offering goods and services on a given market as an economic activity*."[23] The OECD's definition of environmental goods and services is a useful starting point in this respect:

> *"activities which produce goods and services to measure, prevent, limit, minimize or correct environmental damage to water, air and soil, as well as problems related to waste, noise and eco-systems."*[24]

Under this definition, it is submitted, many environmental goods and services are now in fact or at least potentially supplied on a market. This is due, at least in part, to the major increase in the use of economic instruments which, in aiming to put a "price" on pollution, tend to create markets for pollution abatement or reduction, and create at least the possibility of making a profit in the industry. As noted in Chapter 3, however, major differences exist at present in the extent to which Member States have chosen to use the market to achieve environmental protection goals. Some Member States have chosen to open up their environmental services sector to the market far more than others. For

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- was economic in nature, since "*employment procurement has not always been, and is not necessarily, carried out by public entities*."

17 Case C-364/92 *SAT Fluggesellschaft* [1994] ECR I-43.

18 Note 2 above.

19 Case C-231/03 *Coname* [2005] ECR I-7287.

20 Case T-313/02 *Meca-Medina* [2004] ECR II-3291. See also, *Distribution of Package Tours During the 1990 World Cup* OJ [1992] L 326/31 and Latty, "L'arrêt, le livre blanc et le Traité: La *lex sportiva* dans l'ordre juridique communautaire - développements récents" (2008) Revue du Marché commun et de l'Union européenne 43.

21 Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 *AOK-Bundesverband and Others* [2004] ECR I-2493.

22 Case C-309/99 *Wouters* [2002] ECR I-1577 (paras 57-59).

23 See the cases cited in note 2 above.

24 OECD Observer, September 2005, at 2. See also, the discussion of this issue in Chapter 8.

example, some Member States have chosen to open up the waste and recycling services sector to the market; others have not.[25]

Nonetheless, as *Calì & Figli* illustrates, the provision of environmental services may, in certain cases, be considered to be an "essential function of the state", thus falling outside the definition of an undertaking. It follows that, in cases where the state ensures the provision of a particular environmental good or service, which provision would not otherwise be profitable, it may be possible for an entity (whether public or private in form) to fall outside the scope of the competition rules completely.

The question is how far this concept extends in the environmental service area. It is rather unclear, at present, in what circumstances the provision of an environmental service amounts to an "essential function of the State" within the meaning of the Court's case law.[26] Moreover, there is relatively little ECJ case law which expressly considers this issue. In considering the issue, it is useful to examine two approaches - one judicial, one academic - which have been taken in this regard to date.

The first approach is that of Advocate General Cosmas in *Calì & Figli,* who considered the matter in some detail. After analysing the relevant Treaty provisions on the environment (including, in particular, present Article 174 EC, which sets out the principles on which the Community's environmental policy is based), and relevant secondary Community law on the environment, such as the Directive on transfrontier shipment of hazardous waste, he concluded that,

> *"Analysis of the Treaty and secondary Community law seems to me to indicate that protection of the environment, particularly where based on prevention, constitutes a public authority activity that cannot be understood as anything other than a core State activity.*[27]

As a result, supervision and control intended to gauge compliance with legislation that is designed to prevent environmental damage from serious accidents resulting from the transport of dangerous or polluting goods by sea constituted "*public authority activities exercised in order to meet an essential public interest.*"[28] Moreover, the fact that the service was "*provided for the benefit of the whole of the community*" was also, in the Advocate General's view, "*apparent from the fact that the surveillance has to be exercised regardless whether the fees owed by any particular vessel have been paid.*"[29] This observation is reminiscent of the Court's reasoning in the social security cases such as *Poucet and Pistre* considered above, where one of the factors taken into account by the Court is whether the benefits paid out by a social security scheme were proportionate to the level of compulsory contribution by the members of the scheme.

It is submitted that this approach - by which all "environmental protection" activities might, in principle, fall within the notion of an essential function of the state - is too broad. Though not a term of art, the notion of environmental protection activities would seem roughly equivalent to that of environmental services, discussed above. As

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[25] In Ireland, for example, four of Dublin's local authorities decided in April 2008 to revert from a situation where household waste and recycling collection was open to competition from private operators, back to a situation where only the Council (i.e., part of the State) is permitted to do so (or, in some cases, private operators who have won a tender). The reasons cited for this are the space limits on recycling bins outside private houses, as well as the extra pollution and fuel usage involved where a number of companies can collect bins. The decision is under challenge on competition law grounds before the Irish High Court.

[26] This is not a problem specific to environmental services. The outer limits of the notion of an "essential function of the State" are dogged with controversy. See Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), at 55.

[27] Note 10 above, at 56.

[28] *Ibid,* at 62.

[29] *Ibid.*

such, given the recent increase in use of economic instruments at Member State and Community level discussed in Chapter 3, the Advocate General's approach is clearly too extensive to be of practical use in determining the limits of the concept of an undertaking in the environmental context.

A second approach to the concept of an "essential function of the state" has been put forward by academic commentators such as Odudu. Odudu suggests that the test of whether an activity is an essential function of the state should be whether the activity ensures the provision of a "public good" in the economic sense - i.e., the provision of a good which is non-rivalrous (so an infinite number of consumers can use the good without diminishing others' enjoyment) and non-excludable (so other consumers cannot be prevented from using the good once produced).[30] Though the suggestion may perhaps have some merit as regards activities unconnected to environmental protection, it is submitted that, in the environmental sphere, this attempt to inject more certainty into the area fails. This is because, as discussed in Chapter 8, a clean(er) environment always amounts to a public good in the economic sense. As such, the usefulness of the "public good" concept in delimiting the concept of an undertaking in the environmental sphere is limited.

In sum, it is submitted that the question of which environmental services constitute an activity in the public interest can only be answered on a case by case basis, by analysing whether it would be possible for the service at issue to be provided profitably. As demonstrated above, efforts to create an alternative test, or to categorise all environmental protection activities as being in the public interest - though understandable from a legal certainty perspective - have not been successful. In the case of *Calì & Figli* itself, for example, the Court's conclusion was effectively that, given the obligations to which SEPG was subject in carrying out port surveillance, it would not be possible at all for the job to be done profitably.[31] In this regard, the judgment confirms that competition law will not interfere with Member States' choices where they have chosen to set the parameters of public service obligations such that private undertakings would not find it profitable to perform an important environmental service.[32]

Notwithstanding this, the *Calì & Figli* exception for environmental services carried out in the public interest should, it is argued, be narrowly construed. A conclusion that there is no scope whatsoever for profit is an extreme one, which demands clear evidence to this effect.[33] This is so for public policy reasons: in general, submission of the environmental services sector to the competition rules – at least in principle – should improve their quality and efficiency, as well as incentivise innovation within the sector. Put in the terms of the arguments made in Part II, such an interpretation follows in particular from

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[30] See Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81*, note 7 above.

[31] *Ibid,* para 23.

[32] See, for similar reasoning in the healthcare context, the Opinion of Advocate General Jacobs in Joined Cases C-264/01 etc *AOK* [2004] ECR I-2493, para 25 onwards (though the ECJ ultimately came to a different conclusion on the facts of that case). In the case of healthcare, one may draw an analogy between the Court's broad approach to the concept of an undertaking in the meaning of the competition rules and its broad approach to the concept of an economic activity in the meaning of the free movement of services provisions (in, for example, Case C-157/99 *Geraets-Smits and Peerbooms* [2001] ECR I-5473 and Case C-372/04 *Watts* [2006] ECR I-4325). See similarly, Slot, "Applying the competition rules in the healthcare sector" (2003) 24(11) European Competition Law Review 580. As noted below, this analogy fits well with the systematic argument made in Chapter 6.

[33] Contrast, for example, the lower threshold applicable in order for the Article 86(2) EC justification to apply (i.e., undertakings are permitted to operate under "economically acceptable" conditions - which includes some margin of profit - and still rely on the justification: see, for example, Case C-159/94 *Commission v France* [1997] ECR I-5815.

Chapter 6's *systematic argument*, and in particular from the third point of our "working hypothesis" on the meaning of the Article 6 EC integration principle in the competition sphere. In other words, this constitutes a situation where it is possible to interpret the concept of an undertaking in a way that favours environmental protection, and there is no conflict with the goals of competition policy.[34] Moreover, it also follows from Chapter 7's *governance argument*, insofar as the Community courts, as ultimate arbiter of the scope of the concept of an undertaking, will seek to interpret the concept in a way that is most coherent with the aims of both competition and environmental policies - in this case, meaning a narrow construction of the notion of essential functions of the State.

As such, it is generally undesirable to exclude the provision of environmental services from the scope of the competition rules,[35] unless the service, because not profitable, would genuinely not be provided at all on a competitive market. Rather, a less severe solution, and one ultimately more in keeping with the interests of environmental protection, is to treat the provision of services as falling within the scope of the competition rules, subject of course to possible justification where it is shown that strict application of these rules would obstruct the performance of the environmental service within the meaning of Article 86(2) EC.[36]

3. Definition of the "relevant market"

A second issue of broad relevance is whether environmental factors can be relevant when defining the relevant product and geographic markets in a given case. Such a market definition exercise is relevant, *inter alia,* in carrying out an analysis under Article 82 EC and under the Merger Regulation,[37] and can also be relevant to the assessment of market power in the context of Article 81 EC. Due to the nature of market definition as a preliminary issue faced in many competition cases, it is useful to consider the broader issue of the potential effect of environmental factors on the application of these concepts, and thus the present discussion is not confined to the narrower issue of considering which interpretation might best achieve environmental protection goals.

General framework. The starting point in any analysis of market definition is the Commission's Notice on Definition of the Relevant Market (the "Notice on Market Definition"). In assessing the competitive constraints to which an undertaking may be

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[34] One might also make an argument based on the systematic links between competition policy and free movement policy (i.e., the "internal comparative" approach), drawing an analogy, for example, with the broad manner in which the Court currently interprets the notion of services "provided for remuneration" within the meaning of Articles 49 and 50 EC. See, for example, the medical service cases such as Case C-157/99 *Geraets-Smits and Peerbooms* [2001] ECR I-5473 (medical services paid for by a patient abroad falls within the scope of the Treaty, even where reimbursement is applied for under a home state system of benefits-in-kind), and Case C-51/96 and 191/97 *Deliège* [2000] ECR I-2549 (amateur athletes may be considered as engaging in economic activities).

[35] See, similarly, the Commission's approach in *Eco-Emballages*, OJ 2001 L 233/37, point 70.

[36] See, for example, the Court's solution in cases such as Case C-203/96 *Dusseldorp* [1998] ECR I-4075 and Case C-209/98 *Sydhavnens* [2000] ECR 343, which each concerned situations where special or exclusive rights had been granted to private undertakings to guarantee the provision of certain (respectively, hazardous and building) waste disposal services, and which were analysed under Article 86(2) EC. On Article 86(2), see Chapter 14.

[37] Though the approach to market definition is the same in the context of Article 82 EC and the Merger Regulation, clearly the assessment of the competitive constraints is different: under the Merger Regulation, the focus is on the competitive constraints which exist at pre-merger prices, whereas Article 82 EC analysis focuses on whether the relevant firm has market power, requiring analysis of the competitive constraints which would exist at competitive prices. Further, the Commission is more likely to use quantitative and econometric techniques in the merger context than in the Article 82 EC context. See O'Donoghue and Padilla, *The Law and Economics of Article 82 EC* (Oxford, Hart 2006), at 65-67.

subject, the Notice on Market Definition distinguishes between product and geographic markets. Thus, the Notice defines relevant product and service markets as,

> *"all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use."*[38]

The relevant geographic market is defined as,

> *"the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those area."*[39]

More particularly, the Notice refers to three types of competitive constraint to which undertakings are subject.[40]

The first is demand substitution, defined as "*a determination of the range of products which are viewed as substitutes by the consumer*".[41] This is often assessed using the so-called SSNIP or "hypothetical monopolist" test, which asks whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in the range of 5% to 10%) but permanent relative price increase in the products and areas being considered.[42] The second competitive constraint identified in the Notice is supply-side substitutability, which indicates that "*suppliers are able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices*".[43] The final competitive constraint identified in the Notice is potential competition.[44]

Evidence relevant to product market definition includes: whether there is evidence of substitution in the recent past; the extent of own-price and cross-price elasticity;[45] the degree of functional interchangeability of the product; customers' and competitors' views; evidence of consumer preferences (such as consumer surveys); product prices; whether and how the area is regulated; and switching costs, such as regulatory barriers.[46] Evidence relevant to geographic market definition may include: present distribution of market shares;[47] pricing variations; trade flows and buying patterns; the cost of transport; regulatory barriers; and national preferences.[48]

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[38] Notice on the definition of the relevant market OJ 199 C 32/5, at point 7.
[39] *Ibid,* at point 8.
[40] *Ibid,* at point 13.
[41] *Ibid,* at point 15.
[42] If substitution is enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. *Ibid,* at point 17. Though the hypothetical monopolist test may be particularly appropriate in merger control, it may be less appropriate in the Article 82 EC context, in particular in a situation of "cellophane fallacy" – i.e., where a monopolist is already charging a monopoly price, meaning that if it were to raise its price further, its customers would cease to buy from it at all. See, for example, DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005, 281.
[43] *Ibid,* at point 20.
[44] This, the Commission states, is not taken into account at the market definition stage. Rather, "*if required, this analysis is only carried out at a subsequent stage, in general once the position of the companies involved in the relevant market has already been ascertained, and when such position gives rise to concerns from a competition point of view*." Point 23.
[45] I.e., the extent to which demand for the product changes in response to a change in its own price or another product's price.
[46] See further, Lindsay, *The EC Merger Regulation: Substantive Issues* (London, Sweet & Maxwell 2006), O'Donoghue and Padilla, note 37 above.
[47] Notice on Market Definition, note 38 above, point 28.
[48] See further, Lindsay, note 46 above and O'Donoghue and Padilla, note 37 above.

Environment-specific issues. Having set out this basic framework, let us turn to consider environment-specific issues of market definition in the context of defining the relevant product and geographic markets, respectively. As a preliminary matter, it is submitted that the arguments put forward in Part II do not, as such, lead to the conclusion that a "special", or different, approach to market definition is necessary where environmental issues arise. Using a *systematic* approach, for example, it is not possible to argue, as a general matter, that a given method of market definition in environment-related cases would *per se* favour environmental protection more than another. This means that point 3 of Chapter 6's working hypothesis (which covers issues, such as market definition, which are not dealt with expressly by the Treaty) does not apply here. In particular, the adoption of a wider market definition in the case of environment-related issues would not necessarily be in the interests of environmental protection. Rather, it is submitted that environmental protection aims can be achieved most effectively if the exercise of market definition is carried out as objectively as possible, with environmental factors being taken into account where relevant at the next stage of the competitive analysis. For similar reasons, the *governance* and *economic* arguments do not, it is submitted, lead to the conclusion that any *per se* different market definition approach should be used.

a. Relevant product and service markets

i. Demand-side substitutability

Defining relevant product markets. The essential question is whether environmentally friendlier, or more damaging, products are regarded as "*interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.*" A number of issues arise in this regard.

First, a question which arises increasingly frequently is whether recycled goods form part of the same product market as "original" goods.[49] This will be the case if they satisfy the SSNIP test, i.e., if a consumer would switch between the products in the event of a 5-10% price increase.[50]

However, in some cases, recycled or otherwise environmentally friendlier products may be considerably more expensive than "original" products (indicating failure of the price mechanism due to externalities), thus forming separate markets.[51] This may lead to relatively narrow market definitions for recycled goods, meaning that producers of such goods may run a greater risk of being viewed as holding positions of market power. The Dutch system of implementing the Packaging and Packaging Waste Directive by means of legislation combined with binding agreements, discussed in Chapter 4, provides an interesting example of an attempt to counter this problem. Under that system, an environmental surcharge was paid by producers, which was paid into a fund in exchange

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[49] See DG Competition Paper concerning issues of waste management in recycling system of September 22, 2005, "*it is clear that the markets for recycled materials will become a major if not the key resource market of the future*" (at point 4).

[50] See Lindsay, note 46 above, 3-051. Likewise, the US Horizontal Merger Guidelines recognise that recycled goods may be included in the product market if their sale would be a competitive constraint on the activities of a hypothetical monopolist: para 1.31. See, for example, Case COMP/M.1779 *Anglo American/Tarmac*, decision of January 13, 2000.

[51] Examples include Case COMP/M.4495 *Alfa Acciai/Cronimet/Remondis/TSR Group*, decision of February 6, 2007, and Case IV/M.753 *Anglo American Corporation/Lonrho*, decision of April 23, 1997 (recycling and recovery of platinum group metals was very long and costly in comparison to primary metals, and this was unlikely to change within the next five years).

for a guarantee that their waste would be taken back and recycled.[52] Participating recyclers could draw from this fund in cases where the recycling of the waste had no commercial value (i.e., could not be done profitably), meaning that without the fund the recycling would not be done. Where, however, recycling of the waste had a commercial value (i.e., could be done profitably), recyclers could not draw on the fund.[53] As a result, the cost of otherwise unprofitable recycling processes was borne by the producers, rather than being incorporated by the recyclers in higher prices for the recycled material, meaning higher prices for goods produced from such material. As noted in Chapter 4, this system has inspired others, discussed further in Chapter 10.

Further, one can envisage a situation in which environmentally-friendlier products form separate markets where consumers, for reasons of taste or conscience, would not switch to a "dirty" equivalent - one might make an analogy to the more traditional example of the distinction between cheap and expensive perfume.[54] Clearly, this depends on the product, and the relative popularity of "green consciousness" in relation to that product. Thus, one can imagine that consumers who choose to purchase a "hybrid" engine car may not view traditional, more polluting, cars in a similar price category as being interchangeable.

Evidence as to consumer preferences will be important here, such as consumer surveys. While, as Bishop and Walker note, this method "*suffers from arbitrariness*",[55] it means that, as long as a "reasonable" number of consumers would be willing to switch in response to a relative price change, "the existence of other consumers who would not switch (even if these account for the majority of consumers) does not imply a narrow market."[56]

Second, from a decisional perspective, though the environmental performance of a product has been a decisive factor in defining separate product markets in numerous Commission decisions to date[57] - due sometimes to differing environmental regulatory regimes[58] - it has not always been a conclusive factor where the characteristics of the products were otherwise similar.[59]

The result may be that, as consumers become more environmentally-conscious, it may be more likely that environmentally-friendly products will form separate markets. This may

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52 See Vogelaar, "Verpakkingen en verpakkingsafval: de richtlijn 94/62/EEG en haar tenuitvoerlegging in Nederland" in Deketelaere and Wiggers-Rust, *Actualiteiten Europees Milieurecht*, Brugge, Die Keure, 1997, at 126.

53 *Ibid.*

54 See, by analogy, *Yves Saint Laurent Parfums* OJ 1992 L 12/24.

55 Bishop and Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (2nd ed., London, Sweet & Maxwell, 2002), at 4.55.

56 *Ibid,* at 4.57. They takes the example of Case COMP/M.431 *Medeol/Elosua*, in which bottled olive oil was distinguished from bottled sunflower oil, partly as the two products appealed to different groups of consumers.

57 See, for example, Case COMP/M.2690 *Solvay/Montedison-Ausimont*, at 70 (product market was hydrogen peroxide, as no other substitute (eg sodium hypochlorite or chlorine) was environmentally friendly); Commission decision of December 11, 2001 *Zinc Phosphate* OJ 2003 L 153/1, at 44 (separate product markets for zinc chromate and zinc phosphate as the former environmentally unfriendlier).

58 See, for example, Case COMP/M.2588 *Reinbraun Brennstoff/SSM Coal*, decision of September 17, 2001, where fuel grade petcoke was found not to be a substitute for coal to a sufficient degree, because national environmental regulations on sulphur dioxide emissions constrained the amount of fuel grade petcoke that could be used in a blend with coal. See further, Case COMP/M.4742 *Oxbow/SSM*, decision of August 7, 2007.

59 See, for example, Case COMP/M.1882 *Pirelli/BICC* (fluid-filled power cables and XLPE cables were substitutes, despite the fact that XLPE cables were more environmentally friendly, as there was no risk of leakage), and Case COMP/M.1356 *Metsä-Serla/UK Paper*, at 11 (pulp made from wood and pulp made from waste paper or recycled fibres form part of a single market).

lead to the irony that incumbent undertakings in those markets for environmentally-friendly goods are - in principle - more likely to be judged to occupy a dominant position under Article 82 EC,[60] or to be prohibited from merging under the Merger Regulation. Similarly, where innovative, environmentally-friendlier products are being developed, they may create new, separate product markets, resulting in very large market shares for the innovator(s).[61] However, this problem is, as we have seen, tempered by the fact that, as long as a "reasonable" number of consumers would still switch between the products, no separate market should be found to exist.[62]

Defining relevant service markets. The major issue here has been the definition of markets for collecting, processing, recovering or recycling waste.[63]

First, a distinction will generally be drawn based on the type of waste at issue. Thus, for example, the following have been accepted as constituting relevant markets:

- A market for servicing hazardous waste, in contrast to "ordinary" waste;[64]
- Within the category of ordinary waste, a distinction has been made in some cases between servicing ordinary household waste, on the one hand, and ordinary industrial and commercial waste, on the other, though the Commission has in other cases left the question open;[65]
- A market for the processing of waste oil and products contaminated with waste oil has been accepted;[66]
- Separate markets have been accepted for recycling gold and silver materials, as against platinum materials.[67]

Secondly, the regulatory framework may be crucial, whether set at EU or national level.[68] In particular, the Commission has made clear that separate markets may exist for collection, sorting and recovery services in the context of recycling arrangements.[69] This is made very clear, for example, in the Commission's 2005 Waste Management Paper,

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[60] Though this in itself is not prohibited, and the environmental qualities of the product may be taken into account at the abuse stage: see Chapter 12.

[61] See likewise, the (non-environmental) "new product" cases, where products or services have yet to be supplied, but there is clear customer demand for the product and a reasonable likelihood of the product becoming available in the reasonably foreseeable future: Bishop and Walker, note 55 above, at 3-052.

[62] A further point arises in the case of pollutants which do not themselves constitute a separate product (i.e., capable of commercial exchange). In such cases, the Commission has indicated that the relevant market encompasses that of the product into which the pollutant is incorporated: Horizontal Cooperation Guidelines OJ 2001 C 3/2, point 182.

[63] There is, of course, an overlap between goods and services here, as waste has been accepted to be a "good" by the Court: see, for example, Case C-2/90 *Commission v Belgium* [1992] ECR I-4431.

[64] See Case M.1059, *Suez Lyonnaise/BFI*, at para. 11; Case M.2897, *Sita SverigeAB/Sydkraft Ecoplus*, at para. 10, and Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006, at point 31.

[65] Case M.916, *Lyonnaise des Eaux/Suez*, at point 25 (issue left open). See also, however, Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006 (separate markets for municipal waste management and industrial and commercial waste management).

[66] See Case C-203/96 *Dusseldorp* [1998] ECR I-4075. Contrast Case C-209/98 *Sydhavnens* [2000] ECR 343, where the Court declined to form a view on whether the processing of non-hazardous building waste constituted a separate market, leaving this to the national court.

[67] Case COMP/M.3213 *Umicore/OMG/Precious Metal Group*, decision of July 29, 2003.

[68] See DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, at para 8; Case IV/M.266 *Rhone Poulenc/Chimie/SITA* (Commission took special nature of waste and environmental regulations into account in defining market).

[69] Horizontal Cooperation Guidelines OJ 2001 C 3/2, point 182. See, for example, Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006 (separate markets for municipal waste management and industrial and commercial waste management).

which takes three specific EU-based regulatory frameworks by way of illustration: the End-of-Life Vehicles (ELV) Directive, the Packaging Waste Directive, and the Waste Electronic Equipment (WEEE) Directive.[70] The Commission typically distinguishes between:[71]

- The market(s) for the organisation of systems to fulfil undertakings' obligations under the Directives.[72] Where it is much more difficult to set up one type of system than another type of system, these system types may form different markets.[73] Similarly, where the practical organisation or legal requirements involved in setting up systems is very different, they may form different markets. An example is the distinction under the Packaging Waste Directive's regime between setting up systems to collect household packaging waste and setting up systems to collect commercial packaging waste.[74]

- The market(s) for the collection, sorting and treatment of the relevant waste product.[75] Collection and sorting may, for example, form different markets. Further, the markets for collecting and sorting different types of waste may form separate sub-markets. Examples are household vs. commercial waste;[76] or, within household or commercial waste, packaging vs. non-packaging waste,[77] or electronic vs. other waste. Depending on Member States' sorting and recycling facilities, distinctions may be made between different materials, such as glass, paper and plastic.

- The market(s) for the recovery and marketing of secondary material. In this case, each material to be recovered (for example, glass, metal or plastic) may form a

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[70] Directive 2000/53/EC on end-of life vehicles OJ 2000 L 269/34, as amended, Directive 94/62/EC on packaging and packaging waste OJ 1994 L 365/10, Directive 2002/96 on waste electronic and electrical equipment OJ 2003 L 37/24, as amended.

[71] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[72] Under the End of Life Vehicles Directive, for example, Member States have to ensure that the reuse and recovery targets are attained by the economic operators and that the producers and importers pay for the costs of the free take-back of ELVs.

[73] See, for example, *DSD* OJ 2001 L 166/1. In that case, the German Packaging Ordinance, which made packaging producers responsible for the collection and recycling of waste packaging, gave producers a choice between setting up individual, collective system or self management system or, alternatively, joining an "exemption system" set up via s.6(3) of the Ordinance. As exemption systems had to cover at least one Land and meet high collection and recycling quotas, they were, in the Commission's view, more onerous to set up than the first option. As a result, a separate product market existed for the provision of services via exemption systems - which in turn gave DSD, as the only body offering an exemption system in Germany, a 100% market share (para 80).

[74] Directive 94/62/EC of 20 December 1994 on packaging and packaging waste OJ 1994 L 365/10.

[75] Under the ELV Directive, for example, the Commission states that this market may in turn be subdivided into markets for dismantling the ELV and "shredding" (sorting out and recovering) ferrous and non-ferrous material. Further submarkets may exist for individual car brands where producers or importers set up their own dismantling and/or shredding systems: DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[76] Major differences include: differences in logistical requirements of collection (household waste having many collection points, small amounts of waste, and thus strong network economies); and differences in materials collected (tin, aluminium and plastic being recovered from households, but not normally from industry): *ibid.*

[77]The Commission reasons that packaging and non-packaging household waste are collected and sorted separately; packaging waste can and is recycled, whereas non-packaging waste is sent to landfill. Similarly, as regards commercial waste, companies generally have reporting obligations as regards packaging waste, but not for other types of industrial waste: *ibid.*

separate market. Where the same operator provides collection, treatment and recovery services, these may constitute a single market.

ii. Supply-side substitutability

The issue of supply substitutability has arisen on numerous occasions in environment-related cases. Suppliers or producers may be incapable of switching to environmentally-friendlier production within the short term, or unwilling to do so, for a number of reasons. For example, it may take a long time to switch (as with the production of organic produce, in comparison to "regular" produce).[78] It may require very different equipment, which cannot be acquired in the short term. In addition, producing environmentally-friendlier products may be more costly, dissuading any such switching. Inversely, it may be the case that suppliers or producers would not readily switch to environmentally-unfriendlier alternatives. For example, the alternative may be less easy to recycle,[79] or more costly to process in an environmentally-friendly way.[80] Again, it may require radically different equipment, with an example being the different types of equipment which may be necessary to process different types of waste.[81]

Again, the regulatory framework may be very important in this regard. For example, where regulation is based on the polluter pays principle, meaning that producers are subject to more onerous responsibilities if their product is environmentally unfriendly, this may diminish supply-side substitutability.[82]

b. Relevant geographic market

Environmental considerations may also be relevant to the definition of the geographic market. A number of factors bear particular mention.

First, once again, variations in environmental regulatory systems, at a regional or Member State level, may be a major consideration in defining the relevant geographic market.[83] Thus, for example, the Commission has indicated that the markets for organising systems to deal with undertakings' obligations, and the collection and sorting of packaging waste, ELVs[84] and WEEE,[85] are national or regional markets at present, due to differences in regulatory frameworks. In the case of general (non-packaging) waste, markets may be as

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[78] See, however, in the US context, *FTC v Whole Food Market Inc* (Unreported, August 23, 2007)(DG Cir (US)), where the US Court of Appeals in Washington DC refused to block the merger of Whole Foods Market and Wild Oats Markets on the ground, *inter alia*, that the FTC had failed to prove that "premium natural and organic supermarkets" was an appropriate relevant product market. Rather, the relevant product market had to be at least as broad as the retail sale of good and grocery items in supermarkets.

[79] See Giotakos, "The Commission's Review of the Aluminium Merger Wave" 2000 Competition Policy Newsletter 2, 8 (aluminium and tinplate kept apart, as tinplate cans are less attractive to recycle).

[80] See, for example, Case IV/M.402 *Powergen/NRG Energy/Morrison Knudsen/Mibrag*, decision of June 27, 1994 (brown coal more costly to process in an environmentally-friendly manner than other types of coal).

[81] See, for example, Case COMP/M.3213 *Umicore/OMG/Precious Metal Group*, decision of July 29, 2003 (different technology required to recycle different types of waste).

[82] See, for example, Case COMP/M.2588 *Reinbraun Brennstoff/SSM Coal*, decision of September 17, 2001, where fuel grade petcoke was found not to be a substitute for coal to a sufficient degree because national environmental regulations on sulphur dioxide emissions constrained the amount of fuel grade petcoke that could be used in a blend with coal.

[83] See in the environmental context, DSD OJ 2001 L 319/1 and M.575 *Orkla/Volvo* (Norway was a separate geographical market due inter alia to environmental taxation scheme concerning packaging).

[84] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, para 109.

[85] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, para 150.

narrow as municipal, due inter alia to the public procurement rules at issue.[86] In contrast, geographic markets for recovery of packaging waste, ELV, WEEE and secondary material may, in the Commission's view, be EU wide - though the Commission gives no substantial reasoning for this conclusion.[87] Similarly, restrictions on export of waste may contribute to separate geographic markets.[88]

A second factor which the Commission has accepted to be important in defining the relevant geographic market, and which may be of particular relevance here, is the variation in national preferences and culture. As then-Commissioner Monti observed,

> *"Factors such as national preferences or preferences for national brands, language, culture and life style…are all important factors in defining the relevant geographic market."*[89]

This could, it is argued, ultimately lead to different geographic market definitions in a case where consumers in some (groups of) Member States have a definite preference for environmentally-friendlier goods, if this is not the case in some other Member States.

A final area where environmental considerations may be relevant in defining geographic markets is transport costs.[90] Customers may not be willing to pay for the cost of transport over and above a certain distance, meaning that the geographic market reaches its limits.[91] However, the importance of transport costs in defining the relevant market will depend on the proportion which such costs comprise of the overall price.[92] In estimating acceptable shipping distances, for example, the Commission may examine the average distance between a supplier and its customers and the radius within which a large proportion of customers is located.[93] On this point, one might imagine, changing consumer preferences might, in the future play a role: should consumers, for environmental reasons, shift strongly to prefer goods produced "closer to home" in the case of foodstuffs, for example, this may ultimately lead to narrower geographic markets

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[86] See, for example, Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006, where a market definition of the collection of municipal waste for London was considered – though not ultimately decided upon – by the Commission. The distortionary effects of differing "green" public procurement rules is to be tackled in an action plan announced by the Commission in 2008: Commission Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions, on the Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan COM (2008) 397/3 and Communication on Green Public Procurement COM (2008) 400/2. The Commission intends to link public procurement standards with standards established by, for example, the Energy Labelling Directive, Directive 92/75 OJ 1992 L 297/16.

[87] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, para 46. The Commission notes that some smaller Member States do not have recycling facilities and have to export their waste to other Member States. See, in contrast, decisions such as Case COMP/M.3213 *Umicore/OMG/Precious Metal Group*, decision of July 29, 2003, in which the markets for recycling of platinum, gold and silver materials were held to be world wide.

[88] *Ibid,* para 47. Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006 (geographic market for processing hazardous waste is national, due to regulatory barriers to inter-state export)

[89] Speech of October 5, 2001 "Market Definition as a cornerstone of EU Competition Policy". An example would be a national preference for Danish pork in Denmark. See also, Notice on Market Definition, note 38 above and Case M.1313 *Danish Crown/Vestjyske Slagterier*.

[90] See DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, para 46 and Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006.

[91] See Bishop and Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (2nd ed., London, Sweet & Maxwell, 2002), 4.68 referring to cases in which the Commission has used the "Elzinga-Hogarty" test on the relevance of transport costs.

[92] See Lindsay, *The EC Merger Regulation: Substantive Issues* (London, Sweet & Maxwell 2006), at 3-076, Notice on Market Definition paras 29 and 50 and M. 603 *Crown Cork & Seal/Carnaud Metalbox*.

[93] See, for example, M.3431 *Sonoco/Ahlstrom* (Commission identifies proportions of parties' sales by volume to customers within particular radii and rejected parties' argument that relevant geographic market covered EEA as proportions of sales shipped more than 600 km was very small).

being defined. In addition, should transport costs rise due, for example, to increased taxation on polluting vehicles (e.g., road haulage), or indeed to increased petrol costs, this could lead to narrower geographic market definitions.

4. Effect on inter-State trade

Another requirement of broad relevance for the application of much of Community competition law - in particular, Articles 81, 82 and 87 EC - is the jurisdictional criterion that the competitive restriction must have an effect on trade between Member States.[94] The Commission's 2004 Guidelines on the Effect on Trade criterion divide the effect on inter-state trade requirement into three sub-concepts: the requirement of "*trade between Member States*"; the requirement that the restriction "*may affect*" trade; and the requirement that the effect be appreciable.[95]

a. Trade between Member States

An important point in the environmental context is that, in principle, purely "environmental" agreements may not necessarily, in themselves, actually or potentially restrict trade.[96] The 2004 Guidelines take a broad view of the notion of trade:

> *"The concept of 'trade' is not limited to traditional exchanges of goods and services across borders. It is a wider concept, covering all cross-border economic activity including establishment…the concept of 'trade' also encompasses cases where agreements or practices affect the competitive structure of the market."*[97]

Vedder, for instance, takes the example of an agreement between undertakings in different Member States to reduce emissions as being unconnected with inter-state trade.[98] A further example of an agreement unconnected with "trade" was that at issue in the *EUCAR* decision, which concerned an agreement between car manufacturers to engage in research into environmentally friendlier cars.[99] Nonetheless, as the polluter pays principle is increasingly implemented at Community and Member State level and by private undertakings, thus internalising environmental externalities within the pricing mechanism (as described in Chapters 3 and 4), it will become increasingly difficult to argue that environmental agreements are wholly unconnected with trade.[100] Moreover, it is submitted that the arguments set out in Part II confirm the validity of adopting a broad notion of "trade" in this context. The interests of environmental protection favour such a broad notion for the same reasons as they favour a broad interpretation of the concept

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[94] Note that the practical importance of this requirement has certainly become less relevant in recent years, as many Member States' national competition laws are now modelled on, and mirror closely, the equivalent Community competition law provision. Nonetheless, the distinction between Community and national competition law still retains relevance - for example, insofar as the initiation of proceedings by the Commission for the adoption of a decision under Articles 81 or 82 EC automatically relieves national competition authorities of their power to apply these articles (see Article 11(6) of Regulation 1/2003 OJ 2003 L 1/1).

[95] OJ 2004 C 101/81, point 18. Restrictions which do not satisfy the inter-state trade criterion may of course, however, fall within the jurisdiction of national competition law - whether of Community or third country states.

[96] This may have been the conclusion, for example, in the *Pro-Europe* notification of 2001 C 153/4 – COMP/38.051, which comprised *inter alia* a general licensing agreement where DSD granted to Pro Europe the right to control the trademark outside Germany.

[97] Note 95 above, points 19-20.

[98] Vedder, *Competition Law and Environmental Protection in Europe: Towards Sustainability?* (Groningen, Europa Law Publishing, 2003), 118.

[99] See the Commission's Annual Competition Report 1998 at 132.

[100] Similarly, an agreement, for example, on an private "eco-label" might lower the economic output of certain producers, or make it harder for non-labelled products to enter the market.

of an undertaking - that is to say, subjecting a practice to competition rules in principle increases efficiency in the provision of environmental goods and services.

b. "May affect" inter-state trade

As is well-known, this criterion was interpreted by the Court very early on in an extremely broad fashion, as extending to any restriction,

> *"capable of constituting a threat, either direct or indirect, actual or potential, to freedom of trade between member states in a manner which might harm the attainment of the objective of a single market between states."*[101]

In its Notice on Effect on Trade, the Commission summarised the case law here as requiring proof of:

(1) "*A sufficient degree of probability [of an effect on trade] on the basis of a set of objective factors of law or fact*";

(2) An influence on the "*pattern of trade between Member States*";

(3) "*A direct or indirect, actual or potential influence" on the pattern of trade.*[102]

The very broad nature of the jurisdictional criterion means, for example, that the mere fact that all parties to an (environmental) agreement are situated in one Member State,[103] or that all parties to an (environmental) agreement are situated in non-EU countries,[104] does not in itself take the agreement outside the scope of the Community competition rules.[105] One might also imagine that an agreement to export waste outside the Community might also potentially restrict inter-state trade insofar as it might incidentally restrict the re-importation of that waste for recovery.

In contrast, however, in the Dutch *Stibat* case, a (purely national) agreement on battery take-back and recycling, including a standardised levy charged to producers for these services, was found not to satisfy the inter-state trade criterion.[106] As a result, the Commission granted a comfort letter – despite the fact that the agreement involved over 90% of Dutch industry.[107] An interesting comparison can be made between the outcome in *Stibat* and that in the *VOTOB* decision,[108] discussed further in Chapters 10 and 11, in which the Commission chose to deal with an agreement between the six undertakings with storage capacity for chemicals in the Netherlands whereby the undertakings decided to impose a set "environmental surcharge" for their services, which varied according to the polluting qualities of the chemical to be stored. It will be clear from the factual similarities outlined above that the difference in approach between these two cases is difficult to explain on objective grounds. Rather, it is submitted, it reflects an essentially

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101 See, for example, Joined Cases 56, 58/64 *Consten & Grundig* [1966] ECR 429 and point 23 of the Guidelines on Effect on Trade, note 95 above.

102 *Ibid,* point 24.

103 See, for example, the *Eco-emballages* (France), *DSD* (Germany), and *VOTOB* (the Netherlands) cases, discussed in Chapters 10 and 11.

104 See for example, the negative clearance for equivalent commitments by the Association of Japanese Automobile Manufacturers and the Association of Korean Automobile Manufacturers. See the Commission's Annual Competition Report 1998, at 160.

105 Thus, the Commission states that, "*in many cases involving a single Member State the nature of the alleged infringement, and in particular, its propensity to foreclose the national market, provides a good indication of the capacity of the agreement or practice to affect trade between Member States.*" Guidelines on Effect on Trade, note 95 above, point 77.

106 See the decisions of the Dutch competition authority (the NMa) of December 18, 1998 and May 31, 1999 in Case 51/98 *Stibat* and Case 3142/02 (on prolongation of the exemption).

107 The case then fell to be assessed by the Dutch competition authority.

108 XXIInd Competition Report 1992, paras 177-186.

political decision on the Commission's part. Though *Stibat* may, therefore, be rather surprising from a substantive perspective, it is in this sense analogous to the (heavily politically influenced) approach adopted by the Commission in another non-economic area – culture – when considering the German resale price maintenance scheme for German language books.[109]

c. Appreciable effect on inter-state trade

It was established early on in the Court's case law that only restrictions with an appreciable effect on inter-state trade would fall within the scope of the Community competition rules.[110] In effect, this constitutes the outer limit of the jurisdictional scope of Community competition law. In its 2004 Notice on Effect on Trade, the Commission states that, "*the assessment of appreciability depends on the circumstances of each individual case, in particular the nature of the agreement and practice, the nature of the products covered and the market position of the undertakings concerned.*"[111] In that Notice, the Commission sets out quantitative indications of its view of the market share and turnover thresholds which an agreement must fall below if it has no appreciable effect on inter-state trade.[112] However, the more serious the restriction which is at issue - such as cross-border cartels, cross-border horizontal agreements or cross-border abuses - the more likely it is that the effect on inter-state trade will be judged appreciable.

The notion of appreciable effect on inter-state trade should be distinguished from the Commission's quantification, as set out in its Notice on Agreements of Minor Importance, of situations where it will not consider a restriction to have an appreciable effect on competition, meaning that it will not institute proceedings in such circumstances (the *de minimis* rule).[113] Again, it sets out market share thresholds as guidance for situations where a restriction is unlikely to be considered to have an appreciable effect on competition. Agreements containing hard core restrictions will not be considered to be *de minimis*.

These criteria apply in the same way to environment-related activities as to other activities. Moreover, it is submitted, the arguments set out in Part II are, in themselves, neutral on the issue of how these appreciability elements should be interpreted. The reason for this is that, as these elements essentially delimit the boundary between the application of Community competition law and national competition law, the interests of environmental protection are not *per se* favoured by interpreting them in a broader, or indeed narrower, fashion.[114]

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[109] The German government had called upon the Commission to keep in mind cultural policy in deciding whether to prohibit the resale price maintenance scheme for German language books, a position which had been reinforced by the Council (see the Council Resolution on fixed book prices in homogeneous cross-border linguistic areas OJ [1999] C 42/3). The ultimate solution - that the agreement did not have an effect on trade between Member States, so that Article 81(1) EC did not apply in the first place - was announced by Commissioner Monti, then Competition Commissioner, as having been arrived at by maintaining "*regular contacts*" with the Commissioner for Education and Culture, and was fully supported by that Commissioner (IP/00/183).

[110] See, for instance, Case 22/71 *Béguelin Import* [1971] ECR 949, at para 16.

[111] Guidelines on Effect on Trade, note 95 above, point 45.

[112] In that Notice, the Commission indicates that it generally considers there to be no appreciable effect on trade in the case of horizontal agreements, for instance, where the parties' combined market share on any relevant market within the Community is less than 5%, and the aggregate annual turnover of the parties concerned in the products covered by the agreement is less than €40 million. *Ibid.*

[113] Notice on agreements of minor importance OJ 2001 C 368/13.

[114] One might imagine an argument that environmental interests favour a broad interpretation of the jurisdictional requirement, on the ground that bringing a practice within the scope of competition law increases efficiency in production and the provision of services. Such an argument fails, however, as

practices which fall outside the scope of Community competition law may still, of course, fall within the scope of national competition law.

Chapter 10: Article 81(1) EC

1. Introduction

Article 81(1) EC provides:

> "The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
>
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
>
> (b) limit or control production, markets, technical development, or investment;
>
> (c) share markets or sources of supply;
>
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

This Chapter considers whether, and how, Article 81(1) EC can be applied in the context of agreements with environmental protection objectives. It deals in turn with the two elements of Article 81(1): (1) an agreement, decision by an association of undertakings, or concerted practice; which (2) has the object or effect of restricting competition.[1]

As a preliminary point, the main type of environmental protection instrument which may engage Article 81(1) is what are termed "voluntary environmental agreements", which we considered in Chapter 4. As noted there, "environmental agreements" was defined very broadly by the Commission in its Horizontal Guidelines, as well as in a 2002 Communication, as,

> *"those by which stakeholders undertake to achieve pollution abatement, as defined in environmental law, or environmental objectives set out in Article 174 EC."*[2]

As also noted, such environmental agreements may be divided broadly into two types: self regulation (where an agreement is put in place solely by undertakings on a voluntary basis) and co-regulation (where the legislator establishes the key elements of the regulation). As we saw, the Commission - in DG Environment-led documents - signalled its approval and encouragement of the use of environmental agreements in Communications of 1996 and 2002.

2. Agreements, decisions by an association of undertakings, or concerted practices

Clearly, in order to fall within the concept of an "agreement" between undertakings, it is not necessary for the agreement to be legally binding, as long as there is a common intention

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[1] Effect on trade and the scope of the concept of an undertaking have been dealt with in the previous Chapter.

[2] Communication on Environmental Agreements, COM (2002) 412 final. See also, Horizontal Cooperation Guidelines OJ 2001 C 3/2, at point 180: "*the target or the measures agreed need to be directly linked to the reduction of a pollutant or a type of waste identified as such in relevant regulations" and does not extend to "agreements that trigger pollution abatement as a by-product of other measures*."

expressed in a way that gives rise to an obligation.[3] In contrast, a concerted practice, while requiring common intention, does not require a legally or morally binding obligation. As indicated in Chapter 4, environmental self-regulatory agreements may take the form of binding agreements or "gentlemen's agreements". As long as the arrangement contains a common intention expressed in a way that gives rise to an obligation, it will qualify as an "agreement" within the meaning of Article 81(1); if a common intention can be proven but no legally or morally binding obligation, it will qualify as a concerted practice.[4] A point of some interest in the environmental context is that, in order to fall within Article 81(1), the agreement, decision or practice must be voluntary. This is of particular relevance to co-regulation, as it raises the issue of whether the "state action" defence, discussed further in Chapter 14, applies.

3. Object or effect of preventing, restricting or distorting competition on the market

a. Overview of the concept of "restriction of competition"

The Commission's current thinking on the concept of "restriction of competition" under Article 81(1) EC is set out in its 2004 Guidelines on the Application of Article 81(3) (the "Article 81(3) Guidelines").[5] The Guidelines are an example of the Commission's movement towards economics-driven, consumer-welfare focused[6] reasoning. Clearly, any agreement with the object of restricting competition falls within Article 81(1) EC.[7] As regards agreements with an alleged restrictive effect, the Commission will make its assessment "*within the actual context in which competition would occur in the absence of the agreement with its alleged restrictions.*"[8] The focus at all times is on "*how and to what extent the agreement affects or is likely to affect competition on the market*".[9] The Commission will look, in particular, at two issues:

(1) Does the agreement restrict actual or potential competition that would have existed without the agreement? If so, the agreement may be caught by Article 81(1), as it restricts inter-brand competition.

(2) Does the agreement restrict actual or potential competition that would have existed in the absence of the contractual restraint(s)? If so, the agreement may be caught by Article 81(1), as it restricts intra-brand competition.[10] In the Guidelines, the Commission takes

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[3] See generally, Bellamy and Child, *European Community Law of Competition* (6th ed., London, Sweet & Maxwell, 2008), 2.022 onwards.

[4] Note the Commission's warning that the meaning of "agreement" within Article 81(1) does not necessarily correspond to the definition of an "agreement" in Commission documents dealing with environmental issues, such as the Communication on environmental agreements COM(96) 561 final: see Horizontal Guidelines, note 2 above, footnote 50.

[5] OJ 2004 C 101/97.

[6] *Ibid*, for example, at point 21.

[7] *Ibid*, points 20-23. The Commission indicates that "hard core" restrictions will normally be presumed to have a restrictive object, i.e. *per se* restrictions – price fixing, sharing markets, limiting output, fixing minimum resale prices, imposing export bans.

[8] *Ibid,* point 17.

[9] *Ibid,* point 18.

[10] As Kjolbe, a Commission official, clarifies, "*In the absence of restrictions of inter-brand competition, the agreement can only restrict competition created by the agreement, namely intra-brand competition. If in the absence of a particular restraint the agreement would not have been concluded, no competition would have been created in the absence of the restraint. Consequently, there is no competition to restrict*…" Kjolbye, "The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81" (2004) European Competition Law Review 570, at 568.

the example of a situation where a supplier restricts its distributors from competing with each other, so that (potential) competition that could have existed between the distributors absent the restraints is restricted. Such restrictions include resale price maintenance and territorial or customer sales restrictions between distributors.[11]

A further aspect to the economic approach adopted in the Article 81(3) Guidelines, as well as in the Vertical and Horizontal Guidelines, is the emphasis on the importance on market power in assessing whether competition is restricted.[12] As a result, the Commission states that it will normally be necessary to define the relevant market in order to apply Article 81.[13]

In addition, even where the main transaction is non-restrictive of competition, the Commission states that it may also be necessary to examine any individual "*ancillary restraints*" present in the agreement, to see whether they are "*directly related and necessary to the implementation of a main non-restrictive transaction and proportionate to it.*"[14] In contrast to Article 81(3), application of the "*ancillary restraint*" concept does not as such involve any weighing of pro-competitive and anti-competitive effects.[15]

b. Restrictions "objectively necessary" for an agreement to exist and the "rule of reason" debate

In the Article 81(3) Guidelines, the Commission also indicates that some restraints may not be caught by Article 81(1) when the restraint is "*objectively necessary for the existence of an agreement of that type or that nature.*" Such an analysis can,

> *"only be made on the basis of objective factors external to the parties themselves and not the subjective views and characteristics of the parties. The question is not whether the parties in their particular situation would not have accepted to conclude a less restrictive agreement, but whether given the nature of*

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[11] Examples one might point to from the case law illustrating this principle include Case 56/65 *Société Technique Minière* [1966] ECR 235 and Case 26/76 *Metro I* [1977] ECR 1875, where the Commission decided that restrictive provisions contained in a selective distribution system may fall outside Article 81(1) where they satisfy objective, qualitative criteria and are applied in a non-discriminatory manner. On appeal, the Court upheld the Commission decision, as the interest in maintaining the channel of distribution "*forms one of the objectives which may be pursued without necessarily falling under the prohibition contained in Article [81(1)]…This argument is strengthened if, in addition, such conditions promote improved competition inasmuch as it relates to factors other than prices*." This approach has since been confirmed, *inter alia*, in the Commission's Guidelines on Vertical Restraints OJ 2000 C 291/1. See further, the cases cited by Bellamy and Child, note 3 above, at 2.089 onwards.

[12] Article 81(3) Guidelines, note 5 above, point 25.

[13] *Ibid,* point 27. See also, the Vertical Guidelines, point 11 above, and the Horizontal Cooperation Guidelines OJ 2001 C 3/2.

[14] Article 81(3) Guidelines, note 5 above, point 29. Note that the term "ancillary restraints" is also common in merger analysis. See Eijsbouts, Jans, Vogelaar, *Europees Recht: Algemeen Deel* (Groningen, Europa Law Publishing, 2006), at 171-172, where Vogelaar argues that the concept of "ancillary restraints" is in fact a species of the genus "inherent restriction" (discussed below), whereby an acceptable ancillary restraint must be limited in time, but an acceptable inherent restriction need not be.

[15] A final point to note is that, where agreements tend to frustrate the single market goal – such as market-partitioning agreements - they will normally be found to restrict competition within the meaning of Article 81(1). However, in Case T-168/01 *GlaxoSmithKline* [2006] ECR II-2969, the CFI clarified that, in order to fall within Article 81(1), agreements restricting parallel trade must still be shown to have as their object or effect the restriction of competition: see para 120, clarifying Cases 56 & 58/64 *Consten and Grundig* [1966] ECR 299, at 340.

the agreement and the characteristics of the market a less restrictive agreement would not have been concluded by undertakings in a similar setting."[16]

Among the examples given by the Commission in the Guidelines is a prohibition imposed on all distributors on sale to certain categories of end users where the restraint is "*objectively necessary for reasons of safety or health related to the dangerous nature of the product in question*."[17]

Some commentators have described this principle as a type of "rule of reason."[18] The meaning of the rule of reason concept, and whether the concept exists within Community competition law, has given rise to considerable controversy in the Community courts, the Commission and academia. It remains a considerably murky area of Community competition law. However, a number of points are clear.

First, it is vital in any debate in this area to clarify what is meant by a "rule of reason". There is no one, universally accepted, meaning of the "rule of reason" concept. Hence, commentators who dispute its existence in Community competition law are often arguing at cross-purposes.[19]

Second, if by "rule of reason" is meant a US-style[20] balancing process between the pro-competitive and anti-competitive effects of an agreement, the CFI has made clear in judgments such as *Van den Bergh*, *Métropole*, and *European Night Services*[21] that no such concept exists in Community law. Rather, such balancing occurs within Article 81(3).[22]

Third, if by "rule of reason" is meant a role for certain non-economic factors to be taken into account in assessing whether a restriction of competition exists under Article 81(1), the Community courts - and, in particular, the ECJ - have, in certain judgments, confirmed such an approach. This can be seen as an application of the "objective justification" analysis referred to, as noted above, in the Commission's Article 81(3) Guidelines. The use of the term "rule of reason" to describe such an approach in the Community law context is easily understandable, given its analogy to the so-called "rule of reason" approach adopted by the ECJ in its free movement of goods judgments on the

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[16] Article 81(3) Guidelines, note 5 above, point 18.

[17] The Commission also refers to case law such as Case 258/78 *Nungesser* [1982] ECR 2015.

[18] See, for example, Bourgeois and Bocken, "Guidelines on the Application of Article 81(3) of the EC Treaty or How to Restrict a Restriction" 32(2) Legal Issues of Economic Integration (2005) 11.

[19] See further, Hildebrand, *The Role of Economic Analysis in the EC Competition Rules* (2nd ed., The Hague, Kluwer, 2002), at 220, Robertson, "What is a restriction of competition? The Implications of the CFI's judgment in *O2 Germany* and the Rule of Reason" (2007) European Competition Law Review 28(4) 252, and Wesseling, "The rule of reason in EC competition law" in *Rethinking another Classic of EC Legal Doctrine* (Groningen, Europa Law Publishing, 2005).

[20] As adopted by the US Courts in interpreting the Sherman Act prohibitions, beginning with Justice White in the *Trans-Missouri* case of 1897, discussed by Bork in Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York, Basic Books, 1978, 1993 reprint with new introduction and epilogue), at 22. See further, Elhauge and Geradin, *Global Competition Law and Economics* (Oxford, Hart, 2007), at 174.

[21] Case T-65/98 *Van den Bergh Foods* [2003] ECR II-4653, para 106, Case T-112/99 *Métropole* [2001] ECR II-2459, paras 73-76, Case T-34/94 *European Night Services* [1998] ECR II-314, para 136.

[22] Guidelines on Article 81(3), note 5 above, point 10. Nicolaides summarises the "consensus" here as follows: "*Although an agreement is assessed on all the relevant economic facts and often this requires a determination of whether the restrictions contained in an agreement are necessary for the placing of a product on the market, the weighting of any efficiency gains and pro-competitive effects, which is an indispensable element of the US rule of reason is left for Art. 81(3). The assessment in Art. 81(1) is about the necessity of restrictions rather than the efficiency or competition impact of restrictions. It is certainly not about the weighing of pro- and anti-competitive effects*…" Nicolaides, "The Balancing Myth: The Economics of Article 81(1) & (3)" 32(2) Legal Issues of Economic Integration (2005) 123, at 131.

scope of Article 28 EC, starting with the classic judgment *Cassis de Dijon*.[23] In other words, only restraints which are, in the context of the objective pursued, "unreasonable", fall within the scope of Article 81(1). However, due to the risk of confusing what is meant with the US "rule of reason", the doctrine might more clearly be described as the "inherent restriction" principle. One can point to a variety of judgments as illustrative of this principle, including early cases such as *Gøttrup-Klim* and *Campari*.[24] More recently, leading judgments include those on labour policy and collective bargaining in cases such as *Albany*, *Brentjens*, *Drijvende Bokken* and *Pavlov*; and the judgment on lawyers' regulatory rules in *Wouters*.[25]

i. Early cases

In *Gøttrup-Klim*, for example, the Court held that a provision in the statutes of a Danish cooperative purchasing association, which forbade its members from participating in other forms of organised cooperation in direct competition with it, did not necessarily restrict competition. In the Court's view, the provision would not be caught by Article 81(1) if it was proportionate (i.e., limited to what was necessary to ensure that the co-operative functions properly and maintains its contractual power in relation to producers).[26] The Court and/or Commission also accepted, in earlier cases, that *prima facie* restrictions on competition could be "objectively justified" by reasons such as the need to maintain quality control (in, for example, *Campari*, *Pronuptia* and *Windsurfing International*);[27] the need to avoid damaging the product itself (in, for example, *D'Ieteren Motor Oils*) [28] and the need to safeguard consumer health (in, for example, *Kathon Biocide* and *Tetra Pak*)[29]. If the restriction was objectively justified and proportionate to its aim, it would fall outside the scope of Article 81(1).[30]

ii. More recent cases: *Albany* and *Brentjens*

In *Albany*, the ECJ held that, in principle, collective bargaining between organisations representing employers and employees falls outside the scope of Article 81 EC. In so holding, the ECJ reasoned that the Community's activities within the meaning of Article 3 EC included not only a competition policy, but also a "*policy in the social sphere*." The Court conclusion was heavily based on the social policy aspect of the cases, reasoning that certain competitive restrictions are inherent to collective agreements and for this reason fall outside Article 81(1) EC:

> "*It is beyond question that certain restrictions of competition are inherent in collective agreements between organisations representing employers and workers. However, the social policy objectives pursued by such agreements would be seriously undermined if management and labour were subject to Article*

[23] Case 120/78 *Rewe-Zentrale AG (Cassis de Dijon)* [1979] ECR 649.
[24] Case C-250/92 *Gøttrup-Klim* [1994] ECR I-5641, *Campari* OJ 1978 L 70/69.
[25] Case C-67/96 *Albany* [1999] ECR I-5751, Joined Cases C-115-117/97 *Brentjens* [1999] ECR I-6025, Case C-219/97 *Drijvende Bokken* [1999] ECR I-6121, Joined Cases C-180 & 184/98 *Pavlov* [2000] ECR I-6451, Case C-309/99 *Wouters* [2002] ECR I-1577.
[26] *Gøttrup-Klim*, note 24 above.
[27] *Campari,* note 24 above, Case 161/84 *Pronuptia* [1986] ECR 353, Case 193/83 *Windsurfing International* [1986] ECR 611.
[28] OJ 1991 L 20/42.
[29] Case T-83/91 *Tetra Pak II* [1994] ECR II-755.
[30] More broadly, earlier judgments such as *Société Technique Minière*, *Metro I* and *Nungesser* (notes 11 and 17 above) may, to a certain extent, be viewed as illustrations of this principle in an intra-brand context, dealing with the objective justification for exclusive or selective distribution networks.

> *[81](1) of the Treaty when seeking jointly to adopt measures to improve conditions of work and employment. It therefore follows from an interpretation of the provisions of the Treaty as a whole which is both effective and consistent that agreements concluded in the context of collective negotiations between management and labour in pursuit of such objectives must, by virtue of their nature and purpose, be regarded as falling outside the scope of Article [81](1) of the Treaty.*"[31]

The Court has confirmed this "inherent restrictions" approach in numerous subsequent social policy cases, including *Brentjens* (concerning, as was the case in *Albany*, a collective agreement setting up a supplementary pension scheme managed by a pension fund to which affiliation may be made compulsory) and *Pavlov* (also concerning a collective agreement regarding a pension fund).[32]

iii. *Wouters*

In *Wouters*, the ECJ seemed to follow a similar approach, this time in the context of a regulation of the Dutch bar banning multi-disciplinary partnerships. In finding that the regulation did not constitute a restriction of competition contrary to Article 81(1), it seemed to apply an "objective justification"-style approach:

> *"[N]ot every agreement between undertakings or every decision of an association of undertakings which restricts the freedom of action of the parties or of one of them necessarily falls within the prohibition laid down in [Article 81(1)] of the Treaty. For the purposes of application of that provision to a particular case, account must first of all be taken of the overall context in which the decision of the association of undertakings was taken or produces its effects. More particularly, account must be taken of its objectives, which are here connected with the need to make rules relating to organisation, qualifications, professional ethics, supervision and liability, in order to ensure that the ultimate consumers of legal services and the sound administration of justice are provided with the necessary guarantees in relation to integrity and experience…It has then to be considered whether the consequential effects restrictive of competition are inherent in the pursuit of those objectives.*"[33]

As accountants, in contrast to lawyers, were not subject to a code of professional conduct, the Court reasoned, it did not appear that the restrictive effects of the regulation went "*beyond what is necessary in order to ensure the proper practice of the legal profession.*"[34] In other words, "reasonable" regulatory rules did not fall within the scope of Article 81(1) EC.[35] In so holding, the ECJ rejected the approach of Advocate General Léger, who had concluded that the regulations amounted to a restriction of competition under Article 81(1). AG Léger had argued that Article 81(1) only allows for an assessment whether, in view of all the circumstances, an agreement on balance restricted competition: it allowed for,

> *"a purely competitive balance-sheet[36] of the effects of the agreements…The only legitimate goal which may be pursued in accordance with that provision is therefore exclusively competitive in nature."*[37]

iv. Discussion

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[31] *Albany*, note 25 above, paras 59-60.

[32] *Brentjens* and *Pavlov,* note 25 above. Likewise, in *Van der Woude*, the Court held that a collective agreement for a health care insurance scheme fell within the *de minimis* doctrine, as the purpose of the agreement was to improve working conditions: Case C-22/98 [2000] ECR I-7111.

[33] *Wouters,* note 25 above, para 97. See also, the Commission's decision in *EPI Code of Conduct* OJ 1999 L 106/14.

[34] *Ibid,* para 26.

[35] See also, *Belgian Architects Association* OJ 2005 L 4/10.

[36] *"Bilan économique".*

[37] Opinion in *Wouters*, note 25 above, para 104.

It is clear that, in view of the earlier decisional practice discussed above, as well as cases such as *Wouters* and *Albany*, it is possible in certain cases to balance (legitimate) non-competition objectives of a measure against what would otherwise constitute a restriction of competition under Article 81(1). Where the competitive restrictions are deemed inherent in an agreement's legitimate non-competition objectives, such that the agreement would not have been concluded in the absence of the restriction, Article 81(1) is not infringed. The question is to what extent can the reasoning in such judgments apply by analogy to restrictions inherent in environmental protection measures. On this issue, a number of points can be made.

First, in the case of judgments like *Albany* and *Brentjens,* the Court's use of the concept of inherent restrictions can be seen as aimed at achieving a balance between the Community's competition policy, as an activity set out in Article 3(1)(g) EC, and principles of the Community's social policy, including a respect for the outcome of collective bargaining procedures. As such, from Chapter 6's *systematic* perspective, the Court rightly sought to achieve a compromise between these two policy fields, making clear that competition policy does not "trump" social policy, and that restrictions inherent in, and proportionate to the aim of, collective agreements fall outside the scope of Article 81(1) EC. From Chapter 7's *governance* perspective, such cases support the "realist's" argument made there, insofar as they constitute good examples of the Court's taking non-economic factors (in this case, the aims and means of the Community's social policy) into account in interpreting and applying the competition provisions of the Treaty. As a result, though on their facts these cases concern the specific legal context of collective bargaining, the Court's reasoning is also implicitly encouraging as an indication of its potential approach to the interrelation between competition and environmental policy objectives. Were the Court to be faced with a competitive restriction in an environmental agreement which is objectively necessary to the achievement of the agreement's environmental objective, such that these objectives would be "*seriously undermined"* were the restriction to fall within Article 81(1) EC, *Albany* and *Brentjens* should be interpreted by analogy to mean that Article 81(1) EC does not apply.

Secondly, in the case of the *Wouters* judgment, in contrast, the Court applies a "rule of reason" in a different context - that of regulation of a profession - holding that restrictions necessary to ensure the "*proper practice of the legal profession*" did not come under the Article 81(1) EC prohibition. There seems no reason why this reasoning should be confined to the regulation of professions.[38] Rather, the Court's reasoning here could apply in the context of any public interest regulatory tasks being performed by private undertakings or associations of undertakings, at least where such regulation would otherwise likely have had to be carried out by the state. Thus, it is submitted, privately-run regulatory systems set up for environmental protection purposes, where such regulation would likely otherwise have been undertaken by the state, be viewed as falling within the *Wouters* logic. This would mean that what would otherwise amount to competitive restrictions would, if inherent in, and

[38] As Giorgio Monti argues, *Wouters* "*introduces a "new generation" of public policy arguments which can now be used to exclude the application of the competition rules*." Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057, at 1088. See also, the Opinion of Advocate General Cosmas in Joined Cases C-51/96 and C-191/97 *Deliège* [2000] ECR I-2549, who reasoned that, "*rules which, at first sight, reduce competition, but are necessary precisely in order to enable market forces to function or secure some other legitimate aim, should not be regarded as infringing the Community provision on competition*" (para 110). The ECJ did not consider the issue.

necessary for, the achievement of the regulation's environmental protection goals, fall outside the scope of Article 81(1).[39]

On this point, I must disagree with Loozen, who has argued that the *Wouters* reasoning cannot be applied by analogy to environmental protection regulation as,

> "*competition rules merely protect the public interest of effective competition. The protection of the environment covers another public interest safeguarded by the state in other policies*…"[40]

With respect, this approach is too simplistic. It takes as its starting point the view that "*the basic assumption underlying the EC Treaty is that the state safeguards the public interest, whilst undertakings act in their own, private interests.*"[41] As has been argued consistently above, this dichotomy between public and private interest, while superficially attractive, is inappropriate and outmoded in the area of environmental protection. As discussed in Chapters 3 and 4, one of the key features of modern environmental policy, and one viewed as crucial if effective environmental protection is ever to be achieved, is the privatisation of environmental policy making, via the enrolment of private actors in situations where state-led action has proven to be ineffective. Loozen's approach ignores this development which, as argued in Chapter 6, has blurred the distinction between the public and private sectors in this area. Moreover, her approach runs counter to the imperative, as also argued in Chapter 6, of interpreting the Treaty's competition rules in a systematic manner and in conformity with Article 6 EC.[42] Further, it is submitted that Chapter 7's *governance* argument suggests that the Court would, in practice, be more likely to adopt a more holistic, systematic approach were the matter to arise before it (and judgments such as *Albany* are good examples of such an approach).

A further issue arising from *Wouters* is the question of which body has the final say as to what restrictions are necessary and essential in order to carry out the regulatory task at hand. In *Wouters*, the Court accepted that the ban on multi-disciplinary partnerships could, as the Dutch Bar contended, reasonably be considered to be essential to the sound administration of justice, as it was consistent with the fundamental principles of independence and professional secrecy governing the Dutch Bar. This can be contrasted, for instance, with the decision of the Dutch competition authority (the NMa) in its *NOVA* decisions. In *NOVA I*, the NMa considered the compatibility of the Dutch bar's prohibition on contingency fee (i.e., no win, no fee) arrangements with the Dutch equivalent of Article 81(1) EC. Rejecting the Dutch Minister of Justice's position that the rule followed from the fundamental principles applicable to members of the Dutch bar, so that lawyer should not have a financial interest in the outcome of a case, the NMa considered that the prohibition constituted a restriction of competition which was not objectively necessary for the sound administration of justice (as it did not follow directly from the bar's fundamental principles).[43] The NMa's

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[39] Giorgio Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057. See also, Wesseling, *The Modernisation of EC Antitrust Law* (Oxford, Hart, 2000).

[40] Loozen, "Professional Ethics and Restraints of Competition" (2006) 31(1) EL Rev 28, at 46.

[41] *Ibid,* at 33.

[42] See, for instance, the approach in Case C-176/03 *Commission v Council* [2005] ECR I-7879, at paras 41-43 (discussed in Chapter 6), where the Court uses Article 2 EC (providing that one of the goals of the Community is the achievement of a high level of protection of the environment) and Article 6 EC (the integration principle, discussed in Chapter 2) to interpret Article 47 EU and Article 175 EC.

[43] Decision of the NMa of Feb.21, 2002 in Case No. 560 (*NOVA I*), at points 65-75. See also, on further developments following *NOVA I*, the 2005 Annual Report (*Jaarverslag)* of the NMa, at 11.

position seems right, and transposable to the interpretation of Article 81(1): the *Wouters* test asks what is objectively necessary for the regulatory task to be performed, rather than what the regulator views as being necessary.

As a result, it is submitted that, where a competitive restriction is objectively necessary to the achievement of an agreement's environmental objectives, such that the agreement would not otherwise have been entered into (*Albany, Brentjens*), or is necessary to carry out an environmental regulatory task (*Wouters*), it falls within point 4 of Chapter 6's working hypothesis on the implications of the Article 6 EC integration principle. In other words, it constitutes a situation where it is possible to interpret Article 81(1) in a way that favours environmental protection, and there is a potential conflict with the goals of competition policy, such that the proportionality principle applies to resolve this conflict. As argued in Chapter 6, this means that, where a private measure is necessary to achieve the Community's environmental policy goals, and there is no less restrictive means of achieving this goal, the measure should be allowed under Article 81(1) EC. In effect, it is submitted, the Court's reasoning in these judgments demonstrates precisely this kind of proportionality-based approach.

One can also arrive at this conclusion on the basis that, from an *economic* perspective as discussed in Chapter 8, the environmental benefits flowing from an agreement should, where reasonably quantifiable, be taken into account in assessing whether the agreement leads to economic inefficiency, and thus is restrictive of competition. Article 81(1) is engaged only where such benefits are outweighed by the agreement's restrictive, utility-reducing effects. However, it should be noted that such economic reasoning is not immediately apparent from judgments like *Albany* and *Wouters*, which are more evidently explained on the basis of the Court's systematic, coherence-based approach to judicial reasoning.

Thirdly, it is admitted that a possible doctrinal criticism of this approach is that, even though it has indisputably been adopted in a variety of cases to date, it could potentially elide the analyses of Article 81(1) and Article 81(3). If the analysis under Article 81(1) extends to considering whether a *prima facie* restriction is objectively justified and proportionate, how does this differ from the function of Article 81(3)? This is indeed a valid question. To answer it properly requires us to take a view on the function of Article 81(3), which will be discussed in greater detail in the following Chapter. For the present, however, three points are important.

To begin, it is arguable that the function of the inherent restriction doctrine, as described above, is different to the function of Article 81(3) EC - though the Court has never been explicit about this. By this argument, the inherent restriction doctrine under Article 81(1) would apply where an agreement aimed at achieving a legitimate non-competition objective would not have been entered into in the absence of the restriction. In contrast, Article 81(3) EC would apply where, while the measure might have been entered into without the restriction, the presence of the restriction generates greater efficiencies within the meaning of Article 81(3) EC and is indispensable to achievement of the objective. In addition, Article 81(1) and 81(3) remain very different as, in order to evade prohibition under Article 81(3), four conditions must be satisfied, rather than a pure proportionality test, as is the case for

public policy objective justifications under Article 81(1).[44] Finally, and in any event, since Regulation 1/2003 and the "modernisation" of the enforcement of Article 81, the practical distinction between escaping Article 81(1) altogether via objective justification, and escaping prohibition via Article 81(3), has decreased. The burden of proof in each situation lies on the parties to the agreement. Further, since the abolition of the exemption system, parties do not receive formal Article 81(3) exemption decisions in response to notifications to the Commission;[45] similarly, national courts can now apply the whole of Article 81, not just Article 81(1).

It is important to admit, however, that Part II's arguments are to a certain extent agnostic as to whether environmental protection requirements are taken into account in the context of Article 81(1) or 81(3), as long as the practical outcome is the same - that is, non-prohibition of agreements the competitive restrictions of which are proportionate to their environmental benefits. The argument is confined to the point that, to the extent that an inherent restriction approach has been adopted for other non-economic objectives (e.g., social policy in *Albany*) and other regulatory tasks (*Wouters*), it should also be adopted for environmental protection measures in similar situations.

Fourthly, it is interesting to note that the *Albany, Brentjens* and *Wouters* judgments bring the Court's interpretation of the scope of Article 81(1) closer to its approach to justifications for indistinctly applicable measures which restrict free movement of goods under Article 28 EC (as epitomised by *Cassis de Dijon*), as well as indirectly discriminatory measures which restrict freedom of establishment and freedom to provide services under Articles 43 and 49 EC.[46] In each instance, the outcome of the Court's case law is to enable a restrictive measure to be justified otherwise than by recourse to the express derogation(s) set out in the Treaty (i.e., Articles 81(3), 30, 46 and 55 respectively). Indeed, on the basis of the *systematic argument* set out in Chapter 6, it is submitted that the rapprochement between the two areas in itself supports the validity of the Court's reasoning in these cases. Moreover, it is submitted, the ECJ's reasoning in these cases is an excellent example of the *governance argument* – positing coherence in judicial reasoning between separate areas of Community law - in action.

Arguably, however, the *Viking* and *Laval* judgments demonstrate that the Court has gone even further in taking non-economic considerations into account in assessing the scope of Article 81(1) in judgments like *Albany* and *Brentjens* than it is prepared to do in assessing the scope of Articles 43 and 49 EC.[47] In *Viking*, for example, the Court expressly dismissed the Finnish trade unions' arguments that the reasoning in *Albany* should be applied in the Article 43 EC context such that restrictions on establishment inherent in collective action flowing from a collective agreement should fall wholly outside the scope of Article 43 EC. In

[44] See Mortelmans, who argues that the Article 81(1) route may be more attractive for environmental justifications for this reason: Mortelmans, "Towards Convergence in the Application of the Rules on Free Movement and on Competition?" 38 CML Rev (2001) 613, at 641.

[45] It is, however, still open to the Commission to give a finding of "inapplicability" under Article 10 of Regulation 1/2003 OJ 2003 L 1/1, to the effect that Article 81 of the Treaty is not applicable to an agreement, a decision by an association of undertakings or a concerted practice. However, such a finding may be made either because the conditions of Article 81(1) of the Treaty are not fulfilled, or because the conditions of Article 81(3) of the Treaty are satisfied.

[46] See Mortelmans, note 44 above.

[47] Case C-438/05 *Viking*, judgment of December 11, 2007, not yet reported, and Case C-341/05 *Laval*, judgment of December 18, 2007, not yet reported.

particular, the Court refused to accept that it was inherent "*in the very exercise of trade union rights and the right to take collective action*" that freedom of establishment would be restricted.[48]

More generally, the whole idea of objective justification and inherent restriction in this sense, it should be noted, sets the Community regime firmly apart from that of the US. Most commentators would agree that, in accordance with Chicago School theory, the US regime does not allow for non-competition policy factors to be taken into account in deciding whether competition is restricted: rather, as noted above, the inquiry is restricted into assessing whether the pro-competitive effects of an agreement or provision outweigh its anti-competitive effects.[49]

Finally, it is interesting to note that *Albany* and *Wouters*, as applications of the inherent restriction doctrine, were decided by the ECJ, and not the CFI. It was admitted in Chapter 7's *governance* argument that the realist limb of that argument may be more forceful in the case of the ECJ than the CFI (i.e., the argument that, in practice, the Community courts are not likely to refuse to take environmental protection factors into account in competition analysis), because the ECJ deals more frequently with environmental policy and cross-cutting issues involving a variety of Community policy areas, whereas the CFI is more specialised in terms of time devoted to competition cases. However, the fact that the CFI was not the first to come out with judgments such as *Albany* and *Wouters* may equally, it is submitted, be explained on the ground that it is not open to the CFI, to the same extent, to make new departures (as these cases were) in fundamental competition law principles of Treaty interpretation.

c. Relevance of environmental factors to the concept of "restriction": some practical examples

Having surveyed the applicable theoretical framework, we move now to consider some examples of situations in which environmental agreements can be considered to restrict competition within the meaning of Article 81(1), considering in turn agreements with actual or potential competitors ("horizontal" situations) and agreements with undertakings which are not actual or potential competitors ("vertical" situations).

i. Horizontal situations

The starting point here is the Commission's 2001 Horizontal Guidelines, chapter 7 of which is devoted to "environmental agreements". The Commission distinguishes between three categories of environmental agreement: those which do not fall under Article 81(1); those which may fall under Article 81(1); and those which "*almost always*" fall under this provision.

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[48] *Viking, ibid,* para 52. The Court added, at para 53, that "*the fact that an agreement or an activity are excluded from the scope of the provisions of the Treaty on competition does not mean that that agreement or activity also falls outside the scope of the Treaty provisions on the free movement of persons or services since those two sets of provisions are to be applied in different circumstances.*" Nonetheless, there remains a certain degree of similarity between the Court's reasoning in *Albany* and *Viking/Laval* judgments: the Court's acceptance, in principle, of the validity of a justification on grounds of protection of workers and maintenance of employment conditions in *Viking* and *Laval* was based on its observation that the Community has *"not only an economic but also a social purpose*" (*Laval*, para 105). This was also, as we have seen, the basis for its conclusion in *Albany*.

[49] Thus, Elhauge and Geradin suggest that, if *Wouters* had been decided under US law, the US courts would not consider the justification to be pro-competitive, as it amounts to an argument that competition should be decreased to increase quality. Elhauge and Geradin, *Global Competition Law and Economics* (Oxford, Hart, 2007), at 180 and see Chapter 5's discussion of the difference in relevance of the Chicago School approach in the US, compared to the EU.

An environmental agreement is "*not likely*" to fall under Article 81(1), irrespective of the aggregated market share of the parties, in three situations.

First, this is so if "*no precise individual obligation is placed upon the parties or if they are loosely committed to contributing to the attainment of a sector-wide environmental target.*"[50] This will be assessed by looking at the extent of the discretion left to the parties as to the means that are technically and economically available in order to attain the environmental objective agreed upon. The more varied such means, the less appreciable the potential restrictive effects. In *ACEA*, for example, the Commission found an agreement between members of the European association of automobile manufacturers to reduce carbon dioxide emissions from cars did not appreciably restrict competition. This was for a number of reasons: the parties had only agreed on a sector-wide emissions reduction aim, rather than a binding obligation for individual parties; and parties were left free to decide the technical means by which they would meet the aim.[51]

Secondly, if the agreements set the environmental performance of products that "*do not appreciably affect product and production diversity in the relevant market or whose importance is marginal for influencing purchase decisions.*"[52] This may apply, for example, where categories of a product are in any event banned from the markets.

Thirdly, if the agreements "*give rise to genuine market creation…provided that and for as long as, the parties would not be capable of conducting the activities in isolation, whilst other alternatives and/or competitors do not exist.*"[53] The Commission gives the example of recycling agreements in this regard (though, interestingly, does not deal with the tricky areas of environmental covenants and surcharges). A further example might be an agreement to develop and produce an environmentally-superior product which the contracting parties would not otherwise have sufficient resources to be able to develop otherwise.[54] Viewed in the economic terms of Chapter 8, the dynamic efficiency of such agreements is such that they increase consumer welfare.

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[50] Horizontal Cooperation Guidelines OJ 2001 C 3/2, points 184-185.

[51] Commission Press Release IP/98/865 and XXVIIIth Report on Competition Policy (1998). See also, the negative clearance for equivalent commitments by the Association of Japanese Automobile Manufacturers and the Association of Korean Automobile Manufacturers. Competition Report 1998, at 160. A further example is *CEMEP*, where the Commission granted negative clearance to an agreement to improve energy efficiency of electric motors for similar reasons: Commission Press Release IP/00/508 and Martinez Lopez, "Commission Approves an Agreement to Improve Efficiency of Washing Machines", Competition Policy Newsletter 1, 13 (2000). The agreement set an overall reduction target of 50%, rather than precise individual obligations. One might also include within this category certain agreements between undertakings to set up private eco-labels (on which, see Chapter 4), participation in which is voluntary and which leave participants relatively broad discretion as to how they satisfy the eco-label's requirements.

[52] Horizontal Guidelines, note 50 above, point 186. An example is the Commission's clearance by comfort letter of the hydro power production joint venture between E.ON and Verbund, on the ground that effective competition in the Austrian and German power markets would not be restricted, as the joint venture would not appreciably alter the market position of the relevant parent companies: IP/02/62.

[53] Horizontal Guidelines, note 50 above, point 187.

[54] See, by analogy, the *EUCAR* case, which concerned an agreement termed the European Council for Automotive Research and Development between Europe's leading car manufacturers to engage in R&D in environmentally-friendlier projects in the industry at the pre-competitive stage, meaning that the products obtained from the research would not be directly usable in a specific type of vehicle. See Competition Report 1998, at 150.

It is worth noting here that, clearly, an agreement which does not restrict competition in any way, but which is damaging to the environment, cannot on any reading fall under Article 81(1). As observed earlier, this would run counter to the express wording of Article 81(1), and none of the three arguments made in Part II suggests a different conclusion.[55] For instance, Chapter 6's *systematic* argument concluded that where there is, on its wording, no scope for interpreting a Treaty competition provision in a way that favours environmental protection, the integration principle is not relevant.

In contrast, an environmental agreement will "*almost always*" fall under Article 81(1) where "*the cooperation does not truly concern environmental objectives, but serves as a tool to engage in a disguised cartel*" or "*if the cooperation is used as a means amongst other parts of a broader restrictive agreement which aims at excluding actual or potential competitors.*"[56] Clearly, evidence as to the aim of the parties is crucial in this regard: cases where the parties have a genuine environmental protection objective for their agreement do not, it is submitted, fall within this category. An example of such a "disguised cartel" is the *IAZ* case, where the Belgian *Association Nationale des Services d'Eau* agreed with Belgian manufacturers and sole importers of washing machines and dishwashers that all appliances sold in Belgium should have a conformity label showing that they complied with technical requirements of Belgian law. The Commission found that an ulterior purpose of the agreement was in fact to hinder parallel imports, as the labels were only available to Belgian manufacturers or sole importers. In upholding this finding, the Court held that the agreement "*clearly expresses the intention of treating parallel imports less favourably*".[57]

Agreements fixing a proportion of costs or prices, reducing output or allocating markets thus always fall under Article 81(1), even where the parties have an ostensibly genuine environmental protection motivation. This was the case in *VOTOB*, where the Commission held to fall under Article 81(1) EC an agreement between the six undertakings with storage capacity for chemicals in the Netherlands whereby the undertakings decided to finance investments via a set "environmental surcharge" on their services. The surcharge depended on the product to be stored according to its polluting qualities, and there was an obligation to pass the charge on completely to consumers and detail the charge separately on their bills. In the Commission's view, this constituted horizontal price-fixing contrary to Article 81 EC. The fact that the charge amount to only 4% of average total costs of storage was irrelevant.[58]

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[55] See Chapter 6 and, similarly, Winter, "On the effectiveness of the EC administration: the case of environmental protection" 33 CML Rev (1996) 689.

[56] Horizontal Guidelines, note 50 above, point 188.

[57] Joined Cases 96-102 etc/82 *IAZ* [1983] ECR 3369, at para 23. See also, Decision 82/371 *Anseau-Navewa* and *Olieranches Faellerad* XXIVth Report on Competition Policy (1994) at 368 and, for example, the raids of the German cartel office on more than 140 German-based waste management companies on suspicion of bid fixing for waste disposal contracts from DSD (see Financial Times September 12, 2003). Since Case T-168/01 *GlaxoSmithKline* [2006] ECR II-2969, however, the CFI has clarified that, in order to fall within Article 81(1), agreements restricting parallel trade must still be shown to have as their object or effect the restriction of competition: see para 120, clarifying Cases 56 & 58/64 *Consten and Grundig* [1966] ECR 299, at 340.

[58] See XXIInd Competition Report 1992, paras 177-186. See also, the Dutch competition authority's decision in Case 51/98 *Stibat*, which concerned a Dutch system (Stibat) set up to collect and recycle used batteries, pursuant to individual battery producers' obligations under the Dutch legislation implementing the Batteries Directive, Directive 91/157 OJ 1991 L 78/38 (since replaced by Directive 2006/66 OJ 2006 L 266/1). Part of the case concerned the legality of Stibat's charging a standardised levy to producers for its services. The fact that the levy amounted, in Stibat's contention, to less than 5% of the batteries' sale price did not, in the NMa's view, prevent it from amounting to a restriction of competition within Dutch legislation's equivalent to Article

More recently, a similar conclusion was reached in the Commission's *Industrial and Medical Gases* decision, concerning a fixed "environmental and safety" surcharge imposed on the sale of cylinder gases by participants in a cartel.[59] Other serious restrictions might include a collective refusal to deal with "dirtier" suppliers;[60] or an agreement to clean up pollution in line with the "source" principle of Community environmental law (i.e., the principle that pollution should be remedied at source) amounting to allocation of markets to local undertakings.[61] However, such restrictions may, depending on the features of the agreement, be saved by Article 81(3). This approach, it is submitted, tallies with the arguments made in Part II, and in particular with the *systematic* argument by which the Article 6 EC integration principle requires Article 81 to be interpreted so that environmental objectives are achieved in the manner least restrictive of competition.[62]

Finally, the Commission identifies a category of "borderline" cases, which may fall within Article 81(1) depending on the effect of the agreement on the market. This may occur in situations where an environmental agreement made between parties with substantial market shares appreciably restricts the parties' ability to "*devise the characteristics of their products or the way in which they produce them*", or "*substantially affects*" the output of third parties, as suppliers or as purchasers.[63] It is in this borderline category of cases where, it is submitted, the possibility of relying on the inherent restriction doctrine of otherwise restrictive measures, discussed at length above, becomes relevant. As argued above, therefore, where a restriction is inherent to achievement of an agreement's environmental protection goal, such that the agreement would not otherwise have been entered into (*Albany, Brentjens*), or where a restriction is necessary in order to perform an environmental regulatory task (*Wouters*), it may fall outside Article 81(1) EC.

Many types of environmental agreements may fall within the category of horizontal agreement categorised as "borderline" by the Commission. Common examples include agreement on environmental standards, specialisation and production agreements, agreements on quota allocation, and exclusive recycling agreements.

Environmental standards. A first example of a borderline case, and one taken in the Horizontal Guidelines, is an agreement which aims at defining environmental standards for products or production processes, and which "*significantly affects a large proportion of the parties' sales as regards their products or production processes*".[64] As with non-environmental standards, where based on non-discriminatory, open and transparent procedures and open to all market players, such agreements fall outside the scope of Article 81(1) EC.[65] An example in the environmental context would be an agreement to create a (private) eco-label, or creating a

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81(1). However, this part of the Stibat system was ultimately exempted under the Dutch equivalent to Article 81(3).

[59] Commission decision in *Industrial and Medical Gases* OJ 2003 L 84/1. See also, Commission decision of December 3, 2003 C/38.359 *Electrical and mechanical carbon and graphite products* (environmental surcharge used as pretext for price rises in cartel).

[60] Note, however, that a national agreement phasing out a pollutant or waste identified as such in relevant Community directives may not be assimilated to a collective boycott on a product which circulates freely in the Community: see footnote 51, Horizontal Guidelines, note 50 above.

[61] See, for example, Case C-203/96 *Dusseldorp* [1998] ECR I-4075.

[62] See point 4 of the working hypothesis on the integration principle, Figure 1, Chapter 6.

[63] Horizontal Guidelines, note 50 above, point 189.

[64] Horizontal Guidelines, note 50 above, point 189.

[65] *Ibid.*

set of environmental management standards, participation in which is voluntary and open to all, and which sets out a transparent set of standards to be followed by participants in producing a large proportion of their products.[66] However, standardisation agreements aimed at excluding actual or potential competitors from the market are generally caught - for example, where a national manufacturers' association sets a standard and puts pressure on third parties not to market products that do not comply with the standard. In *APB*, for example, it was held that an environmental quality mark cannot be used to create exclusive sale or purchase networks; rather, it should relate to an objective standard, and other market players should be free to participate in the network.[67] In *CECED*, the Commission considered that Article 81(1) EC applied to an agreement on energy efficiency standards between importers and producers of washing machines in the Community because the parties held over 95% of the market.[68] Further, the Commission found that energy consumption was "not negligible" as a factor which would be taken into account in making decisions to purchase a washing machine.[69] Similarly, in *EACEM*, an agreement between manufacturers of television sets and video cassette recorders to reduce the electricity consumption of televisions and video recorders when in "standby" mode was found by the Commission to fall under Article 81(1).[70]

A further issue here, as with many environmental agreements, is the potential competitive restrictions which may arise from information exchange which takes place as a result of environmental agreements. This may, for example, mean that undertakings know more about the products which their rivals intend to develop; or more than about their rivals strategies and pricing structures, than they would otherwise have known. Clearly, if entering into the environmental agreement is a pretext for such information exchange, Article 81(1) will apply. However, it is submitted that, by analogy to *Albany,* where information exchange is limited to what is absolutely necessary to achieve an environmental aim, and the environmental agreement would not otherwise have been entered into without the information exchange provisions, it falls outside Article 81(1).[71]

Specialisation and production agreements. A second example of environmentally-motivated restrictions might include specialisation or production agreements. One can, for example, imagine a production agreement analogous to that at issue in *Ford/Volkswagen*,[72] such as where two major manufacturers agree to form a joint venture to develop environmentally-friendlier cars, though environmental performance constitutes an important way in which to compete. Where the parties have a significant market share, it is submitted,

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[66] See the discussion in Chapter 4 of eco-labels and environmental management ventures as voluntary corporate initiatives.
[67] *APB* OJ L 18/35(1990).
[68] Commission Decision 2000/475 OJ 2000 L 187/47.
[69] *Ibid,* para 42.
[70] See the Annual EC Competition Report 1998, at 152.
[71] See, for example, the approach of the Dutch competition authority in Case 51/98 *Stibat* which, as mentioned above, concerned a Dutch system (Stibat) set up to collect and recycle used batteries, pursuant to individual battery producers' obligations under the Dutch legislation implementing the Batteries Directive, Directive 91/157 OJ 1991 L 78/38 (since replaced by Directive 2006/66 OJ 2006 L 266/1). The NMa concluded that the information exchange which might result from the Stibat system did not amount to a restriction of competition within the meaning of the Dutch equivalent to Article 81(1), as Stibat's members provided data (on the number of batteries sold, divided by type) to an independent body, meaning that the information would not be accessible to Stibat's members as such.
[72] OJ 1993 L 20/14.

such an arrangement should fall within Article 81(1), unless they could show that there was no less restrictive way of achieving such environmental benefits (i.e., that the restriction was proportionate).

Quota allocation. A third example is agreements to allocate individual pollution quotas.[73] Such agreements may fall within Article 81(1) where a market for such quotas exists - i.e., a tradable permit scheme, one of the economic instruments discussed in detail in Chapter 4. In the context of the EU's Emissions Trading Scheme (ETS), for example, it is conceivable that Article 81(1) may cover situations of allowance "pooling", for which Member States may choose to provide under Article 28 of the ETS Regulation - though few have as yet chosen to do so.[74] As discussed in Chapter 4, this Article allows Member States to enable operators of installations to form a "pool" of installations from the same activity for Phase I and/or 2 of the ETS, on application to the competent authority. If such a pool is allowed, the operators must nominate a trustee to "take over" the individual operators' ETS responsibilities – e.g., to be issued with the total allowances for the group, to be responsible for surrendering allowances, and to be liable to penalties in the event of failure to do this. Any penalty which the trustee fails to pay falls to be paid, however, by the constituent individual members of the pool. In the context of Article 81(1), such allowance pooling may be significant because, clearly, the number of allowances held by an installation has a direct and substantial effect on its (permitted) output levels. By forming a pool, therefore, installations are coordinating on an important factor in production levels. As a result, such pooling would seem *prima facie* to fall within Article 81(1).[75]

Exclusive recycling agreements. A fourth example, and one mentioned by the Commission in its Horizontal Guidelines, is an agreement by which a group of competitors appoint a single undertaking as exclusive provider of collection and/or recycling services for their products, where other potential providers exist.[76] This brings us to a major area to date in the interface between competition and environmental protection: the competition assessment of national systems set up to implement the EU's Packaging Waste Directive of 1994.[77] As these systems raise both horizontal and vertical issues, they are discussed below.

ii. Vertical situations

Environmental agreements may also, of course, be concluded in vertical situations. Here, as with all vertical agreements, major guidance on competition assessment can be found in the Commission's Vertical Guidelines. Adopting an economic approach, the Vertical Guidelines specify that "*for most vertical restraints, competition concerns, exemption and the disapplication of the*

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[73] Horizontal Guidelines, note 50 above, point 190.

[74] Pooling was advocated by Germany, who wished to reconcile the EU ETS with domestically binding negotiated voluntary agreements with major industries for carbon reduction. Sweden and Finland do not permit pooling as such; the UK allows it only for the second phase of the ETS. As the same monitoring obligations and liability regime apply, it is thought unlikely that many applications for pooling will be made. See Chapter 4 and Anttonen, Mehling and Upston-Hooper, "Breathing Life into the Carbon Market: Legal Frameworks of Emissions Trading in Europe" (2007) European Environmental Law Review 96, at 111.

[75] In addition, such pooling does not seem objectively justifiable using the *Albany*--based reasoning set out above, in that the environmental goal could be achieved using means less restrictive of competition, i.e., the installations' complying with their ETS obligations singly. Pooling arrangements may, of course, be open to justification under Article 81(3) and, potentially, to application of the State action defence, discussed in Chapters 11 and 14, respectively.

[76] Horizontal Guidelines, note 50 above, point 191.

[77] Directive 94/62/EC of 20 December 1994 on packaging and packaging waste OJ 1994 L 365/10.

Block Exemption can only arise if there is insufficient inter-brand competition, i.e. if there is some degree of market power at the level of the supplier or the buyer or at both levels."[78] Vertical agreements will be assessed in their "*legal and economic context*", save for hardcore restrictions[79] where it is not necessary to examine the effect on the market. However, the Commission recognises that vertical agreements may often have positive effects, by promoting non-price competition and improved quality of service via optimising distribution and manufacturing processes.[80]

As a result, where environmental vertical agreements contain any hardcore restrictions - price fixing, reduction of output or allocating markets - these will always fall within the scope of Article 81(1), as long as there is an appreciable effect on inter-state trade and on competition.[81] For the same reasons as discussed in the context of horizontal agreements, the arguments put forward in Part II do not tend to any other analysis of such restrictions. In all other cases, where the supplier's (or, in the case of exclusive supply agreements, the buyer's) market share is 30% or less, a full competition analysis is not necessary, as the agreement falls within the scope of the Vertical Agreements Block Exemption Regulation.[82] Where this market share threshold is exceeded, Commission has indicated that the following factors are most relevant in assessing whether a vertical agreement falls within Article 81(1): the supplier's market position; competitor's market positions; the buyer's market position; entry barriers; the market's maturity; the level of trade; and the nature of the product.[83]

In the context of environmental agreements, the existence of barriers to entry may be of particular relevance. For example, environmental regulation, first mover advantages for environmental innovation, or environmental government subsidies may all constitute barriers to entry. A further potential factor of particular relevance may be market maturity: where the markets for environmental products and services are innovative and rapidly changing, it is less likely that competition will be restricted under Article 81(1). Vertical restraints which are necessary to open up new markets are not generally considered by the Commission to restrict competition.[84] Moreover, it is submitted, proportionate environmentally-motivated restrictions inherent to the conclusion of the environmental agreement should be considered to fall outside Article 81(1) EC for the same reasons as argued above in the context of horizontal agreements.[85]

One type of potentially restrictive clause sometimes found in vertical environmental agreements is the exclusive distribution clause. Exclusivity is often the competitive issue in vertical environmental agreements, in particular in the case of waste collection, discussed further below. While it may lead to reduced intra-brand competition and market partitioning, exclusive distribution may also have beneficial effects, such as achieving efficiencies and economics of scale.[86] An example is the *International Fruit Container Organisation* case, where German food retailers set up a system for reusable plastic fruit

[78] Guidelines on Vertical Restraints OJ 2000 C 291/1, point 6.
[79] See Article 4 of the Vertical Agreements Block Exemption Regulation, Regulation 2790/1999 OJ 1999 L 336/21.
[80] Guidelines on Vertical Restraints, note 78 above, point 115.
[81] Guidelines on Vertical Restraints, *ibid*, points 9-10.
[82] Guidelines on Vertical Restraints, *ibid*, point 121.
[83] Guidelines on Vertical Restraints, *ibid*, point 121.
[84] Guidelines on Vertical Restraints, *ibid*, at p 25.
[85] Indeed, as vertical restrictions are generally less competitively damaging than horizontal restrictions, they are in general more likely to be proportionate.
[86] Guidelines on Vertical Restraints, note 78 above, Section 2.2.

containers. The Commission objected to a proposed exclusivity provision whereby only fruit in IFCO containers would be accepted by the system. However, when this was removed from the agreement and some other amendments were made, the arrangement fell outside Article 81(1) EC.[87] In contrast, selective distribution is normally viewed more favourably, and is less likely to be restrictive under Article 81(1), where distributors are selected on the basis of objective qualitative criteria, as established by the ECJ in the *Metro I* judgment.[88] This could conceivably apply in the context of environmental agreements, if distributors were, for example, selected on the basis of their environmental performance to date.

iii. Focus on National Packaging Waste Disposal Systems

A category of environmental agreement to which much attention has been paid in recent years by the Commission is the agreements stemming from obligations imposed on undertakings under national law in implementation of the Packaging Waste Directive. Similar systems have been set up pursuant to obligations under the End of Life Vehicles Directive and the Waste Electrical and Electronic Equipment Directive, which raise similar competition issues, though they have not given rise to much decisional practice yet.[89] The national systems to which most attention has been paid by the Commission so far have been those of Germany (via DSD), France (via Eco-emballages), Austria (via ARA), and the UK (via Valpak).

Germany. DSD was founded following the imposition of a take-back obligation for all sellers and producers in the German Packaging Waste Ordinance. The German government agreed not to apply the obligation to undertakings participating in a private collection system of packaging waste with blanket coverage and which was easy for individuals to use. This led, in 1990, to the foundation of a system by a coalition of 95 undertakings from packaging and filling industries, packaging producers and traders, run by the private undertaking DSD, which commenced operations in 1992.[90] DSD is the only undertaking operating a nationwide system for collection and recovery of sales packaging within the meaning of the Packaging Ordinance. The system is termed "dual" because collection and recovery is outside the public waste disposal system, operated by a private undertaking. The Commission assessed the compliance of DSD's system with Article 81 by decision in 2001, some months after its (separate) decision on Article 82 issues, discussed in Chapter 12.[91] At the request of the German *Bundeskartellamt*, DSD is no longer owned by the obligated

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[87] *IFCO*, see Press Release IP/93/430, XXIII Competition Report (1993) at 102, XXVIII Competition Report (1998) at 165 and Notice pursuant to Article 19(3) of Council Regulation 17 OJ 1995 C 48/4.

[88] Guidelines on Vertical Restraints, note 78 above, Section 2.3 and Case 26/76 *Metro I* [1977] ECR 1875. In addition, selective distribution systems benefit from the safe haven of the Verticals Block Exemption (Regulation 2790/1999 OJ 1999 L 336/21).

[89] Directive 2000/53/EC on end-of life vehicles OJ 2000 L 269/34, Directive 2002/96 on waste electronic and electrical equipment OJ 2003 L 37/24, Directive 94/62/EC of 20 December 1994 on packaging and packaging waste OJ 1994 L 365/10, all as amended. See generally, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[90] See generally, Lehmann, "Voluntary Environmental Agreements and Competition policy: The case of Germany's private system for packaging waste recycling", Fondazione Eni Enrico Mattei, Nota Di Lavoro 78.2000 (2000) and Boute, "Environmental Protection and EC Anti-Trust Law: The Commission's Approach for Packaging Waste Management Systems" RECIEL 15(2) (2006) 146.

[91] Commission Decision 2001/837 OJ 2001 L 319/1, confirmed by Case T-289/01 *DSD,* judgment of May 24, 2007.

packaging producers, but was acquired by an independent US investor company.[92] The system is financed by fees from the undertakings participating in system. Undertakings that pay a fee are exempted from the Ordinance's obligation to take back and recover packaging. They also receive the right to use the "Green Dot" trademark on their sales packaging.

The DSD system comprises several "layers" of agreement. The first layer is DSD's constitution and shareholder agreement. As this agreement contained no exclusivity clauses - meaning its shareholders are free to enter into other contracts with competing organisations if they wish - and as its membership is open to all German and foreign distributors, bottlers, packagers, manufacturers of packaging and suppliers of packaging material, it was found not to result in an appreciable restriction of competition under Article 81(1).[93]

The second "layer" of agreement comprises (vertical) service agreements with downstream local collecting undertakings, by which the collecting undertaking has the exclusive task of collecting and sorting used sales packaging in a certain area. As a result, DSD refuses to contract with any other undertakings within a given area. However, collectors may, if they wish, work for undertakings other than DSD.

In the Commission's decision, such service agreements were held to fall within Article 81(1), as their exclusivity provision meant that access to the market for the collection and sorting of household packaging waste by domestic and foreign collectors was obstructed. This was particularly so because the network of DSD's service agreements covered the whole of Germany; DSD was the only undertaking in Germany with an extensive packaging take-back operation; and the exclusivity was "*particularly long lasting*". Given these (rather extreme) restrictive factors, it is submitted, the arguments put forward in Part II would not suggest any other conclusion. However, the restriction was exempted under Article 81(3) EC, as considered in Chapter 11.

A further potential restriction in the service agreements was the "zero-interface" principle, whereby collecting undertakings were prohibited from marketing the materials collected, but were obliged to pass them free of charge to the undertakings recovering used packaging. While DSD removed this clause for most materials, the clause remained in the case of plastic.[94] On this point, however, the Commission found that, "*in view of the exceptional circumstances and conditions surrounding the establishment of a new, functioning market*" in the recovery of sorted plastics, this clause did not appreciably restrict competition on the market for recovery services and secondary raw materials, and fell outside Article 81(1).[95] This reasoning demonstrates the Commission's sensitivity to the dynamic efficiencies justifying the zero-interface clause, the particular technological difficulties in recovering plastics, and the environmental interest in nurturing such a recovery market. Similarly, there was no

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[92] See Commission Decision of 07/01/2005 declaring a concentration to be compatible with the common market (Case No IV/M.3638 - *KKR / DSD*). This removed concerns that informal discriminatory practices, such as treating shareholders of DSD more leniently with regard to overdue licence fees, could be taking place. See, for example, Lehmann, "Voluntary Environmental Agreements and Competition Policy" 28 Environmental & Resource Economics (2004) 435.

[93] *DSD,* note 91 above, point 107.

[94] *Ibid*, point 111.

[95] *Ibid,* para 114. The exceptional circumstances were that plastics had a negative market value at the time, meaning that without the zero-interface principle there was a risk that plastics would be channelled into a cheaper disposal method, which would breach the Packaging Ordinance.

restriction as regards competitors' access to collectors' infrastructure (e.g., recycling bins), as DSD's competitors were free to use these facilities.[96]

The third "layer" of agreement comprises agreements between DSD and its so-called "guarantee" undertakings, which accept and recover used packaging on a long-term basis depending on quotas imposed. As there was no exclusivity clause in these agreements, they were found not to fall under Article 81(1).[97]

France. Following French legislation laying down producer responsibility for packaging waste, a similar collective take-back and recycling scheme to that in Germany was set up. The scheme is run by Eco-Emballages and was considered by the Commission in parallel to DSD.[98]

In this case, there are five levels of agreement:

The first is Eco-Emballages' articles of association which, as they did not contain any competitive restrictive, was found to fall outside Article 81(1).[99]

Secondly, Eco-Emballages concludes contracts with producers who use packaging, licensing them the right to print a "green dot" on their packaging in return for a licence fee. Prior to the Commission's decision, Eco-Emballages undertook to make clear to manufacturers that they may choose to join the system for just certain types of packaging if they wish, and that they may terminate their contract each year with no penalty.[100] As a result, these agreements were found to fall outside Article 81(1).[101]

Thirdly, Eco-Emballages acquired the right to license the Green Dot from the Community-wide licensee "Pro-Europe".[102] As Eco-Emballages agreed to sub-license this right to other collecting systems,[103] this agreement did not fall within Article 81(1).[104]

Fourthly, Eco-Emballages concludes contracts for a duration of six years with local authorities, which have a statutory obligation to ensure that waste in their locality is disposed of in an environmentally sound manner. By these contracts, Eco-Emballages agrees to finance the local authorities in exchange for an undertaking to give the waste collected to a recovery company of the local authority's or Eco-Emballages' choice. Prior to the Commission's decision, Eco-Emballages undertook to ensure that local authorities could terminate their contract unilaterally at any time, meaning that only Eco-Emballages was actually bound for six years. Hence, competition was found not to be restricted.[105]

Fifthly, Eco-Emballages concludes contracts with sectoral recovery undertakings for six years, by which the undertakings undertake to recover and recycle the household waste in

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[96] *Ibid,* point 139. Such access was, however, made a condition of the Commission's decision: point 164.
[97] *Ibid,* point 120.
[98] *Eco Emballages*, OJ 2001 L 233/37.
[99] *Ibid,* point 72.
[100] See Article 19(3) Notice, OJ 2000 C 227/3, at 92 onwards.
[101] *Eco-Emballages,* note 98 above, point 75.
[102] Pro-Europe (short for Packaging Recovery Organisation Europe) licenses the Green Dot trademark from DSD and is run by various national producer responsibility organisations. Its constitutive agreements were notified in OJ 2001 C 153/4. The Commission did not raise any objections.
[103] Other smaller schemes which existed at the time included Adelphe (glass and multimaterial collection), Cyclamed (pharmaceuticals) and Edouard Leclerc (plastic bags).
[104] *Eco-Emballages,* note 98 above, point 82.
[105] *Eco-Emballages, ibid*, point 78.

certain sectors (e.g., steel, aluminium, paper, plastic, glass). Only one contract is concluded per sector. The sectoral take-back undertakings in turn sub-contract this responsibility to individual take-back undertakings. As with the local authorities' contracts, because the exclusivity was unilateral (Eco-Emballages was obliged to present the contracted sectoral undertaking to the local authorities, but these undertakings were free to collect for other systems), they did not restrict competition. As a result, negative clearance was granted to all of the notified agreements. This conclusion is, it is submitted, perfectly in line with the arguments put forward in Part II.

Austria. Somewhat later, the Commission considered the Austrian system for producer responsibility in packaging waste, run by Alstoff Recycling Austria AG (ARA).[106]

First, as with the DSD system, participating undertakings enter into a dispensation and licence agreement, whereby their obligations under the Austrian Packaging Ordinance are transferred from the obligated undertaking to ARA, with the payment of a fee. However, obligated undertakings need to provide evidence of the use of another disposal system or self-disposal in order to be exempted from the ARA obligations. This requirement was found not to be contrary to Article 81(1).[107] Similarly, the fact that the licence fee was compulsory did not restrict Article 81(1), as the fee was in every case for a dispensation service actually provided, rather than for the use of the Green Dot trademark *per se*; hence, the "no service, no fee" rule was respected. Further, ARA undertook not to invoke its licence rights to the Green Dot mark in Austria against undertakings participating in other Green Dot schemes, or which are required to affix the Green Dot to their packaging, as long as those undertakings could show that such packaging complied with their Packaging Ordinance obligations.[108]

Secondly, ARA concludes waste disposal contracts with sectoral recycling undertakings - e.g., those in charge of plastic, aluminium, wood, ferrous metal and paper packaging recycling - which give these undertakings the task of organising the collection, sorting, transport, and recycling of specific categories of packaging. As in the *DSD* decision, these contracts were considered to fall under Article 81(1) because they were concluded exclusively with one undertaking per locality. Moreover, and even more restrictively than in *DSD,* such undertakings were not entitled to work with non-ARA systems.[109]

Thirdly, sectoral recycling undertakings conclude contracts with regional disposal undertakings to perform actual collection, sorting, and recycling functions (the "collection partner" agreements). These contracts contained exclusivity clauses for the benefit of the collection partners,[110] whereby ARA sectoral recycling undertakings only worked with one collection partner per region. Due to the substantial network effects, and the fact that these

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[106] *ARA, ARGEV, ARO*, OJ 2004 L 75/59, under appeal as Case T-419/03.
[107] *ARA,* note 106 above, point 197.
[108] *ARA, ibid*, point 202. In contrast to the situation in Germany and France, national law in Austria does not require undertakings to affix a mark, such as the Green Dot, to all packaging falling under a collective system.
[109] *ARA, ibid*, points 208-209.
[110] In the Commission decision, those sectoral companies which had previously included "most favoured company" clauses in their existing contracts with disposal companies - meaning that repeat business would be awarded to those undertakings - undertook to remove these clauses. Moreover, disposal companies were not to be prevented from working for competitors of the ARA system.

agreements generally lasted five years, this constituted a barrier to entry for new collection partners, and was found to be restrictive of competition under Article 81(1).[111]

The United Kingdom. The UK has a slightly different regulatory framework for implementing the Packaging Waste Directive, as set out in its Producer Responsibility Obligations (Packaging Waste) Regulations 1997.[112] By this system, individual producers do not necessarily have to take back their own packaging waste. Rather, each undertaking is allocated an obligation to recover packaging waste per packaging material, based on the volume it brought into circulation. Undertakings are free to decide how to discharge their responsibility. They can collect their waste themselves and conclude individual contracts with recyclers; or they can participate in compliance schemes which organise collection and recycling. Alternatively, as the confirmation from recycling undertakings that a particular quantity of packaging waste has been recycled (called a "Packaging Recovery Note" or PRN) is tradable, they can purchase PRNs to discharge their obligations. In the UK, Valpak is the largest non-profit-making industry-led compliance scheme set up to discharge the packaging waste recovery and recycling obligations of members. Following examination by the Commission,[113] Valpak's membership agreements were found to restrict competition under Article 81(1), as they obliged businesses wishing to join the scheme to transfer all their obligations for all packaging materials (an "all or nothing" approach), thus restricting material-specific competition between Valpak and other schemes. This conclusion, it is submitted, accords with the arguments put forward in Part II, as the competitive restrictions went beyond what was necessary to achieve the environmental benefits at issue.

[111] *ARA,* note 106 above, point 229. The same conclusion followed for similar exclusive agreements between a sectoral recycling undertaking and sorting partners.

[112] See further, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 25.

[113] See the Annual EC Competition Report 1998, at 153.

Chapter 11: Article 81(3) EC

1. The scope and function of Article 81(3) EC: general

Article 81(3) EC provides:

> "The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
>
> — any agreement or category of agreements between undertakings,
>
> — any decision or category of decisions by associations of undertakings,
>
> — any concerted practice or category of concerted practices,
>
> which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
>
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
>
> (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

The application of Article 81(3) is not an area overly characterised by clarity.[1] This is partly due to the fact that, as will be argued below, the Commission's 2004 Article 81(3) Guidelines are sometimes difficult to reconcile with the approach of the Community courts, and indeed with the Commission's own past practice.[2] Nonetheless, subject to this caveat, the Guidelines currently form a useful starting point for any consideration of the Commission's approach to application of Article 81(3). At least two areas of controversy in relation to the scope and function of Article 81(3) EC are relevant to the present discussion.

First, there is disagreement over whether the function of Article 81(3) is to allow for agreements which increase consumer welfare,[3] or whether something more must be demonstrated.[4] Some commentators, for instance, argue on the basis of neo-classical economics that the Article 81(1) exercise - assessing whether competition is restricted in the first place - focuses on consumer welfare, whereas Article 81(3) must be about something more, in order to have an independent purpose.[5] Odudu, for example, argues

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1 See, generally, Nicolaides, "The Balancing Myth: The Economics of Article 81(1) & (3)" 32(2) Legal Issues of Economic Integration (2005) 123 (who argues that Article 81(3) is "*the least understood component of the EC competition policy*") and Lugard and Hancher, "Honey, I Shrunk the Article! A Critical Assessment of the Commission's Notice on Article 81(3) of the EC Treaty" (2004) 7 European Competition Law Review 410.

2 See similarly, for instance, Pijnacker Hordijk, "De richtsnoeren inzake de toepassing van artikel 81 lid 3 EG" (2004) 4 Markt en Mededinging 129, Vogelaar, "Modernisering, Self-Assessment en Horizontale Overeenkomsten" in *Actualiteiten in het Europese Mededingingsrecht* (The Hague, T.M.C. Asser Press, 2006), Ehlermann, "The Modernisation of EC Antitrust Policy: A Legal and Cultural Revolution" 37 CML Rev (2000) 537, at 549, Wesseling, *The Modernisation of EC Antitrust Law* (Oxford, Hart, 2000), at 104, Monti, "Article 81 EC and Public Policy" 39 CML Rev (2002) 1057, at 1083, Mortelmans, "Towards Convergence in the Application of the Rules on Free Movement and on Competition?" 38 CML Rev (2001) 613 at 641, and Boute, "Environmental Protection and EC Anti-Trust Law: The Commission's Approach for Packaging Waste Management Systems" RECIEL 15(2) (2006) 146.

3 Kjolbye, "The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81" 9 European Competition Law Review (2004) 570.

4 Hawk, for instance, observes that, "*the bifurcation of what ideally should be a single anti-trust analysis into the double tests of Article [81(1)] and Article [81(3)]*" results in "*near anarchy*". Hawk, "The American (Anti-Trust) Revolution: Lessons for the EEC?" 9 European Competition Law Review (1981) 53, at 69.

5 Nicolaides, note 1 above, Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006).

that Article 81(3) allows account to be taken of productive efficiency benefits, i.e., producer welfare.[6] The Article 81(3) Guidelines take the approach that Article 81(3) is concerned with net consumer welfare, with the Commission stating its view that the function of Article 81(3) is to determine, where an agreement is found to be restrictive of competition under Article 81(1), the "*positive economic effects*" of the agreement, i.e.,[7]

> *"to determine the pro-competitive benefits produced by that agreement and to assess whether these pro-competitive effects outweigh the anti-competitive effects."*[8]

By "pro-competitive effects", the Commission means efficiency gains, which "*may create additional value by lowering the cost of producing an output, improving the quality of the product or creating a new product.*"[9] Where the pro-competitive effects of an agreement outweigh its anti-competitive effects, the "*net effect of such agreements is to promote the very essence of the competitive process, namely to win customers by offering better products or better prices than those offered by rivals.*" [10] Nonetheless, the Guidelines have not settled this controversy over the economic function of Article 81(3), and how this fits with the function of Article 81(1). This fundamental ambiguity is of clear relevance to the question of interest to the present research: the extent to which Article 81(3) allows account to be taken of environmental considerations.

A second area of controversy is the role of what we termed in Part II "non-economic" factors - factors other than economic efficiency - in Article 81(3). In the Article 81(3) Guidelines, the Commission indicates its view that, for this exception to apply, the agreement must offer "*objective economic benefits*". Thus, it states,

> *"[t]he four conditions of Article 81(3) are…exhaustive. When they are met the exception is applicable and may not be made dependant on any other condition. Goals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Article 81(3)."*[11] (emphasis added)

As will be discussed below, the Commission sees economic efficiency benefits to be at the core of the first of these four conditions - the promotion of technical and economic progress. Similarly, in its White Paper on the modernisation of the rules implementing Articles [81 and 82] of the Treaty, the Commission observed that the purpose of 81(3) is "*to provide a legal framework for the economic assessment of restrictive practices and not to allow the application of the competition rules to be set aside because of political considerations*".[12]

As mentioned above, however, many argue that the Commission and Community courts have in practice gone beyond economic efficiency considerations in applying Article 81(3) in the past, and that this is the correct approach.[13] They refer to judgments like *Métropole Télévision*, where the CFI held that,

> *"the Commission is entitled to based itself on considerations connected with the pursuit of the public interest in order to grant exemptions under Article [81(3)]"*[14]

Wesseling, for example, argues that the Commission's "*assertion*" that applying Article 81(3) is a pure economic test is not simply at odds with the case law of the Community

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[6] Odudu, *ibid,* at 7.
[7] OJ 2004 C 101/97, point 32.
[8] *Ibid,* point 11.
[9] *Ibid,* point 33.
[10] *Ibid.*
[11] Article 81(3) Guidelines, note 7 above, point 42.
[12] White Paper on the modernisation of the rules implementing Articles 85 and 86 of the Treaty, Brussels, April 28, 1999, at para 57.
[13] See, for example, the literature referred to in note 2 above.
[14] Case T-112/99 *Métropole* [2001] ECR II-2459, para 118.

courts; it also flies in the face of the general trend towards increasing cross-cutting policy integration within the Community institutions.[15] In the context of restrictive provisions with an environmental protection aim, this argument is, essentially, similar to the *systematic* argument put forward in Chapter 6. In his view, the purpose of Article 81(3) is "*to provide a legal framework within which the bodies competent to apply it may pursue certain non-competition policy objectives provided that competition is restricted as little as possible.*"[16] Again, as discussed further below, in the environmental context this conclusion mirrors point 4 of Chapter 6's working hypothesis on the practical implications of the integration principle (i.e., applying the proportionality principle where Article 81(3) can be interpreted in a way that favours environmental protection, but where there is a potential conflict with competition goals). Boute takes a similar position, suggesting that Article 81(3) should be interpreted in the same way as Article 30 EC, so that environmental protection would in itself be sufficient to justify a competitively restrictive agreement, provided that the restrictions of competition are reasonably necessary to the attainment of the objectives.[17] Other commentators, however, would assign a slightly different role to non-economic factors in Article 81(3). Giorgio Monti, for example, argues that non-economic factors are never in themselves sufficient to bring an agreement within Article 81(3); rather, they may do so only in combination with efficiency-enhancing factors.[18]

The dispute has, of course, not been confined to the potential relevance of environmental considerations to Article 81(3), but has extended to a range of non-economic considerations, including culture,[19] sport,[20] and social and employment policy.[21]

2. The Article 81(3) conditions and their application to environmental agreements

We turn now to focus on how the four cumulative conditions of Article 81(3) may be applied to environmental agreements.[22] To date, most case law has concerned the application of the last two conditions (proportionality and non-elimination of competition). One of the aims of the Article 81(3) Guidelines was to place more emphasis on first two conditions and "*to bring the application of all four conditions in line with the realities of Regulation 1/2003.*"[23]

As the Commission makes clear in the Guidelines, consistently with its adoption of a more economic approach,[24] each case will be assessed in its own context and in light of

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15 Wesseling, note 2 above, at 105. He concludes that, "*If the application of the Community antitrust rules, in particular Article 81(3) EC, would be reduced to a "pure" competition test this would go against this trend. The Commission might ultimately not be able to consider, for example, environmental policy concerns under Article 81(3) which would be contrary to Article 6 EC…*"

16 *Ibid.*

17 Boute, note 2 above, at 158.

18 Monti, note 2 above, at 1094, concluding that, "[i]n this way, "*exempting private agreements which contribute to achieving the policies of the Commission will continue to be an important mechanism to achieve the Treaty goals…*"

19 See, for example, Psychogiopolou, "EC Competition Law and Cultural Diversity: The Case of the Cinema, Music and Book Publishing Industries" 30(6) EL Rev (2005) 838 and Mayer-Robitaille, "Le statut ambivalent au regard de la politique communautaire de concurrence des accords de nature culturelle et des aides d'Etat relatives à la culture" RTD Eur 40(3) (2004) 477.

20 See, for example, the Opinion of Advocate General Lenz in Case C-415/93 *Bosman* [1995] ECR I-4921.

21 See, for example, *Synthetic Fibres* OJ 1984 L 207/17; Case 42/84 *Remia* [1985] ECR 2545, and *Ford/Volkswagen* OJ 1993 L 20/14.

22 See generally, Vedder, "Voluntary Agreements and Competition Law" Fondazione Eni Enrico Mattei, Nota di Lavoro 79.2000 (2000) and Rehbinder, "Environmental Agreements: A new instrument of environmental policy" (European University Institute, Jean Monnet Chair Paper RSC No 97/45).

23 Guidelines on Article 81(3), note 7 above.

24 See further, Chapter 5.

all the circumstances.[25] Where a block exemption applies, however, the presumption is that the agreement satisfies the conditions of Article 81(3), though the benefit of a block exemption may be withdrawn for any given agreement where necessary due to its competitive effects.[26] There is no block exemption for environmental agreements, though this has been called for by some commentators.[27] However, naturally, certain environmental agreements may fall within the scope of general block exemptions, with obvious examples including the Vertical Block Exemption (where the supplier, or the buyer in the case of exclusive supply agreements, holds a market share of 30% or under and the agreement does not contain hard core restrictions); the Block Exemption for Research and Development Agreements; and the Block Exemption for Specialisation Agreements.[28] We will not look in detail at the features of these block exemptions here, but focus instead on the four substantive conditions of Article 81(3).

a. The agreement must improve the production or distribution of goods or promote technical or economic progress

This interpretation of this first condition is, certainly, the crux of the issue as regards environmental agreements. Does the provision of environmental benefits constitute improving the "*production or distribution of goods*" or promoting "*technical or economic progress*"?

Let us begin with the Commission's approach to this issue which, since its movement towards an efficiency-based approach, is ambiguous.

Article 81(3) Guidelines. From its Article 81(3) Guidelines, where it devoted substantial space to analysis of the scope of this condition, it would seem that its answer may be in the negative. In those Guidelines, it gave the following observations about the first Article 81(3) condition.

First, in the Commission's view this condition concerns objective economic efficiencies, or "*pro-competitive effects*", achieved by the agreement.[29] Efficiencies are defined as stemming

> *"from an integration of economic activities whereby undertakings combine their assets to achieve what they could not achieve as efficiently on their own or whereby they entrust another undertaking with tasks that can be performed more efficiently by that other undertaking."*[30]

The Commission distinguishes between "*cost efficiencies*" and "*efficiencies of a qualitative nature whereby value is created in the form of new or improved products, greater product variety etc.*"[31] Cost efficiencies, for example, may follow from the development of new production technologies and methods, synergies resulting from the integration of existing assets, or economies of scale and scope. Qualitative efficiencies, in contrast, may flow from research and development agreements, combinations of assets creating synergies, or distribution agreements. Examples of qualitative efficiencies accepted in past case law

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[25] *Ibid*, point 6.

[26] *Ibid*, point 35.

[27] See, in the context of horizontal agreements, Vogelaar, "Towards an Improved Integration of EC Environmental Policy and EC Competition Policy: An Interim Report" in 1994 Fordham Corp. L. Inst. (B. Hawk ed. 1995) 529.

[28] Regulation 2790/1999 on the application of Article 81(3) to certain categories of vertical agreements and concerted practices OJ 1999 L 336/21, Regulation 2659/2000 on the application of Article 81(3) to categories of research and development agreements OJ 2000 L 304/7, Regulation 2658/2000 on the application of Article 81(3) to categories of specialisation agreements OJ 2000 L 304/3.

[29] Guidelines on Article 81(3), note 7 above, point 59. See similarly, Horizontal Cooperation Guidelines OJ 2001 C 3/2, point 32.

[30] Guidelines on Article 81(3), *ibid*, point 60.

[31] Guidelines on Article 81(3), *ibid*, point 59. The Commission notes that the types of efficiencies mentioned in the Guidelines are "*only examples and are not intended to be exhaustive*" (point 63).

include health and safety improvements;[32] new, improved, production processes or improved production structures;[33] and the satisfaction of subjective consumer desires, in the case of agreements to protect a product's image where the image is valued by consumers.[34]

Secondly, efficiencies are not to be assessed from the subjective point of view of the parties, so an increase in producer profits, for example, is irrelevant.[35]

Thirdly, a key issue in assessing whether the condition is fulfilled is evidentiary. The parties must provide evidence of the nature of the claimed efficiencies; the link between the agreement and the efficiencies; the likelihood and magnitude of each claimed efficiency; and how and when each claimed efficiency would be achieved."[36] The value of the efficiencies must be calculated as "*accurately as reasonably possible*" and must describe in detail how the amount has been computed, using verifiable data.[37]

In the light of this, it seems, the Commission's position in its Article 81(3) Guidelines is that, where a non-economic goal cannot be translated into efficiency gains, it can only be of ancillary relevance in assessing whether the first condition is satisfied - i.e., efficiencies must always be proven as well (viz. Giorgio Monti's view mentioned above). The Commission backs up its position on this by reference to the *Matra* case, where the Commission stated in its decision that the impact of a joint venture on public infrastructure, employment and European integration "*would not be enough to make an exemption possible unless the conditions of Article [81(3)] were fulfilled, but it is an element which the Commission has taken into account.*"[38] In this respect, the Commission seems to differ significantly from the view of the ECJ in judgments such as *Metro II*, which held that objectives of a "*different nature*" to those of competition law may justify competitive restrictions, if proportionate.[39] More broadly, the Commission's view is inconsistent with its own past decisional practice, when it considered a variety of non-economic factors as very important in assessing the first condition of Article 81(3), including social policy and employment,[40] culture,[41] and industrial policy.[42]

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32 See, for example, the arguments put forward in Case 39.165 *Asahi/Saint-Gobain* (safer glass in cars).

33 See, for example, *Stichting Baksteen* OJ 1994 L 131/15.

34 See, for example, *Yves Saint Laurent Parfums* OJ 1992 L 12/24.

35 Guidelines on Article 81(3), note 7 above, point 49. This position seems, to a certain extent, to belie Odudu's argument that Article 81(3) is concerned with productive efficiency, to which reference was made above.

36 *Ibid,* points 50-51.

37 *Ibid,* point 56.

38 *Ford/Volkswagen*, OJ 1993 L 20/14. In that case, the joint venture under review was the largest ever single foreign investment in Portugal, estimated to lead, *inter alia*, to the creation of about 5,000 jobs and indirectly to create up to another 10,000 jobs, as well as attracting other investment in the supply industry. The Commission concluded that it "*therefore contributes to the promotion of the harmonious development of the Community and the reduction of regional disparities which is one of the basic aims of the Treaty. It also furthers European market integration by linking Portugal more closely to the Community through one of its important industries*" (point 36). On appeal, the CFI held that, even if these circumstances had not been referred to, the operative part of the decision adopted would have been exactly the same as that of the contested decision.

39 Case 75/84 *Metro II* [1986] ECR 3021, para 20.

40 See, for example, *Ford/Volkswagen*, note 38 above.

41 For example, Commissioner Monti confirmed in 1999 that, in the Commission's view, cultural benefits may justify exemption having regard to the amended Article 151(4) EC, which provides that, in exercising its competences under other Treaty provisions, the Community shall take cultural aspects into account "*in particular in order to respect and to promote the diversity of its cultures.*" See the Parliamentary Answer by Commissioner Monti to Written Question E-1401/99 OJ 2000 C 27E/46.

42 See, for example, *Synthetic Fibres* OJ 1984 L 207/17; Case 42/84 *Remia* [1985] ECR 2545, *Bayer/BP Chemicals* OJ [1976] L 30/13, *Stichting Baksteen* OJ [1994] L 131/15, *KSB/Goulds/Lowara/ITT* OJ 1991 L 19/25

In the case of the goal of market integration, however, it would seem that the Commission believes that this goal can be included within efficiency aims. Thus a Commission official has commented that this aspect of the Guidelines,

> *"should not be taken as an indication that the market integration goal is being de-emphasised or abandoned. It merely reflects the fact that in the context of Art. 81(3) market integration and the benefits flowing from the internal market must and normally will translate into the types of efficiencies that are covered by Art. 81(3)."*[43]

Horizontal Guidelines and previous Commission statements. Though it did not deal with the issue expressly in the Article 81(3) Guidelines, in its 2001 Horizontal Guidelines the Commission accepted that environmental benefits may, in themselves, satisfy the first condition of Article 81(3), insofar as they can be valued economically. Its view then was that,

> *"Environmental agreements caught by Article 81(1) may attain economic benefits which, either at individual or aggregate consumer level, outweigh their negative effects on competition. To fulfil this condition, there must be net benefits in terms of reduced environmental pressure resulting from the agreement, as compared to a baseline where no action is taken. In other words, the expected economic benefits must outweigh the costs."*[44]

This encouraging statement makes clear that the Commission is willing to go beyond a narrow conception of economic benefits in the case of environmental improvements, and to engage in (some form of) environmental valuation, as has been argued for the economic argument set out in Chapter 8. This interpretation is backed up by the footnote added by the Commission to the above statement, which notes that this approach "*is consistent with the requirement to take account of the potential benefits and costs of action or lack of action set forth in Article 174(3) of the Treaty and [the Fifth environmental action plan]*."

The Commission even gives a view on how valuation might take place, suggesting a two stage process. In cases where consumers "*individually have a positive rate of return from the agreement under reasonable payback periods*", there is "*no need for the aggregate environmental benefits to be objectively established*." In other cases, however, a "*cost-benefit analysis may be necessary to assess whether net benefits for consumers in general are likely under reasonable assumptions*."[45] In its worked example of an environmental agreement in the Horizontal Guidelines, the Commission goes even further, suggesting that the evaluation should weigh up the benefits for the environment against the damage to the environment caused by the agreement.[46] This approach is to be commended.

Prior to this, the Commission had confirmed on multiple occasions that environmental benefits are relevant to the Article 81(3) assessment. In its XXVth Report on Competition Policy, the Commission summarised its approach to environmental agreements under Article 81(3) as follows:

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[43] Kjolbye, "The New Commission Guidelines on the Application of Article 81(3): An Economic Approach to Article 81" 9 European Competition Law Review (2004) 570, at 573.

[44] Horizontal Cooperation Guidelines OJ 2001 C 3/2, at 193.

[45] *Ibid,* at 194.

[46] *Ibid,* at 198. The Commission takes an example modelled on the *CECED* case. See similarly, Geradin, "EC Competition Law and Environmental Protection" 2 Yearbook of European Environmental Law (2001), Jacobs, "EEC Competition Law and the Protection of the Environment" Legal Issues of Economic Integration 1 (1993) 37 and Vogelaar, "Modernization of Competition Law, Economy and Horizontal Co-operation between Undertakings" (2002) 1 Intereconomics 19, who suggests that it is unlikely that a national court applying Article 81(3) would be comfortable with declaring an environmental agreement compatible with Article 81(3) in similar circumstances. See *contra,* the realist's limb of the governance argument made in the context of national courts, Chapter 7 above.

> *"When the Commission examines individual cases, it weighs up the restrictions of competition arising out of an agreement against the environmental objectives of the agreement, and applies the principle of proportionality in accordance with Article [81(3)]. In particular, improving the environment is regarded as a factor which contributes to improving production or distribution or to promoting economic or technical progress."*[47]

Likewise, in its submissions to the OECD's 1996 Review of the interaction between competition policy and environmental policy, the Commission stated that it tried to strike a balance between competition and environmental policy, a task which it submitted was "*relatively easy*" to ensure by using Article 81(3) and applying the proportionality principle.[48]

Decisional practice. A large number of examples exist in the decisional practice of the Commission and Courts in which environmental benefits have been included in the concept of "*technical or economic progress*." Such "*progress*" has, for example, been found to include better energy efficiency (*CECED* and *EACEM*),[49] better waste management (*VOTOB*, *DSD*),[50] a reduction in use of raw materials and volume of waste (*Exxon/Shell*),[51] and the development of environmentally-friendlier production techniques (*Assurpol, Carbon Gas Technologie, BBC Brown Boveri*),[52] including the emission of less pollution in manufacturing (*ZVEI/Arge Bat, Philips/Osram*).[53] In some cases, traditional "narrow" economic efficiency benefits were present also; in others, this was not (at least on the face of the decision) the case.[54]

The Commission has not often, however, explicitly engaged in the cost-benefit analysis which it propounds in the Horizontal Guidelines. A rare, and oft-cited, example is the *CECED*[55] decision, where the Commission granted an individual exemption to an agreement between producers and importers of washing machines which together

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[47] XXVth Report on Competition Policy, points 83-85.

[48] OECD, Competition Policy and the Environment (Paris, OECD, 1996), at 74.

[49] *CECED,* Commission Decision 2000/475 OJ 2000 L 187/47, *EACEM,* Competition Report 1998, at 152.

[50] *VOTOB,* XXIInd Competition Report 1992, paras 177-186, *DSD,* Commission Decision 2001/837 OJ 2001 L 319/1, confirmed by Case T-289/01 *DSD,* judgment of May 24, 2007.

[51] *Exxon/Shell* OJ 1994 L 144/20.

[52] *Assurpol* OJ 1992 L 37/16, *Carbon Gas Technologie* OJ 1983 L 376/17, *BBC/Brown Boveri* OJ 1988 L 301/68.

[53] Notice pursuant to Article 19(3) *ZVEI/Arge Bat* OJ 1998 C 172/13, *Philips/Osram* OJ 1994 L 378/37.

[54] For other environmentally-motivated Article 81(3) decisions, see Decision 68/319 *ACEC/Berliet* OJ 1968 L 201/7, Decision 76/248 *United Reprocessors* OJ 1976 L 51/7, Decision 82/371 *Navewa Anseau* OJ 1982 L 167/39, Decision 91/38 *KSB/Goulds/Lowara/ITT* OJ 1991 L 19/25, Decision 91/301 *Ansac* OJ 1991 L 152/54, Notice pursuant to Article 19(3) *EEIG EFCC* OJ 1993 C 351/6, Notice pursuant to Article 19(3) *IFCO* OJ 1997 C 48/4, Notice pursuant to Article 19(3) *EUCAR* OJ 1997 C 185/12; *KSB/Goulds/Lowara/ITT* OJ 1991 L 19/25, and the comfort letter on the European Wastepaper Information Service (*EWIS*), reported in 18th Report on Competition Policy (1988), para 63. In some cases, environmental factors were of an ancillary nature to the reasoning: for example, *ACEC/Berliet*, *BMW* OJ 1975 L 29/1, para 24, *United Reprocessors*, *LEWA* OJ 1976 L 51/15; *DSD* (where, at paras 143-145, the Commission found that the agreement gave "*positive network effects in the collection of household packaging waste, and substantial scale and scope advantages can be achieved*", giving efficiency gains and generating economies of scale), *KSB/Goulds/Lowara/ITT,* para 27, and *ARA, ARGEV, ARO*, OJ 2004 L 75/59. See generally, XXVIIIth Report on Competition Policy 1998 para 129, "*The Commission regularly grants exemptions on the basis of the environmental benefits caused by product improvements*." See also, the Dutch competition authority's decision in Case 51/98 *Stibat*, where the NMa expressly considered (in the context of a battery collection and recycling system) that environmental protection benefits satisfied the Dutch equivalent of the first Article 81(3) condition, on the grounds that (1) preventing environmental damage is cheaper than trying to remedy it thereafter in later generations; and (2) in any event, improving environmental protection contributes to improving the production or distribution of goods and to economic and technical progress (paras 63-64).

[55] *EACEM,* note 49 above.

accounted for more than 95% of European sales. The agreements aimed, *inter alia*, at discontinuing production and imports of the least energy efficient washing machines, which represented around 10-11% of then-Community sales, and pursuing joint energy efficiency targets, improving consumer information on energy-efficiency use and developing more environmentally friendly machines. On the "cost" side, the agreement removed one of the dimensions on which sellers competed - and thus might restrict competition and increase prices by up to 14% (as generally speaking, "dirtier" machines are cheaper and more environmentally-friendly machines are more expensive). Nonetheless, the "collective" environmental benefits for society (i.e., a reduction in energy consumption) outweighed these costs, [56] so the agreement was exempted. [57] At the time, this decision was heralded by Commissioner Monti as clearly illustrating the principle, "*enshrined in the Treaty*", that environmental concerns are "*in no way contradictory with competition policy*."[58]

A further example of the Commission engaging in this type of cost-benefit analysis is the *EACEM* case,[59] in which a comfort letter was granted to an agreement between EACEM setting out a voluntary commitment to reduce energy consumption by televisions and video recorders when on stand-by mode. A report prepared by the Commission's DG XVII (Energy) quantified the power use of these televisions and recorders in stand-by mode and found that, simply by reducing average standby power use from 10W to 6W, total power use could be reduced by 3.2 TWh a year by 2005 and by 4.9 TWh a year by 2010. As a result, the cost of energy saved would ultimately outweigh the maximum cost per unit of reducing the standby power use of a television or video recorder, which was estimated at ECU 3.

Comment. It is submitted that, insofar as they can be substantiated and economically valued, environmental benefits - in themselves - constitute "*technical and economic progress*" within the meaning of Article 81(3).[60] In the present author's view, this follows from each of the arguments put forward in Part II.

More particularly, it clearly follows from Chapter 8's *economic* argument, which posited that, where reasonably quantifiable, environmental benefits should be taken into account in assessing the efficiencies flowing from a transaction. Indeed, as we have seen, this is precisely the approach adopted by the Commission in the Horizontal Guidelines, where it envisages the use of cost-benefit analysis "*to assess whether net benefits for consumers in general are likely under reasonable assumptions*." Clearly, therefore, the Commission is in principle willing to engage in estimating environmental value, despite the quantification difficulties inherent in this process discussed in Chapter 8.

Moreover, this approach also follows from Chapter 6's *systematic* argument, in that this is an instance where the Treaty (i.e., the terms "*technical and economic progress*") may be

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[56] Press Release IP/01/1659 of November 26, 2001. For an illustration of CECED standards in action, see Case COMP/38.380 *Whirlpool + BSH + Electrolux + Merloni* OJ 2002 C 139/5.

[57] Similarly, in *CEMEP*, the Commission cleared an agreement between 20 manufacturers of low voltage electric motors to reduce the sales of motors with low energy efficiency by at least 50% by the end of 2003 in order to reduce CO2 emissions. The case was distinguished from CECED, as the CEMEP agreement imposed no individual obligation on each manufacturer's behaviour, and achievement of its aims could be monitored without disclosing individual companies' data. Commission Press Release IP/00/58 of May 23, 2000.

[58] IP/00/148.

[59] *EACEM,* note 49 above.

[60] See similarly, Vogelaar, "Modernization of Competition Law, Economy and Horizontal Co-operation between Undertakings" (2002) 1 Intereconomics 19 and Vogelaar, "Modernisering, Self-Assessment en Horizontale Overeenkomsten" in *Actualiteiten in het Europese Mededingingsrecht* (The Hague, T.M.C. Asser Press, 2006).

interpreted in a way that favours environmental protection, and there is no conflict with the goals of competition policy. As a result, inclusion of environmental benefits is required by the third point of our working hypothesis on the Article 6 EC integration principle. A further question is whether, by a systematic argument, environmental benefits should only be considered to be "technical and economic progress" if they are reasonably economically quantifiable. As discussed in Chapter 8, an approximate economic valuation can, under modern environmental economics, be given of virtually all environmental benefits, though accurate valuation of some benefits - such as biodiversity - is fraught with difficulty. However, it is submitted that any such difficult in economic quantification should, on a systematic approach, not preclude the acceptance of the environmental benefit as "progress" under Article 81(3) EC.[61]

Finally, it is submitted, Chapter 7's *governance* argument also confirms this approach, insofar as institutions applying Article 81(3) are obliged to do so in a manner coherent with Community environmental policy. Further, it leads us to conclude that, even if the Commission attempted to exclude environmental benefits from the scope of Article 81(3), the Community and national courts, as well as many national competition authorities, may realistically not be inclined to follow.

It is true, however that the Article 81(3) Guidelines seem to cast some doubt on the inclusion of environmental benefits as "*technical and economic progress*". This is particularly so because of the statement therein that its analysis supersedes that of the Horizontal Guidelines as regards Article 81(3).[62] If the purported effect of the Article 81(3) Guidelines is to rule out the relevance of environmental benefits in the assessment of the first Article 81(3) condition - which is not clear - this is, for the reasons set out above, wholly misguided. Rather, the Commission's approach in its Horizontal Guidelines was, it is submitted, an enlightened one.

b. Consumers must receive a fair share of the resulting benefit

The application of the second Article 81(3) condition to environmental agreements can be dealt with more briefly.

i. The meaning of "consumers"

A first important issue is the scope of the term "*consumers*" from a geographic and temporal perspective. Environmental benefits are typically diffuse and do not adhere, for example, simply to the "consumers" of a product or service in the relevant geographic market; nor do they necessarily adhere with immediate effect. Can environmental benefits nonetheless satisfy this condition? In the Article 81(3) Guidelines, the Commission stated that,

> *"the concept of 'consumers' encompasses all direct or indirect users of the products covered by the agreement, including producers that use the products as an input, wholesalers, retailers and final consumers, i.e. natural persons who are acting for purposes which can be regarded as outside their trade or profession. In other words, consumers within the meaning of Article 81(3) are the customers of the parties to the agreement and subsequent purchasers."*[63]

Prima facie, this definition would seem to exclude consideration of environmental benefits to the broader group of "consumers", outside the relevant geographic market but inside

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[61] See, however, Maks, "The "New" Horizontal Agreements Approach in the EU: An "Economic" Assessment" (2002) 37(1) Intereconomics 28, who suggests a cost-benefit economic analysis of environmental benefits in the first stage of Article 81(3), in order to assess whether, on balance, an agreement will result in "*technical and economic progress.*"

[62] Article 81(3) Guidelines, note 7 above, point 5.

[63] Article 81(3) Guidelines, *ibid*, point 84.

the EU (or indeed beyond). Once again, however, such a conclusion does not follow from the wording of the Treaty, nor indeed from the Commission's own prior decisional practice. Though the Commission's decisions on environmental agreements frequently gloss over this issue,[64] the *CECED* decision is exemplary in its clarity. In that case, the Commission explicitly acknowledged that it was taking into account the "*collective environmental benefits*" of the agreement: the "*environmental results for society would adequately allow consumers a fair share of the benefits even if no [economic] benefits accrued to individual purchasers.*"[65] In particular, the Commission estimated that the saved external costs (to the environment) exceeded the increase in purchase costs of washing machines by around seven times. Such reasoning was confirmed in the Horizontal Guidelines.[66]

This approach is, it is submitted, wholly correct. Quite apart from the fact that it would make no sense to include environmental benefits within the scope of the first condition, only to read "consumers" in a narrow sense in this second condition, the broader interpretation is, it is submitted, required by each of the arguments set forth in Part II. In particular, from a *systematic* perspective, such an interpretation of "consumers" is required by the integration principle. Again, this falls under point 3 of Chapter 6's working hypothesis, where it is possible to interpret the Treaty wording in a way that favours environmental protection, and there is no conflict with the goals of competition policy. From a *governance* perspective, institutions interpreting the term consumers will, and should, do so in a manner coherent with Community environmental policy, which is by Article 2 EC aimed at achieving a high level of protection and improvement of the quality of the environment, without restriction as to the beneficiaries of such protection.[67]

One outstanding question is, however, whether environmental benefits to "consumers" outside the EU may be taken into account. As regards restrictive agreements other than environmental agreements, this issue is undecided.[68] Though it is not necessary to take a view on this issue in the present research, it suffices to observe that, at least in cases where the environmental benefits of an agreement for the EU cannot realistically be disassociated from those for a broader geographic area, such broader benefits should be taken into account.

A further relevant question is whether benefits to consumers in the future count under Article 81(3). Here, in its Article 81(3) Guidelines, the Commission is broader in its approach, stating that delayed benefits are also relevant, though subject to discounting where necessary. It observes that,

> *"[t]he fact that pass-on to the consumer occurs with a certain time lag does not in itself exclude the application of Article 81(3). However, the greater the time lag, the greater must be the efficiencies to compensate also for the loss to consumers during the period preceding the pass-on."*[69]

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[64] See, for example, *Philips/Osram* OJ 1994 L 378/37, "*the use of cleaner facilities will result in less air pollution, and consequently in direct and indirect benefits for consumers from reduced negative externalities*" (point 27).

[65] Note 49 above, para 56.

[66] See the Horizontal Cooperation Guidelines OJ 2001 C 3/2, at point 194, which distinguishes between individual benefits for consumers and cases where "*net benefits for consumers in general*" are likely, in which case a cost-benefit analysis will be applied.

[67] See further, Chapter 2.

[68] In some commentators' view, it refers only to consumers within the Community - though this has never been expressly decided in the EU. See Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (Oxford, Oxford University Press, 2006), at 152 and the Australian authority cited therein.

[69] In making this assessment, the Commission continues, the fact that "the value of a gain for consumers in the future is not the same as a present gain for consumers" must be taken into account. It notes that, *"[t]he value of saving 100 euro today is greater than the value of saving the same amount a year later. A gain for consumers in the future therefore does not fully compensate for a present loss to consumers of equal nominal size. In order to allow for an*

This approach, it is submitted, fits well with the arguments set out in Part II, and in particular with the *economic* argument, which argued for the use of techniques of environmental valuation developed by environmental economics, most of which techniques entail some form of discounting for future benefits. As noted in Chapter 8, however, choosing which discounting measure is appropriate in a particular case will likely be extremely controversial.

ii. Passing on a "fair share" of benefits

The Commission's approach. A second issue is how to assess whether a "*fair share*" of benefits will be "passed on" in environmental agreements. Insofar as environmental improvements constitute qualitative "efficiencies" (i.e., new or improved products or services, in contrast to "cost efficiencies"), the passing on of such benefits is, in the Commission's view, generally presumed.[70] The Article 81(3) Guidelines state that,

> *"The availability of new and improved products constitutes an important source of consumer welfare. As long as the increase in value stemming from such improvements exceeds any harm from a maintenance or an increase in price caused by the restrictive agreement, consumers are better off than without the agreement and the consumer pass-on requirement of Article 81(3) is normally fulfilled."*[71]

However, the Commission continues, in cases where the likely effect of the agreement is to increase prices for consumers within the relevant market, it must be "*carefully assessed whether the claimed efficiencies create real value for consumers in that market so as to compensate for the adverse effects of the restriction of competition*."[72] Even where the agreement is not likely to increase prices, in assessing whether a "fair share" of any benefit is passed on, the Commission will use a sliding scale, in an approach that seems to elide the second and third Article 81(3) conditions. Thus, the Commission states that "*the greater the restriction of competition found under Article 81(1) the greater must be the efficiencies and the pass-on to consumers*."

The process of assessing whether qualitative efficiencies will be passed on is, the Commission admits, vague and, "*necessarily requires value judgment. It is difficult to assign precise values to dynamic efficiencies of this nature*…" In this regard, the Commission will take a reasonable approach to the evidence required from undertakings, only requiring them to substantiate their claims "*by providing estimates and other data to the extent reasonably possible, taking account of the circumstances of the individual case.*"[73]

In many of the cases on environmental agreements to date - as, indeed, with many non-environmental cases - this element of Article 81(3) has been assessed only cursorily by the Commission. In its *DSD* decision, for example, it confined itself to asserting that "*consumers will…benefit as a result of the improvement in environmental quality sought, essentially the reduction in the volume of packaging.*"[74] Even more broadly, in *Exxon/Shell* the Commission relied on consumers' perception of environmental improvements. Thus, such

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appropriate comparison of a present loss to consumers with a future gain to consumers, the value of future gains must be discounted. The discount rate applied must reflect the rate of inflation, if any, and lost interest as an indication of the lower value of future gains." Article 81(3) Guidelines, note 7 above, points 87-88.

[70] *Ibid*, points 85-86.

[71] *Ibid,* point 104.

[72] *Ibid,* points 103-104. See, for an example of an acceptable quality improvement, *REIMS II* OJ 2004 L 56/56.

[73] *Ibid,* point 94. In assessing whether cost efficiencies will be passed on, the Commission will take into account: (a) The characteristics and structure of the market; (b) The nature and magnitude of the efficiency gains; (c) The elasticity of demand; and (d) The magnitude of the restriction of competition.

[74] Commission Decision 2001/837 OJ 2001 L 319/1, para 148, confirmed by Case T-289/01 *DSD,* judgment of May 24, 2007.

improvements would "*be perceived as beneficial by many consumers at a time when the limitation of natural resources and threats to the environment are of increasing public concern*."[75]

Comment. This element of Article 81(3) is, as the Commission admits in its Article 81(3), a particularly subjective one and not one which lends itself to an overly scientific, economics-based approach. However, the following points are at least, it is submitted, clear. First, this element of Article 81(3) makes it rather difficult to argue that Article 81 EC is neutral as between consumer and producer welfare: it positively requires an increase in consumer welfare in order for Article 81(3) to apply. Secondly, where the principal benefits flowing from an agreement are environmental, however, and these benefits are genuine, it follows *ceteris paribus* that this condition will be satisfied, as it is inherent in such benefits that they will be passed on to consumers (defined in the broader sense set out above). This is so, it is submitted, even where the agreement may result in price rises. Where, however, the benefits from an agreement are not purely environmental, but include wider benefits (e.g., economic benefits), it will be necessary to assess whether a reasonable ("fair") share of such benefits will accrue to consumers.

c. Agreement must not contain dispensable restrictions

The third condition, that restrictions must be indispensable, is akin to the general principle of Community law of proportionality.[76] According to the Article 81(3) Guidelines, there are two aspects to the indispensability requirement. First, the agreement itself must be "*reasonably necessary in order to achieve the efficiencies*." Secondly, the individual restrictions of competition that flow from the agreement must also be "*reasonably necessary for the attainment of the efficiencies*."[77] In both cases, "*the question is not whether in the absence of the restriction the agreement would not have been concluded, but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restrict*ion."[78] The parties must show "*why such seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient*."[79] Again, the test is a sliding scale: the more restrictive the restraint, the stricter the test here. Restrictions that are black listed in block exemption regulations or identified as hardcore restrictions in Commission guidelines and notices are "*unlikely to be considered indispensable*."[80]

This requirement applies to environmental agreements in the same way as to any other restrictive agreement.[81] Indeed, it is submitted, this fits well with Chapter 6's systematic argument, which concluded, in point four of its working hypothesis on the implications of Article 6 EC integration principle that the principle requires a proportionality analysis in cases of conflict between competition and environmental goals. In its Horizontal Guidelines, the Commission adds that this requirement is more likely to be fulfilled by an environmental agreement if its economic efficiency is objectively demonstrated: if restrictions seem *prima facie* not to be indispensable, they "*must be supported with a cost-effectiveness analysis showing that alternative means of attaining the expected environmental benefits,*

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[75] *Exxon/Shell* OJ 1994 L 144/20, para 71.

[76] See Steenbergen, "Proportionality in Competition Law and Policy" (2008) 35(3) Legal Issues of Economic Integration 259, who views this indispensability test as the second limb of Article 81(3) proportionality analysis, with the first limb being the "suitability" test of whether the agreement contributes to improving production or distribution or to promoting technical or economic progress.

[77] Article 81(3) Guidelines, note 7 above, point 73.

[78] *Ibid,* point 74.

[79] *Ibid,* point 75.

[80] *Ibid, p*oint 79.

[81] See further, Vogelaar, "Towards an Improved Integration of EC Environmental Policy and EC Competition Policy: An Interim Report" in 1994 Fordham Corp. L. Inst. (B. Hawk ed. 1995) 529, at 559.

would be more economically or financially costly, under reasonable assumptions."[82] The Commission takes the example of a uniform fee, charged irrespective of individual costs for waste collection (such as in the *VOTOB* case, discussed below) as a case where indispensability must be clearly demonstrated.

For some environmental agreements assessed in the past, proportionality has not been a problem. In *CECED*, for example, the phasing out of less efficient washing machines was the only measure that would achieve the intended energy reductions.[83] For example, industry-wide targets, information campaigns or eco-labelling schemes could not achieve the same result at the same cost. In *EACEM*, the voluntary agreement to reduce energy used in stand-by mode of video recorders and televisions discussed above, was found to be proportionate partly because unnecessary information exchange was eliminated from the arrangement: an independent consultant was appointed to gather information from the undertakings on their sales and the power use of units sold, and would simply report the names of manufacturers not meeting their commitment.[84] This concern of the Commission to avoid "spillover effects" in horizontal environmental agreements has been increasingly emphasised.[85]

In numerous decisions to date, however, this condition has been the downfall of environmental agreements. In most cases, the reason has been that the restriction was not genuinely necessitated by any environmental goal. An example is *Ansac*, which concerned agreements between US soda-ash producers to create a joint export undertaking under the US Webb-Pomerene Act, on the basis that natural soda ash (mainly US-produced) is environmentally friendlier than synthetic soda ash. No Community exemption was granted, as the agreement only concerned setting up a joint sales agency and thus had no connection to the environmental benefit.[86] Although it was not disputed that, from an environmental perspective, natural soda ash might be preferable to synthetic soda ash, this did not necessitate, in the Commission's view, that *Ansac* should be the only way for the parties' products to reach the Community. In other cases, as mentioned above, the alleged environmental goals of an agreement have been found by the Commission to be a pretext for the creation of a barrier to entry to the market.[87]

In many cases, however, the environmental goals of the agreement have been genuine, but the agreement's provisions have been found to be disproportionately restrictive, in the sense that a less restrictive alternative would (in the Commission's view) meet the same goal. An example is the *VOTOB* case,[88] in which the Commission found that a waste management agreement between six tank storage operators, which was financed by

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[82] Horizontal Cooperation Guidelines OJ 2001 C 3/2, points 195-196.

[83] *CECED,* note 49 above, para 59.

[84] See similarly, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 61: "*As a general principle, it is clear that, to the extent that the cooperation on waste management would be "abused" by the participants to exchange sensitive information or to fix or align prices of the packaged products, Article 81 EC would be violated.*"

[85] *Ibid*, at point 116.

[86] Decision 91/301 *Ansac* OJ 1991 L 152/54.

[87] See, for example, Decision 82/371 *Anseau/Navewa* OJ 1982 L 167/39

[88] XXIInd Competition Report 1992, paras 177-186. The case is similar in some respects to the decision of the Dutch competition authority in Case 51/98 *Stibat*, which concerned a battery take-back and recycling scheme set up by Dutch battery producers to comply with their obligations under the Batteries Directive, Directive 91/157 OJ 1991 L 78/38 (since replaced by Directive 2006/66 OJ 2006 L 266/1. The NMa found that two elements of the scheme were disproportionate and failed to satisfy the conditions for exemption under the Dutch equivalent of Article 81(3): first, the requirement that members pass Stibat's fee on to the next level in the distribution chain; second, the requirement that members set out Stibat's fee separately on invoices (paras. 65-70).

a fixed fee ("Environmental Surcharge" or ES) added to all tariffs for storage of covenant products, constituted a restriction of competition. This was because the fixed fee harmonized the costs and thus excluded competition on an important price component. The ES was to have been mentioned separately on operators' invoices and was to be paid by the ultimate polluters - the chemical undertakings offering covenant products for storage. Funds generated by the ES were to be "earmarked" in members' accounts for environmental purposes. Further, the ES proceeds only amounted to around 4% of the undertakings' total costs; the rest of the tariff for storage service could be negotiated freely. In holding that the charge was disproportionate, the Commission found that a system of invoicing total price, and stating that this included environmental costs, would have been a less restrictive solution. Moreover, the flat-fee nature of the ES did not sufficiently take into account different cost considerations of each VOTOB member, and could be mistaken for a government-imposed levy, the amount of which as non-negotiable. Interestingly, as Vogelaar notes, the VOTOB agreement was the direct sequel of an environmental covenant entered into between the Dutch government and the VOTOB members (i.e., what we termed in Chapter 4 "co-regulation").[89] In particular, the Dutch government had been threatening VOTOB members with imminent and severe legislation should they refuse to comply with their obligations under the covenant to reduce emissions and invest in new, environmentally friendlier technology.[90]

One can appreciate the motivation behind the VOTOB decision – i.e., to maintain competition even in environmental abatement measures, so that pollution is reduced at the least cost to society. Nonetheless, on its facts the decision seems, in retrospect, rather harsh, given the small proportion which the ES represented of the undertakings' overall costs.[91] Moreover, from a transparency perspective, it seems preferable that environmental costs would be visible to chemical customers on invoices, to incentivise them in turn to reduce overall pollution for storage. In its 2005 Waste Management Paper, the Commission gives welcome clarification that, in cases where environmental agreements lead to a certain amount of commonality of costs,

> *"it will have to be carefully examined on a case-by-case basis whether price competition in the markets of the packaged products is appreciably restricted or whether the development of better and more environment-friendly products is hampered as a result of such cooperation on waste management."*[92]

Were VOTOB to be decided today, therefore, it is far from clear that it would be found to amount to an appreciable restriction of competition. Nonetheless, it is evident that, in principle, an environmental charge is more likely to be considered proportionate if it is not in the form of a fixed, flat-rate charge. Moreover, this position seems reasonable, unless the parties to the agreement can put forward positive arguments why a flat-rate charge is necessary to achieve the environmental benefits. In *ZVEI/Arge Bat*, for example, the Commission exempted an agreement between manufacturers to prefer less-polluting batteries and to use recyclable materials, where the disposal costs were to be shown separately on invoices for the batteries, but not in the form of a fixed charge.[93] Similarly, in relation to charges imposed on a collective basis to pay for compliance with

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[89] See Vogelaar, "Towards an Improved Integration of EC Environmental Policy and EC Competition Policy: An Interim Report" in 1994 Fordham Corp. L. Inst. (B. Hawk ed. 1995) 529, at 549.

[90] *Ibid*, 550. Further, a state aid scheme in Netherlands for investments at time had been withdrawn after signing of the covenant, so the VOTOB members were faced with an immediate financing problem

[91] See similarly, *ibid,* 560.

[92] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 60. See also, Horizontal Cooperation Guidelines, note 82 above, points 23-24 and 88.

[93] Notice pursuant to Article 19(3) *ZVEI/Arge Bat* OJ 1998 C 172/13.

the End of Life Vehicles Directive[94] and the Waste Electrical and Electronic Equipment Directive,[95] the Commission has indicated that flat-rate charges may, in some cases, be justified.

A further area where proportionality has been critical is in agreements related to packaging waste management schemes. A major issue here has been whether exclusivity arrangements are genuinely indispensable to achieve the intended efficiencies and environmental benefits. In some cases, the Commission has concluded that the exclusivity clauses are indispensable. For example, in the case of the UK's packaging recovery scheme Valpak, the structure of which we looked at in Chapter 10, potential members of the scheme were obliged to use it for all their packaging (the "all or nothing" approach). In the Commission's view, such exclusivity was justified, as it was necessary in order for the scheme to be viable. A comfort letter was granted, with the Commission reserving the right to itself to re-examine the case.[96] Since this and similar decisions, however, the Commission has made clear that this principle has its limits:

> *"the all or nothing rule cannot be exempted when it becomes evident that further substantial investment in waste collection infrastructure is no longer necessary to fulfil the obligations under the Packaging Directive and/or the rule may no longer be regarded as an effective means of securing new investment. Consequently, in all Member States with established systems that reach the recovery and recycling targets, the all or nothing rule cannot be regarded as indispensable for the functioning of these systems."*[97]

In *DSD*, as we have seen, the Commission found that the clause in DSD's service agreements with downstream local collecting undertakings, whereby the collecting undertaking has the exclusive task of collecting and sorting used sales packaging in a certain area, restricted competition under Article 81(1). However, the restriction was exempted under Article 81(3) EC. In particular, such exclusivity was deemed indispensable in light of the investments which collectors are obliged to make in collection vehicles, bins and containers, and sorting facilities.[98] However, the Commission took issue with the planned length of the exclusivity in the agreement: after carrying out "*comprehensive calculations of investment and profitability*",[99] it stated that, from 2003 onwards (at which point the DSD system would be considered to be "*fully established*"),[100] an exclusivity period of three years would be considered reasonable in

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[94] Importantly, the Commission cites with approval a decision of the Dutch NCA that a collective system based on a voluntary agreement among the interested parties for the recovery and recycling of car wrecks set up in the Netherlands prior to the ELV Directive and still in operation, did not infringe Dutch competition law, even though the car recycling system includes a flat fee of €45 to be paid to ARN by car producers and importers for each registered car. The car producers and importers may obtain an exemption if they can demonstrate that they take care of their ELVs in an equivalent way: DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[95] With regard to WEEE obligations, the Commission cites with approval the Belgian system set up by producers and importers of EEEs, Recupel, which is funded through a recycling premium paid by purchasers of new equipment. The level of the premium is based on an estimate of the number of appliances returned per year and the estimated costs of collection, treatment and recycling. The premiums are passed through the chain from the final retailer to his supplier, and then to the manufacturer or importer who transfers the money to Recupel: DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[96] XXVIII Annual Competition Report (1998), at 165. See also, the comfort letters in the Biffpack, Wastepak and Difpak cases: XX Annual Competition Report (2000), at 148.

[97] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 79.

[98] Commission Decision 2001/837 OJ 2001 L 319/1, point 153.

[99] *Ibid,* point 155.

[100] *Ibid.*

order to recoup investments.[101] Significantly, it is submitted, the exclusivity only went "one way" in that case: the collecting undertakings were, if they wished, free to work with undertakings other than DSD.[102]

Similarly, in *ARA*, the Commission found that a requirement of exclusivity in contracts between sectoral recycling undertakings and regional disposal undertakings (collection and sorting partners) as regards both household and commercial waste was indispensable within the meaning of Article 81(3) in order "*to ensure lasting and reliable collection services, which are indispensable for the success of the system as a whole.*"[103] Given the collection and sorting partners' investments in setting up and maintaining the necessary infrastructure (e.g., collection vehicles, containers), an exclusivity period of between three and five years was acceptable.[104] Clearly, therefore, the Commission was prepared to allow a longer exclusivity period in the *ARA* case than it had allowed for *DSD*. One reason for this, at least in the case of commercial waste, may have been the lower market share, and resultant diminished buyer power, enjoyed by the *ARA* system sectoral recycling undertakings.[105]

As regards household waste, however, the Commission simply based its conclusion that an exclusivity period of three to five years would be proportionate on the reasoning that, "*the special circumstances involved in implementing the requirements of the Packaging Ordinance and, in that connection, establishing a countrywide take-back and dispensation system*",[106] making no reference whatsoever to the *DSD* decision. The paucity of reasoning in this regard is disappointing, and certainly not in the interests of legal certainty. One might observe that this kind of case - though a recent one - is a good illustration of the subjective way in which Article 81(3) is still applied, and of how far removed this remains from, for instance, the narrow Chicago School conception of competition theory.

d. Agreement must not substantially eliminate competition in the relevant market

The final Article 81(3) condition aims at ensuring that effective competition remains in the relevant market, indicating, in the Commission's words, that, *"[u]ltimately the protection of rivalry and the competitive process is given priority over potentially pro-competitive efficiency gains which could result from restrictive agreements.*"[107] Thus, "*the ultimate aim of Article 81 is to protect the competitive process.*"[108] Essentially, it may be viewed as a "long-stop" application of the proportionality principle, making explicit that a restriction can never be viewed as proportionate where it eliminates, or almost eliminates, competition. In its Article 81(3) Guidelines, the Commission specifies that the application of the last condition of Article 81(3) requires a "*realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered.*"[109] The

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[101] *Ibid,* point 157. The Commission claims that the new service agreements reduce DSD's costs for the collection and sorting of plastic packaging by more than 20% (about € 200 million per year). This will lead to a reduction of the fees which DSD charges to its clients. See DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[102] This was ultimately made a condition of the exemption which, as discussed below, was unsuccessfully challenged by DSD before the CFI.

[103] *ARA, ARGEV, ARO*, OJ 2004 L 75/59, point 274.

[104] *Ibid*, points 277 and 327. However, as discussed below, this conclusion was reached on the basis that the collection and sorting partners should be free to deal with systems other than ARA.

[105] *Ibid,* point 327.

[106] *Ibid,* point 277.

[107] Article 81(3) Guidelines, note 7 above, point 105.

[108] *Ibid.*

[109] *Ibid,* points 108-110.

Commission goes on to specify that this condition will not be satisfied if competition in "*one of its most important expressions*" is eliminated, giving the examples of the elimination of price competition or competition in respect of innovation and development of new products.[110]

More particularly, in the context of environmental agreements, the Commission has indicated that this condition means that, irrespective of the "*environmental and economic gains and the necessity of the intended provisions*", the agreement must not eliminate competition in terms of "*product or process differentiation, technological innovation or market entry in the short or, where relevant, medium run.*"[111] The application of this condition to environmental agreements is, it is submitted, fully consistent with Part II's arguments. On a *systematic* approach, the wording of Article 81(3) does not allow for any other interpretation, and hence this falls under point two of Chapter 6's working hypothesis on the implications of Article 6 EC. It should be added that it is difficult to conceive of a situation where total elimination of competition on an important competitive parameter would be indispensable to achieve the environmental aims of an agreement. For instance, the elimination of competition in respect of product innovation would, in the long term, run the risk of harming environmental protection by stifling the development of environmentally cleaner technology.

As competition on environmental factors normally only forms one of many potential parameters of competition, however, voluntary standardisation initiatives (e.g., those at issue in *CECED* and *EACEM* or, more broadly, the creation of private eco-labels or private environmental management standards) are likely to satisfy this condition. Once again, exclusivity provisions in waste management systems, however, may cause more problems here. In the Horizontal Guidelines, the Commission stresses that, in such cases, "*the duration of such rights should take into account the possible emergence of an alternative to the operator.*"[112] Clearly, the greater the system's market share, the more likely it is that exclusivity clauses will eliminate competition.[113]

In the *DSD* case, however, a three-year exclusivity clause in its service agreements with collectors was, "*regardless of DSD's position on the relevant markets*" not likely to eliminate competition on the market in the collection and sorting of household packaging waste. This was because collectors excluded by DSD remain free to offer their services to undertakings wishing to manage their own waste. In addition, the "*marked network effects*" and "*special conditions of supply*" in the market meant that it was economically advantageous to entrust the task to one collector in each designated area, as well as practically unavoidable due to space restrictions and collection logistics as regards bins for household waste.[114] Further, the contracts were legally required by the Packaging Ordinance to be awarded by competitive tender – a requirement that the Commission has since emphasised as crucial in the context of exclusivity.[115] As a result, competition would not be substantially eliminated by the exclusivity arrangements, on condition that there was free and unimpeded access to the collection infrastructure set up by DSD

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110 *Ibid.*

111 Horizontal Cooperation Guidelines OJ 2001 C 3/2*,* point 197.

112 *Ibid,* point 198.

113 For example, where the market share of participating recycling companies is 30% or below, exclusive arrangements of up to five years fall under the Vertical Agreements Block Exemption, save where network effects exist in the meaning of Article 6 of the Block Exemption.

114 Commission Decision 2001/837 OJ 2001 L 319/1, points 157-158.

115 *Ibid,* point 161. See DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, points 76 and 82. Following a large number of uneconomic offers in the first round of DSD's tendering procedures in Germany, DSD – at the suggestion of the German Bundeskartellamt – amended the tender rules.

collectors.[116] However, the Commission imposed two express obligations on DSD in its exemption decision: first, DSD was obliged to allow its collectors from contracting with its competitors; second, it was obliged to ensure that access to its collectors' infrastructure was unrestricted.

Though DSD appealed to the CFI on the attachment of these obligations, the appeal was rejected in a judgment of May 2007.[117] As to the first condition (on collectors' freedom to contract with competitors), DSD argued that this was disproportionate as, if collectors contracted with DSD's competitors, it would be impossible for DSD to know which of the collected packaging it had responsibility for under the Packaging Ordinance. This argument was rejected by the CFI on the facts, after receiving detailed explanations from the parties on how the exemption systems worked, and on the possibility of dividing up packaging received by the collectors between different systems on the basis of quotas.[118] Further, insofar as collectors worked for non-DSD systems, DSD was free to reduce the fee it paid to those collectors proportionately.[119]

As to the second condition (obligatory access to collectors' infrastructure), DSD had argued that, as it was the economic owner of the collection infrastructure, an essential facilities analysis should be used, and that the conditions of the essential facilities doctrine were not satisfied in the present case. The CFI rejected the contention that DSD was the economic owner of this infrastructure, as it is the collectors who make the necessary investments therein and who bear the risks relating to these investments. Moreover, the CFI confirmed that, in order for competitors to have any real chance of entering the market, access to this infrastructure was essential, as it would be very difficult to duplicate.[120] The – virtually wholesale – approval by the CFI of the Commission's approach to (commitments in) waste management agreements will give the Commission important reassurance in using this approach to assess other such systems.[121] More importantly, it seems correct as a matter of principle: there were, it is submitted, no good environmental reasons underlying DSD's challenge to the obligations. As such, DSD's position is not supported by any of Part II's arguments. Rather, at the core of the Commission's decision was simply a concern to ensure that the increasingly lucrative waste management markets function competitively.

Similarly, in *ARA*, the exclusive arrangements in contracts with collection and sorting partners were not such as would substantially eliminate competition.[122] Reasoning in much the same way as in the DSD case, the Commission emphasised that, in the case of household waste, it was imperative that ARA collectors and sorters should be free to conclude contracts with other non-ARA systems (i.e., that the exclusivity was unilateral, only for the benefit of the collectors and sorters). Once again, its reasoning was that

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[116] *Ibid,* point 163.
[117] Case T-289/01 *DSD,* judgment of May 24, 2007.
[118] *Ibid,* para 166.
[119] *Ibid,* para 167. The CFI also rejected an argument that the collectors' use of the "Green Dot" logo on their facilities, which indicated that those collectors were part of the DSD system, would be confusing for consumers if those collectors also worked for non-DSD systems. The CFI found, *inter alia*, that it was not strictly necessary under the Packaging Ordinance for the collectors to have the Green Dot logo on their facilities at all: para 190.
[120] *Ibid,* paras 106-107. The CFI held, however, that the obligation to provide access only extended to other collective exemption systems, and not to self management solutions: para 121.
[121] See the comments of the Commission officials heavily involved in this area, Gremminger and Miersch, "The Court of First Instance confirms Duales System Deutschland's abuse of dominant in the packaging recycling system" Competition Policy Newsletter 3 (2007) 47, who state that, "*The full confirmation of [this Commission decision and that on Article 82] gives an important signal to the market players*…" (at 49).
[122] *ARA, ARGEV, ARO*, OJ 2004 L 75/59, point 278 onwards.

there were "*substantial practical, legal and economic reservations that militate against setting up either another parallel collection system or an alternative bring-it-yourself system*."[123] A number of obligations were imposed on ARA in order to ensure this freedom.[124] An appeal from these obligations is currently pending with the CFI.[125]

The final issue as regards the fourth Article 81(3) condition is its relationship with Article 82. Formerly, the Commission had considered that competition would be eliminated by an agreement if a party to the agreement will become dominant as the result of an agreement.[126] However, the position has since changed: as has been recently held by the CFI, it is possible for restrictive agreements entered into by a dominant undertaking to be exempted under Article 81(3), as long as competition is not eliminated.[127] In the environmental context, this is illustrated by the Article 81 *DSD* decision itself, which did not ultimately prohibit any of DSD's arrangements, despite its dominant position (though, as discussed in Chapter 12, the Commission also issued an Article 82 decision in that case).[128] The change in approach is particularly important given that, as we saw in Chapter 9, environment-related markets may well be narrowly defined, making a finding of a dominant position more likely. Rather, any finding that competition would be eliminated by an agreement must necessarily be based on a variety of factors, including the market positions of the parties to the agreement, competitors' market positions, and whether or not there are substantial barriers to entry.

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[123] *Ibid,* point 286.

[124] In particular, any requirement for disposal firms to provide evidence of quantities of packaging that are not collected for the ARA system was forbidden.

[125] Case T-419/03 *ARA*.

[126] See, for example, Guidelines on Vertical Restraints OJ 2000 C 291/1, point 135.

[127] See, for example, Joined Cases T-191/98 etc *Atlantic Container Line* [2003] ECR II-3275, para 939. Further, the Article 81(3) Guidelines confirm that, *"[n]ot all restrictive agreements concluded by a dominant undertaking constitute an abuse of a dominant position*." Article 81(3) Guidelines, note 7 above, point 106. The Article 81(3) Guidelines explain, in footnote 92, that henceforth the statement in the Vertical Guidelines on this point should be understood in this sense.

[128] For example, where a recycling system has a *de facto* monopoly for the recycling and recovery of household packaging waste, it may be abusing its dominant position in that market by entering into a network of agreements with downstream collectors of commercial packaging waste, due to potential leveraging effects. See, by analogy, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 64.

Chapter 12: Article 82 EC

1. Introduction

Article 82 EC provides:

> "Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.
>
> Such abuse may, in particular, consist in:
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

Article 82 prohibits abusive conduct by dominant undertakings. Unlike Article 81 EC, Article 82 EC can apply to unilateral conduct by dominant undertakings, as well as agreements concluded by them. In comparison to Article 81 EC, the parameters of Article 82 EC and their interrelation with environmental protection factors constitute relatively uncharted territory, due primarily to the fact that there has been little case law on the issue to date. The most important development to date has certainly been the 2001 Commission decision on the DSD system, upheld on appeal in 2007 by the Court of First Instance.[1] This will be discussed in detail below. The potential application of Article 82 to tradable permit schemes, an economic instrument discussed in Chapter 4, will also be discussed.

The indeterminate nature of the Article 82 prohibition is not confined to environment-related cases. Due to the rather amorphous nature of the prohibition - particularly from an economic perspective - in current decisional practice, the Commission is presently undertaking a major reform of the Article, commencing with a 2005 Discussion Paper. One of the primary goals of the reform is to make Article 82 more economically sound: in the words of Commissioner Kroes, the Commission "*simply want[s] to develop and explain theories of harm on the basis of a sound economic assessment for the most frequent types of abusive behaviour to make it easier to understand our policy, not only as stated in policy papers but also in individual decisions based on Article 82*."[2] To the extent potentially relevant to environment-related cases, the reform process will be discussed further below.

2. Dominance: assessment and significance

As is well known, the classic legal definition of dominance is that of the ECJ in *Hoffmann-La Roche* as,

> *"[a] situation where one or more undertakings wield economic power which would enable them to prevent effective competition from being maintained in the relevant market by giving them the*

[1] OJ [2001] L 166/1 and Case T-151/01. This judgment is currently itself under appeal: see Case C-385/07P.

[2] Speech to the Fordham Corporate Law Institute, Speech/05/537, September 23, 2005.

opportunity to act to a considerable extent independently of their competitors, their customers, and, ultimately, of consumers."[3]

In its 2005 Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses (the "Discussion Paper"), the Commission divides this definition into three elements:

a) a position of economic strength on a market which

b) enables the undertaking(s) in question to prevent effective competition being maintained on that market by

c) affording it, or them, the power to behave independently to an appreciable extent.[4]

Given these elements, it is clear that market share alone is not sufficient to conclude that an undertaking is dominant; rather, a wide range of characteristics may be relevant.[5] These include the number of competing suppliers of the same products, their market shares, barriers to entry and expansion (including legal barriers, capacity constraints, economies of scale and scope for larger undertakings, preferential access to essential resources, and first-mover advantages), buyers' market positions, and the degree of product differentiation. Higher than "normal" profits may also, potentially, be an indication of market power, though are not a prerequisite for a finding of dominance. Further, in order for Article 82 to apply, dominance must exist in a "*substantial part of the common market*". This test has been broadly interpreted by the Commission and Court.[6]

From an environmental perspective, as mentioned when discussing market definition, the nature of some environment-related markets may result in significant market power. This may flow from the existence of legal barriers to entry from environmental regulatory regimes, such as a limited supply of permits to pollute. It may also result from the innovative and rapidly developing nature of markets for certain environmentally superior products may result - at least temporarily - in substantial market power for individual undertakings. Such market power may become more permanent where barriers to entry exist, such as high costs of developing equivalent environmentally-friendly technology, or strategic advantages from being the first mover in the market. As submitted in Chapter 9, however, the arguments in Part II do not in themselves lead to the conclusion that market definition, market power, and therefore dominance, should be assessed in any manner different to that normally employed in other cases. Rather, it is submitted, such arguments become relevant when considering the circumstances in which environment-related practices carried out by an undertaking in a dominant position should be prohibited as abusive.

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[3] Case 85/76 *Hoffmann-La Roche* [1979] ECR 461, para 38. Economically, dominance may be defined as the possession of substantial market power, where market power constitutes "*the ability of a firm or group of firms to raise price, through the restriction of output, above the level that would prevail under competitive conditions and thereby to enjoy increased profits from the action.*" Bishop and Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (2nd ed., London, Sweet & Maxwell, 2002), at 3.04.

[4] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005.

[5] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005.

[6] Including in the environment-related cases Case C-343/95 *Calì & Figli* [1997] ECR I-1547, where the Port of Genoa was considered to meet the test, and Case C-209/98 *Sydhavnens* [2000] ECR 343, where the market for processing building and construction waste in the municipality of Copenhagen was considered to meet the test, though no ultimate decision on market definition was taken in that case.

3. Abuse of a dominant position and environmental protection considerations

a. The concept of abuse - general

The economic rationale of Article 82 EC is, in essence, that undertakings with significant market power (that is, a position of dominance) have the incentive or ability to engage in anti-competitive practices and, ultimately, raise prices until their profit is maximised - resulting in a dead weight loss to society.[7] The Community Courts have consistently approached Article 82 EC by stating that dominant undertakings have a "*special responsibility*", "*the actual scope of [which] must be considered in relation to the degree of dominance held by that undertaking and to the special characteristics of the market which may affect the competitive situation.*"[8] The greater the undertaking's market power, therefore, the greater its "responsibility". The boundaries of dominant undertakings' responsibilities are defined, on a case by case basis, by the scope of the concept of abuse. In assessing whether conduct has abusive effects, it is useful to distinguish, as the Discussion Paper does, between exclusionary abuses (i.e., abuses which are capable of having, and likely to have, a foreclosure effect on the market)[9] and exploitative abuses (i.e., which are directly exploitative of consumers).[10]

ECJ's Definition of Abuse. The concept of abuse within Community competition law remains, in many cases, rather unclear. The classic definition remains, once more, that given in *Hoffmann-La Roche*, defining abuse as,

> *"an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition."*[11]

This definition makes clear that the key elements of abuse are: (a) the objectivity of the concept; (b) the requirement of a certain anti-competitive effect; resulting from (c) use by the dominant undertaking of methods "*different from those which condition normal competition*". Consistently with the Commission's movement towards a more economic approach, the central focus in assessing whether Article 82 has been infringed is (b) - examining the actual or likely effects of the allegedly abusive conduct on the market.[12] There has been no general consensus on how to define abusive conduct economically.[13]

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[7] Though the various schools of competition theory have differed considerably as to when the behaviour of firms with significant market power should be prohibited, restraining certain such behaviour is central to the US (via section 2 of the Sherman Act) and Community competition regimes. For an interesting discussion on the differences between pre-Chicago, Chicago and post-Chicago approaches to the concept of abuse, see O'Donoghue and Padilla, *The Law and Economics of Article 82 EC* (Oxford, Hart 2006).

[8] See, for example, *Deutsche Post AG – Interception of cross-border mail* OJ [2001] L 331/40.

[9] Discussion Paper, point 1. A "foreclosure effect" is defined very broadly in the Discussion Paper as. "*that actual or potential competitors are completely or partially denied profitable access to the market.*" A further distinction is sometimes made between price and non-price based abuse. See, with regard to exclusionary abuses, point 61 of the Discussion Paper.

[10] *Ibid,* point 59. Analysis of whether conduct is abusive cannot, in the Commission's view, be carried out mechanically based on the nature or form of the conduct, but rather takes into account all the features of the market, such as the degree of dominance, the extent to which the conduct is applied across the market and (in the case of exclusionary abuses) the existence of network effects and economies of scale or scope.

[11] Case 85/76, note 3 above, para 91.

[12] DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005, point 55.

[13] See as regard to exclusionary abuses (which comprise the vast majority of Article 82 EC cases to date), Temple Lang and O'Donoghue: "*Neither the Commission's decisional practice nor the case law of the Community*

Economic theories of abuse. One test of abuse commonly suggested, and that adopted by the Commission in its Discussion Paper, is whether the dominant undertaking's practice has, or is likely to have, a material net adverse effect on consumer welfare (the net consumer welfare test).[14] This test would, therefore, incorporate a balancing of pro-competitive effects (efficiencies) against anti-competitive effects (e.g., an increase in price with no corresponding increase in quality; or a reduction in output, including a reduction in quality). As the efficiencies side of the equation is considered by the Commission to be a "defence" (meaning that the burden of proof lies on the dominant undertaking), it will be considered further below. As *Hoffmann-La Roche* makes clear, the notion of protecting consumer welfare extends to protecting the structure of the market, and does not simply refer to the protection of consumers' immediate interests.[15]

Though the net consumer welfare test is the Commission's currently preferred unified definition of exclusionary abuses, a number of other proposals for a unified definition have also been made by lawyers and economists. The two other leading theories can be termed the "profit sacrifice" test and the "equally efficient competitor" test.

Under the profit sacrifice test, which has been influential in the US,[16] it is presumed that a firm would not rationally engage in exclusionary conduct unless the short term sacrifice of profits is considered to be less than expected gains from excluding or discouraging rivals. As a result, the question whether conduct is abusive depends on whether the long-term gains from that conduct are likely to outweigh its short-term costs. The classic example of an abuse that fits this model is predatory pricing, discussed further below.

Under the equally efficient competitor test, exclusionary conduct is defined as conduct that would exclude an equally efficient rival firm. The theory behind this test - which originated in Chicago School theory)[17] - is essentially that, where a dominant firm's conduct excludes a less efficient firm, this is not abusive as the aim of competition law is ultimately to encourage efficiency. Where, in contrast, a dominant firm's conduct excludes an equally or more efficient firm, Article 82 EC should apply - subject always to the possibility that the exclusionary effect of the dominant firm's conduct is offset by efficiency gains.

Recourse to methods different from those governing normal competition. The scope of the third element of the *Hoffmann-La Roche* concept of abuse – recourse to methods different from those governing normal competition – is also controversial, as it clearly requires some kind of (economic? value?) judgment as to what constitutes "normal" competition on a given market.[18] While the meaning of "normal" competition

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Courts provide a clear, consistent definition of exclusionary abuses." Temple Lang and O'Donoghue, "The Concept of Exclusionary Abuse Under Article 82 EC" GCLC research papers on Article 82 (July 2005).

[14] See, as regards exclusionary abuses, Discussion Paper, point 4. See also, the comments of Neelie Kroes that, "*consumer welfare is now well established as the standard [for] assessing…infringements of the Treaty rules on cartels and monopolies*" (Speech of September 15, 2005, "European Competition Policy - Delivering Better Markets and Better Choices"). See further, O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*, note 7 above, 192, in the context of exclusionary abuses. See also, Faull & Nikpay (ed.), *The EC Law of Competition* (2nd ed., Oxford, Oxford University Press, 2007), 4.09.

[15] See further, Case T-219/99 *British Airways* [2003] ECR II-5917, at 68.

[16] For instance, this test was essentially relied upon by the US Department of Justice in its submissions as *amicus curiae* in *Trinko* (*Verizon Communications Inc v Law Offices of Curtis V. Trinko LLP* 540 US 398 (2004). See O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*, note 7 above, 186.

[17] This is the test propounded, for instance, by Judge Posner in *Antitrust Law* (2nd ed. Chicago, University of Chicago Press, 2001), to which reference has already been made in Chapter 5.

[18] See O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*, note 7 above, who argue convincingly that, "*…the terms "normal competition", "competition on the merits" and "genuine undistorted competition"*

remains highly ambiguous, the essence of this element of the test is, in the Commission's view, to ensure that a dominant undertaking's competitors are also able to expand in or enter the market and compete therein on the merits, "*without facing competition conditions which are distorted or impaired by the dominant firm.*"[19] Article 82 does not, however, aim to protect competitors from dominant undertakings' genuine competition based on factors such as higher quality, novel products, opportune innovation or otherwise better performance.[20] To a certain extent, this feeds into the notion of objective justification, to which we now turn.

b. "Defences": objective justification and efficiencies

Article 82 contains no "exemption" provision equivalent to Article 81(3). Nonetheless, in cases where the conduct of a dominant undertaking leads to anti-competitive effects in the sense discussed above, it may be possible for that undertaking to escape the Article 82 prohibition if it can provide an objective justification for its behaviour, or can show that its conduct produces efficiencies which outweigh the negative effect on competition.[21] It is important to note that such possibilities, though referred to by the Commission as "defences", do not formally constitute true defences as they form part of the concept of abuse. In that sense, their (suggested) designation as "defences" – meaning that the burden of proving them lies on the dominant undertaking – is highly controversial.[22] In its 2005 Discussion Paper, the Commission mentions three kinds of "defences", two constituting "objective justifications" and the third constituting an "efficiency" defence.

The first, which it terms the "objective necessity" defence, applies where "*otherwise abusive conduct is actually necessary conduct on the basis of objective factors external to the parties involved and in particular external to the dominant company.*"[23] The Commission gives the example of product-related safety and health reasons, where, without the conduct, the product "cannot or will not be produced or distributed in that market".[24] This evidently draws on cases such as *Hilti* and *Tetra Pak I*, where it was (unsuccessfully) argued that the behaviour of the dominant undertaking was necessary in order to make sure that the product was used safely (in the case of Hilti's nail guns) or was safe for people to consume (in the case of the consumable products inside Tetra Pak cartons). The Commission makes clear, however, that it will interpret this defence strictly: in particular, a dominant undertaking cannot "*take steps on its own initiative to eliminate products which it regards, rightly or wrongly, as dangerous or inferior to its own product.*"[25]

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are not merely vague, but also conclusory. That is, they are defined according to what the Commission, Community Courts, or national authority happen to conclude is an abuse in each case. This is highly unsatisfactory…"

[19] Point 54, Discussion Paper.

[20] *Ibid.* This sentiment has been echoed forcefully by Commissioner Kroes, who has stated, "*I like aggressive competition – including by dominant companies – and I don't care if it may hurt competitors – as long as it ultimately benefits consumers. That is because the main and ultimate objective of Article 82 is to protect consumers, and this does, of course, require the protection of an undistorted competitive process on the market.*" Speech at Fordham Corporate Law Institute, note 2 above.

[21] See point 77 of the Discussion Paper, and cases cited therein.

[22] See, Article 2 of Regulation 1/2003 OJ 2003 L 1/1, which provides that the burden of proving infringement of Article 82 rests on the party or authority alleging infringement, the observations of AG Jacobs in Case C-53/03 *Syfait* [2005] ECR I-4609, at para 72 of the Opinion, and the criticism of commentators such as Albors-Llorens, "The role of objective justification and efficiencies in Article 82 EC" 44 (2007) CML Rev 1727.

[23] Discussion Paper, point 78.

[24] *Ibid,* point 80.

[25] *Ibid.* Case T-30/89 *Hilti v Commission* [1991] ECR II-1439, Case T-51/89 *Tetra Pak* [1990] ECR II-309. See Albors-Llorens, note 22 above, at 1756, who criticises the Commission's approach as meaning that a

The second, which it terms the "meeting competition" defence, applies where the "*otherwise abusive conduct is actually a loss minimising reaction to competition from others.*"[26] This is illustrated by the rather enigmatic statements by the Community Courts to the effect that dominant undertakings can take "*reasonable steps*" to protect its own commercial interests if they are attacked,[27] and are entitled to compete "*on the merits*". In order to amount to a valid defence, the Commission states that such behaviour must be proportionate,[28] in the threefold sense of being suitable, indispensable and constituting a proportionate response in view of the aim of Article 82 EC. The Court's judgment in *Sot Lelos* constitutes a rare example, couched in the specific legal context of the pharmaceutical industry, of the success of a defence based on "meeting competition" (in that case, the competition posed by the activity of parallel importers of pharmaceuticals).[29]

The third possible defence mentioned by the Commission is the "efficiencies" defence. This applies where,

> *"efficiencies brought about by the conduct concerned outweigh the likely negative effects on competition resulting from the conduct and therewith the likely harm to consumers that the conduct might otherwise have."*[30]

In other words, this defence allows account to be taken of pro-competitive effects in applying a consumer welfare test, as seen above. The Commission suggests that, to establish this defence, the dominant undertaking must satisfy four conditions, equivalent to the conditions of Article 81(3), i.e.:

1) the conduct must contribute to improving the production or distribution of products or to promoting technical or economic progress, for instance by improving the quality of the product;
2) The conduct must be indispensable to achieve these efficiencies;
3) The efficiencies must benefit consumers; and
4) Competition must not substantially eliminated in the market.[31]

Most attention is paid by the Commission to the requirement of consumer benefit, stating that the dominant undertaking must show that "*efficiencies brought about by the conduct concerned outweigh the likely negative effects on competition and therewith the likely harm to consumers that the conduct might otherwise have.*"[32] Further, the Commission indicates that it is "*highly unlikely*" that a near-monopolist (which it defines as having a market share of over 75%) could ever make out the efficiency defence for its abusive conduct.[33] Example of efficiencies might include increasing prices reflecting increased quality, cutting prices in order to expand the overall market or to increase efficiency, conduct to protect

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dominant undertaking may be forced to wait for the competent authority to act, rendering "*health and safety considerations rather ineffectual as grounds for justification.*"

[26] *Ibid.*

[27] See, for example, Case 27/76 *United Brands* [1976] ECR 207, Case T-203/01 *Michelin II* [2003] ECR II-4071.

[28] Points 81-83, Discussion Paper. On the notion of proportionality in EC competition law, see Vogelaar, "Comments on Prof. Jacques Steenbergen's contribution on 'Proportionality in Competition Law and Policy'" (2008) 35(3) Legal Issues of Economic Integration 269.

[29] Joined Cases C-468/06 to C-478/06 *Sot Lelos*, judgment of September 16, 2008.

[30] *Ibid,* point 79. The Commission's recognition of an efficiency defence is in line with its movement towards a Chicago School approach: see O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*, note 7 above. See also, the discussion of the Horizontal Merger Guidelines in Chapter 13.

[31] *Ibid,* point 84.

[32] *Ibid,* point 87.

[33] *Ibid,* point 92.

customer-specific investment, such as exclusive dealing, or – as was argued in the *Microsoft* case – refusal to supply in order to maintain product quality.[34] This confirmation of the relevance of efficiencies analysis to Article 82 EC is to be welcomed. In the first place, it provides greater clarity and structure to the notion of abuse, and therefore increased legal certainty for dominant undertakings. Moreover, the presence of a parallel in analysis between Articles 81 and 82 EC makes eminent good sense, given that, ultimately, each of these Treaty provisions pursues the same aim.[35]

To date, however, these defences have been rarely successful in practice when argued before the Commission and Community Courts - though argued in almost all Article 82 cases.[36] In many instances, such arguments have been dismissed with little substantive reasoning – perhaps because, on the facts, the "defence" was not strong enough.[37] In order for an argument of objective justification or efficiencies to succeed, it is critical that the undertaking convince the Commission or Court that its conduct is genuinely motivated by the relevant objective justification. Nonetheless, it is submitted, the decisional practice to date demonstrates that it will be very difficult to do so. There is, therefore, a strong argument that, to date, the Community Courts and Commission have in reality only paid lip service to such defences, depriving them of all substance.[38] It might be hoped that the Discussion Paper - which gives far more detail on the Commission's thinking here than has been previously given - is a portent of change in this regard.

c. Relevance of environmental protection considerations to the notion of abuse

Relevance to the Theory of Abuse. Theoretically, environmental protection considerations might be relevant to the concept of abuse in two ways.

First, it might be argued that, if a dominant undertaking is engaged in restrictive conduct aimed at improving environmental protection, this is (or should be) relevant to whether such conduct qualifies as an exclusionary abuse. This argument, it is submitted, is in principle convincing, for a number of reasons.

From a *legal theoretic* perspective, it follows from Chapter 6's *systematic* argument that the concept of abuse - not being defined in the Treaty - must be interpreted in the light of

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[34] See *Microsoft,* decision of March 24, 2004, COMP 37/792, points 704-712.

[35] See Commissioner Kroes, who makes the Article 81-82 analogy forcefully: "*At the most basic level, the same conduct can be analysed under both Article 81 and Article 82. It would be rather strange if we concluded that a particular form of conduct is not anti-competitive under Article 81, but infringes Article 82, with the only explanation for that divergence being that we cannot work out how to take the pro-competitive aspects into account under Article 82*…" (Speech to Fordham Corporate Law Institute, note 2 above). Despite the analogy, it is still of course possible that conduct exempted by 81(3) may still be abusive: see, for example, Case T-51/89 *Tetra Pak* [1990] ECR II-309.

[36] For a rare example, see Joined Cases C-468/06 to C-478/06 *Sot Lelos*, judgment of September 16, 2008, discussed above. See also Loewenthal, "The Defence of "Objective Justification" in the Application of Article 82 EC" 28(4) World Competition (2005) 455. For further unsuccessful examples, see, Case 311/84 *RTL Télémarketing* [1985] ECR 3261, para 26; *Portuguese Airports* OJ 1999 L 69/31; *BBI/Boosey and Hawkes* OJ 1987 L 286/36; *BPB Industries* OJ 1989 L 10/50; *Napier Brown-British Sugar* OJ 1998 L 284/41*; NDC Health/IMS Health: Interim Measures* OJ 2002 L 59/18. Moreover, as noted above, these cases have generally not considered the notion of objective justification or efficiencies as a "defence" - rather, they have been considered as part of the concept of abuse.

[37] Exceptions are *Hilti* and *Tetra Pak I,* note 25 above, where the arguments were considered at some length.

[38] See, for example, O'Donoghue and Padilla, *The Law and Economics of Article 82 EC*, note 7, at 232: *"[T]here is something of a disconnect between theory and practice on objective justification. Efficiency defences have typically been rejected with cursory analysis by the Community institutions and without any indication of the analytical framework in mind. This deficiency should be addressed, since a defence that is recognised in theory, but not in practice, is the same as no defence*."

the EC's Article 2 EC goal of a high level of protection of the environment and the Article 6 EC integration principle. This means that, where a dominant undertaking's conduct restricts competition, but is aimed at achieving environmental protection goals, this conflict between competition and environmental objectives should be reconciled via a proportionality analysis. This would mean, as argued in Chapter 6's working hypothesis on the implications of Article 6 EC, that where the restrictive behaviour is suitable to achieve the Community's environmental policy objectives, and there is no way of achieving these objectives that is less restrictive of competition, the measure should not fall within the concept of abuse.[39]

This position is, it is submitted, supported by Chapter 7's *governance* argument, which argued that the Community and national courts, as well as the Commission and national competition authorities, are in reality inclined to take an approach to competition law based on coherence with environmental policy aims, and are obliged to do so by the principles of good governance.

From an *economic theoretic* perspective, the question of where environmental factors fit in depends on which economic theory of abuse one subscribes to. The discussion above outlined the present three principal economic theories of abuse: the net consumer welfare test, the profit sacrifice test, and the equally efficient competitor test. Under the net consumer welfare test, it has been argued in Chapter 8 that the environmental implications of a dominant undertaking's behaviour should be taken into account at an economic level in assessing such behaviour's impact on utility (and thus on consumer welfare). It follows that environmental benefits of otherwise restrictive practice should be taken into account in balancing the pro-competitive and anti-competitive effects of that practice.

In the case of the profit sacrifice test, this is, as discussed above, based on the assumption that an undertaking would not rationally engage in exclusionary conduct unless it considers that any short-term losses will be made up for in the longer term. This test is of most obvious relevance in the case of predatory pricing, dealt with further below. Environmental factors could, it is submitted, also be relevant in the context of this test, if they provide a genuine and proportionate explanation for what might otherwise seem to be profit-sacrificing behaviour. For instance, one might imagine that, where the reason for adopting temporarily lower prices is genuinely environmental protection (such as the launch of a new environmentally friendlier product which demands a change in consumer habits, meaning that its adoption requires particularly strong price incentives for consumers to switch), and there is no less restrictive way of achieving those aims, this should not be viewed as abusive.

Finally, in the case of the equally efficient competitor test, where conduct should be categorised as abusive if it excludes or discourages equally or more efficient competitors, the efficiency of the dominant undertaking should be measured taking into account, in the manner argued in Chapter 8, the environmental benefits of its conduct. As a result, environmentally unfriendlier competitors would be less likely to be deemed equally or more efficient.

A second way in which environmental protection considerations might be relevant to the concept of abuse concerns the (rarer) concept of exploitative abuse. Such abuses focus on harm caused directly to consumers (for instance, via excessive pricing), meaning that conduct need not be restrictive of competition as such in order to be qualified as an exploitative abuse. In this sense, the scope of the concept of abuse has the potential to

[39] See point 4 of Chapter 6's working hypothesis on the import of the integration principle, *ibid.*

go beyond the (restriction-based) scope of Article 81 EC. The boundaries of the notion of exploitative abuse are, however, unclear. However, it is submitted that, insofar as discrete categories of exploitative abuse have been developed in Community competition law - such as excessive pricing, the imposition of unfair contract terms, or exploitative discrimination of consumers - environmental considerations can be relevant to each of these categories. From a legal theoretic perspective, the same arguments for taking environmental considerations into account apply as set out above for exclusionary abuses. From an economic theoretic perspective, the lack of a unifying economic theory behind exploitative abuses means that creating a unified economic argument for the relevance of environmental considerations to such abuses is difficult. However, insofar as the unifying thread underlying exploitative abuses is the direct exploitation of consumers, it is submitted that environmental considerations can be relevant in two ways. First, the imposition of environmentally damaging requirements, or conditions, by a dominant undertaking, or discriminating against environmentally friendlier customers, could be exploitative. Secondly, the extra costs which might be entailed in producing environmentally friendlier products should be taken into account in assessing whether price levels are excessive, as discussed further below.

Relevance to "Defences". The Commission's view that it is possible to justify otherwise abusive conduct by means of one of three possible "defences" - objective necessity, meeting competition and efficiencies - has been discussed above.

In this regard, it is submitted that environmental protection reasons may constitute a defence of "objective necessity". This would apply, for example, where the allegedly abusive conduct was necessary and proportionate in order to achieve a vital environmental objective. In this sense, the analysis would be very similar to that suggested in Chapter 10 in the context of Article 81(1) - i.e., in the sense of the Article 81(1) *Albany* judgment, restrictive conduct which is inherent in achieving the environmental benefit would not be considered abusive.[40] The crucial difference is, of course, that, because the restriction of competition will be greater in an Article 82 situation – where competition is, due to the position of dominance, already weakened to some extent – than in those Article 81(1) situations where there is no dominance, the burden of proving that the conduct is proportionate will in the former case be more difficult to discharge.

Admittedly, this conception of "objective necessity" does not satisfy the Commission's requirement in its Discussion Paper that "*the dominant company must be able to show that without the conduct the products concerned can not or will not be produced or distributed in that market.*"[41] However, it is submitted that the Commission's statement is inappropriate where there is a genuine environmental protection goal justifying the dominant undertaking's conduct, and where the competitive restriction is proportionate to that goal. Such a narrow conception, if it excluded all possibility of reliance on environmental protection considerations. In turn, this would fly in the face of the Article 6 EC integration principle, as well as the coherence-based governance imperative, as argued in Chapters 6 and 7.

In addition, environmental protection reasons may be relevant to an efficiencies defence. As noted, the Commission views such a defence as having four conditions, analogous to those of Article 81(3). For the same reasons as set out in Chapter 11, therefore, it is submitted that environmental protection requirements should, when susceptible to valuation, be considered to be "*technical and economic progress*" within the meaning of the

[40] Case C-309/99 *Wouters* [2002] ECR I-1577, para 97.
[41] Discussion Paper, point 80.

first condition of the efficiencies defence. Once again, a proportionality test will be applied in assessing whether restrictions are indispensable to the environmental objective at hand, and this accords with the requirements of Article 6 EC on a *systematic* analysis, as set out in Chapter 6.[42] However, it is undeniable that it will in general be more difficult for the four conditions to be made out in the Article 82 context than in the Article 81(3) context: due to the undertaking's dominance, it is more likely that the fourth condition – no substantial elimination of competition – will not be satisfied. In addition, the same problem of discounting future environmental benefits to consumers may arise in the Article 82 context as we saw in Article 81(3).[43] As we noted in Chapter 11, this may be of particular relevance in assessing whether consumers receive a "*fair share*" of the benefits resulting from the agreement.

Practical Relevance of Environmental Factors for Some Individual Abuses. Given this, and given the above outline of the concept of abuse, it is submitted that the following constitute examples of individual abuses to which environmental considerations may be relevant.

- **Tying**. Article 82(d) provides that it is abusive to make the "*conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.*"[44] Where there is a good reason of environmental protection for only offering two products together, or for offering the bundled products at a lower price, it is submitted that such tying is not abusive under Article 82 EC. This would extend to the situation, for instance, where an environmentally friendlier producer offers two of its products together at a lower price than if sold separately, even if this underprices a less environmentally friendly producer of one of the products. Further, should an environmentally friendlier product be manufactured in a way that only allows environmentally friendlier products to be used with it, these should be viewed as products which have a natural connection with each other. An example might be a washing machine which only functions properly with biodegradable, environmentally friendly washing powder.

- **Exclusive dealing.** Obliging a customer to obtain all or most of its requirements for a product from a dominant undertaking is in principle abusive.[45] However, it is submitted that exclusive dealing motivated by environmental protection considerations may be objective justified, if proportionate. For instance, dominant undertaking might legitimately enter into long term exclusive contracts to enable its contracting party to recoup investments in environmentally-friendly infrastructure.[46] However, the limits of exclusivity are evident in the Article 82 *DSD* decision and judgment, considered below.

- **Refusal to supply or to grant access to an essential facility.** A refusal to supply an existing customer without objective justification may be abusive.[47] Likewise, a refusal to grant access to a facility which is likely to eliminate all competition in a downstream market, where access to the facility is indispensable for the requestor's

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[42] See likewise, Steenbergen, "Proportionality in Competition Law and Policy" (2008) 35(3) Legal Issues of Economic Integration 259, at 263.

[43] As the Commission states, "…*it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers. In general, the later the efficiencies are expected to materialise in the future, the less weight the Commission can assign to them*…" Discussion Paper, point 89.

[44] See, for instance, Case T-30/89 *Hilti* [1991] ECR II-1439.

[45] See, for instance, Case 85/76 *Hoffmann-La Roche* [1979] ECR 461.

[46] See, for example, *Hoffmann-La Roche*, note 3 above.

[47] Joined Cases 6 and 7/73 *Commercial Solvents* [1974] ECR 223.

business and there is no actual or potential substitute for it, is abusive unless objectively justified.[48] Environmental considerations may be relevant to these doctrines in at least the following ways. First, one might imagine a situation where environmental constraints might be taken into account in deciding whether access to the facility is indispensable to the requestor's business. In its judgment in *Bronner*, the ECJ held that the test of indispensability will depend upon the presence of "*technical, legal or even economic obstacles*" to the creation of a similar facility by the requestor, if necessary in conjunction with other undertakings.[49] One might imagine that planning and/or environmental regulations might, for instance, pose legal obstacles preventing the building of an additional airport or railway line on a given route. Secondly, a dominant undertaking might legitimately refuse to supply, or to grant access to an essential facility, to an undertaking whose practices are objectively extremely environmentally dangerous. Alternatively, a dominant undertaking might refuse to grant access to an essential facility, if a natural resource, or might cease supply of this resource to an existing customer, because it would risk unsustainably exhausting or overusing this resource. This would, it is submitted, fall within the existing notion of objective justification inherent in judgments such as *Commercial Solvents* and *Bronner*.[50]

- **Discriminatory pricing and abusive discounts.** A grant by a dominant undertaking of loyalty-inducing discounts,[51] or discriminating in prices charged to customers without objective justification,[52] is abusive. However, it is submitted that a dominant undertaking might legitimately distinguish between prices granted to environmentally-damaging undertakings and environmentally-friendlier undertakings, as long as this was done on an objective and proportionate basis. Further, a dominant undertaking may, it is submitted, legitimately take (differing) environmental costs into account in prices charged to customers.[53]

- **Predatory pricing.** As is well known, the test of abusive predatory pricing under Article 82 EC is set out in the *AKZO* judgment,[54] where the Court held that prices below Average Variable Cost (AVC) are presumed to be predatory, whereas prices above AVC but below Average Total Cost (ATC) are not presumed to be predatory, but will be considered so if they are part of a plan to eliminate a competitor. Environmental considerations could, it is submitted, be relevant to this abuse in two ways. In the first place, evidence that the intention of a dominant undertaking pricing above AVC but below ATC was genuinely pursuing environmental protection aims in so doing should mean that the conduct is not considered abusive.[55] This follows, however, from applying the *AKZO* test itself, without needing to consider the effect of Article 6 EC. In the second place, however,

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[48] Case C-7/97 *Bronner* [1998] ECR I-7791. See also, *Spa Monopole/GDB*, XXIIIrd Report on Competition Policy (1993) at point 240, where a Belgian mineral water producer was refused access to a pool of reusable glass bottles set up by the Association of German Sources (GDB). As a result of undertakings accepted by GDB to open its pool to foreign producers, who had to abide by the GDB's rules (for example, the bottles provided by GDB to Spa could only be used by Spa on the German market), the complaint was withdrawn and no formal decision was taken.

[49] *Bronner,* note 48 above, para 44.

[50] Notes 47 & 48 above.

[51] See, for instance, Case C-95/04 P *British Airways* [2007] ECR I-2331, Case T-203/01 *Michelin II* [2003] ECR II-4071.

[52] See, for instance, *Eurofix-Bauco* OJ 1988 L 65/19.

[53] See, for example, Case T-203/01 *Michelin II* [2003] ECR II-4071

[54] Case C-62/86 *AKZO Chemie* [1991] ECR I-3359. See also, Case C-333/94 P *Tetra Pak* [1996] ECR I-5951 and Case T-340/03 *France Télécom* [2007] ECR II-107.

[55] See Eilmansberger, "How to distinguish good from bad competition under Article 82 EC: In search of clearer and more coherent standards for anti-competitive abuses" 42 CML Rev (2005) 129, at 139.

evidence that a dominant undertaking pricing below AVC was genuinely pursuing environmental protection aims, and that there is no less restrictive way of achieving these aims, should rebut the *AKZO* presumption of abuse. As mentioned above, an example might be the launch of a new environmentally friendlier product which demands a change in consumer habits, meaning that its adoption requires particularly strong price incentives, at least initially, for consumers to switch.

- **Other ways of limiting the development of products or services.** Article 82(b) qualifies as abusive "*limiting production, markets or technical development to the prejudice of consumers*." Aside form the individual abuses considered above, an integrated approach to interpreting this provision would, it is submitted, mean that it would be abuse for a dominant undertaking to limit the ability of third parties to develop environmentally-friendlier production methods or products,[56] or to fail to satisfy a clear demand for an environmental service,[57] or to be extremely inefficient in refusing to use environmentally-friendlier technology, thus increasing environmental costs.[58] This also follows from Chapter 8's *economic* argument, insofar as that argument posits that consumers derive benefits from environmentally-friendlier products and services, such that limiting the development of such products and services will have an adverse effect on consumer welfare.

- **Excessive prices**. Article 82(a) provides that an abuse may consist in "*directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions*." The charging of a price by a dominant undertaking which bears no reasonable relation to the product's economic value may be excessive.[59] This may be determined by, *inter alia,* comparing the supplier's costs with the price charged, and by comparing the price charged to other prices charged by the dominant undertaking in other markets, or to prices charged by other firms on the same relevant market.[60] As such, environmental considerations may be relevant in a number of ways. First, a dominant undertaking using a more costly, environmentally friendlier method of production should not have the prices that it charges compared with an undertaking producing in a less environmentally friendly manner. Further, it is theoretically arguable that a dominant undertaking which factors in the broader environmental costs of production into its ultimate price charged to customers should be permitted to use the combined figure of ordinary production costs plus these environmental costs, where it can prove that the portion of the price attributable to these costs is, for instance, re-invested in environmental protection projects or the development of cleaner technologies. From a policy perspective, this would be the equivalent of implementing the polluter pays principle via imposing a private environmental "tax" on consumers. However, it would be crucial to prove that the costs so received were

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[56] By analogy to, e.g., Case 40/73 *Suiker Unie* [1975] ECR 1663. See also, Stone's interesting suggestion (Stone, "Restraints on Competition through the alteration of the environment at the genetic level" 8 NYU Envtl LJ 704) that organic farmers using competition law to prevent GM companies altering the environment by introducing genetically altered strains could, in the future, be held to violate section 2 of the US Sherman Act. Stone argues in effect that this could amount to an abusive limitation of third parties' ability to use environmentally friendlier methods, insofar as dominant companies thereby raise organic farmers' costs or make their business untenable, resulting in harm to consumers.

[57] By analogy to, e.g., *P&I Clubs IGA* OJ 1999 L 125/12.

[58] By analogy to, e.g,, *Port of Genoa* OJ 1997 L 301/27.

[59] See, for instance, , Case 27/76 *United Brands* [1978] ECR 207 (though the Commission's case on this point was not upheld), Case 26/75 *General Motors* [1975] ECR 1367 (though, again, the Commission's case on this point was not upheld), the Commission's decisions in Case COMP/36.568 *Port of Helsingborg* and *Deutsche Post - Interception of Cross-Border Mail* OJ 2002 L 331/40. See also, the decision of the UK Competition Appeal Tribunal in *Napp Pharmaceutical Holdings* [2002] CAT 1.

[60] *Ibid.*

destined for an environmental use; otherwise, this would allow dominant companies to reap windfall profits from producing "dirty" products, by passing on the environmental cost of production to the consumer. Admittedly, this would pose substantial monitoring and enforcement issues.

- **Unfair trading conditions.** Finally, a further type of exploitative abuse is the imposition by a dominant undertaking of unfair trading conditions on its customers. Environmental considerations might be relevant in this regard if, for instance, a contractual condition obliged a customer not to object to the environmentally harmful nature of the product or service.[61]

4. Principal case law to date: *COBAT* and *DSD*

COBAT. One of the few environment-related Article 82 cases to date is the *COBAT* case, in which proceedings were informally closed in 2000.[62] The Commission had suspected a consortium which coordinated the collection and recycling of used lead batteries in Italy (COBAT) of abusing a dominant position on the Italian market for recyclable lead waste. Italy had given the exclusive right to the COBAT consortium to collect, stock and sell used batteries and other waste containing lead.[63] Owners and collectors of lead waste were obliged by law to give COBAT their waste, with the aim of achieving a high collection rate. In effect, COBAT was carrying out an environmental service of general interest, which was financed by the revenue from selling waste and a *sovrapprezzo* (a surcharge on the sale of new batteries charged to final consumers as an indirect tax). COBAT organised tender procedures for collectors and assigned the winners exclusive territories; losers could only work as sub-contractors for winners. In addition, the export of waste abroad was forbidden.

Following a complaint of a "losing" collector undertaking about this exclusivity procedure and the ban on exporting waste, the Commission investigation found that COBAT clearly enjoyed a dominant position by virtue of its exclusive rights granted by legislation. Moreover, any abusive conduct was not justified by its environmental task. First, the exclusive collection zones gave rise to unnecessary discrimination between collectors, unfairly excluding third parties. Secondly, COBAT was found to apply different conditions to its sale of waste to different undertakings, depending on whether the undertaking was in another Member State or in Italy - in particular, applying more favourable sales prices to Italian recycling undertakings. As a result of the proceedings, COBAT accepted a number of changes to the system, so that any undertaking permitted by law to collect waste could do so, without territorial restriction; COBAT would buy waste at the same rate from all collectors; and COBAT would sell the waste on to recycling undertakings at the same, best possible rate, whether the undertakings were Italian or not. As a result, anti-competitive practices – which were not justified by any environmental need – were minimised.

This outcome is, it is submitted, perfectly in line with the interests of environmental protection and, thus, the arguments set out in Part II: in principle, the injection of competition into collection of waste is beneficial to environmental protection (if such competition will not obstruct the performance of a service of general economic interest within the meaning of Article 86(2)). Further, price discrimination based purely on the

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[61] See, for instance, *GEMA II* OJ 1982 L 94/12 and Case T-83/91 *Tetra Pak II* [1994] ECR II-755.

[62] IP/00/1351. See also, Baccaro, "Collecte et recyclage des batteries usagées en Italie: droits exclusives, exigencies environnementales et droit de la concurrence" Competition Policy Newsletter 1 (2001) 39.

[63] The important role of the state in the *COBAT* decision means that it may be viewed as not a "pure" Article 82 EC, but one where Article 86 EC-based reasoning played an important role (see further, Chapter 14).

purchaser's nationality is clearly not justified on environmental grounds. In contrast, one might imagine that charging different prices might potentially be justified if the differences, for example, corresponded to the distance which the waste would have to travel to be recycled. In that case, COBAT might have made the argument that it was implementing the Article 174(2) principle that environmental damage (or, in this case, the production of waste) should be rectified at source,[64] or that the price included the environmental costs of transporting the waste.

DSD. The second, and more significant, environment-related case to date is, as aforementioned, the Article 82 EC *DSD* case. In 2001, the Commission found that DSD had abused its dominant position on the market for the organisation of the take-back and recovery from private final consumers of used sales packaging in Germany.[65] The abuse concerned a provision in DSD's agreements with obligated undertakings under the German Packaging Ordinance (e.g., packaging producers). By this provision (the "payment" provision), these obligated undertakings had to pay DSD a fee for all the sales packaging distributed within Germany which bore the Green Dot trademark, irrespective of whether the DSD system ultimately provided the "exemption service" of collection and recycling, etc. This meant that manufacturers who chose to have some of their packaging disposed of themselves, or using a competing exemption system, had to pay the same amount to DSD as if they had used DSD for all of their packaging (i.e., they had to pay for the of some packaging twice). Further, it also meant that manufacturers who did not use DSD's exemption system at all, but whose products bore the Green Dot because they participated in a Green Dot system in another Member State, had to pay DSD for services they did not receive, unless they set up two sets of packaging – one for Germany and one for other Member States – which would be expensive. This provision, the Commission found, infringed the "no service, no fee" principle, which applied to all waste management services, and prevented undertakings from contracting with DSD's competitors. It was thus abusive in two senses: it was exploitative of customers, in requiring a fee for a service not actually provided; and it was exclusionary, in making it harder for competing systems to be set up. As a result, DSD was ordered to stop charging a fee for that part of packaging which was in fact recycled by a non-DSD system. DSD appealed this part of the decision, and sought interim measures.[66]

As to interim measures, the President of the CFI's 2001 rejection of this application was rather predictable: very few such applications succeed in satisfying the CFI's stringent criteria of urgency and likelihood of irreparable damage. This was similarly the case here: the President rejected, in particular, DSD's arguments that its whole exemption system, and its right to the Green Dot trademark, would be irreversibly jeopardised by the imposition of the obligation pending the CFI's final judgment. Moreover, the balance of interests lay in the Commission's favour, due to the public interest in bringing infringements of Article 82 to an immediate end.[67]

In the CFI's judgment of May 2007, DSD's appeal was finally rejected. In a lengthy judgment, the CFI held first that "mixed" systems – where a packaging manufacturer or distributors divides its packaging between the DSD system and another system (whether a self management or exemption system) – were, in contrast to DSD's submissions,

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[64] See, by analogy in the free movement of goods context, Case C-2/90 *Commission v Belgium* [1992] ECR I-4431 (*Walloon Waste*).

[65] OJ 2001 L 166/1. On the definition of the market, see point 92 and Chapter 9 above.

[66] On interim measures, see Case T-151/01 R, Order of the President of the Court of First Instance of November 15, 2001.

[67] Case T-151/01, judgment of May 24, 2007, not yet reported, para 220.

perfectly possible under the Packaging Ordinance. Further, it was not necessary under the Packaging Ordinance for only that packaging which was to be taken back and recovered by DSD to bear the Green Dot logo. For example, if DSD assumed responsibility for taking back and recovering half of a manufacturer's packaging, DSD would, in order to satisfy the Packaging Ordinance, simply have to show that it had taken back and recovered an equivalent quantity of packaging, irrespective of whether that packaging bore the Green Dot logo.[68]

Next, the CFI dealt with DSD's arguments that the Decision effectively required it to grant a free licence of its Green Dot trademark to any undertaking participating in the DSD system, because the Decision required that such undertakings be able to affix the Green Dot logo to packaging irrespective of whether the packaging was in fact recycled by the DSD system. In particular, DSD had argued that the situation fell outside the Court's essential facilities doctrine (as set down in cases like *Magill* and *Bronner*) on a number of grounds.

To begin, DSD had argued that it was not "essential" for undertakings to use the Green Dot logo on their packaging in order to be able to participate in a non-DSD system; it was open to undertakings simply to put the logo on that part of their packaging disposed of by DSD, and not on the rest of their packaging.[69] In rejecting this argument, the CFI held that this would lead to significant additional costs for manufacturers and distributions wishing to put uniform packaging into circulation across the EU, or wishing to adopt mixed systems within Germany. In any event, such efforts might be nugatory, as it was the final consumer who would ultimately decide where to dispose of the packaging – e.g., within a shop itself, such as a fast-food outlet, using its self-management system; or in domestic household bins, using the DSD system.[70]

Secondly, DSD argued that competition was not in fact "eliminated", as some undertakings had in fact chosen to set up self-management systems and/or to participate in other exemption systems - an argument which the CFI held "[could] not suffice" to call into question the Commission's conclusion that DSD's conduct was abusive.[71]

Thirdly, DSD argued that its refusal to licence the Green Dot trademark was objectively justified in a number of ways. To start, it was justified by the objectives of the German Packaging Ordinance, which requires transparency and clear labelling for consumers. If packaging participating in non-DSD systems were allowed to bear the Green Dot logo, consumers would not know how they should dispose of their packaging (e.g., bringing it back to the point of purchase as with self-management solutions, or leaving it to be collected by the DSD system). Once again, this argument was rejected by the CFI, on the aforementioned ground that the Packaging Ordinance in no way forbade mixed systems.[72] Finally, DSD claimed that a refusal to licence the Green Dot trademark was justified by the distinctive function of the trademark itself, which was to indicate to consumers that the packaging would be disposed of by DSD. The CFI rejected this argument on the facts, holding that the function of the Green Dot logo is to "identify the possibility of having the package at issue collected by the DSD system", which function was perfectly compatible with the affixing of a competitor's logo as well.[73]

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[68] *Ibid,* para 135.
[69] *Ibid,* para 93.
[70] *Ibid,* paras 141-145.
[71] *Ibid,* paras 95 and 148. Notably, the Court did not give substantive reasoning on this point.
[72] *Ibid,* paras 151-154.
[73] *Ibid,* paras 156-162.

Nor did the obligation infringe the general principle of proportionality, as DSD would still be remunerated for the service it provides, and it would be more expensive and difficult for packagers to affix the Green Dot logo selectively. However, the CFI accepted DSD's argument, which had not been specifically addressed in the Decision, to the effect that it should be allowed to levy an "adequate" fee for use of the Green Dot trademark, even where DSD's services are not otherwise being used for the packaging.[74]

Analysis. The Commission's decision and the CFI's judgment in *DSD* each demonstrate a real concern to ensure that, in the developing, lucrative, but normally very concentrated, area of waste management,[75] effective competition is ensured. The competitive issues here are, on their face, standard, non-environment-specific, Article 82 concerns: the charging of a fee to its customers by a (super-)dominant[76] undertaking for a service it did not in fact provide. In contrast, as the Commission has stated, in waste management systems such as DSD's, the fees paid by packagers should depend on the actual amount of packaging which is exempted as a result of the undertaking's participation in the system, the packaging waste volume, the type of material and the costs of collection and recovery - i.e., the objective characteristics of the waste recovered and the services provided.[77] As such, the DSD case would seem a fairly blatant case of anti-competitive exploitation and foreclosure - once again, it was not a case where DSD was putting forward genuine environmental protection reasons for its payment provision.

Rather, the core of DSD's problems with the Commission's obligations was essentially a fear that its systems would be economically unworkable without a guaranteed licence fee for all Green Dot products, as DSD would end up treating packaging which bore the Green Dot mark, but for which they were receiving no licence fee. If this were really so – and thus the obligation would place the continued viability of the main waste management system in Germany in jeopardy, with no alternative way of organising itself – the justification should, it is submitted, be accepted. Crucially, however, this was not, on the facts, the case. Thus, after receiving detailed written and oral submission on this point from the parties, the CFI rejected (as had the Commission) the contention that DSD would be obliged to treat packaging over and above the quantities for which it was paid:[78] if and insofar as DSD's system was in fact used for packaging bearing the Green Dot, but for which DSD had not received a fee, this could be rectified by compensation agreements between the different system operators "*to share the quantities of material recovered by the collection undertakings to which they have recourse in respect of the quantities of the material for which they are responsible under the contracts signed with manufacturers and distributors of packaging.*"[79]

Vedder criticises the *DSD* case forcefully, arguing that it, "*conveys a very powerful message: the Commission will not take environmental considerations into account in considering whether or not abuse*

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[74] *Ibid,* paras 191-196.

[75] See, for example, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 30.

[76] The Commission estimated that around 70% of all sales packaging in Germany was covered by the DSD system, and it held 100% of the "exemption system" sub-market: point 95.

[77] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 68.

[78] For example, DSD's submission that, "…*the contested decision will lead to a situation where almost all packaging in Germany will bear the [Green Dot mark]. Thus, participation in the DSD system for just 1% of marketed packaging could enable a user of the logo to use that mark, free of charge, for the remaining 99%. The DSD system therefore is likely, in the short term, to have to treat packaging brought erroneously to its system and for which DSD does not receive any fee*…"

[79] Note 67 above, paras 137-138. See also, points 147-148 of the Decision, note 65 above.

of a dominant position took place."[80] Such criticisms are, it is submitted, misguided on the facts of the case. It should not be the case that a "diluted" form of Article 82 should apply to a dominant undertaking simply because it is active in an environment-related sector: indeed, it is in the very interest of environmental protection that such sectors should be competitive, efficient and innovative.[81] Save insofar as genuinely necessary to perform its environmental function,[82] Article 82 should apply in the normal way to undertakings such as DSD; for example, if waste management systems give loyalty rebates to packagers for using their system, these should also, *prima facie*, be prohibited.[83] Rather, the essence of the judgment is essentially the insistence that the link between the Green Dot logo and the ultimate treatment of packaging by DSD is not required by the Packaging Ordinance, is anti-competitive and thus should be broken. As such, it is more of interest as a case on the CFI's approach to the relevance of trademarks to Article 82 than as a case on the interplay between competition and environmental policy. On the former issue, the Court's ruling that DSD should be entitled to charge a fee for use of its trademark is, it is submitted, significant.

5. Tradable permit schemes and Article 82 EC?

Although not the subject of any case to date, is it interesting to consider, as a footnote to this Chapter, the potential application of Article 82 to tradable permit schemes such as the EU's Emissions Trading Scheme (ETS), the functioning of which was considered above in Chapter 4. In this regard, we might distinguish two different relevant product markets.[84]

The first might be a market for the allocation of allowances in the first place. At present, as we saw in Part I, most of this allocation is carried out on a gratuitous basis by Member States (at least 95% had to be thus allocated in Phase I; at least 90% in Phase II of the ETS). The rest of the allowances are allocated by auction. As it is the action of the Member States, and not that of private undertakings,[85] which determines how allowances are allocated, this market is not susceptible to Article 82 analysis (though it may, as Chapters 14 and 15 shall examine, be susceptible to Article 86 and 87 analyses).

The second, more obvious, relevant product market might comprise a market for the purchase and sale of allowances (including, by virtue of the Linking Directive discussed in Chapter 4, the broader Kyoto Clean Development Mechanism and Joint

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[80] Vedder, *Competition Law and Environmental Protection in Europe: Towards Sustainability?* (Groningen, Europa Law Publishing, 2003), at 332. He goes on to voice the criticism that, *"[i]n practice…meting the Commission's objections to DSD's financing structure would boil down to obliging DSD to subsidise the entrant*."

[81] See further, the contentions of firms like Wella AG and L'Oréal, which wanted to set up their own systems to take back packaging on the ground that DSD was not cost-efficient in recycling: International Herald Tribune, July 13, 2002.

[82] For example, one might imagine a situation where Article 86(2) might apply, to avoid a situation of "cherry picking" of the most lucrative items to recycle. For example, plastics are uneconomical and difficult to recycle. In many Member States, however, this problem is avoided by placing material-specific obligations on exemption systems. See further, Chapter 10, which discusses the Article 81 *DSD* decision on this aspect (in which greater competitive restrictions were permitted for recovery of plastics, due to the difficulties inherent in the area).

[83] See DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, point 71. The fee structure of a dominant system can be abusive if it offers rebates designed to attract the entire amount of packaging of an obliged company.

[84] On determining the relevant market(s) in the ETS context, see Bode and Scharifi, "Market shares and dominant market positions in the case of emissions trading" (2007) 2 Carbon and Climate Law Review 105.

[85] If the Commission's plans come to fruition, allowances will be allocated using criteria harmonised at Community level from Phase III onwards, thus taking Member States' NAPs out of the equation: see further, Chapter 4.

Implementation allowances).[86] It is likely that the relevant geographic market here would be the EU, combined with the allowance markets of any other countries or states which may become linked with the EU ETS in the future.[87] Despite this broad geographic market definition, it is - at a push - conceivable that one (or a group) of undertakings might be found to hold a (collective) dominant position market in the sense of being able to behave "*to an appreciable extent*" independently of competitors; where an undertaking holds considerable market power on the market.[88] Clearly, the manner in which a Member State may choose to allocate allowances may result in one or more undertakings' holding a large proportion of these allowances. Further, substantial barriers to entry may exist for new entrants, depending on how the relevant Member State has decided to treat new entrants in its National Allocation Plan. As seen in Part I, new entrants may have to purchase emission allowances on the market, instead of receiving them for free - thus evidently giving them higher operating costs compared to incumbents who received allowances via the "grandfathering method". In addition, new entrants' allocations may be made on the basis of different, less favourable, criteria than incumbents' allocations.[89]

In such a situation, such dominant undertaking(s) would be subject to the Article 82 "special responsibility" not to abuse their position. One might imagine for example - again, admittedly, at a push - the application of the essential facilities doctrine here, as the possession of allowances may be indispensable for their competitors to be active in a related market for the production of (pollutant) products.[90] Similarly, a dominant undertaking could be accused of abusively "*limiting production, markets or technical development*" within the meaning of Article 82(b) insofar as it restricts access to allowances for competing undertakings. Due to the commodity-like nature of the allowances market, however, it is *prima facie* difficult to imagine significant pricing abuse taking place.

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[86] See Bazelmans, "De koppeling van CDM en JI aan het Europese emissiehandelssyteem", Nederlands tijdschrift voor Europees recht 6 (2004) 151.

[87] As discussed in Chapter 4, for instance, the EFTA countries have already joined in the ETS.

[88] See, Chavez and Strandlund, "Enforcing Transferable Permit Systems in the Presence of Market Power" 24 Environmental and Resource Economics (2003) 65 and Newbery, "Climate Change Policy and its Effect on Market Power in the Gas Market" (2008) Journal of the European Economic Association 727, who concludes on the basis of economic analysis that one effect the EU ETS in the UK is to amplify the market power of gas suppliers (by reducing the price elasticity of demand for gas appreciably), resulting in a Lerner Index increase of up to 50%. Ideally, the ETS is intended to give rise to a liquid, homogenous market (if working properly) with many market players, making the acquisition of substantial market power less likely.

[89] See Weishaar, "The European emission trading system and competition – anticompetitive measures beyond reach? An assessment of the grandfathering allocation method and the performance standard rate system" at 5. An analogy might be made here with the approach taken to licences of the third generation (3G) telephony standard (via the Universal Mobile Technology System (UMTS), which allows high-speed transmission of data on mobile phones). Though the network operators are unlikely to be considered to hold positions of single dominance, the relatively small number of such operators means that competition problems may nonetheless arise, in particular as these operators control the number of service providers and the conditions under which such providers operate. As a result, it is possible that the network operators could be considered to hold a position of collective dominance. See further, Faull and Nikpay (eds.), The EC Law of Competition (2nd ed., Oxford, Oxford University Press, 2007), at 13.185 onwards and Petit, "The Commission's Contribution to the Emergence of 3G Mobile Communications - an Analysis of Some Decisions in the field of Competition Law" 7 European Competition Law Review (2004) 429.

[90] As is well-known, an abuse may take place on a related market to that in which dominance is held: see, for example, Case T-83/91 *Tetra Pak II* [1994] ECR II-755.

Chapter 13: Merger Policy

1. Introduction: Is there a role for environmental considerations in the Community's merger regime?

Prima facie, there is considerably less scope for taking environmental considerations into account in applying the Community's merger regime than with any other area of Community law. This is essentially because, despite the transition in Regulation 139/2004 (the "Merger Regulation") to the test of whether a concentration would "significantly impede effective competition" (the SIEC test), the Commission has been clear that, in practice, one of the primary forms of competitive harm in the case of concentrations remains "the creation or strengthening of a dominant position" (the "dominance" test).[1] This means that, where a proposed concentration will create or strengthen a dominant position – a test which, as we saw in Chapter 12, is based solely on whether economic power is significantly increased[2] - the possibilities of nonetheless concluding that the SIEC test is not satisfied are few. Nonetheless, they are not non-existent, and in this sense the current Merger Regulation offers greater possibilities for integration than its 1989 predecessor, which relied solely on the dominance test.[3] This Chapter will examine the ways in which it might be argued that environmentally beneficial concentrations do not satisfy the SIEC test.[4]

2. Overview

The Merger Regulation provides for a variety of factors to be taken into account in assessing whether a proposed concentration is compatible with the common market, i.e., whether the concentration would "*significantly impede effective competition*" (the SIEC test).[5] Some of these are set out in Article 2, headed "appraisal of concentrations", though this is not an exhaustive list. Thus, Article 2 provides that the Commission shall take into account,

> *"(a) the need to maintain and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or outwith the Community;*

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[1] See Regulation 139/2004 on the control of concentrations between undertakings OJ 2004 L 24/1 and Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings OJ 2004 C 31/5, points 2 and 4. The extent to which environmental factors may be relevant to assessing whether a firm is (likely to be) dominant (e.g., regulatory barriers to entry, innovative and dynamic markets, first-mover advantages, etc) have been discussed in the context of Chapters 9 and 12 (on market definition and Article 82 EC, respectively), and will not be repeated here. See, for an example of environmental regulation creating barriers to entry relevant to merger analysis, M.2533 *BP/E.ON* (high barriers to entry of market confirmed by fact that environmental regulations restricted building extra capacity at the coast, at 118) and further cases cited in Chapter 9 on market definition.

[2] See, Horizontal Merger Guidelines, *ibid.*

[3] Note that the enaction of the predecessor to the 2004 Merger Regulation, the 1989 Merger Regulation, followed a debate of some years on what approach should be taken in the Community to mergers, with countries such as Germany and the UK arguing that mergers should be judged on competition grounds alone, but countries such as France arguing for industrial policy and social issues to be taken into account. Though, overall, Germany and the UK prevailed, as Motta notes "…*this does not imply that other public policy considerations will never play any role in the EU merger policy*." Motta, *Competition Policy: Theory and Practice* (Cambridge, Cambridge University Press, 2004), at 14.

[4] As with the analysis in Article 81(1) and Article 82, it is submitted that, where a merger would be environmentally detrimental, but does not otherwise restrict competition, it can never be prohibited by the Merger Regulation, nor do Part II's arguments lead to any different conclusion. For an example of a (likely) environmentally-damaging merger which was (rightly) allowed, see, Case ECSC/1252 *RAG/Saarbergwerke/Preussag Anthrazit II*.

[5] This test is set out in Article 2(2) and (3) of the Merger Regulation.

> *(b) the market position of the undertakings concerned and their economic and financial power, the alternatives available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition."*

In contrast to some other merger regimes, where environmental protection benefits may expressly be taken into account in merger assessment, the Community regime has no such express provision.[6] Nonetheless, the final factor listed in the excerpt from Article 2 above – the requirement to take into account the "*development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition*" – clearly provides a close parallel with three of the conditions set out in Article 81(3). In fact, the first two Article 81(3) conditions are almost identical (promotion of technical and economic progress and a fair share of benefits to consumers), though the final two conditions (proportionality and non-elimination of competition) are rolled into the single (apparently stricter) requirement that the concentration should "*not form an obstacle to competition*".

Prima facie, this leads us to the conclusion that, for the same reasons as set out in considering Article 81(3) in Chapter 11, and relying in particular on the *systematic* and *economic* arguments set out in Part II, benefits to environmental protection - or, at the least, those which can reasonably be valued in some way - must be taken into account by the Commission in assessing whether a concentration will significantly impede competition. This conclusion is bolstered by the systematic approach taken in recital 23 to the Merger Regulation, which provides that, in assessing whether a concentration is compatible with the common market, "*the Commission must place its appraisal within the general framework of the achievement of the fundamental objectives referred to in Article 2 of the Treaty establishing the European Community and Article 2 of the Treaty on European Union.*"[7]

In practice, as the Commission has indicated and in a similar manner to our analysis under Articles 81(3) and 82, such technological and economic progress will be taken into account in merger assessment using an efficiencies analysis.[8] This means that the best way of taking environmental benefits into account in the merger context is by viewing them as efficiencies, as we did in the context of Articles 81(3) and 82.

3. Efficiencies

One of the innovations of the 2004 Merger Regulation was its explicit reference to the requirement for the Commission, in determining the impact of a concentration on competition in the common market, to take into account any "*substantiated and likely efficiencies put forward by the undertakings concerned.*"[9] As the Merger Regulation notes,

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[6] See, for example, the new Spanish merger regime, whereby the authorities should consider the public interest in otherwise anti-competitive mergers: Law 15/2007 of 3 July for the Defence of Competition 10(3)(d): "*protección del medio ambiente*" is a public interest to be taken into account. See by analogy, the situation under the former UK merger regime where public interest concerns could be invoked in merger analysis: see s.84 Fair Trading Act 1973, Rodger and Goyder, "Public Interest Criteria in the Assessment of Mergers in the United Kingdom by the Monopolies and Mergers Commission" International antitrust law & policy proceedings of the Fordham Corporate Law Institute (1994) 125.

[7] This approach, it is submitted, is given further force by th Article 6 EC integration principle, as set out in Chapter 6's *systematic* argument.

[8] See Horizontal Merger Guidelines, note 1 above, at 76.

[9] Recital 23, Merger Regulation, note 1 above. See similarly, the US DOJ/FTC Horizontal Merger Guidelines. Originally, the Commission had rejected the relevance of efficiencies to merger analysis: see, for example, *Danish Crown/Vertjyske Slagterier* OJ 2000 L 20/1, *MSG Media Service* OJ 1994 L 364/1, *Nordic Satellite Distribution* OJ 1996 L 53/20. See generally, Bishop and Walker, *The Economics of EC Competition*

> *"It is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that it might otherwise have and that, as a consequence, the concentration would not significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position."*[10]

The Merger Regulation announced that Commission guidelines on this issue would be forthcoming, which duly appeared in the form of the 2004 Horizontal Merger Guidelines. In these Guidelines, the Commission confirmed that,

> *"[i]t is possible that efficiencies brought about by a merger counteract the effects on competition and in particular the potential harm to consumers that it might otherwise have."*[11]

In order for such efficiencies to be taken into account, the Commission must be in a position to conclude, "*on the basis of sufficient evidence*" that the efficiencies flowing from the merger are "*likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have*."[12]

More particularly, the Horizontal Merger Guidelines set down three conditions which must be satisfied in order for efficiencies to be taken into account.

First, efficiencies have to benefit consumers. In order for this to be achieved, "*efficiencies should be substantial and timely and should, in principle, benefit consumers in those relevant markets where it is otherwise likely that competition concerns would occur.*"[13] It is evident from this statement that, unlike in some other jurisdictions, consumer welfare is the chosen welfare standard in the Community's merger regime: thus, purely productive efficiencies do not count for these purposes.[14] The Commission gives the examples of efficiencies as including cost savings in production or distribution, giving the merged entity the ability and incentive to charge lower prices post-merger, or new or improved products or services,

> *"for instance resulting from efficiency gains in the sphere of R & D and innovation. A joint venture undertaking set up in order to develop a new product may bring about the type of efficiencies that the Commission can take into account."*[15]

Law: Concepts, Application and Measurement (2nd ed., London, Sweet & Maxwell, 2002), Lindsay, *The EC Merger Regulation: Substantive Issues* (London, Sweet & Maxwell 2006), Luescher, "Efficiency Considerations in European Merger Control - Just Another Battle Ground for the European Commission, Economists and Competition Lawyers?" (2004) European Competition Law Review 7, Theeuwes, "An Economic Analysis of the New Regulation 139/2004" 32(2) LIEI (2005) 209 and the seminal article by Williamson, "Economics as an Antitrust Defense: The Welfare Tradeoffs" 58 American Economic Review (1968) 407. Form CO now has a section on efficiency gains: s 9.3.

[10] *Ibid.* Note that this phraseology means that, in Community merger law, efficiencies do not constitute a true "defence" as such, but rather form part of the assessment whether the SIEC test has been satisfied. Nonetheless, as is the case with Article 82 "efficiencies", the Commission has asserted that the burden of proving efficiencies in the merger context lies on the parties.

[11] Horizontal Merger Guidelines, note 1 above, point 76.

[12] *Ibid,* point 77.

[13] *Ibid,* point 79.

[14] See, for example, Neven and Röller, "Consumer surplus vs. welfare standard in a political economy model of merger control" 23(9-10) International Journal of Industrial Organization (2005) 829, who argue that a consumer surplus, rather than a total welfare, model is from an economic perspective appropriate in many cases, as productive efficiencies are rarely generated by mergers and as total welfare is difficult to measure accurately when competition authorities have a large case load. See, *contra*, the decision of the Canadian Federal Appeal Court in *Superior Propane*, which approved a total surplus standard: see Elhauge and Geradin, *Global Competition Law and Economics* (Oxford, Hart, 2007), 892, 901.

[15] Horizontal Merger Guidelines, note 1 above, point 81. See likewise, US FTC Horizontal Merger Commentary 2006: "*Efficiencies in the form of quality improvements also may be sufficient to offset anticompetitive price*

In many cases, it is qualitative efficiencies which will be decisive. Thus, Philip Lowe (Director General of DG Competition), has stated that in most efficiency cases, the Commission will use a qualitative assessment of the transaction's welfare impact.[16] Clearly, therefore, improvements in products or services resulting from greater environmental benefit should be taken into account in this respect. However, the Commission emphasises that - just as we saw in the context of Articles 81 and 82 - in order to be taken into account, efficiencies have to be timely. The later the efficiencies are expected to materialise in the future, the less weight the Commission will assign to them.[17] As discussed in Chapter 8's economic argument, this aspect of the efficiencies analysis could, depending on the method of discounting employed, mean heavy discounting of future environmental benefits. It is submitted, however, that a *systematic* approach to choice of discount method demands that this choice should be exercised in the light, *inter alia,* of Article 2 EC's sustainability aim. As we saw in Chapter 2's analysis of that aim, there is an important intergenerational component to the notion of sustainable development.[18] This, it is argued, would militate against the use of a heavy discounting rate.

It is important to note that an efficiencies analysis would not mean that, simply because a merger takes place in an environment-related sector, it should *per se* be treated more leniently in applying the SIEC test. An example might be a merger between waste collection undertakings which would result in a large degree of market power. The fact that new entrants would be at a significant cost disadvantage relative to incumbents due, for example, to incumbents' economies of scale and network effects, may, in such a case, make it more likely that prices would go up post-merger without any particular countervailing environmental benefits.[19]

Secondly, in order to be taken into account, efficiencies have to be merger-specific, i.e., they must be a "*direct consequence of the notified merger*" and must not be achievable to a similar extent by reasonably practicable, less anti-competitive, alternatives.[20]

Thirdly, efficiencies have to be verifiable, "*such that the Commission can be reasonably certain that the efficiencies are likely to materialise, and be substantial enough to counteract a merger's potential harm to consumers.*"[21] Once again, in the environmental context, this may pose certain problems insofar as the value of present, or future, environmental benefits may, as discussed in Chapter 8, be difficult to quantify. Nonetheless, as concluded there, as long as such benefits are *reasonably* quantifiable using accepted environmental valuation techniques - albeit not fully quantifiable - they should, it is submitted, satisfy this requirement.

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increases following a merger. Because a quality improvement involves a change in product attributes, a simple comparison of pre- and post-merger prices could be misleading. A careful analysis of the effects of changes in product attributes and prices on consumer welfare is likely to be necessary."

16 Speech, Brussels, February 17, 2003.

17 Horizontal Merger Guidelines, note 1 above, point 83.

18 Viz. the classic definition of sustainable development put forward in the Brundtland Report as, "development which meets the needs of the present without compromising the ability of future generations to meet their own needs" (Brundtland et al, *Our Common Future* (Oxford, Oxford University Press, 1987).

19 See, for example, Case COMP/M.4318 *Veolia/Cleanaway*, decision of September 21, 2006 (proposed merger resulting in a market share of 85-95% on the market for commercial hazardous waste incineration raised serious doubts as to compatibility with the common market, though commitments were ultimately accepted). For an equivalent conclusion in the US system, see *Waste Management-Allied* (DOJ 2003), discussed in Elhauge and Geradin, *Global Competition Law and Economics*, note 14 above, at 882.

20 Horizontal Merger Guidelines, note 1 above, point 85.

21 *Ibid,* point 86.

Where a proposed merger is not horizontal, but vertical or conglomerate, efficiencies may carry even greater weight. This is due to the fact, as observed by the Commission in its Non-Horizontal Merger Guidelines, this that countervailing competitive restrictions are likely to be weaker than in the case of horizontal mergers, because direct competition is not eliminated.[22] Further, the activities and/or products of the undertakings involved in vertical and some conglomerate mergers tend to complement each other, meaning that integrating these undertakings may "*produce significant efficiencies and be pro-competitive.*"[23]

No mergers have yet been explicitly cleared on efficiencies grounds, due partly to the fact that the policy was formalised by the Commission relatively recently, but due also undoubtedly to the stiff probative hurdles with which merging parties are faced in "substantiating" the likely efficiencies from the merger. The Commission's first detailed consideration of efficiencies arguments, *Inco-Falconbridge*, is - though not itself environment-related - a good indication of the stringent approach which the Commission intends to adopt towards efficiencies arguments.[24] In that case, the Commission rejected arguments put forward by the parties that the proposed transaction would generate efficiency gains because certain of their nickel mines/processing facilities were close to each other, which would have allowed them to optimize their mining and processing operations, meaning increased production at lower cost, benefiting nickel customers. The Commission rejected this on a number of grounds. First, the efficiencies were not merger-specific, as a joint venture between Inco and Falconbridge limited to mining and processing operations in a limited locality would have allowed most of the operating synergies between the two undertakings to materialise, while not preventing them from competing at the refining and marketing levels. Secondly, the benefits from the merger would not have been adequately passed on to customers, as the efficiencies were expected to be achieved at the upstream mining and processing levels only, so any potential benefit would have been spread between all the merged undertaking's finished nickel and cobalt products, a significant part of which were sold on other markets than the three relevant markets where competition concerns were identified. Thirdly, as a result of the proposed transaction, the merged undertaking would have acquired an almost monopolistic position in these markets, and it would thus have had only limited incentives to share the benefits of the efficiencies with end customers in these markets. In sum, the parties had failed to satisfy the burden of proof placed on them to demonstrate adequate efficiencies flowing from the proposed transaction.

Despite this apparently strict approach, one can look to a number of cases under the old Merger Regulation in which something akin to an efficiencies analysis succeeded, though not recognised at the time as such. The main example here is the manner in which the Commission and Court have, in certain exceptional cases, taken social and industrial policy concerns into account in assessing mergers.

A classic illustration is the *Nestlé/Perrier* case,[25] where the Commission argued before the CFI that an action by workers' representatives organisations to annul a Commission decision approving a takeover, despite fears of job losses, was inadmissible due to lack of interest. In the Commission's view, it had no duty to perform a detailed analysis of employment issues. In rejecting this contention, the ECJ held that Article 2(1)(b) of Regulation entailed an obligation to draw up "*an*

[22] *Ibid,* point 12.
[23] *Ibid,* point 13.
[24] Case M.4000 *Inco-Falconbridge*, decision of July 4, 2006.
[25] Case T-12/93 *Vittel* [1993] ECR II-785. See also, recital 45 of the new Merger Regulation: "*This Regulation in no way detracts from the collective rights of employees, as recognised in the undertakings concerned, notably with regard to any obligation to inform or consult their recognised representatives under Community and national law.*"

economic balance" (*bilan économique*) which may "*entail considerations of a social nature*."[26] In particular, the Commission was obliged to "*ascertain whether the concentration is liable to have consequences, even if only indirectly, for the position of the employees*."[27] A further example one might cite is the "failing firm" defence accepted in exceptional circumstances by the Commission and Community Courts. The leading case here is *Kali + Salz*,[28] where the Commission, in its decision allowing a merger to go ahead, referred specifically to the severe structural weakness of the regions in East Germany affected by the proposed concentration, and the likelihood of serious consequences for them of the closure of the former State enterprise, Mitteldeutsche Kali. The ECJ did not criticise this aspect of the decision and the existence of a limited "failing firm" defence has been recognised in a number of subsequent decisions, as well as in the Horizontal Merger Guidelines.[29]

Similarly, in the environmental context, one might point to a (limited) number of cases where, albeit not considered in the format of efficiencies as such, environmental benefits have been taken into account by the Commission in assessing the merger. In many of these cases, however, it is fair to conclude that the environmental benefits were, as least ostensibly, ancillary to the overarching conclusion that the merger would not create or strengthen a dominant position.[30] Nonetheless, for the *systematic* and *economic* reasons set out above, it is submitted that there is a strong case in principle that reasonably quantifiable post-transaction environmental benefits should be considered to be efficiencies in the context of merger analysis. Moreover, it is submitted, this can be done by analogy with decisional practice in which social factors were taken into account, such as *Nestlé/Perrier* and *Kali + Salz.* Indeed, the case for taking environmental considerations into account in interpreting the Merger Regulation is, given Article 6 EC, arguably stronger on a *systematic* analysis than that for taking social considerations into account.

4. Applicability of Article 21(4) of the Merger Regulation to national measures taken in the environmental interest?

Aside from their relevance in efficiencies analysis, a further conceivable way in which environmental factors might play a role in the Community's merger regime lies in Article 21(4) of the Merger Regulation (which corresponds to Article 21(3) of the old Merger Regulation). This provides that, notwithstanding Articles 21(2) and (3), which lay down the "one-stop-shop" principle granting exclusive jurisdiction to the Commission to assess mergers falling within the jurisdictional scope of the Merger Regulation, Member States may take "appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law." The Article goes on to specify that public security, plurality of the media and prudential rules shall be regarded as legitimate interests, but that,

> *"Any other public interest must be communicated to the Commission by the Member State concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above*

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[26] *Ibid,* para 39.
[27] *Ibid,* para 38.
[28] Joined Cases C-68/94 & 30/95 *France v Commission* [1998] ECR I-1375.
[29] See, for example, Horizontal Merger Guidelines, note 1 above, point 89 onwards and *Bertelsmann/Kirch/Première* OJ 1999 L 53/1.
[30] See, for example, M.2987 *Sydkraft/Ecoplus*, M.2780 *GE Wind Turbines/Enron*, M.2712 *Electrabel/Photovoltech*, Case COMP/M.3213 *Umicore/OMG/Precious Metal Group.*

may be taken. The Commission shall inform the Member State concerned of its decision within 25 working days of that communication."

National measures taken for environmental protection reasons are, evidently, not expressly mentioned here. Conceivably, however, it might be argued that certain environmental reasons for a concentration fall within the concept of "public security": though, in the context of free movement of goods and services, the term has been interpreted relatively narrowly, one might reason by analogy with cases such as *Campus Oil*, in which the concept was held to justify ensuring the continued security of oil supplies in Ireland.[31] One might, for example, imagine that the concept could extend to mergers relating to the increasingly emphasised public security risks flowing from climate change, for example, or the public security benefits of environmentally-friendlier, domestically-sourced energy sources (such as renewable energies).[32]

For environment-related cases which could not be brought within the notion of public security, however, a Member State wishing to take "*appropriate measures*" would be obliged to notify the Commission of its intentions in advance and await the Commission's assessment of the measure's compatibility with "*the general principles and other provisions of Community law*" - which clearly, as discussed in Chapters 2 and 6, include the principles of sustainability and integration.[33] If this were done, and if the national measure taken genuinely served environmental protection objectives, it is submitted that the Commission would – unless it could demonstrate that such objectives would be protected by a decision under the Merger Regulation - be bound to take no objection to such a measure.

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[31] See Articles 30 and 55 EC and Case 72/83 *Campus Oil* [1984] ECR 2727. For examples of cases falling under the old Article 21(3), see M.423 *Newspaper Publishing* and M.1858 *Thomson-CSF/RACAL*.

[32] See further, the paper presented by the High Representative for the Union's Common Foreign and Security Policy and the European Commission to the European Council, March 14, 2008, "Climate Change and International Security": "*Unmitigated climate change beyond 2ºC will lead to unprecedented security scenarios as it is likely to trigger a number of tipping points that would lead to further accelerated, irreversible and largely unpredictable climate changes. Investment in mitigation to avoid such scenarios, as well as ways to adapt to the unavoidable should go hand in hand with addressing the international security threats created by climate change; both should be viewed as part of preventive security policy*" (at 1). The report was welcomed by the European Council (Presidency Conclusions of the Brussels European Council, March 13-14, 2008); recommendations from the Council on the matter are to follow. For the potential relationship between climate change and security, see Sindico "Climate Change: A Security (Council) Issue?" (2007) 1 Carbon and Climate Law Review 29.

[33] See, for example, M. 1724 *BSCH/Champalimaud*.

Chapter 14: The Relevance of State Action to Articles 81 and 82 EC

1. Introduction

Though, as argued in Part I, private actors play an increasingly significant role in environmental policy and protection, Member States' role in reinforcing this role remains significant. Member States may, for example, seek to reinforce the effectiveness of voluntary environmental agreements by recognising them in law; or grant special rights to certain undertakings to perform environmental services which would not otherwise be profitable. This Chapter deals with Community competition law's approach to such Member State efforts.

2. State action as a defence for undertakings

Where undertakings are required by national legislation to act in an anti-competitive manner, such undertakings may rely on their national law obligations as a defence to proceedings for breach of Articles 81 or 82 EC. This principle was laid down most famously in *Ladbroke Racing*, where the ECJ held that,

> *"Articles [81 and 82] apply only to anti-competitive conduct engaged in by undertakings on their own initiative…If anti-competitive conduct is required of undertakings by national legislation or if the latter creates a legal framework which itself eliminates the possibility of competitive activity on their part, Articles [81 and 82] do not apply. In such a situation, the restriction of competition is not attributable, as those provisions implicitly require, to the autonomous conduct of the undertakings…"*[1]

The test for application of the state action is, therefore, strict: all possibility of competition must be eliminated. Where a state measure restricts the scope for competition, but leaves a residual field of competition, Articles 81 and 82 EC apply to this field.[2] Similarly, where a state measure simply encourages or gives binding force to an agreement, but does not require action by law, the state action defence is not made out (though it may be a mitigating factor in the fine or penalty imposed).[3] This is so even where the conduct takes place following consultation with the national authorities,[4] or where such state measures are subsequently found themselves to contravene Community competition law.[5] Finally, as held by the ECJ in *CIF*, national competition authorities (NCAs) are obliged to adopt a decision to disapply national law which contravenes EC competition law, thereby removing the undertaking's state action defence as soon as the decision by the NCA has become definitive.[6] Until the NCA takes this step, however,

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[1] Cases C-359 & 379/95P *Commission and France v Ladbroke Racing* [1997] ECR I-6265, para 33. See generally, Blomme, "State Action as a Defence Against 81 and 82 EC" 30(2) World Competition (2007) 243 and Castillo de la Torre, "State Action Defence in EC Competition Law" 28(4) World Competition (2005) 407.

[2] See, for example, Case 40/73 *Suiker Unie v Commission* [1975] ECR 1663 and Case T-387/94 *Asia Motor France (No. 3)* [1996] ECR II-961.

[3] See also, Joined Cases 240, 241, 242, 261, 262, 268 and 269/82 *SSI* [1985] ECR 3831, Case C-35/96 *Commission v Italy* [1998] ECR I-3851 (customs agents) and *French Beef* Commission decision of April 2, 2003, OJ 2003 L 209/12.

[4] *SSI*, *ibid.*

[5] *Ladbroke*, note 1 above. For stringent criticism, see Castillo de la Torre, at 414, who argues that the State action defence "*implies that the direct effect of Article 81 EC is in some measure subordinated to national law*": note 1 above.

[6] Case C-198/01 *CIF* [2003] ECR I-8055. See similarly, with regard to Community public procurement law, Case 103/88 *Fratelli Costanzo* [1989] ECR 1839. On the potential ambiguity of the idea of "definitively" setting national measures aside, see Rizza, "The Duty of National Competition Authorities to Disapply Anti-Competitive Domestic Legislation and the Resulting Limitations on the Availability of the State Action Defence" European Competition Law Review (2004) 126.

undertakings enjoy immunity from fines and from claims for damages, at least in the Commission's view.[7]

Clearly, therefore, to the extent that anti-competitive action is in fact required by environmental legislation, this doctrine provides a defence for the undertakings involved from any possible Article 81 and 82 EC proceedings. An example would be where a state measure requires undertakings to operate a price cartel in a market for environmental reasons,[8] or where the state requires an undertaking to collect a potentially anti-competitive environmental levy.[9]

More likely, however, is a situation where national environmental measures set out the overall regulatory framework, but leave more or less important elements to be decided on by undertakings active in the market. As we saw in Part I, this type of voluntary agreement, termed "co-regulation", is common in certain Member States, such as the Netherlands. Thus co-regulatory initiatives may, for example, involve the State's defining the initiative's objectives, the deadlines and mechanisms relating to its implementation, methods of monitoring the application of the legislation, and any sanctions which are necessary to guarantee the legal certainty of the legislation - but leave the rest up to private undertakings.

The stringency of the *Ladbroke* test means that the state action defence will rarely be met in co-regulatory situations. This is, it is submitted, quite correct: as has been argued in previous Chapters, areas where the competition rules do not apply should be kept to a minimum, as competition in residual areas will improve consumer welfare while - if the competition rules are interpreted in the manner propounded by this research - taking environmental protection requirements into account as appropriate.[10] As such, this approach accords fully with, for instance, Chapter 6's *systematic* argument, as an example of a potential conflict between competition and environmental policy which should be reconciled using the proportionality principle, i.e., the means least restrictive of competition which still attains the environmental aim.[11] For example, the state action defence will evidently not be made out in packaging waste management cases, where Member States legislation transposes the requirements of the Packaging Waste Directive in a way that enables (or requires) private undertakings to set up collective systems to fulfil obligated undertakings' waste recovery requirements, but does not set out the conditions under which such systems must operate. Examples are the DSD and EcoEmballages schemes, where competition law applied albeit in the context of national legislation adopted under the EU Packaging Directive.[12]

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[7] DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[8] The defence will, evidently, also apply where the legislator decides to act rather than private undertakings, an example being the replacement of the *ACEA* voluntary agreement between car manufacturers on CO2 emission limits by legislation: see Proposal for a Regulation of the European Parliament and of the Council setting emission performance standards for new passenger cars as part of the Community's integrated approach to reduce CO2 emissions from light-duty vehicles COM (2007) 856 final.

[9] See Case C-207/01 *Altair Chimica v ENEL* [2003] ECR I-8875.

[10] See similarly, Vogelaar, "Towards an Improved Integration of EC Environmental Policy and EC Competition Policy: An Interim Report" in 1994 Fordham Corp. L. Inst. (B. Hawk ed. 1995) 529, at 554.

[11] See point 4 of Chapter 6's working hypothesis on the implications of Article 6 EC.

[12] See Chapters 10-12 and, similarly, the approach of the Danish competition authority to an agreement on the collection, recycling and destruction of used refrigerants containing CFC gas (*Kølebranchens Miljøordning*). Though the Danish environmental authorities had requested industry to sign up to this agreement, the agreement was nonetheless held to be anti-competitive, as companies ought to have been free to use their own recycling system if they wished: see the Danish government's submissions to the OECD, *Competition Policy and the Environment* (Paris, OECD, 1996).

The question of applicability of the state action defence is particularly interesting in a situation, such as that under the Dutch *Wet milieubeheer*, where industry comes up with a proposal for a voluntary environmental agreement, and requests the Dutch environment minister to declare the proposal universally binding.[13] *Prima facie*, the input from participating undertakings in coming up with the terms of the agreement seems such as to negate application of the defence: insofar as the agreement "*eliminates competition*" within the *Ladbroke* meaning, this is not, therefore, as a result of the action of the state. Indeed, the Dutch competition authority (NMa) has taken a similar approach in cases such as *Stibat*, which concerned a battery collection and recycling system set up by Dutch battery producers and importers to fulfil their obligations under the Dutch legislation implementing the Batteries Directive.[14] In that case, the Stibat arrangement had been notified to the Dutch environment minister, who had approved it subject to its being notified to the Dutch minister for economic affairs for a competition law assessment - and expressly without prejudice to its being found compatible with Dutch and Community competition law. In its decision finding part of the Stibat arrangement to contravene Dutch competition law, the NMa noted that the Dutch legislation implementing the Batteries Directive did not require any collective agreement between producers and importers, or lay down the content of any such agreement.[15]

However, this conclusion may seem harsh in the case of undertakings in the industry who may not have been party to the original proposal, but who are nonetheless bound by it following the Minister's declaration, and who have no scope for obtaining an exemption from the declaration's binding force.[16] In this case, it would seem that such undertakings should be entitled to rely on the state action defence. This argument would reach its limits, however, where it would have been possible for an undertaking to gain an exemption from the declaration, but no such exemption was in fact applied for.[17]

A separate potential issue arising out of legislation such as the *Wet milieubeheer* is the extent to which the state could itself be in breach of competition law, under the *Van Eycke* doctrine discussed below, by declaring proposed agreements universally binding. This is considered below.

Even where the conditions for the state action defence in the above sense are not made out, it may in some cases, as discussed in Chapter 9, still be possible for an undertaking

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[13] See *Wet milieubeheer*, section 9.40, discussed further below and, in the case of waste management contribution agreements, section 15.36. See also, the example of the *Dutch car wrecks* case of the Dutch Competition Authority, discussed by the Commission in its DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005, where a collective system for the recovery and recycling of car wrecks set up in the Netherlands prior to the ELV Directive (Directive 2000/53/EC on end-of life vehicles OJ 2000 L 269/34, as amended), an agreement on which was declared binding by the government for a three-year period, on a renewable basis, to all car producers and car importers under Dutch law, was found not to be anti-competitive. The system was not granted exclusivity by the government, as it was possible for the car producers and importers to obtain an exemption if they can demonstrate that they take care of their ELVs in an equivalent way. See also, for example, Case 51/98 *Stibat*, decision of the Dutch competition authority of December 18, 1998, where it was open to battery producers and importers to opt out of Stibat's battery collection and recycling system, which two importers had in fact chosen to do (para 12) - though they were far outnumbered by Stibat's 481 members.

[14] Directive 91/157 OJ 1991 L 78/38, since replaced by Directive 2006/66 OJ 2006 L 266/1. This makes battery producers and importers responsible for battery waste.

[15] Case 51/98 *Stibat*, para 41.

[16] See, *Wet milieubeheer* section 9.40(2): a request for an agreement to be made universally binding can be made to the Minister by "*those persons or organisations representing persons who, in terms of their number and the total volumes of the substances, preparations or other products concerned, form in the opinion of Our Minister a significant majority of those performing operations with these products.*"

[17] See the *Dutch car wrecks* case, note 13 above.

to argue that, due to the nature of its activity carried out in the public interest, it falls outside the definition of an undertaking. Alternatively, undertakings may try to invoke Article 86(2) as a defence, discussed below.

3. The duties of the State under Articles 10 and 3(1)(g) EC read with Articles 81 and 82 EC

While Articles 81 and 82 EC only apply to undertakings, the Community Courts have long made clear - beginning with the *INNO* judgment - that Member States have a duty to refrain from enacting or enforcing national rules which might jeopardise the effectiveness of these Articles. This duty flows from Article 10 EC and was summarised by the ECJ in *Van Eycke* as follows:[18]

> *"…Articles [81 and 82] of the Treaty, read in conjunction with Article [10], require the Member States not to introduce or maintain in force measures, even of a legislative nature, which may render ineffective the competition rules applicable to undertakings. Such would be the case…if a Member States were to require or favour the adoption of agreements, decisions or concerted practices contrary to Article [81] or to reinforce their effects or to deprive its own legislation of its official character by delegating to private traders responsibility for taking decisions affecting the economic sphere."*[19]

There are far more cases on the extent of Member States' Article 10 EC duties in conjunction with Article 81 EC, rather than Article 82 EC: indeed, the extract from *Van Eycke*, above, takes as its example the Article 81 EC situation. Nonetheless, the same principles apply by analogy in the Article 82 EC context. In each case, Member States' obligations in this context may be divided into three categories.

a. Duty not to require or favour the adoption of anti-competitive agreements, or abuses by a dominant undertaking

In order to breach this duty, there must be an agreement or concerted practice between undertakings which is contrary to Article 81 EC, or an abuse by a dominant undertaking contrary to Article 82 EC. As such, the respective elements of the Article 81 or 82 EC prohibitions must be made out. For example, where the state requests industry to sign up to a recycling system which does not restrict competition, as it is open to all participants and self-management is also possible, Article 10 EC is not breached.[20]

In the case of an Article 81-related breach, there must be an agreement or concerted practice linked to the state measure at issue: it is not sufficient that national legislation itself has an anti-competitive effect equivalent to an agreement contrary to Article 81 EC.[21] An example of a potential breach of this duty in the environmental sphere might be a state packaging waste measure that, in addition to providing for the establishment of collection and recovery systems, recommends or requires that producers of packaged products cooperate in order to devise identical packaging for their competing products,

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[18] See Case 13/77 *INNO v ATAB* [1977] ECR 2115 and, generally, Buendia Sierra, *Exclusive Rights and State Monopolies under EC Law* (Oxford, Oxford University Press, 1999) and Thunström, Carle and Lindeborg, "State Liability Under the EC Treaty Arising From Anti-Competitive State Measures" World Competition 25(4) (2002) 515.

[19] Case 267/86 *Van Eycke v ASPA* [1988] ECR 476.

[20] See, by analogy, the *Danish Environmental Refrigerant System* case, discussed at note 12 above, where, after alterations made at the behest of the Danish Competition Commission, a system to which the Danish ministry had requested that industry sign up was found non-restrictive, as companies could use their own recycling systems (and would be exempted from environmental tax, just as KMO members), all companies fulfilling objective reasonable criteria could be approved, and approval was free of charge.

[21] See Case C-2/91 *Meng* [1993] ECR I-5751 and Case C-245/91 *Ohra* [1993] ECR I-5851.

leading to communality of costs and price alignment.[22] Nonetheless, where an agreement is in fact adopted by a body acting in the public interest - which may in some circumstances, as we saw in Chapter 9, include environmental activities - and so does not qualify as an agreement between undertakings, resultant legislation does not breach Article 10.[23] Further, just as we saw in our discussion of Article 81(1) in Chapter 10, it may be argued that an agreement is not anti-competitive because it is objectively justified, including on environmental grounds.[24]

If this fails, Article 81(3) may apply to environmentally-motivated restrictions, in the manner we saw in Chapter 11. An interesting question is whether, beyond the standard objective justification and Article 81(3) "defences" available to private undertakings, Member States may rely on a wider category of justifications for their action based, for example, on Article 30 EC. As Mortelmans notes, this was an issue raised, though not decided, in the *Meng* case.[25] If this is the case, there is no doubt that Member States will be able to rely on cases such as *PreussenElektra* to argue that proportionate environmentally-motivated measures requiring or favouring anti-competitive agreements are justified.[26]

In the environmental context, an interesting potential application of this duty could include abusive conduct flowing from the allocation of allowances by a Member State in the context of the EU's Emissions Trading Scheme. As discussed in Chapter 12, it may be possible - in extreme cases - to envisage that the way in which allowances are allocated by a Member State might lead to a position of dominance as, in the current Phase of the ETS, 90% of allowances are allocated free-of-charge and, subject to compliance with rather broad allocation guidelines, at the Member State's discretion.[27] Where abusive conduct subsequently takes place (for instance, where a dominant undertaking unfairly restricted competitors' access to allowances), it could be argued that, where there was evidence that the Member State "*required or favoured*" such abuse, this constitutes a breach of that state's obligations. An example might be where a dominant undertaking over-reported its own emissions in order to be over-allocated allowances, and the Member State subsequently allocated allowances on the inflated basis.

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[22] See DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[23] See, by analogy, Case C-185/91 *Reiff* [1993] ECR I-5801, discussed below, where the Court held that Article 81 EC, read in conjunction with Article 10 EC and Article 3(1)(g) did not preclude a situation where compulsory tariffs were set by tariff boards and the board members, though chosen by the public authorities after proposals from trade sectors, were not representatives of these trade sectors, but rather were acting in the public interest, and where the public authority acted in the public interest in deciding whether to approve the board's decision: paras 18 and 24.

[24] This has been argued, at times successfully, by numerous Member States, in cases which we have already considered such as *Albany* and *Pavlov*: Case C-67/96 *Albany* [1999] ECR I-5751, Joined Cases C-180 & 184/98 *Pavlov* [2000] ECR I-6451.

[25] *Meng,* note 21 above. See Mortelmans, "Towards Convergence in the Application of the Rules on Free Movement and on Competition?" 38 CML Rev (2001) 613, who notes that the Court raised this issue with the interveners, which responded variously, but it was not ultimately necessary to decide the issue in that case. Note there is a certain analogy between this approach and the reasoning in Joined Cases C-267/91 and C-268/91 *Keck* [1993] ECR I-6097.

[26] See Case C-379/98 *PreussenElektra* [2001] ECR I-2099, and the discussion on this point in Chapters 2 and 7.

[27] On which, see Chapter 4.

b. Duty not to reinforce the effects of anti-competitive agreements, or an abuse by a dominant undertaking

A first element for this Article 10 EC duty to be breached is that there must be an anti-competitive agreement between undertakings, or an abuse by a dominant undertaking. In this regard, the same considerations discussed under section (a) apply.

A second element of breach is that the effects of the anti-competitive agreement(s) or abuse must be reinforced by the national measure. One way how this might happen is if the Member State incorporates an anticompetitive agreement into national legislation. This was the case, for example, in *Asjes*, where a French law approved certain airline tariffs.[28] It was also the case in *Vlaamse Reisbureaus*, which concerned a prohibition against travel agents transferring commission to clients, which had the same effect on the market as anticompetitive agreement.[29] In order to contravene Article 10, the ECJ held, a number of conditions must be satisfied:

(1) The legislation must give the (pre-existing) agreement a permanent character;

(2) The agreement must be made generally binding through legislation and undertakings must be able to rely on it before national courts against a third party;

(3) The legislation must provide effective remedies to be applied against any undertaking that does not follow the rules set out in the legislation.[30] Once again, if national law simply entails the same effects as an anti-competitive agreement, without actually implementing it, this is not sufficient to breach Article 10 EC.[31]

This category of duty is clearly potentially of application to co-regulatory environmental initiatives which, as discussed above, are common in certain Member States.[32] Taking once again the Dutch example, where the Minister may declare an environmental agreement universally binding, upon request by industry (and subject, where requested, to exceptions), such declarations may be made for up to five years, arguably giving it a "permanent character".[33] Further, there is provision in the *Wet milieubeheer* for an investigation and sanction procedure on the part of the Minister if an agreement declared universally binding is breached.[34] Nonetheless, Member States using a co-regulatory approach may be saved by the fact that, in order to contravene Article 10 EC, the agreement being reinforced by national legislation must itself be anti-competitive. As set out above in the context of Member States' duty not to require or favour the adoption of anti-competitive agreements, universally binding agreements may not be anti-competitive, for example, where exemptions are possible from the universally binding system.[35] Further, as discussed above, it may, depending on the circumstances of the

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[28] Joined Cases 209/84 etc *Asjes* [1986] ECR 1425. See also, Case 123/83 *BNIC v Clair* [1985] ECR 391.
[29] Case 311/85 *VVR v Sociale Dienst* [1987] ECR 3801.
[30] *Ibid*, at para 23.
[31] See *Van Eycke* and *Meng*, notes 19 and 21 above.
[32] On this, note the Commission's comment in its Horizontal Cooperation Guidelines OJ 2001 C 3/2, at point 183 and Weishaar, "The European emission trading system and competition – anticompetitive measures beyond reach? An assessment of the grandfathering allocation method and the performance standard rate system" (concluding that Member States' National Allocation Plans under the EU's ETS are unlikely to contravene Article 10 EC read with Article 81).
[33] *Wet milieubeheer*, section 9.41 and section 15.39 (waste management contribution agreements).
[34] *Wet milieubeheer*, section 9.44, 9.45 and section 15.41 (waste management contribution agreements).
[35] See the *Danish Environmental Refrigerant System* case, note 12 above. See also, the Dutch submissions to the OECD 1996 and the approval given by the Commission in its Waste Management Paper to the Dutch competition authority's reasoning in the *Dutch car wrecks* case, note 13 above, where an agreement declared

case, be arguable that the environmental protection goal of the agreement means that the competitive restriction should be viewed as inherent to this goal (under Article 81(1) EC) or that the agreement falls under Article 81(3) EC.

In this regard, an interesting example is that of the Dutch *verwijderingsbijdrage* (return and recycling fee), which has been imposed, by virtue of Dutch legislation, on all electronic goods since 1999. The idea is that consumers, who pay the fee on all electronic goods purchased, can return such equipment for recycling without charge when they go to purchase a replacement.[36] The level of this fee is set by an organisation of all Dutch producers and importers of electronic equipment (the *Stichting RTA*). It is submitted that, under the above argument, the Dutch state would not be in breach of the *Van Eycke* doctrine in this situation as long as it could be shown that such a system was proportionate, i.e., that there was no less restrictive means of achieving the same environmental goal as effectively. In this case, the argument would be that only such a universal system, which obliges retailers to take back old electronic equipment irrespective of brand, can achieve maximum environmental impact, as it makes life very easy for consumers. The fact that the EU has since itself made such a system compulsory EU-wide in its Waste Electronic Equipment Directive is strong evidence that such a system is, from an environmental policy perspective, necessary to achieve recycling goals.[37] However, as discussed below, it would be important by analogy to cases such as *Reiff* that the state retained ultimate decisional power over the fee levels, and that the *Stichting RTA* would be obliged to act in the interests of environmental protection, rather than out of the private interests of its members.

c. Duty not to deprive legislation of official character by delegation

The third category of Member State duty under Article 10 EC comprises a duty not to "*deprive its own legislation of its official character by delegating to private traders responsibility for taking decisions affecting the economic sphere.*" This was the situation in *INNO*, where the Belgian tax code allowed manufacturers or importers of tobacco products to set the basic price of tobacco; they then purchased tax labels to affix to each product.[38] In *Arduino*, however, the ECJ held that Italian legislation fixing minimum and maximum fees chargeable by Italian lawyers, after the State was presented with a draft by the professional association of lawyers, did not constitute delegation contrary to Article 10 EC. This was because Italy had not waived its power to make decisions of last resort or to review implementation of the tariff, which could be amended by the relevant Italian minister; further, national courts could depart from minimum and maximum fees under exceptional circumstances.[39] Similarly, in *Reiff*, no illegal delegation was found even where rates were set by committees which included representatives appointed by undertakings or trade associations, where the legislation required that the public interest

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binding for a renewable three year period did not infringe Dutch competition law, even though the car recycling system was based on a voluntary agreement among the interested parties and included a flat fee of €45 to be paid to ARN by car producers and importers for each registered car. The system was not granted exclusivity and exemptions were possible if there was proof that the car manufacturer or importer could take care of its ELVs in an equivalent way. They were thus free to set up alternative systems or to adhere to eventual alternative systems. See likewise, the arrangement in the decision of the Dutch competition authority in Case 51/98 *Stibat,* in which the Stibat battery collection and recycling system was not granted exclusivity, and other battery producers/importers were free to undertake their own collection and recycling.

[36] Originally by the *Besluit verwijdering wit- en bruingoed,* followed by the *Besluit beheer elektrische en elektronische apparatuur* implementing the Waste Electronic Equipment Directive.

[37] Directive 2002/96 OJ 2003 L 37/24.

[38] *INNO*, note 18 above.

[39] Case C-35/99 *Arduino* [2002] ECR I-1529.

be taken into account in setting rates and the public authority retained the power to substitute its own decision on rates for the committee's decision. As Schepel observes, the effect of the Court's interpretation of delegation is that,

> *"[s]elf-regulatory arrangements are to be protected from antitrust if they can make a plausible claim to put the "public interest" over narrow private interests."*[40]

Unlike the first and second categories of duty, the Court did not in *Van Eycke* mention the necessity for an anti-competitive agreement or abuse in order for the third category of duty to be breached. However, it is clear from subsequent cases that this requirement also applies to the third category. As a result, the same justificatory arguments as set out above would apply to environmentally-motivated practices.[41]

Applying this case law to the environmental context, it is submitted that a *systematic* approach to the concept of public interest means that genuine environmental protection requirements ought to be viewed as public interest requirements for this purpose. This would mean that, where national environmental legislation delegates certain environmental standard-setting to be decided by industry members, and obliges them to act on environmental protection grounds, Article 10 would not be breached insofar as the state retained ultimate power of decision. Moreover, Chapter 7's *governance* argument suggests that the Community courts would be likely to interpret the above jurisprudence in this manner, using a coherence-based approach to judicial reasoning. As the *INNO* line of cases represents the Court's explicit recognition of the relevance of non-economic, public interest factors in considering whether Article 10 is breached, this is not an area where Chapter 8's *economic* arguments in themselves need to be made.

[40] Schepel, "Delegation of Regulatory Powers to Private Parties under EC Competition Law; Towards a Procedural Public Interest Test" 39 CML Rev (2002) 31, at 50.
[41] See Schepel, *ibid,* at 48.

4. Article 86(1) EC – rights granted to privileged undertakings

Article 86(1) provides,

> "In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89."

As is well-established, Article 86(1) essentially represents a particular application, in the context of so-called "privileged" undertakings, of the general Article 10 EC duty of Member States not to jeopardise the attainment of the Treaty's objectives.[42]

a. Public undertakings and undertakings granted special or exclusive rights

The first issue in applying Article 86(1) EC is whether the undertaking at issue is a "*public*" undertaking or one to which a Member State has granted "*special or exclusive rights*". Though the Treaty does not define the notion of "public" undertaking, the Commission has defined it as including every undertaking over which the public authorities may exercise, directly or indirectly, a dominant influence by virtue of ownership of it, or their financial participation in it or the rules which govern it.[43] Defining undertakings to which "special or exclusive" rights have been granted has proven to be more difficult. Nonetheless, in *Ambulanz Glöckner*, the ECJ stated that special and exclusive rights exist where,

> *"protection is conferred by a legislative measure on a limited number of undertakings which may substantially affect the ability of other undertakings to exercise the economic activity in question in the same geographical area under substantially equivalent conditions."*[44]

Though this definition does not differentiate between special and exclusive rights, a distinction has been made in at the legislative level in, *inter alia,* the Transparency Directive.[45]

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[42] See *INNO*, note 18 above, para 42.

[43] See, for example, Notice on the allocation of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services OJ 1998 C 39/2.

[44] Case C-475/99 *Ambulanz Glöckner* [2001] ECR I-8089, para 24. Examples of cases where the Court has held an exclusive right to exist include, in *Höfner and Elser*, an undertaking granted a monopoly over the provision of recruitment services and, in *La Crespelle*, a body administering a scheme for the artificial insemination of cattle in France (Case C-41/90 *Höfner and Elser* [1991] ECR I-1979, Case C-323/93 *Centre d'Insémination de la Crespelle* [1994] ECR I-5077).

[45] See Directive 2006/111 on the transparency of financial relations between Member States and their public undertakings OJ 2006 L 318/17, which (at Article 2(1)(f) and (g)) defines exclusive rights as "rights that are granted by a Member State to one undertaking through any legislative, regulatory or administrative instrument, reserving it the right to provide a service or undertake an activity within a given geographical area" and special rights as "rights that are granted by a Member State to a limited number of undertakings, through any legislative, regulatory or administrative instrument, which, within a given geographical area: (i) limits to two or more the number of such undertakings, authorised to provide a service or undertake an activity, otherwise than according to objective, proportional and non-discriminatory criteria; or (ii) designates, otherwise than according to such criteria, several competing undertakings, as being authorised to provide a service or undertake an activity; or (iii) confers on any undertaking or undertakings, otherwise than according to such criteria, any legal or regulatory advantages which substantially affect the ability of any other undertaking to provide the same service or to operate the same activity in the same geographical area under substantially equivalent conditions."

Article 86(1) is clearly of significant potential relevance to the environmental sphere, in that it is foreseeable that Member States may choose to create special rights for undertakings carrying out some environmental services (via, for example, licenses or permits). This is due to the fact that, as we saw in Chapter 8, environmental benefits and damage may often constitute externalities, meaning that - in the absence of economic instruments internalising such externalities - performing environmental services may not be profitable. To date, there have been two principal cases on the application of Article 86(1) in the environmental context: *Dusseldorp* and *Sydhavnens*.[46] Each concerned the grant by Member State legislation of what in the Court's view amounted to an exclusive right within the meaning of Article 86(1). *Dusseldorp* concerned Dutch rules requiring undertakings to deliver their waste for recovery (such as oil filters) to a national undertaking, AVR Chemie, on which Dutch rules had conferred the exclusive right to incinerate dangerous waste, unless the processing of their waste in another Member State is superior to that performed by that undertaking.[47] In contrast, *Sydhavnens* concerned Danish rules authorising just three undertakings to receive building waste produced within the boundaries of the Municipality of Copenhagen with a view to recovering it - the case thus demonstrating the Court's acceptance that exclusive rights may be granted "collectively" to a number of undertakings.[48] While there are no environment-related cases concerning "special" rights, one might include in this category any undertakings which have been granted rights where there are a limited number of operators - in contrast to situations where any operator which meets certain objective criteria gets access to the right.[49] Under this analysis, situations where national measures limit, for example, the number of waste processors or purchasers in a locality or territory - for instance, to try to ensure that each processor had a sufficient amount of waste to allow it to remain economically viable - would qualify.[50]

Perhaps more controversially, applying this reasoning to the EU's Emissions Trading Scheme, in cases where Member States allocate rights to operators otherwise than in accordance with objective criteria or by auction - and insofar as their allocation methods are (or appear to be) discretionary - there would seem to be a real argument that they qualify as "special" rights.[51]

Finally, a Member State act granting special or exclusive rights must constitute a "*measure*" in order to fall under Article 86(1) EC. This includes administrative directions and even non-binding recommendations; and can include the very grant of a special or

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[46] Case C-203/96 *Dusseldorp* [1998] ECR I-4075 and Case C-209/98 *Sydhavnens* [2000] ECR 343. See also, Case 172/82 *Inter-Huiles* [1983] ECR 555, para 15, where the Court did not decide the question whether an environmentally-motivated right falls under Article 86(1).

[47] *Dusseldorp*, *ibid,* para 54. See also, the measure at issue in Case C-343/95 *Diego Calì & Figli* [1997 ECR I-1547 (though, as discussed in Chapter 9, the environmental nature of the pollution surveillance services meant that SEPG did not qualify as an "undertaking").

[48] *Sydhavnens,* note 46 above, para 53 (by analogy with the concept of collective dominance). Note, however, that this could perhaps more easily be viewed as the grant of "special" rights (see, for example, the "special rights-limitation" analysis of Buendia Sierra, note 18 above), though in practice nothing turns on the special/exclusive rights distinction here.

[49] See Buendia Sierra, note 18 above, chapter 2.

[50] One might make an analogy here with justifications for systems of quantitative selective distribution, where it is argued that, without a limit on the number of distributors in a territory, there would be no guarantee of economic viability for those distributors. Quantitative selective distribution systems are covered by the Verticals Block Exemption if the other criteria (i.e., market share threshold) set down in that exemption are met. See Regulation 2790/1999 OJ 1999 L 336/21.

[51] See *contra*, Weishaar, note 32 above, at 27, who (correctly) points out that, where non-objective and discretionary criteria are used in allocating allowances, the Member State NAP should not, in principle, be approved in the first place by the Commission.

exclusive right itself.[52] In the *Dusseldorp* case, for example, it extended to the Dutch Long-term Plan for the Disposal of Dangerous Waste;[53] in *Sydhavnens*, to a decision of the Municipality of Copenhagen.[54]

b. Measures in breach of Articles 81 or 82 EC

The core of Article 86(1) EC is its requirement that Member States refrain, in the case of privileged undertakings, from enacting or maintaining in force any measure contrary to the Treaty. For our purposes, measures contrary to Article 81 or 82 are most relevant.[55] In practice, however, Article 86(1) tends to be applied in conjunction with Article 82, with the interrelationship between national measures and Article 81 tending to be considered under the *Van Eycke* doctrine, considered above.

Article 86(1) and Article 82. Where the privileged undertaking enjoys a dominant position in a substantial part of the common market, the national measures may, in certain cases, be found to breach Article 86(1) in conjunction with Article 82.

The Court normally first considers whether the privileged undertaking holds a dominant position. Where an undertaking is granted exclusive rights over the whole territory of a Member State, this condition will always be satisfied. An example is *Dusseldorp*, which as we have seen concerned the grant of exclusive rights for the incineration of dangerous waste on the whole of the Netherlands.[56] The issue normally gets more attention, however, where there is dispute as to the definition of the relevant market, or whether the relevant market amounts to a substantial part of the common market. An example is *Sydhavnens*, where there was a dispute, *inter alia*, as to whether the relevant geographic market was the Municipality of Copenhagen, or whether a broader definition should be adopted. The ECJ left the matter for the national court to decide, though hinting that the geographic market may be nation-wide, due to the fact that one third of the building waste produced in Denmark was produced in the Municipality of Copenhagen.[57]

Originally, it seemed that, in order for there to be a breach of Article 86(1) read with Article 82, it had to be shown that the privileged undertaking, merely by exercising the exclusive rights granted to it, could not avoid abusing its dominant position.[58] From more recent cases, however - including *Dusseldorp* and *Sydhavnens* - it is clear that a breach may also occur where the exclusive rights granted are liable to create a situation in which that undertaking is induced to commit such abuses.[59] These tests have been found to be satisfied in a variety of situations.

A first situation is where the privileged undertaking is led to commit an Article 82(b) abuse of "*limiting production, markets or technological development to the detriment of consumers.*" One illustration of this is where the undertaking is unable to meet demand for a product or service, as in *Höfner and Elser*, where the fact that the Federal Employment Office in Germany enjoyed a legal monopoly acting as an intermediary in the employment market

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[52] Case C-202/88 *France v Commission (Telecommunications Terminal Equipment)* [1991] ECR I-1223.
[53] Note 46 above, para 12.
[54] Note 46 above, para 15.
[55] See also, however, judgments like Case T-266/97 *Vlaamse Televisie* [1999] ECR II-2329 (grant of the exclusive right to broadcast television advertising to the Flemish community), in which the CFI applied Article 90(1) EC in conjunction with Article 43 EC on freedom of establishment. In such cases, justifications on grounds of imperative requirements of the public interest (which, as discussed in Chapter 7, include environmental protection grounds) may, pursuant to the Court's consistent case law be accepted if proportionate. In that case, justification on cultural policy grounds was not made out on the facts.
[56] Note 46 above, para 60.
[57] Note 46 above, para 63.
[58] See also, *Crespelle*, note 45 above.
[59] See *Sydhavnens*, note 46 above, and *Dusseldorp,* note 46 above, para 61.

infringed Article 82 EC, as the FEO was manifestly unable to satisfy demand and the legal monopoly prevented competitors from entering the market to satisfy that demand.[60] A further common argument in this category is that outlets have been limited by a grant of exclusivity. This was the case, for example, in *Dusseldorp* itself, where the effect of the ban on exporting oil filter waste was to force Dusseldorp to deliver its filters to AVR Chemie, "*even though the quality of processing available in another Member State was comparable to that performed by the national undertaking.*"[61] Such an obligation favoured AVR Chemie, by enabling it to process waste intended for processing by a third undertaking, and thus abusively restricted outlets for waste processing.[62] From an analytical perspective, this conclusion is surely correct: the waste processing at the foreign plant at issue was not found to be of a lower standard than that of AVR Chemie, hence the (extremely harsh) competitive restriction could not be said to be justified by, or proportionate to, environmental protection goals.[63] Put in the terms of Chapter 6's *systematic* argument, therefore, this is a situation where the Article 6 EC integration principle did not require AVR Chemie's exclusivity, as a case where the same environmental result could be ensured in a manner less restrictive of competition.[64] In the terms of Chapter 8's *economic* argument, consumer welfare would have been greater in the absence of AVR Chemie's exclusivity even when environmental benefits were included in the utility function, as such benefits were not necessarily increased as a result of the exclusive right. Limitation of outlets was also one of the abuses alleged to result from the grant of exclusivity at issue in *Sydhavnens*.[65] The issue was not, however, ultimately decided by the ECJ, as an Article 86(2) defence applied there in any event.[66]

A second situation where Article 86(1) has been found to be infringed is where a national measure creates a situation of conflict of interest, where a privileged undertaking is put in a position controlling parts of its competitors' activities.[67] In the environmental context, an example might be if a privileged waste management undertaking were involved in deciding which other waste management undertakings should be granted permits. A related situation is where the national measure helps the privileged undertaking extend its dominant position to a different market. An example is *GB-INNO-BM*, which concerned the extension of market power of the public telephone network operator into the ancillary market of supply of telephone apparatus, resulting from a national measure conferring the power on the operator to lay down specifications for, and grant approval for, such apparatus.[68] Again, in the environmental context, one might imagine this

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[60] Case C-41/90 *Höfner and Elser* [1991] ECR I-1979.

[61] Note 46 above, para 62. In *Sydhavnens*, the Court emphasised that the mere fact of being granted an exclusive right over part of the national territory was not, in itself, an abuse: note 46 above, para 68.

[62] *Ibid,* para 63.

[63] *Ibid,* para 21 and see the observation of Advocate General Jacobs that a restriction amounting to a prohibition of export from a Member State would rarely be justifiable under Article 86(2) (Opinion, at para 98). In practice, therefore, one of the main problems with the Dutch rules was that the system effectively meant that all exports were prohibited, as the Netherlands - rightly or wrongly - did not generally consider any other state's processing methods to be as high quality as its own. See the submissions of the Dutch government to OECD, *Competition Policy and the Environment* (Paris, OECD, 1996), at 54.

[64] See the fourth point of the working hypothesis on the meaning of the integration principle, set out in Chapter 6 at Figure 1.

[65] Note 46 above, para 72.

[66] *Ibid,* para 81.

[67] As was the case in Case 260/89 *ERT* [1991] ECR I-2925, for example, where the Court held that the Greek television and radio station's monopoly over broadcasting could, if exercised in an abusive manner (e.g., by discriminating in favour of its own broadcasts), breach Article 86(1) EC read in conjunction with Article 82 EC. See further, *Albany*, note 24 above.

[68] Case C-18/88 *GB-INNO/BM* [1991] ECR I-5941. See also, *Ambulanz Glöckner*, note 44 above, where the Court held that a law adopted by German *Länder* on the provision of ambulance services contravened

occurring where a privileged waste management system is also active in a competitive downstream collection or recovery market, and has the power to prefer its own activities in that market to those of its competitors. It should be emphasised that none of Part II's arguments suggests that environment-related cases should receive any special treatment in such situations, as a less competitively restrictive solution is generally available which achieves the same environmental benefits - i.e., outsourcing the job which creates the conflict to an independent body.

A third situation where Article 86(1) has been found to be infringed is where the national measure sets or confirms tariffs to be charged by a privileged undertaking in a way which amounts to abusive pricing, whether in the form of excessive pricing, exclusionary rebates, or discriminatory pricing.[69] This issue was raised, for example, in *Sydhavnens*, though it was not ultimately contested that the prices charged by the three waste management undertakings in that case were freely determined by those undertakings and, should they become excessive, would be reviewable by the Danish competition authority.[70] Such an abuse might also occur, for example, where a privileged waste management undertaking grants fidelity rebates to customers such as to exclude its competitors.

However, possible breaches are not confined to the above situations, and could be found in relation to any type of Article 82 abuse. Other examples of potential abuse in the environmental context might include a state measure leading to the application of discriminatory membership criteria vis à vis foreign participants by the dominant collective waste packaging system,[71] or tying the conclusion of recycling contracts with the conclusion of contracts for the sale of recovered material in a manner contrary to Article 82(d). Importantly, however, genuine environmental protection reasons may constitute an objective justification for *prima facie* abusive conduct, just as we saw in Chapter 12 on Article 82. As submitted there, Chapter 6's *systematic* argument leads to the conclusion that otherwise abusive practices may be justified on genuine environmental protection grounds, if proportionate. Moreover, using Chapter 8's *economic* argument, quantifiable environmental benefits should be taken into account in assessing whether a practice is abusive in the first place, insofar as such benefits should be factored into the assessment of the practice's impact on consumer welfare.

Even where a Member State measure *prima facie* breaches Article 86(1), however, it is possible that the measure may be justifiable under Article 86(2); it is to this provision we now turn.

Article 86(1) EC, as medical aid organisations with an exclusive right to provide emergency ambulance services could also offer non-emergency patient transport services, though this could have been carried out by independent undertakings.

[69] See, for example, Case C-242/95 *GT-Link v DSB* [1997] ECR I-4449 and Case C-163/99 *Portugal v Commission* [2001] ECR I-2613.

[70] Note 46 above, para 71.

[71] An example taken by the Commission in its DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

5. Article 86(2) EC

Article 86(2) provides,

> "Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."

For our purposes, Article 86(2) is important for two reasons: first, it confirms that undertakings entrusted with "*services of a general economic interest*" are subject to the Treaty competition rules; second, and most importantly, it provides a potential derogation to the application of these rules where this would prevent such undertakings from carrying on the task entrusted to them by a Member State. In this way, Article 86(2) provides a potential derogation from undertakings' obligations under Articles 81 and 82 EC, and from Member States' obligations under Articles 86(1)[72] and 87 EC. As such, the derogation may be relied upon as a defence by both undertakings and Member States. The provision starts from a position of respect for Member States' legitimate concern to ensure the continued provision of important, but not necessarily otherwise profitable, public services, but requires competition to take place to the extent that this allows the provision of such services to continue.[73] As an exception to the competition rules, Article 86(2) EC is to be interpreted narrowly.[74]

a. Entrustment with the operation of a service of general economic interest

In order to fall within the derogation, a service of general economic interest must have been entrusted to an undertaking by an act of public authority.[75] Moreover, the scope of the duty entrusted will be narrowly interpreted. For example, it will not extend to other services offered by the undertaking which may be dissociated from the service of general economic interest, as such services do not make a direct contribution to carrying out this service.[76] The wording of the national measure entrusting the undertaking with the service will be narrowly construed.

In *Commission v France*, for example, the Court refused to accept France's argument that monopoly importers of gas and electricity were not only entrusted with supplying power subject to public service obligations such as ensuring continuity of supply, but also with contributing to environmental and regional policies.[77] In rejecting the argument, the ECJ underlined that the scope of the "services of general economic interest" concept extends only to obligations which are specific to the undertakings in question - and not,

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[72] See Case C-260/89 *ERT* [1991] ECR I-2925.

[73] See *Albany*, note 24 above, where the Court underlined the function of Article 86(2) EC as being the reconciliation of Member States' interest in "*using certain undertakings, in particular in the public sector, as an instrument of economic or fiscal policy with the Community's interest in ensuring compliance with the rules on competition and preservation of the unity of the common market.*" See also, White Paper on Services of General Interest (COM(2004) 374 final, para 2.1.

[74] See the DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[75] See Case 123/73 *BRT v SABAM* [1974] ECR 313, Case 172/80 *Züchner* [1981] ECR 2021 (banks' transfer of customer funds not entrusted by an act of public authority), and Case C-393/92 *Almelo* [1994] ECR I-1477 (non-exclusive concession to ensure electricity supply in part of national territory amounted to entrustment by an act of public authority).

[76] See, for example, Case C-320/91 *Corbeau* [1993] ECR I-2533.

[77] Case C-159/94 *Commission v France* [1997] ECR I-5815.

therefore, to generally applicable obligations such as environmental obligations.[78] This reasoning, it is submitted, should not be taken too far. It is surely correct that environmental rules applying across the board to all undertakings, as would seem to have been the case in *Commission v France*, should not be sufficient to constitute "*entrustment*" in this sense - otherwise, this would open the floodgates to practically all undertakings subject in some sense to environmental legislation to rely on Article 86(2). Where, however, specific environmental obligations are placed on a category of undertakings, or on a particular sector, this should satisfy the entrustment requirement.[79] This, it is submitted, is necessary in recognition of the movement towards use of the market to achieve environmental goals, as described in Chapters 3 and 4, and follows from Chapter 6's systematic approach to interpreting "entrustment".

A second issue is the scope of the concept of services of "general economic interest" - a concept nowhere defined in the Treaty.[80] In its 2004 White Paper on Services of General Interest, the Commission defined services of general economic interest as,

> *"services of an economic nature which the Member States or the Community subject to specific public service obligations by virtue of a general interest criterion."*[81]

In turn, "*public service obligations*" are defined as,

> *"specific requirements that are imposed by public authorities on the provider of the service in order to ensure that certain public interest objectives are met, for instance, in the matter of air, rail and road transport and energy."*[82]

As such, it is clear that services of a non-economic nature are not included in this category.[83] However, bodies which are not engaged in economic activity will not generally need to rely on the Article 86(2) derogation, as they will not, as discussed in Chapter 9, fall within the scope of the concept of an "undertaking" in the first place.

It follows that environmental services may fall within the definition of services of general economic interest, insofar as the services are economic.[84] This was specifically confirmed by the Commission in its 2004 White Paper, making express reference to the EU's

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[78] *Ibid*, para 69.

[79] See, for instance, the facts at issue in Case C-343/95 *Diego Calì & Figli* [1997 ECR I-1547 (though, as discussed in Chapter 9, the environmental nature of the pollution surveillance services meant that SEPG did not qualify as an undertaking).

[80] Article 16 EC, inserted by the Treaty of Amsterdam, confirms "*the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion.*" The Commission has published a number of documents on the issue of services of general economic interest, including Communications in 1996 (OJ 1996 C 281/3) and 2001 (OJ 2001 C 17/4) on services of general economic interest, a 2002 non-paper on services of general economic interest and state aid (November 12, 2002) and a White Paper on Services of General Interest (COM(2004) 374 final). See also, Article 36 of the Charter of Fundamental Rights, which affirms respect for access to SGEIs, and Boutayeb, "Une recherche sur la place et les fonctions de l'intérêt general en droit communautaire" (2003) 39(4) RTD eur. 587.

[81] White Paper on Services of General Interest COM(2004) 374 final, Annex I.

[82] Examples of activities held to constitute services of general economic interest include the operation of basic postal services (*Corbeau*, note 76 above), television broadcasting (*ERT,* note 67 above), the provision of a supplementary pension scheme (*Albany*, note 24 above), and the operation of an otherwise unviable air route (Case 66/86 *Ahmed Saeed* [1989] ECR 803).

[83] See, for example, Case C-37/92 *Vanacker* [1993] ECR I-4947, where AG Lenz was of the opinion that Article 86(2) didn't apply to the case, as the measure created regional collection and treatment monopolies for waste oil - as the entities at issue were state bodies, no undertakings were involved.

[84] Again, where the services are non-economic, there will be no need to rely on Article 86(2). See, for example, Case C-343/95 *Calì & Figli* [1997] ECR I-1547.

sustainable development policy.[85] The leading case here is *Sydhavnens*, where the ECJ recognised that waste management may constitute a service of general economic interest within the meaning of Article 86(2) EC.[86] In that case, as noted above, three undertakings had been entrusted with the task of processing building waste produced in the Municipality of Copenhagen. In its earlier *Dusseldorp* judgment, the ECJ had declined to rule on the issue - in that case, the service being the incineration of dangerous waste. Though the Dutch government had argued that the exclusivity granted was necessary to reduce the costs of AVR Chemie, and thus to enable it to be economically viable, the ECJ left the application of Article 86(2) to the national court.[87] In his Opinion, however, Advocate General Jacobs, foreshadowing *Sydhavnens*, expressed the view that, "*a waste management function might well be said to constitute a service of general economic interest.*"[88] Similarly, in *COBAT*, though the case was closed by comfort letter, the Commission indicated its view that an exclusive right granted by Italy to collect, stock and sell used batteries and other waste containing lead amounted to the entrustment of a service of general economic interest.[89]

More recently, in *AVR*, the Commission found that the treatment of hazardous waste with a view to disposal constituted a service of general economic interest.[90] The Commission based its decision on a number of factors, which constitute by far the most explicit formulation of its reasoning in this area to date.[91] These were:

(1) the "*obvious public interest in appropriate treatment when hazardous waste is disposed of*" and the Community objective of self-sufficiency in the disposal of waste;

(2) The necessity of public intervention in that case, as otherwise the treatment depots would have been forced to close down as unprofitable;[92]

(3) The fact that the measures did not infringe the "polluter pays principle", because waste suppliers were not favoured by the measure;

(4) The fact that the qualification of the activity as a service of general economic interest did not, in the Commission's view, circumvent the state aid rules, as the measures did not constitute prohibited operating aid to undertakings producing waste;[93]

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[85] Note 73 above, section 3.4: "*in line with the Union's policy on sustainable development, due consideration has to be taken also of the role of services of general interest for the protection of the environment and of the specific characteristics of services of general interest directly related to the environmental field, such as the water and waste sectors.*"

[86] Note 46, para 75: "*The management of particular waste may properly be considered to be capable of forming the subject of a service of general economic interest, particularly where the service is designed to deal with an environmental problem.*" Advocate General Léger had left the matter to be decided by the national court, on the basis that the extent of the privileged undertakings' obligations was unclear from the parties' submissions: see Opinion, para 104. See also, by analogy, *Inter Huiles*, note 46 above, which was the first case where it was held that environmental protection activities could be a task of general economic interest.

[87] Note 41 above, paras 66 and 67. Similarly, in its two *DSD* judgments, the CFI declined to rule on whether DSD was providing a service of general economic interest, "*in the same way as all exemption systems approved by the authorities of the Länder*" (Case T-151/01, judgment of May 24, 2007, para 208; Case T-289/01 *DSD,* judgment of May 24, 2007, para 207).

[88] Note 46 above, para 103.

[89] IP/00/1351.

[90] *AVR* OJ 2006 L 84/37, point 78.

[91] *Ibid*, point 79 onwards.

[92] Without the aid the undertaking, AVR, would have closed its rotary kilns by the end of 2001.

[93] This part of the Commission's reasoning is not wholly clear, as in principle operating aid to any undertaking - whether a waste producer or not - is generally frowned upon in assessment for compatibility

(5) The fact that the service benefited a broad, not a restricted, number of users; and

(6) Though there was no market failure in that case, the measure was based on the legitimate objectives of self-sufficiency in waste disposal and waste disposal close to the source of the waste.

This reasoning, it is submitted, is to be welcomed as an excellent example of the Commission's incorporating environmental policy principles (e.g., the polluter pays principle and the principles of self sufficiency in waste and disposal of waste close to the source) into its application of Article 86(2). Once again, such an interpretation of the notion of "services of general economic interest" follows, in particular, from Chapter 6's *systematic* argument - more specifically, from the Article 6 EC integration principle. Moreover, insofar as environmental protection has been confirmed as constituting a "mandatory requirement in the public interest" within the free movement of goods provisions, such an interpretation also follows from the systematic links between free movement of goods and competition policies, as argued in Chapter 6.[94] Finally, the decision may be viewed as a good illustration of the Commission's acting in accordance with Chapter 7's *governance* argument, insofar as it takes express cognisance of environmental principles, with the outcome being coherence between competition and environmental policies.

b. Obstruction of the performance of the tasks assigned

General. Article 86(2) states that undertakings entrusted with a service of general economic interest shall be subject to the Treaty, save "*in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them.*" Moreover, the development of trade must not be affected to such an extent as would be "*contrary to the interests of the Community.*" Essentially, these provisions have been interpreted to mean that the Article 86(2) derogation only applies to anti-competitive behaviour by an undertaking, or to anti-competitive State measures, insofar as such behaviour or measures are necessary to enable the undertaking to perform the tasks entrusted to it.[95] In substance, this amounts to a proportionality test: only anti-competitive behaviour indispensable for the service of general economic interest to be carried out falls under the Article 86(2) derogation. The ECJ has interpreted the notion of necessity broadly in this context, to mean that it must be possible for the undertaking to perform the tasks entrusted to it under economically acceptable conditions - i.e., including, where appropriate, a reasonable element of profit.[96]

However, the proportionality analysis may apply differently depending on whether private undertakings or Member States are invoking the Article 86(2) derogation. In

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with the State aid provisions. In this sense, the Commission seems to be taking a more lenient approach than in non-environmental areas. See further, Chapter 15's discussion.

[94] See, for example, such free movement of goods cases as Case C-379/98 *PreussenElektra* [2001] ECR I-2099, where environmental protection was held to be a mandatory requirement of public interest within the Article 28 EC context (as discussed in Chapters 2 and 7)

[95] See, for example, *Sydhavnens*, note 46 above, para 74.

[96] In *Albany*, for example, an exclusive right to manage a supplementary pension scheme was held necessary to ensure health insurance which covered young and old, and to avoid the risk that young employees in good health would leave for a private insurer, making performance of the task under economically acceptable conditions impossible. *Albany*, note 24 above, paras. 108-111. See also, *Ambulanz Glöckner*, note 42 above, where the Court was of the view that a German law protecting providers of emergency ambulance services against competition from independent operators, which extended to protection in related non-emergency transport market, could be justified under Article 86(2) EC, if this was "*necessary*" for them to perform their tasks in economically acceptable conditions.

particular, private undertakings may find it easier to satisfy the proportionality test than Member States as they may, due to their lack of control over the legislative framework, have less scope to opt for less restrictive solutions than Member States.[97] For example, in *Almelo* (which concerned contractual restrictions in supply contracts entered into by Dutch electricity undertakings), the ECJ held that it was necessary to take into consideration, "the economic conditions in which the undertaking operates, in particular the costs it has to bear and the legislation, particularly concerning the environment, to which it is subject."[98] Though Member States may thus have a more difficult task than undertakings in proving that their anti-competitive measures are proportionate, the Court made clear in judgments such as *Monopolies of Electricity and Gas* that it is unnecessary for Member States to go as far as to demonstrate that there is no other possible less restrictive measure which would allow the tasks in question to be carried out.[99] In adopting this rather flexible approach, the Court has shown itself sensitive to Member States' competence to decide how best to organise their services of general economic interest, and its unwillingness to second guess such policy choices.

However, in some cases, the Court of First Instance has seemed to demonstrate a stricter approach than that of the ECJ to the scope of Article 86(2). In *Air Inter*, for example, the CFI emphasised that, for the Article 86(2) derogation to be made out, it would not be sufficient for performance of the task entrusted to an undertaking to be "*simply hindered or made more difficult*": it was necessary, the CFI underlined, that performance be obstructed.[100] Moreover, the CFI has, in cases such as *Air Inter* and *FFSA,* adopted an economic approach to Article 86(2)'s proportionality test.[101] *Air Inter*, for instance, concerned the grant of an exclusive right by the French government to the public undertaking Air Inter to operate the routes between Paris Orly airport and Toulouse and Marseille airports, respectively. In holding that Article 86(2) could not be relied on to justify Air Inter's exclusive right, the Court of First Instance underlined that the onus was on the applicant to prove, using an economic analysis, that the grant of exclusivity was proportionate. This should be done by calculating the net cost to Air Inter of providing the - allegedly unprofitable - routes, and comparing this with the economic advantages inherent in exclusivity (by examining the loss of income which would result for Air Inter if other carriers were allowed to compete on the routes in question).[102] A similar exercise was carried out by the Commission, and accepted by the CFI, in *FFSA*. In that case, which concerned tax exemptions granted to the French public undertaking La Poste, the CFI upheld the compatibility of such exemptions with Article 86(2) given that the advantages received by La Poste were less than the costs it incurred in carrying out the tasks.

A final issue is the relationship between Article 87 and 86(2) EC. In the landmark *Altmark* judgment, discussed further in Chapter 15, the ECJ held that, subject to compliance with the test set down in that judgment, where a State measure compensates an undertaking for services provided in discharging public service obligations, it does not fall within the definition of State aid.[103] In practice, this has meant that some national

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[97] See, in this sense, Faull and Nikpay (eds.), The EC Law of Competition (2nd ed., Oxford, Oxford University Press, 2007), at 6.184.
[98] Case C-393/92 *Almelo* [1994] ECR I-1477, *Sydhavnens*, note 46 above, para 77.
[99] Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699, Case C-158/94 *Commission v Italy* [1997] ECR I-5789, Case C-159/94 *Commission v France* [1997] ECR I-5815.
[100] Case T-260/04 *Air Inter* [1997] ECR II-997, para 138.
[101] *Air Inter, ibid*, Case T-106/95 *FFSA* [1997] ECR II-229.
[102] *Air Inter, ibid,* paras 138-140.
[103] Case C-280/00 *Altmark* [2003] ECR I-7747. In particular, it does not grant an advantage within the definition of aid: see Chapter 15.

measures which might have involved the application of Article 86(2) in conjunction with Article 87 now can be considered to fall outside the scope of Article 87 altogether. However, where the *Altmark* criteria are not satisfied, Article 86(2) may still be invoked by Member States in the Article 87 context: where the Article 86(2) derogation applies, the measure will not fall within Article 87(1) and will thus not be notifiable.[104] The Commission's view of how Article 86(2) applies to State aid in the form of public service compensation have been set out in detail in a 2005 Commission decision under Article 86(3).[105]

Environmental cases. In the environmental context, Article 86(2) has been held to justify exclusivity for waste processors in *Sydhavnens*, where this was necessary to ensure a sufficient flow of waste for the new building waste facility. In that case, the ECJ took into account that, at the time when the exclusive right was granted, the Municipality of Copenhagen had been faced with a "*serious environmental problem*", viz. the burial of most building waste in the ground.[106] Though the waste could have been recycled, this was not done because there were no undertakings capable of processing the waste. As a result, undertakings were invited to express an interest in setting up a high-capacity waste facility. As noted by the ECJ, an exclusive right *"limited in time to the period over which the investments could foreseeably be written off and in space to the land within the boundaries of the municipality*" was granted in order that undertakings would be interested in applying.[107] The ECJ considered that no less restrictive means would have achieved the same goal of ensuring that most of the Municipality's building waste would be recycled, "*precisely because there was not sufficient capacity to process that waste*" before the facility was set up.[108] As a result, the grant of an exclusive right was necessary for the performance of a task serving the general economic interest.

In *Dusseldorp*, though the ECJ refrained from making a finding on the applicability of Article 86(2), it emphasised that the burden fell on the Dutch government to show to the satisfaction of the national court that the environmental objective "*cannot be achieved equally well by other means*".[109] As noted above, this is an application of the classic proportionality test: the means of achieving the environmental aim must be the least restrictive as possible of competition. For example, where exclusivity is not strictly necessary for a waste management undertaking in an area, as a number of undertakings could in fact carry out the job to the same level under economically acceptable conditions, exclusivity will not be justifiable under Article 86(2). Similarly, in *COBAT*, Italy had granted the exclusive right within Italy to a consortium to collect, stock and sell batteries and other waste containing lead, with the goal of achieving a high collection rate. Certain of COBAT's activities, however, went beyond what was necessary to fulfil its task - for example, its prohibition on sale of lead waste abroad. Following changes to these activities, the Commission granted a comfort letter.[110] Finally, in the *DSD* judgments, the

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[104] See Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest OJ 2005 L 312/67.

[105] *Ibid.*

[106] Note 46 above, para 78.

[107] *Ibid*, para 79.

[108] *Ibid*, para 80. See also, DG Competition Paper concerning issues of waste management in recycling systems of September 22, 2005.

[109] Note 41 above, para 67.

[110] Note 80 above. See also, *Inter-Huiles*, note 46 above, which concerned a French scheme for collecting and treating waste oils; limited number of chosen undertakings in particular regions. AG Rozès was of the view that the undertaking was performing an SGEI, but that the French scheme was disproportionate. The ECJ did not decide the matter.

CFI rejected DSD's arguments that paying it a fee even where no waste recovery service was in fact provided by the DSD system, and stopping its collectors collecting for competitors, were each necessary for DSD to perform any service of general economic interest.[111]

As regards the application of Article 86(2) in conjunction with Article 87, the leading case here is the Commission's 2005 decision in *AVR*.[112] In that case, the Netherlands sought to rely on Article 86(2) to justify aid granted to AVR Nutsbedrijf Gevaarlijk Afval ("AVR") for treating hazardous waste in the Netherlands with a view to disposal. This aid was essentially aimed at keeping AVR's rotary kilns in business, which constitute a high-cost means of incinerating hazardous waste, but which had seen a drop in waste supply and thus profitability. While €47.3 million operating aid was approved, €2.4 million - compensation for the cost of acquisition of the hazardous waste - was not. Before the Commission, the Netherlands argued both that the *Altmark* judgment applied - so that the compensation did not constitute "aid" under Article 87(1) - and that, to the extent that aid was granted, it was justified by Article 86(2). The Commission first considered whether the test set down in the *Altmark* judgment was made out. Finding in the negative,[113] the Commission went on to examine whether the Article 86(2) derogation applied. After, as noting above, finding that the treatment of hazardous waste amounted to a service of general economic interest, the Commission concluded that the compensation received by AVR for carrying out this service was, *prima facie*, directly related to the carrying out of its public service function. However, the Commission emphasised that overcompensation must be avoided, and requested the Netherlands for this reason to,

> *"verify the actual costs and to adjust the aid level if necessary in order to avoid a situation in which compensation would allow [AVR] to earn a profit margin on its activities higher than is normal for this type of activity in this sector."*[114]

Furthermore, the Dutch measures were proportionate, in the sense that there were no less restrictive means of achieving their goal.[115] As a result, most of the aid was justified, including aid to compensate for the cost of closure of the facility and aid to compensate for additional cost resulting from the closure of the rotary kilns earlier than foreseen.

Nonetheless, the Commission made an exception to its generally positive finding, as regards aid granted to AVR for the acquisition of waste. Although the Commission accepted that minimising the system's costs required maximising the volume of waste treated, and accepted that rebates were justified for this reason, compensation for waste acquisition constituted a disproportionate distortion of competition,[116] as it could lead to excessive amounts of waste being purchased for processing abroad, even when this waste

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111 Case T-151/01 *DSD*, judgment of May 24, 2007, para 208; Case T-289/01 *DSD,* judgment of May 24, 2007, para 208. See also Van Calsten, "De Europese Verpakkingsrichtlijn: Oorsprong, Inhoud en Verhouding met het EG-Verdrag" in Deketelaere and Wiggers-Rust, *Actualiteiten Europees Milieurecht*, Brugge, Die Keure, 1997, on the importance of Member States' complying with Article 86(2) EC when granting special or exclusive rights to waste operators.

112 *AVR* OJ 2006 L 84/37. See, Seinen, "State aid for hazardous waste treatment: the case of AVR, the Netherlands" (2005) 3 EC Competition Policy Newsletter 97.

113 *Ibid*, point 73: "*AVR Nuts was not selected following a public tender procedure, and publication of the concession decision in the Staatscourant, after which interested parties could raise objections for a period of six weeks, cannot be the substitute for an open and transparent tender procedure. Secondly, the level of compensation was not determined on the basis of the costs which an average, well-managed undertaking adequately provided with waste treatment capacity would have incurred…*"

114 *Ibid*, point 92.

115 *Ibid*, point 98.

116 *Ibid*, point 108.

ought to have been recovered, and as AVR's competitors did not receive similar compensation for acquiring waste. In particular, such aid infringed the environmental principle that waste should be treated as near to its source as possible. Moreover, had there been persistent shortages of waste for AVR to process, a less restrictive solution might have consisted in lowering the fees charged for waste processing.[117]

Analysis. Analysing these cases in the light of Part II's arguments, it is submitted that Chapter 6's *systematic* argument (from both its Article 6 EC and free movement of goods policy perspectives) supports the use of a proportionality test in assessing whether application of the competition law rules would "*obstruct*" the performance of an environmental task within the meaning of Article 86(2). As argued in Chapter 6, in the environmental context the proportionality test requires that, where a private or State measure is suitable to achieve the Community's environmental policy objectives, and there is no way of achieving these objectives that is less restrictive of competition, the measure must be allowed under Community competition law.[118] However, the devil is, of course, in the application of this test. In this regard, four points are pertinent.

First, where an environmental task is being carried out by the undertaking entrusted in a way aimed at ensuring a high level of environmental protection, Article 86(2) should apply as long as there is no less competitively restrictive way of achieving *that level* of protection. Put otherwise, it is not, it is submitted, for the Commission or Community Courts to judge that a lower level of environmental protection is adequate, which would entail less restrictive measures.[119] This is so, it is submitted, even where other Member States have themselves been satisfied with a lower level of environmental protection - even where, for example, such Member States may be neighbouring and thus share the same environmental problems. For example, had the Municipality of Copenhagen in *Sydhavnens* decided that a more expensive building waste disposal facility was necessary than that in fact built, in order to ensure that more building waste was recycled, the Court's reasoning - allowing exclusivity for the period of write-off of the facility's cost of building - would apply in precisely the same manner.

Secondly, it is submitted that the more flexible approach to applying proportionality, evident in some of the ECJ's judgments, is to be preferred in the environmental context. In judgments such as *Monopolies of Electricity and Gas,* in emphasising that Member States were not required to prove that there was no other imaginable way of carrying out the tasks in question, the ECJ demonstrated a sensitivity to Member States' primary competence to choose how to construct their "public" services, and the level at which such services should be set. This may be contrasted with ostensibly stricter *dicta* such as that in *Dusseldorp* where, as discussed above, the Court contented itself with its standard proportionality formula to the effect that the burden fell on the Dutch government to show that the environmental aim could not be achieved equally well by other means. The *Monopolies of Electricity and Gas* approach is, it is argued, more appropriate in the environmental sphere, where there is often considerable scientific uncertainty over which manner of regulation produces "best" results for the environment. This is particularly so as regards the new breed of economic environmental instruments, used (as discussed in Chapters 3 and 4) increasingly by Member States to tackle those environmental problems which direct regulatory methods failed to reach. Moreover, the reliance of economic

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[117] *Ibid.*

[118] See the fourth point of the working hypothesis on the import of Article 6 EC, Figure 1, Chapter 6.

[119] This also, it is submitted, follows from a systematic interpretation of Article 86(2) in the light of Article 16 EC, which will be affirmed by the Protocol on Services of General Economic Interest to the Lisbon Treaty. See further, Charles Le Bihan, "Services d'Intérêt économique general et valeurs communes" (2008) Revue du Marché commun et de l'Union européenne 356.

instruments on market-based solutions will, it is foreseeable, mean an increase in the number of environment-related Article 86(2) cases. Where there is a dispute on the evidence over whether a less restrictive alternative would produce the same level of environmental benefit, the precautionary principle familiar to Community environmental law should be applied to give the "benefit of the doubt" to the more restrictive solution.[120] Indeed, the more simplistic approach in *Dusseldorp* is surely explicable on the ground that the ECJ did not, in that case, have to decide the proportionality question, leaving this to the national court.

Thirdly, it is submitted that in cases where an economic analysis is carried out - as, for example, in *FFSA* and *Air Inter* - of the costs of carrying out a task, comparing this to the benefit gained by the undertaking from its advantageous position, environmental costs alleviated by carrying out the task should, where appropriate, be included in this calculation. This may be done using the environmental accounting and valuation techniques discussed in Chapter 8. As this exercise bears strong similarities to that of calculating the amount of "eligible costs" in the context of Community State aid policy, a similar argument is made in Chapter 15 below.[121]

Fourthly, from Chapter 7's *governance* perspective, it is interesting to observe that the more flexible approach to proportionality under Article 86(2) has tended to come from the ECJ, in contrast to the CFI's relatively strict approach in cases such as *Air Inter*. This may, it is argued, be viewed as an illustration of Chapter 7's point that, in some cases, the ECJ may be better positioned and more inclined to adopt a broader, more systematic approach to interpreting the competition rules, in conformity with coherence-based models of judicial reasoning. A further notable decision from a governance perspective is that of the Commission in *AVR*. In finding that aid for the acquisition of waste, including from foreign sources, was disproportionate, DG Competition showed itself to be familiar with principles of Community environmental policy - in that case, the principle that, where possible, waste should be treated at source. Though this was, of course, a State aid decision - and thus an area of Community competition policy where "economisation" is still only beginning to take hold[122] - this is to be welcomed as an example of coherence in decision-making, and thus of good governance in practice.

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[120] Note that this is also in accordance with the approach to the precautionary principle in the free movement of goods context, in cases such as Case 174/82 *Sandoz* [1983] ECR 2445 - and hence is also supported by Chapter 6's argument on the systematic links between free movement of goods and competition policy.

[121] See the references in Chapter 15 to the efforts of some Member States to calculate the amount of aid by reference to the environmentally damaging externalities avoided by, for example, energy saving measures. An example is the "ExternE" (External Costs of Energy) study funded by the Commission published in 2001 after 10 years' work from researchers of all EU MS and the US, which concluded that the cost of producing electricity from conventional sources like coal or oil would double, and cost of electricity production from gas would increase by 30% if external costs like damage to the environment and to health were taken into account.

[122] See Chapter 15.

Chapter 15: State Aid

1. Introduction

While the previous Chapter dealt mainly with Community competition law's response to non-monetary efforts by Member State to bolster undertakings' environmental activities,[1] this Chapter focuses on its response to monetary efforts. Environmental subsidies and taxes - which, as seen in Part I, comprise a key environmental market instrument in many Member States' policies at present - are dealt with under the Treaty State aid rules. Article 87(1) defines prohibited State aid as an advantage granted by a Member State or through state resources, which actually or potentially distorts competition, favours certain undertakings or the production of certain goods, and has an effect on trade between Member States. Article 87(2) and (3) set out ways in which aid can be exempted from the prohibition.

2. A fundamental difference in perspective between State aid control and the rest of competition policy

From an analytical perspective, the key distinction between State aid control and the rest of competition policy is that, while State aid is in principle prohibited (Article 87(1)), the Article 87(2) and (3) exemptions are premised on a recognition that markets may not always work properly left alone – due, for example, to the present of externalities - and may need some intervention from the State to work more effectively, and ultimately raise consumer welfare.[2] As such, the Treaty expressly provides for certain non-economic reasons – which have been interpreted to include environmental reasons - to constitute legitimate justifications for the grant of State aid. In this sense, there are evident parallels between the Treaty State aid rules and the free movement rules of EU internal market law.[3] Nonetheless, there has been a recent forceful drive from the Commission to develop a more economically rational approach to the conditions in which State aid may be justified; indeed, Commissioner Kroes has termed this her "*top priority*" as Competition Commissioner.[4]

The question is, therefore, not whether environmental considerations can or should, in principle, be taken into account in assessing the compatibility of State aid with the Treaty - it is not disputed that they can and should be. Rather, the question is what the right balance ought to be in taking them into account. This issue has most recently been dealt with in the Commission's 2008 Guidelines on Environmental Aid, discussed below, which emphasises the importance that State aid can play in achieving the Community's environmental policy

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[1] Though, of course, Article 86(2) may also be used as a derogation from the State aid rules, as discussed in Chapter 14.

[2] See Schwalbe, "Welfare Effects of Financing State Aid", European State Aid Law Quarterly (2006) 55.

[3] See, for example, Buendia Sierra, "Not like this: some Sceptical Remarks on the "Refined Economic Approach" in State Aid, European State Aid Law Quarterly (2006) 59, who comments that "*State aid "DNA" shares more chromosomes with internal market rules than with antitrust rules…State aid rules are, in substance, just a sub-category of the general rules of the Treaty on the free movement of goods, services and establishment*", at 61-62.

[4] Kroes, Speech to Fordham, 2006 (SPEECH/06/499) "*My top priority as Competition Commissioner has been a comprehensive reform of our state aid rules. Our objective is to help Member States to spend only as much taxpayers' money on subsidies as is absolutely necessary, and to target that expenditure as effectively as possible. So our motto is "less and better targeted state aid". We look first to the markets to deliver, and only where there are clear gaps does state aid play a role*." See also, the Commission's State aid action plan, "Less and better targeted State aid: a roadmap for State aid reform 2005-2009" COM (2005) 107 final, and Hildebrand and Schweinsberg, "Refined Economic Approach in European State Aid Control - Will it Gain Momentum?" 30(3) World Competition (2007) 449.

objectives and reducing negative environmental externalities.[5] However, environmental factors can also be relevant to the definition of aid, which we consider first.

3. Article 87(1): when do national environmental measures constitute State aid?

a. An advantage granted to an undertaking

In order to constitute aid, the Member State measure must constitute an advantage "*intended to encourage the attainment of the economic and social objectives sought*".[6] The "advantage" requirement means that commercially justifiable measures which a private investor or investor in a similar position would adopt will not generally constitute aid (otherwise known as the "market investor" principle). This can raise the issue of whether investment in environmentally friendlier technologies is commercially justifiable at the time of granting the advantage. The answer, clearly, will be a question of fact in each case. In *Van der Kooy*, for example, in deciding whether a preferential natural gas tariff for horticulturists constituted aid, the ECJ had to determine whether the tariff was commercially justified by the wish to prevent a move by users from gas to coal.[7] On the facts, the ECJ found that the tariff was lower than necessary to prevent such a move, and was thus an aid.

One potential question is whether a "market investor" might be read to include a market investor which has taken its corporate social responsibility seriously, and is motivated not just by profit, but also by longer-term environmental considerations. While the issue as such has not arisen before the Community Courts and Commission, a somewhat analogous argument was rejected by the ECJ in *ENI-Lanerossi*, in the context of social and regional motivations for investment.[8] The ECJ held that when investments disregarded any prospect of profitability, even in the long term, this had to be regarded as aid. In the view of Advocate General Van Gerven, there was no fundamental distinction between how public and private investors might operate: a private investor would not be wholly uninfluenced by considerations of a social nature or of regional or sectoral policy. However, an investing undertaking would be in breach of its obligations towards its shareholders, creditors and employees if it covered substantial losses of undertakings operating in a sector where there was over-capacity, without having a serious restructuring plan.

Similarly, Advocate General Jacobs has, in a separate case, given the view that aid is granted whenever a Member State provides funds which "*would not be provided by a private investor applying ordinary commercial criteria and disregarding other considerations of a social, political and philanthropic nature*."[9] This will require a fine line to be drawn between those environmental investments which can be considered to make broader commercial sense, in the longer term or for the reputation of a private investor, for example, and those which do not. In particular, the market investor principle should, it is submitted, be applied in the light of the widespread significant changes in attitude within the private sector towards voluntary corporate environmental initiatives in furtherance of corporate environmental responsibility. Though, as discussed in Chapter 4, this movement has given rise to some scepticism, what is

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[5] Guidelines on State aid for environmental protection, OJ 2008 C 82/1, points 5-14.
[6] Case 61/79 *Denkavit* [1980] ECR 1205, para 31.
[7] Cases 67/85 *Van Der Kooy* [1998] ECR 219.
[8] Case C-303/88 *Italy v Commission* [1991] ECR I-1433, para 18. See further, Karydis, "Le principe de l'opérateur économique privé, critère de qualification des mesures étatiques, en tant qu'aides d'Etat, au sense de l'article 87 §1 du Traité CE" (2003) 39(3) RTD eur 389.
[9] Cases C-278/92 *Spain v Commission (Hyatasa No. 1)* [1994] ECR I-4103.

at the very least clear is that many CEOs increasingly view environmentally-friendlier practices as good for business for a variety of reasons - including the rapid growth in business opportunities in the environmental sector or, more broadly, the ensuing favourable publicity. Moreover, it follows from Chapter 8's *economic* argument that the environmental benefits themselves may often be economically quantifiable, even when such benefits may only accrue in the longer term.[10] Such benefits should therefore be taken into account, insofar as they would accrue to a market investor, in assessing whether the "advantage" criterion is met.

Payment of monies constituting fair compensation for work done will not constitute an "advantage" and thus will not constitute aid. For example, a Dutch scheme whereby recycling undertakings were paid a grant to collect and dispose of car wrecks did not constitute aid, as the undertakings did not receive any advantage, but were granted fair remuneration for their activities.[11] Similarly, where compensation is for the discharge of public service obligations, the ECJ's *Altmark* judgment (discussed briefly in Chapter 14) provides a test to be met for such compensation to escape classification as aid. This is:

(1) The beneficiary must have a clearly-defined public service obligation to discharge;

(2) The compensation must be given on the basis of objective and transparent criteria;

(3) The compensation must not exceed what is necessary to cover the costs incurred in discharging the public service obligations, taking any relevant receipts into account and allowing for a reasonable profit;

(4) Unless the beneficiary was selected by tender selecting the tenderer capable of providing the services at lowest cost to the community, the necessary level of compensation must have been determined on the basis of the costs which a typical efficient undertaking able to meet the public service requirements would have incurred in discharging the obligations, taking relevant receipts into account and allowing for a reasonable profit.

As discussed in Chapter 14 in the context of Article 86(2), the provision of environmental services may, in principle, fall within the definition of a public service obligation. Once

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[10] See, by analogy, Case C-395/89 *Italy v Commission (Alfa Romeo No. 1)* [1991] ECR I-1603, in which the Court held it appropriate to look at "*the conduct of a private holding company or a private group of undertakings pursuing a structural policy - whether general or sectoral - and guided by prospects of profitability in the longer term*" (para 20).

[11] See XXVIIIth Report on Competition Policy (1998) at 255 (Dutch schemes for recycling of PVC façade and cardboard, made binding by the Dutch minister pursuant to a voluntary agreement of industry, were found not to constitute aid for similar reasons), Jean-François Pons, "European competition policy for the recycling markets", Speech of September 20, 2001 and London, "Concurrence et environnement: une entente écologiquement rationelle ?" RTD 39(2) (2003) 267. See also, XXVth Report on Competition Policy (1995) at 234 (Danish scheme imposing a charge on the sale of new batteries containing substances considered to be dangerous for the environment, and the proceeds of which were used to pay companies to collect and dispose of the products after use, was not State aid as the charge was imposed on all products in a non-discriminatory manner, and the payment to the collecting firms was based on normal commercial terms); and XXIVth Competition Report (1994) at 193 (*Danish Waste Tyres*, where a tax was imposed on new or renovated tyres made in or imported into Denmark, the proceeds of which were used to compensate the tyre collection companies for the costs of collection and transport of the tyres. This was viewed by the Commission as compensation for a service provided).

again, therefore, it will be a question of fact whether the *Altmark* criteria are satisfied in the case of compensation for such provision; if not, Article 86(2) may be invoked as a defence, or the Member State may argue that the aid should be exempted under Article 87(2) or (3). Though the *Altmark* criteria bear, it will be observed, resemblance to the analysis under Article 86(2), the Commission's decisional practice demonstrates that differences remain. In *AVR,* for example, benefits to a waste disposal undertaking which failed to satisfy the *Altmark* criteria (because not awarded on objective conditions which would have governed compensation paid to other undertakings in similar situations) nonetheless, for the most part, fell under the Article 86(2) derogation.[12]

Nonetheless, it is submitted that environmental factors may in some cases play an important role in applying the *Altmark* criteria. In particular, the first option of the fourth condition - use of a tender procedure - should, it is submitted, allow environmental conditions or factors to be inserted in the tender document. Moreover, the second option of the fourth condition - comparison of the compensation with the costs which a "typical undertaking" would have incurred in providing services - should be read as referring to a typical undertaking *providing environmental services at the same level of quality*. Further, application of the third condition (relation of the compensation to the costs incurred in providing the service) should, it is submitted, allow for the use of "environmental" accounts where possible (i.e., drawn up to include environmental costs and benefits, in accordance with the "green" accounting standards discussed in Chapter 4.

As a final point, where an undertaking has polluted a particular site, a grant by the State to clean up the pollution will, in compliance with the polluter pays principle, constitute aid unless the clean-up costs are subsequently recovered from the polluter. In *Kiener Deponie Bachmanning*, for example, the Commission held that the owner of a contaminated site was responsible for decontamination costs. As the Austrian authorities had financed the clean-up operation, the Commission decided that no state aid would be involved as long as the costs were recovered from the owner.[13] In contrast, in *Schmidt Schraubenwerke*, the Commission decided that a grant for the decontamination of an industrial site, which had suffered past environmental damage as a result of the operation of a chemical plant, did not confer any advantage on the present owner, who was not responsible for the pollution and who had not been aware that he would have been responsible for it when he purchased the site.[14]

In order to constitute aid, the advantage must be granted to an undertaking. The possibility of environmental operators' falling outside the definition of an undertaking was discussed in Chapter 9.[15]

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[12] *AVR* OJ 2006 L 84/37.

[13] Commission Decision 1999/272/EC OJ 1999 L 109/51.

[14] XXVIIIth Report on Competition Policy (1998) at 256. See further, the observations of AG Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769 on the significance of the polluter pays principle for Article 87(1): "*the principle is used as an analytical tool to allocate responsibility according to economic criteria for the costs entailed by the pollution in question. A given measure will constitute State aid where it relieves those liable under the polluter-pays principle from their primary responsibility to bear the costs". He contrasts this with the significance of the polluter pays principle in Article 87(3), where it "is used by contrast in a prescriptive way as a policy criterion. It is relied on to argue that the costs of environmental protection should as a matter of sound environmental and State aid policy ultimately be borne by the polluters themselves rather than by States*" (paras 68-70).

[15] See, for example, *GAV*, where the fact that the recipient of the aid was a non-profit making company was irrelevant, because it carried on an economic activity in competition with other operators. GAV operated on

b. From Member State resources

Based on the Court's case law, this element of the definition of aid may be broken down into two requirements: first, the advantage must be granted directly or indirectly through State resources; second, the grant must be imputable to the State.[16]

On the first requirement, the leading case is *PreussenElektra*, where the ECJ held that an obligation imposed by German legislation (the *Stromeinspeisungsgesetz*) on private electricity undertakings to buy electricity from renewable resources in their region at a higher price than the electricity's economic value did not amount to aid. The Court's reasoning was that the obligation did not involve any transfer of State resources to the renewable energy generators.[17] The Commission had argued that, if the legislation was not to be viewed as State aid, it was a measure intended to circumvent the State aid rules, as the measure had all the harmful effects of State aid in spite of being financed by private resources, and thus breached Article 10 EC[18] as it constituted an equivalent threat to the effectiveness of Articles 87 and 88 EC. Dismissing this argument, the Court held that Article 10 EC could not be used to extend the scope of Article 87(1) EC. This strict interpretation of State resources is, it is submitted, supported on a *systematic* analysis as an instance where interpretation in the manner suggested by the Commission would not just have gone against the natural meaning of Article 87(1), but would also have imposed an unnecessary burden on States acting, like Germany, on environmental grounds.[19] Analogously, in a subsequent case, the Commission declared that a Belgian measure whereby electricity producers were granted free intangible assets ("green certificates" proving production of renewable energy) by the State which they could resell to distributors were not advantages granted from State resources.[20] The Commission based its reasoning on *PreussenElektra*: the transfer of resources was not from the State to the producers, but was rather from the distributors. In contrast, where a Member State creates an emissions trading scheme whereby tradable allowances are distributed free of charge, in a situation where they could have been sold or put up for auction, this will mean the State has foregone resources, and will thus constitute an advantage within the meaning of the concept of aid.[21]

The question of involvement of State resources also arises in the context of the EU's Emissions Trading Scheme (ETS). As we saw in Chapter 4, the EU's scheme entered into

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the market for the collection and recycling of company waste. Though the collection of household waste was normally done by local authorities, the Commission took the view that this was not the case for the collection, sorting and marketing of company waste, and that many commercial undertakings were active in the field in competition with each other: XXVth Report on Competition Policy (1995) at 227.

[16] This includes any aid administered by private undertakings, though granted by the State: see Case 7876 *Steinike und Weinlig* [1977] ECR 595.

[17] Case C-379/98 *PreussenElektra* [2001] ECR I-2099, para 58: "…*the case law of the Court of Justice shows that only advantages granted directly or indirectly through State resources are to be considered aid within the meaning of Article [87(1)]*." See similarly, the *UK Renewables Obligation and Capital Grants for Renewable Technologies* N 504/2000 [2002] OJ C 30/15 – though one aspect of the scheme (a redistribution fund) constituted State aid, but was compatible with the environmental guidelines.

[18] This argument made an express analogy with the Court's *Van Eycke* doctrine, discussed in Chapter 14. See Case 13/77 *INNO v ATAB* [1977] ECR 2115.

[19] Insofar as qualification of the German measure as "aid" would have meant that all States with similar legislation would have been required to notify such provisions under Article 88 EC, and would be unable to implement such legislation without authorisation from the Commission.

[20] XXXIst Report on Competition Policy (2001), point 363.

[21] Case T-233/04 *Netherlands v Commission*, judgment of April 10, 2008.

force on January 1, 2005, initially providing for a pilot phase (Phase I) from 2005 - 2007, with Phase II corresponding to the first commitment period of Kyoto (2008 - 2012). In the first trading period, it was open to Member States to auction up to 5% of the allowances[22] allocated pursuant to their National Allocation Plans (NAPs). In fact, only Denmark chose to auction this amount. To the extent that other Member States chose not to auction their 5% of allowances, therefore, they were foregoing revenue, thus satisfying the "Member State resources" criterion under Article 87(1). In the second trading period, however, there is far greater potential for aid. The Commission, for one, believes that, as all Phase II allowances must be backed by an Assigned Amount Unit,[23] and as Member States can trade these Units with other Kyoto parties, by allocating any allowances for free or below market price to EU ETS undertakings Member States are foregoing potential revenue from selling the Units.[24] This means, in the view of at least some Commission staff, that around €44 billion of aid per year (based on 2007 allowance values) will be distributed by Member States under the ETS in Phase II.[25] The logic of this - extremely far-reaching - conclusion is, however, debatable: as discussed below, there seems to be a good argument that, because Member States are obliged by the ETS Directive to distribute 90% of allowances for free in Phase II, only the 10% which could potentially be auctioned could amount to aid if distributed for free or at below market price. However, DG Competition arguably has demonstrated its sensitivity to environmental concerns (as suggested by Chapter 7's *governance* analysis) in choosing not to act thus far against Member States on State aid matters potentially raised in the initial stages of the ETS.

On the second requirement – imputability of the grant to the State – the leading case is the *Stardust Marine* case, in which the Court held that, even where the grant is made by public undertakings, it cannot simply be assumed that the State controlled the making of the grant. Rather, account should be taken of all the circumstances in which the grant was made.[26]

This was decisive in a 2006 decision of the Commission holding that a compulsory fixed tariff for electricity from renewable sources in Austria did not constitute aid.[27] In that case, the tariff was calculated to compensate for the difference between the market price for

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[22] As discussed in Chapter 4, these allowances were to emit one tonne of carbon dioxide equivalent.

[23] "Assigned Amount Units" constitute units each equal to one tonne of carbon dioxide equivalent, which added together make up the amount to which a party to Annex B of the Kyoto Protocol (i.e., the most developed countries, including most present EU countries) must reduce its emissions over the (first) five-year commitment period of Kyoto. See further, Chapter 4.

[24] See further, Seinen, "State aid aspects of the EU Emission Trading Scheme: the second trading period" (2007) 3 EC Competition Policy Newsletter 100 and, by analogy, Case T-233/04 *Netherlands v Commission*, judgment of April 10, 2008.

[25] *Ibid.*

[26] Case C-482/99 *France v Commission (Stardust Marine)* [2002] ECR I-4397. The Court relied, *inter alia*, on the *Van der Kooy* case, note 7 above, where preferential tariffs for gas charged by private company Gasunie was aid, because the Dutch authorities held 50% of the shares and Gasunie did not have autonomy in fixing gas tariffs, but rather acted under the control of the public authorities.

[27] See Renner-Loquenz, "State aid in feed-in tariffs for green electricity" (2006) 3 EC Competition Policy Newsletter 61 and IP/06/953, OJ 2006 C 221/04. The case concerned the obligation in the Austrian Green Electricity Act for the so-called eco-balance group representatives (*Ökobilanzgruppenverantwortliche*) to purchase green electricity from eligible generators at a fixed feed-in tariff (*Einspeisevergütung*). The eco-balance group representatives attribute the purchased electricity to the electricity traders, who are obliged by the law to buy the attributed electricity at a fixed transfer price (*Verrechnungspreis*). The difference between the feed- in tariff for electricity and the fixed transfer price is raised by a levy imposed on the consumption of electricity by final consumers (*Förderbeitrag*).

electricity and the long-term marginal costs of green electricity production. Though the fixed tariff aspect of the case bore similarities to *PreussenElektra*, in the Austrian case the purchase prices paid were channelled to the renewable energy producers through a clearing mechanism – the Green Electricity Settlement Centre, in which the State played an important role. For example, the Centre was set up by law and its function was designated by the State; the State also had power to veto changes in the Centre's ownership structure. Further, the electricity purchase obligations themselves were set down by the Austrian Ministry of Economic Affairs and Labour. For all of these reasons, the Commission found that the measures were imputable to the State and constituted aid. In addition, a second way of financing the renewable energy producers - a levy paid by all electricity consumers, the proceeds of which are distributed to green electricity producers - also constituted aid. The Commission found that, because the levy was imposed by the State, its proceeds went to a State-designated body; the proceeds were used to give an advantage to certain undertakings, and the proceeds were used in a way prescribed by the State, the levy constituted State aid.[28] The case demonstrates the Commission's belief that enforcement of the State aid rules, albeit in a way compatible with environmental protection, will be increasingly important in a liberalising electricity market, in which green electricity may play an ever-greater role.[29]

A further point here is that, where a Member State is simply implementing Community legislation, a measure cannot be imputed to the State.[30] Thus, for example, insofar as a Member State implements the EU ETS Directive, giving rise to a difference in treatment between undertakings covered by that scheme and undertakings not covered by that scheme, this is not an action imputable to that State.[31] Likewise - and as mentioned above - insofar as this Directive obliged Member States to allocate a certain percentage of allowances for free in the first and second trading periods (95% and 90%, respectively), such action is not, it is argued, imputable to Member States.

As a final issue, it is clear that one form of transferring State resources is by granting a tax exemption, thus waiving tax revenue.[32] Environmentally-motivated tax exemptions and reductions will be dealt with further in the context of selectivity.

c. Distortion of competition; effect on trade between Member States

Two further elements in the definition of aid are that the measure must be capable of distorting competition and affecting trade between Member States. The Commission has set down *de minimis* thresholds for Article 87(1), most recently in Regulation 1998/2006. Where, therefore, environmental aid granted is below €200,000 (or, in the case of the transport sector, €100,000), it will fall under the *de minimis* rule.

d. Selectivity

In order to fall within the definition of an aid, Article 87(1) states that a measure must favour certain undertakings or the production of certain goods. As the Court has held, this means that, in order to be selective, a measure must be,

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[28] Applying the Court's judgment in *Steinike & Weinlig*, note 16 above.
[29] See Renner-Loquenz, note 27 above.
[30] Case T-351/02 *Deutsche Bahn v Commission* [2006] ECR II-1047.
[31] See further, Seinen, note 24 above.
[32] See, for example, Case C-387/92 *Banco Exterior de España* [1994] ECR I-877.

"such as to favour certain undertakings or the production of certain goods over others which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question."[33]

Where a difference in treatment is capable of being objectively justified, it will not satisfy this selectivity criterion.

The notion of objective justification has, however, been interpreted by the Court in a rather narrow fashion, including in the context of environmental aid. In *Spain v Commission*, for example, the ECJ rejected Spain's argument that its aid scheme for the purchase of environmentally-friendlier vehicles was not selective. The Spanish scheme at issue granted aid only to vehicles purchased by natural persons and SMEs, but not to large undertakings, because, Spain argued, such undertakings could afford to purchase such vehicles in any event. Rejected this argument, the Court found that this did not constitute a valid objective justification for differentiating between large undertakings and others.[34] Nonetheless, the aid was, the Court found, potentially exemptible under Article 87(3)(c), as discussed below.

Tax reductions and exemptions. In the case of tax reductions or exemptions, the Community Courts and Commission have made clear that these will not be considered to be selective, and so will not constitute aid, if justified on the basis of the "nature or general scheme of the system."[35] The limits of this doctrine have given rise to considerable controversy, including in the case of derogations from eco-taxes.[36] The leading case here is *Adria-Wien*, which concerned an Austrian eco-taxation scheme where electricity and natural gas consumption were taxed, with a rebate for manufacturing undertakings.[37] The Court held that the supply of energy on preferential terms to undertakings manufacturing goods constituted aid.[38] In particular, the Court rejected the arguments of Austria and Denmark that such exemptions were justified by the nature and general scheme of Austria's energy taxation package, being necessary in order to shield the industry most affected by a tax on energy. The Court's reasoning was threefold.

(1) First, there was no evidence that the manufacturing industry would necessarily be hit harder by the tax than, for example, the service industry;

(2) Second, nothing in the legislation suggested that the rebate was temporary, to enable the industry to adapt to the new regime;

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[33] C-409/00 *Spain v Commission* [2003] ECR I-1487, para 47. For examples of non-selective measures, see, for example, *UK energy efficiency aid* (IP/02/1480), which concerned the UK's Energy Efficiency Best Practice Programme, providing grants to R&D projects for organisations and information and advice on energy use and efficiency. The grants for provision of information were not considered aid because they were given to public, non-profit-making higher education and research establishments, which would benefit all interested parties in a non-discriminatory way.

[34] *Ibid*, para 53.

[35] Commission Notice on the application of the State aid rules to direct business taxation OJ 1998 C 304/03.

[36] On eco-taxes and state aid generally, see Van Calster, "Greening the E.C.'s State Aid and Tax Regimes" European Competition Law Review (2000) 294, Boeshertz, "Community state aid policy and energy taxation" (2003) 4 EC Tax Review 214 and Renner-Loquenz, "State aid in feed-in tariffs for green electricity" (2006) 3 EC Competition Policy Newsletter 61. Note that Member States' environmental taxation schemes may also be assessed for compatibility with Article 90 EC, and so will be prohibited if found to discriminate between similar products, or to have a protective effect in favour of competing domestic products. The ECJ's strict approach to eco-taxes adopted in Case C-213/96 *Outokumpu* [1998] ECR I-1777, has to a certain extent decreased the popularity of eco-taxes on energy.

[37] Case C-143/99 *Adria-Wien* [2001] ECR I-8365.

[38] *Ibid,* para 40.

(3) Third, the environmental rationale for the eco-tax did not justify exempting the manufacturing sector. Rather, the real reason for the tax was to preserve the competitiveness of the manufacturing sector within the Community.[39]

While this - rather strict - approach meant that the exemption constituted aid, the Court was careful to point out that this did not prejudge its compatibility with the Treaty, referring expressly to the Guidelines on Environmental Aid.[40] Since the *Adria Wien* judgment, the Commission has adopted a large number of decisions based on the Court's approach.[41] Moreover, it is submitted, this approach is supported by Part II's arguments, and in particular Chapter 6's systematic argument, in representing a strict approach to assessing exceptions to environmentally beneficial taxation schemes.

The judgment in *Adria Wien* does not, of course, mean that all eco-tax schemes are selective: a variety of such schemes have since been held to be justified by the nature and scheme of the tax system.[42] Following the ECJ's annulment of the CFI's judgment in *British Aggregates*, however, it is clear that Member States constructing eco-tax schemes whereby not all activities with comparable environmental effects are taxed in a similar manner should expect that their scheme will be classified as selective. The ECJ's judgment provides important guidance on the scope of Article 87(1) for the numerous Member States who have constructed, or are constructing, eco-tax regimes.[43]

The case concerned a UK levy on aggregates (i.e., granular materials used in construction). The Commission had decided not to object to the levy, on the ground that it was justified by nature and logic of tax system - the levy was intended to contribute to a reduction in the use of non-renewable resources, and was not levied on recycled material, or on by-products from other processes, as virgin aggregates have high environmental costs.[44] The applicant appealed this decision, arguing *inter alia* that the levy was not consistently environmentally-friendly. For example, there was, the applicant argued, no good reason for its material scope.[45] In dismissing the appeal, the CFI had emphasised that the choice of whether to

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[39] *Ibid,* paras 50-54. See, in contrast, the view of AG Mischo, who considered that the tax formed part of the "new general system of general ecology taxes", and that there was no derogation from the general rule, as different primary and secondary sectors of the economy could not be compared. Hence, it should be considered to be based on objective criteria. See further, Infeldt, "Eco-tax reliefs for companies in Denmark, Finland and Sweden after the Court ruling in *Adria-Wien Pipeline GmbH* case" 1 Competition Policy Newsletter (2003) 103.

[40] *Ibid,* para 31.

[41] See Infeldt, note 39 above, for a comprehensive list. For an earlier case on environmentally-motivated taxes, see Decision 82/73 *Gasunie* OJ 1982 L 37/29, where preferential tariffs for gas supplies to horticulture sectors were held to be State aid. See also, *Vereniging van Exploitanten van Waterleidingbedrijven in Nederland v Nederland* [1995] 2 CMLR 741, where the Dutch Arrondissementsrechtbank (District Court) held that differential tax treatment could not be justified on environmental grounds, so there was State aid in granting lower tax rates to certain undertakings; and, under the equivalent provisions from the EEA Agreement, the Decision of the EFTA Surveillance Authority of July 26, 2002 No 149/02/COL on Norwegian tax exemptions in the context of eco-taxes on carbon dioxide and sulphur dioxide, in which the EFTA Surveillance Authority followed the *Adria-Wien* approach.

[42] See, for example, Joined Cases C-128/03 and C-129/03 *AEM* [2005] ECR I-2861, where charges on hydra and geothermal electricity undertakings to access the network and use it temporarily were not State aid for those not subject to it, because the exceptions flowed from the nature and economy of the system of charges; and

[43] Case C-487/06 *British Aggregates,* judgment of December 22, 2008.

[44] Case T-210/02 *British Aggregates* [2006] ECR II-2789, para 25.

[45] *Ibid*, para 88.

impose environmental levies in the present state of Community law - where environmental taxes had not been harmonised - was for Member States, which were free to "*set their priorities as regards the protection of the environment and, as a result, to determine which goods or services they are to decide to subject to an environmental levy*." As a result,

> *"in principle, the mere fact that an environmental levy constitutes a specific measure, which extends to certain designated goods or services, and cannot be seen as part of an overall system of taxation which applies to all similar activities which have a comparable impact on the environment, does not mean that similar activities, which are not subject to the levy, benefit from a selective advantage."*[46]

Annulling this part of the judgment, the ECJ adopted a hard-line approach to the scope of justification of environmental taxation schemes on the basis of their environmental objectives, referring expressly to its judgment in *Adria-Wien*. In the ECJ's view, in order to be non-selective, an environmental tax scheme must apply in the same way to all similar activities which have a "*comparable impact on the environment.*"[47] Essentially, the ECJ was thereby confirming that environmental taxation schemes will receive no special treatment from the Court in assessing whether they constitute aid: their structure must be fully consistent with their environmental objective, and only environmental criteria may be taken into account in structuring the scheme. As in *Adria-Wien*, therefore, where non-environmental (e.g., political, industrial or economic) factors have influenced scheme design, this will mean that the scheme is selective. While the ECJ's strict application of the selectivity concept in this field was perhaps to be expected following *Adria-Wien*, it means that the bar has been set rather high for Member States' eco-tax regimes, in the design of which political and industrial sensitivities can often play an unavoidable role. Further, the judgment means that Member States may have to be cautious about relying on certain previous Commission decisions in the more relaxed, pre-*British Aggregates* line.[48] Nonetheless, as discussed below, Member States may well be able to justify such schemes under Article 87(3), and it might be hoped that, in the long term, the strict *British Aggregates* approach will encourage Member States to design schemes as far as politically possible around genuine environmental considerations.

The EU Emissions Trading Scheme (ETS). A further topical question with regard to selectivity in environmental aid is the extent to which allowances granted by Member States under the EU's ETS may be considered selective. It has been argued above that, insofar as it is open to Member States to auction their allowances (which they could do for 5% of allowances in Phase I and 10% of allowances in Phase II), the grant of allowances for free or below market price amounts to an advantage granted from State resources. However, the jury is still out on how the selectivity criterion applies in this context. A number of issues are pertinent.

First, are undertakings within and without the EU ETS to be considered to be in "*in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question*"? It is submitted that the answer to this question is in the negative: undertakings within the ETS - whether there compulsorily or via a Member State's exercising of an opt-out - are subject

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[46] *Ibid.*

[47] Case C-487/06 *British Aggregates,* judgment of December 22, 2008, para 86.

[48] See, for instance, the Danish scheme (XXIst Report on Competition Policy (2001), point 381) by which a company active on land, including road transport firms, but not shipping and air transport firms, could receive a grant to compensate for an environmental tax. The Commission found that the differentiation between land-based and other firms was justifiable by the nature and general scheme of the system..

to a specific regime whereby a market price is placed on their pollution; undertakings outwith the scheme may not have any such price placed on their polluting activities, or at least not a price fixed within the same market parameters as the ETS. Put in another way, it would seem ludicrous for a Member State, in order to avoid selective granting of advantages, to be forced to grant non-ETS undertakings an equivalent monetary advantage to allowances granted for free to ETS undertakings: the result would be an even greater distortion of competition. As a result, the present author would disagree with the suggestion put forward by some, including a Commission official, that non-ETS and ETS undertakings are comparable because "*both sectors without and outside the scope of [the ETS Directive] are subject to climate change policy*."[49] Such an interpretation of Article 87(1), it is submitted, flies in the face of any sensible *systematic* approach based on the Article 6 EC interest of maximising environmental protection levels.

Secondly, within the scope of the ETS, can any distinction legitimately be made by Member States between undertakings on the basis of other criteria, such as, for example, sector? In its 2008 Environmental Aid Guidelines, discussed in detail below, the Commission seems[50] to deal with this issue under Article 87(3)(c) - presumably on the (as argued above, misguided) premise that all Phase II allowances constitute State aid. Nonetheless, some of the factors which the Commission states form part of the Article 87(3)(c) test are, it is argued, very relevant in assessing selectivity. In particular, as regards Phase I of the ETS, the Guidelines state that, in order to fall under Article 87(3)(c), Member State allocation must, *inter alia*, be carried out in a transparent way, "*based on objective criteria and on data sources of the highest quality available*", and the allocation methodology "*shall not favour certain undertakings or certain sectors, unless this is justified by the environmental logic of the system itself or where such rules are necessary for consistency with other environmental policies*". Similarly, as regards Phase II of the ETS, part of the test laid down by the Guidelines is whether the choice of beneficiaries is based on "*objective and transparent criteria*" and must not favour certain competitors. These elements, it is submitted, in truth form part of selectivity analysis: where allowances are allocated on the basis of objective criteria, distinguishing between undertakings on the basis of objective differences, such allocation does not fulfil the selectivity criterion. Indeed, this requirement forms one of the core allocation criteria set out in the ETS Directive itself,[51] criterion five of which stipulates that Member States' NAPs,

> *"shall not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities in accordance with the requirements of the Treaty, in particular Articles 87 and 88 thereof."*[52]

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[49] Seinen, "State aid aspects of the EU Emission Trading Scheme: the second trading period" (2007) 3 EC Competition Policy Newsletter 100.

[50] That this is the approach taken is confirmed by a Commission official in Seinen, *ibid*, at 101. The Guidelines themselves are, as discussed below, not clear on this, stating only (as regards tradable permit schemes in general, and not just the ETS) that, *"[t]radable permit schemes may involve State aid in various ways, e.g., when permits and allowances are granted for less than their market value and this is imputable to the State…*" (Guidelines on environmental aid, note 5 above, point 139).

[51] Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community OJ 2003 L 275/32, Annex III.

[52] Thus, for example, the Commission views differentiation in allocation on sectoral grounds as incompatible aid (though negative discrimination of, for example, the power generation sector has been allowed in Member State NAPs, presumably for polluter pays reasons): see Seinen, note 49 above, 103-104.

In practice, admittedly, as proposed allocations are notified to the Commission in any event in the form of Member States' NAPs, the distinction between Article 87(1) and Article 87(3) analysis is perhaps not as crucial as it might normally be.[53] However, quite aside from its importance for clarity of analysis, the distinction is nonetheless still crucial due to the difference in burden of proof - the burden of proving the elements of Article 87(1) falls on the Commission, while the burden of proving Article 87(3) justification falls on the Member State.

National Emissions Trading Schemes. As a final point, it should be noted that national emissions trading schemes will not be held to satisfy the selectivity requirement, and thus will not constitute aid, as long as the installations to which they apply is determined on an objective basis. Thus, the ECJ, in concluding that the Dutch NOx emissions trading scheme did not fulfil the selectivity test, reasoned that the scheme applied to installations on the basis of an objective criterion (in that case, all industrial facilities with an installed total thermal capacity of more than 20 MWth).[54] Though the Commission argued that installations outside the scheme were subject to the same general obligations of Dutch law concerning environmental management and atmospheric pollution as those inside the scheme (i.e., a similar argument to that being made by the Commission in the ETS context, discussed above), this was rejected by the Court.[55]

e. Application of Article 86(2)

Where the five criteria in the definition of aid outlined above[56] are satisfied, it may still, in the case of compensation for discharge of an environmental public service obligation, be open to a Member State to argue that Article 86(2) applies, so that the compensation falls outside Article 87(1). This has been discussed in Chapter 14.

4. Exemption for environmental aid: Article 87(3)

a. Overview: the 2008 Guidelines on Environmental Aid and the Block Exemption for Environmental Aid

The Guidelines on Environmental Aid. The Commission has issued numerous Guidelines on its approach to exemption, concerning both sectoral and "horizontal" aid. The latter category includes Guidelines on Environmental Aid, as issued most recently in January 2008.[57] These represent a modernisation (though, as we note below, arguably not a

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[53] This situation may change if, as proposed by the Commission, NAPs are abolished in the third ETS trading period (in which the issue of State aid may not, in any event, arise, if the Commission allocates most allowances itself). See Commission Proposal for a Directive to extend and improve the functioning of the EU ETS, COM (2008) 30 final and the discussion in Chapter 4.

[54] Case T-233/04 *Netherlands v Commission*, judgment of April 10, 2008. See also, for example, *UK Climate Change Levy* OJ 2002 L 229/15; *Danish CO2 quota* N 653/1999 OJ 2000 C 322; *Belgian Green Electricity Certificates* N 550/2000 OJ 2001 C 330.

[55] *Ibid,* para 91.

[56] Viz. (1) an advantage (2) granted from State resources capable of (3) distorting competition and (4) affecting trade which (5) is selective in its application.

[57] Note 5 above. Environmental considerations may also, however, come into the analysis of aid under sectoral and other horizontal guidelines, for example, the guidelines on shipbuilding aid (OJ 2003 C 263/2); the guidelines on aid in the steel sector (OJ 2002 C 70/21); the guidelines on aid in the agricultural sector (OJ 2006 C 319/1). On the lead up to the adoption of the 2008 Guidelines, see Branton, "Environmental Aid: a Case for Fundamental Reform (1)", European State Aid Law Quarterly (2006) 4, Holmes "The Environmental Guidelines: Black Smoke or Sustainable Development?" ESTAL 1 (2004) 17, and Andersen, "Revision of the Environmental Guidelines" (2008) European Energy and Environmental Law Review 23.

sufficient modernisation) of its approach in previous Guidelines of 2001[58] and 1994,[59] which in turn built on environmental aid "framework" positions adopted in 1974, 1980 and 1986.[60] As with the rest of Community competition law, however, integration generally works only one way: while environmental benefits from aid are relevant to the State aid assessment, the fact that aid that is otherwise compatible with the common market may damage the environment does not mean that such aid should be held to breach Article 87. This approach, which has been confirmed by the Court of First Instance,[61] is analysed critically below.

The 2008 Guidelines take into account the more economic approach announced in the State Aid Action Plan 2005-2009, as well as significant developments in environmental policy since 2001.[62] The tone of the guidelines is one which emphasises, first, the vital role that Member State aid can play in achieving Community environmental protection goals and, second, the importance of integration between the Community's state aid, environment and energy policies. Indeed, the Guidelines formed one of the pillars in the Energy Action Plan for 2007-2009 adopted by the Spring 2007 European Council.[63] The Guidelines essentially take a bi-dimensional approach to environmental aid: aid should be exempted if, first, it incentivises pollution reduction, via enabling internalisation of environmental externalities by ensuring that polluters pay for pollution (e.g., in the case of eco-taxes); or second, if it creates other incentives to achieve a higher level of environmental protection than currently required under Community or national direct regulation.[64]

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[58] OJ 2001 C 37/3.

[59] OJ 1994 C 72/3. See also, Regulation 994/98 enabling the Commission to adopt block exemptions for state aids OJ 1998 L 142/1, which included in Article 1(1)(a)(iii) a possibility to adopt a block exemption in the field of environmental protection, though no such block exemption was adopted.

[60] The Commission first tackled the topic of environmental State aid formally in its fourth Competition Report of 1974, where it adopted a memorandum on State aid on environmental matters, to the effect that environmental policies both at national and Community level should be implemented by imposing obligations on polluters to make them pay for the cost of protecting the environment, rather than granting State aid which would pass this cost on to the public. This essentially formed the basis of its policy until 1994, though amendments were made in 1980 and 1986. See Xth Report on Competition Policy (1980), points 222-226, and XVIth Report on Competition Policy (1986), point 259. In the 1974 Memorandum, a transitional period of 6 years was provided to give Member States time for full implementation of the polluter pays principle, with a further 6 years being given in 1980. This transitional approach was finally dropped in 1986. See generally, Van Calster, "Greening the E.C.'s State Aid and Tax Regimes" European Competition Law Review (2000) 294.

[61] See, for example, Case T-158/99 *Thermenhotel Stoiser v Commission* [2004] ECR II-1, where the applicant argued that the hotel project to which aid had been granted contravened EC environmental law. Rejecting this argument, the CFI held that the proper mode of recourse was for the Commission to bring an Article 226 EC action against the relevant Member State for breach of its environmental Treaty obligations - i.e., aid need not comply with all EU law provisions to be held compatible with the common market.

[62] The Guidelines do not apply to some areas, for example the financing of environmental protection measures relating to air, road, railway, inland waterway and maritime transport infrastructure: see note 5 above, points 58-69. They may also apply in conjunction with other Guidelines or Block exemptions, for example the Block exemptions on training aid (Regulation 68/2001 OJ 2001 L 10/20, as amended) and on small and medium sized enterprises (Regulation 70/2001 OJ 2001 L 10/33, as amended).

[63] The energy action plan is based on the Commission Communication, "An Energy Policy for Europe" (COM (2007) 1). See also, Green Paper on market-based instruments for environmental and related policy purposes, COM (2007) 140 final and the European Council's conclusions on the review of the EU's Sustainable Development Strategy, asking the Commission to prepare a roadmap for reform of environmentally-harmful subsidies (Council Document 10917/06 of June 26, 2006 on review of the EU's Sustainable Development Strategy).

[64] Guidelines on environmental aid, note 5 above, points 7-10 and 22.

The Commission identifies the main aim of State aid control in the environmental field as ensuring that aid measures "*will result in a higher level of environmental protection than would occur without the aid and to ensure that the positive effects of the aid outweigh its negative effects in terms of distortions of competition, taking account of the polluter pays principle*…"[65] The latter aim epitomises what the Commission considers to be a foundation of its new, more economic, approach to State aid: the "balancing test" - essentially a version of the proportionality analysis familiar to us from other areas of Community law.[66]

This test has three parts. First, the Member State must show that the aid measure is aimed at a "*well-defined objective of common interest*", a concept which includes protection of the environment.[67] Secondly, the aid must be "*well designed to deliver the objective of common interest*". In particular, the aid must be an appropriate policy instrument; there must be an incentive effect for undertakings, meaning that the undertakings would not have changed their behaviour without the aid;[68] and the environmental objective must not be attainable with less aid. This principle has led to the doctrine of "eligible costs": only costs exceeding the economic benefits which an undertaking receives from an investment can be exempted as proportionate environmental aid. Indeed, the Commission goes further: to be proportionate, aid must normally be less than the eligible costs, to take into account broader benefits from an environmental investment, such as an enhanced "green image".[69] Thirdly, distortions of competition and effect on trade must be limited, so that the "*overall balance is positive*".[70] For example, aid which results in the maintenance of inefficient undertakings, the distortion of dynamic incentives, the creation of market power or an artificial change in trade flows will be scrutinised carefully. The Commission asserts, however, that the risks of this occurring if measures are genuinely targeted to counteract the actual extra cost of a higher level of environmental protection are "*normally rather limited*."[71]

The Guidelines draw, for the first time, an important distinction between two ways in which environmental aid can be assessed. The distinction is based on whether the aid exceeds certain thresholds, which vary depending on the type of aid at issue.[72] Where environmental aid falls below these thresholds, it will be subject to what the Commission terms a "*standard assessment*" only; where the aid is above these thresholds, however, it will be subject to a "*detailed assessment*" "in order to allow for a deeper scrutiny of the individual cases which have the greatest potential to distort competition and trade."[73] In particular, in addition to taking

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[65] *Ibid*, point 6.
[66] *Ibid*, point 16 and Section 5 of the Guidelines.
[67] *Ibid*, point 16.
[68] *Ibid*, point 27.
[69] *Ibid*, point 32. The Commission notes that greater aid may be justifiable for small and medium sized undertakings, as the cost of achieving higher environmental protection may be greater for such companies.
[70] *Ibid.*
[71] *Ibid*, point 36.
[72] These thresholds are: in the case of investment aid, where the aid exceeds €7.5 million for a single undertaking; in the case of operating aid for energy saving, where the aid exceeds €5 million per undertaking for five years; in the case of operating aid for the production of renewable electricity and/or combined production of renewable heat, when the aid is granted to renewable electricity installations in sites where the resulting renewable electricity generation capacity exceeds 125 MW; in the case of operating aid for the production of biofuel, when the aid is granted to a biofuel production installation in sites where the resulting production exceeds 150,000 t per year; in the case of operating aid for cogeneration, where aid is granted to a cogeneration installation with the resulting cogeneration electricity capacity exceeding 200MW.
[73] See MEMO/08/31.

into account the factors specific to the type of environmental aid set out below, the Commission will in a detailed assessment apply the "balancing test" discussed above overtly.[74]

In practice, the vast majority of environmental aid is considered under Article 87(3)(c) EC (aid for the development of "certain economic activities or areas"), and as a result the Guidelines focus on this provision. Some environmental aid, however, may fall under Article 87(3)(b) (aid to promote the execution of important projects of common European interest).[75]

The Block Exemption for Environmental Aid. In another first, the Commission has, for the first time, included certain types of environmental aid in a general block exemption.[76] The Block Exemption sets out a variety of categories of environmental aid which, upon fulfilment of certain conditions - including maximum monetary thresholds and transparency requirements - will not need to be notified to it by Member States. Further, Member States are generally entitled to use a simplified method to calculate the environmental aid amount. These categories[77] by and large correspond to the categories discussed separately by the Commission in its Guidelines, as set out below. Indeed, the preamble to the Block Exemption states that it has been possible to include these categories of environmental aid precisely in view of the experience gathered in the application of the Guidelines.[78] The removal of the notification requirement, as well as the generally simplified calculation method for the aid amount, should significantly facilitate the ease of granting environmental aid for Member States in practice, and is thus to be welcomed.

b. Article 87(3)(c) - aid for development of certain economic activities or areas

In the Guidelines, the Commission identifies a variety of common categories of environmental aid which may be compatible with Article 87(3)(c). A common theme throughout is a fundamental difference in approach between investment aid and operating aid, with the latter being far more rarely found to be compatible. Failure on the part of the Commission in a State aid decision to categorise environmental aid as investment or

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[74] Guidelines on environmental aid, note 5 above, section 5.

[75] Other exemptions may, sometimes (though rarely), also potentially apply to environmental aid. Examples include the German scheme giving tax exemptions to consumers purchasing cars with catalytic converters. The Commission found that the measure fell under Article 87(2)(a) as long as it was applied in a non-discriminatory manner (XXIVth Competition Report, at 170). Article 87(2)(b) may also be relevant insofar as it allows aid to compensate damage caused by natural disasters, which may allow for compensation for, e.g., localised environmental damage caused by such disasters.

[76] Regulation 800/2008 OJ 2008 L 214/3. The block exemption essentially consolidates the five pre-existing block exemptions (SMEs, research and development aid for SMEs, aid for employment, training aid and regional aid) and also applies to environmental aid, aid in the form of risk capital, aid for disadvantaged and disabled workers, and aid for R&D for large enterprises.

[77] Investment aid for environmental protection improving on Community standards or to increase the level of environmental protection in the absence of Community standards, aid for the acquisition of transport vehicles which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards, aid for early adaptation to future Community standards for SMEs, environmental aid for investment in energy saving measures, environmental aid for investment in high efficiency cogeneration, environmental aid for investments to exploit renewable energy sources, aid for environmental studies and certain environmental aid in the form of tax reductions. Block Exemption Regulation, *ibid,* section 4.

[78] Block Exemption Regulation, *ibid,* recital 46.

operating aid will amount to a substantial procedural defect leading to annulment of the decision.[79] The common types of environmental aid may be divided as follows.

Aid going beyond Community standards or increasing environmental protection in the absence of Community standards, i.e., investment aid which provides an incentive for an undertaking to improve environmental protection.[80] This expressly includes aid to eco-innovation projects[81] or for new "transport vehicles" which has this effect.[82] The aid intensity shall not exceed 50% of the eligible investment cost, defined as the extra investment costs necessary to achieve a higher level of environmental protection than required by the Community standards.[83] This figure may increase by 10% in the case of the acquisition of an eco-innovation asset or the launching of an eco-innovation project,[84] and may increase to up to 100% where the investment aid is granted in a genuinely competitive bidding process on the basis of clear, transparent and non-discriminatory criteria.[85] Increases are also possible for SMEs.[86] Aid for early adaptation to future Community environmental standards may also be justifiable,[87] as long as the investment is implemented and finalised at least one year before the standard enters into force.[88] However, the permissible aid intensity is lower in this case.[89]

Aid for energy saving. Referring expressly to the Community's climate change policy, the Commission indicates that aid may be appropriate "*where the investments resulting in energy savings*

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[79] Case C-351/98 *Spain v Commission* [2002] ECR I-8031, para 77; Case C-409/00 *Spain v Commission* [2003] ECR I-1487, para 97.

[80] Guidelines on environmental aid, note 5 above, points 74-84.

[81] Defined broadly at p 20 of the Guidelines. See further, the Commission's support of eco-innovation including subsidies, e.g., Commission Communication, "Report of the Environmental Technologies Action Plan" (2005-2006) COM (2007) 162 final.

[82] Guidelines on environmental aid, note 5 above, points 43 and 44 and 85-86. See, for example, IP/02/1322 (aid for purchase of electric or hybrid vehicles in Castilla-León approved); Case C-409/00 *Spain v Commission* [2003] ECR I-1487 (Court included in this category efforts to renew the Spanish fleet of commercial vehicles by granting aid for individuals and SMEs to replace their vehicles, as such a scheme "*enables the average age of those vehicles to be lowered, and as a consequence the level of emission of gaseous pollutants (CO2 and NO2) to be reduced*" (para 82). As a result, the Commission decision was annulled on this point); IP/03/318 (French aid scheme to promote more environmentally friendly modes of transport run by French environmental and Energy Management Agency approved).

[83] *Ibid,* points 76 and 80. Eligible costs are calculated, first, by calculating the investment cost directly related to environmental protection by reference to the counterfactual situation, and second, by deducting operating benefits and adding operating costs: point 80 onwards.

[84] *Ibid,* point 78. See, for example, Decision 2003/647 on State aid which Austria is planning to implement for BMW Motoren GmbH in Steyr, OJ 2003 L 229/24, where part of aid was environmental, as the purpose of the investment was to bring the inspection technology used to test the engines produced up to "start of the art", using "cold control technology". The ultimate aim was to reduce emissions and to meet future legislative provisions. BMW was investing €23.4 million in project. Around €6 million was considered to be eligible investment costs, calculated by deducting saved fuel costs from planning/development costs and extra investment costs compared to current hot engine testing technology. Total aid of €1.9 million (i.e., an aid intensity of 30%) was approved.

[85] *Ibid,* point 77.

[86] *Ibid,* point 79.

[87] *Ibid,* point 45.

[88] *Ibid,* point 87.

[89] *Ibid,* point 88; for example, the maximum intensity is 10% for large enterprises when the aid is granted between one and three years before the date of entry into force or transposition of the Community measure.

are not compulsory pursuant to applicable Community standards, and where they are not profitable…"[90] Both investment and operating aid may be exempted, though in practice exemption of operating aid is rare. In the case of investment aid, the aid intensity must not exceed 60% of the eligible investment costs, or more if the aid is granted in a competitive bid process, as above.[91] In the case of operating aid, the aid shall only be granted to the extent that it compensates for net extra production costs due to the investment, taking energy saving benefits into account, and it shall only be granted for five years.[92]

The Commission also refers expressly to aid for co-generation, which saves energy by producing electricity and heat simultaneously, and aid for district heating, which uses waste heat from industry or utilities, subject to the fulfilment of various conditions.[93]

Aid for renewable energy sources.[94] Referring to the Community's target of 20% of overall EU energy consumption coming from renewable sources by 2020, the Commission states that this increasingly common form of aid may be justified where two tests are satisfied. First, aid is justified if "*the cost of production of renewable energy is higher than the cost of production based on less environmentally friendly sources and if there is no mandatory Community standard concerning the share of energy from renewable sources for individual undertakings*."[95] Secondly, the aid must be for a renewable energy source where the environmental benefit and sustainability are "*evident*". This means, for example, that aid for non-sustainable types of biofuel - defined as those not fulfilling the sustainability criteria in the Proposal for a Directive on renewable energy[96] - may not be justified. Further, technological improvements in the production of renewable energy may reduce the need for aid.[97]

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[90] *Ibid,* point 47. See similarly, points 30-32 of the 2001 Guidelines, note 58 above. In some cases, Member States have tried to calculate the amount of such aid by reference to the environmentally damaging externalities avoided by, for example, energy saving measures. See the "ExternE" (External Costs of Energy) study funded by the Commission published in 2001 after 10 years' work from researchers of all EU MS and the US, which concluded that the cost of producing electricity from conventional sources like coal or oil would double, and cost of electricity production from gas would increase by 30% if external costs like damage to the environment and to health were taken into account. See further, Facenna, "State Aid and Environmental Protection", in Biondi, Eeckhout and Flynn (eds.) *The Law of State Aid in the European Union* (Oxford, Oxford University Press, 2004), who strongly advocates the adoption of internationally recognised external cost measurements of aid, as an effective way of internalising externalities.

[91] *Ibid,* points 95-97.

[92] *Ibid,* points 99-100.

[93] *Ibid,* point 51 and 112-125. The Commission refers to Directive 2004/8 on the promotion of cogeneration, OJ 2004 L 3/33, and the Commission Action Plan for Energy Efficiency: Realising the Potential, COMP (2006) 545 final. For example, aid for cogeneration may be exempted provided that the cogeneration unit satisfies the definition of high-efficiency cogeneration set out in point 70 of the Guidelines. Investment and operating aid may be justified for co-generation. In the case of energy-efficient district heating, only investment aid may be justified (point 120 of the Guidelines). See, for example, approval of aid to a scheme promoting the use of combined heat and power in Denmark, as aid was limited in time and degressive (XXVIIth Report on Competition Policy (1997) points 286 and 298).

[94] Defined at p 20 of the Guidelines as non-fossil energy sources from wind, solar, geothermal, wave, tidal, hydropower installations, biomass, landfill as, sewage treatment plan gas and biogases. See generally, Krieglstein, "Renewable Energy Schemes and EC State Aids Provision" (2001) European Environmental Law Review 51.

[95] Guidelines on environmental aid, note 5 above, point 48. See similarly, point 37 of the 2001 Guidelines, note 58 above.

[96] Proposal for a Directive of the European Parliament and the Council on the promotion of the use of energy from renewable sources, COM (2008) 19 final, Article 14(1).

[97] Guidelines on environmental aid, note 5 above, point 48.

Investment aid and operating aid may be permissible; in the case of investment aid, with an aid intensity of 60% (subject to increase for SMEs or where a competitive bidding process has taken place).[98] In the case of operating aid, Member States may choose between compensating for the difference between the cost of producing energy from renewable sources and the market price of the energy, which aid is permissible until the plant has depreciated; and using market mechanisms such as green certificates or tenders, whereby renewable energy benefits indirectly from a guaranteed demand, which aid may be authorised for 10 year periods.[99]

This part of the Guidelines builds on considerable decisional practice, and clearly fits within the context of the EU's broader strategy on renewable energy, mentioned above.[100] In its 2002 decision in *French Biofuels*,[101] for example, the Commission considered a French measure reducing the domestic tax rate for biofuels. In granting a six-year exemption, the Commission took the Community's renewable energy policy into account, and found that the reduction did not discriminate in favour of French biofuel producers, and would create jobs as biofuels were "*highly labour intensive*."[102] Indeed, the Commission found that the only way of promoting use of the relevant biofuel as a partial substitute for petrol was to "*make such substitution cost free for the consumer*."[103] Though the decision arrives at a similar conclusion as that suggested under the 2008 Guidelines, it is interesting to note that the Commission took a broader range of factors - including employment policy - into account in its 2002 decision than it (presumably) might have under 2008's "economic approach".

Aid for waste management. The Commission indicates that investment aid to undertakings managing or recycling waste may be justified, subject to compliance with the polluter pays principle and if competition on the market for secondary materials is not distorted.[104] In particular, aid may only be permissible if the investment is aimed at reducing

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[98] Aid intensity is often here, as with other types of environmental aid, crucial to the Commission's decision on whether renewable energy aid should be exempted: see for example, IP/02/1405 (Italian renewable energy production and energy conservation scheme, some part of which were approved, some further investigated because of the aid intensity involved).

[99] Guidelines on environmental aid, note 5 above, points 109-111. Member States may also choose to grant operating aid for renewable energy in the same way as they grant operating aid for energy saving: see point 111. See Case N326/07 *Italian Tax Reduction Biodiesel,* where the Commission noted that the combination of a supply obligation for biofuels with a tax reduction may mean that the normal method of calculating the acceptable maximum amount of aid (ie, contrasting the market price of corresponding fossil fuel) is not appropriate, because the supply obligation means that biodiesl is no longer in direction competition with fossil diesel.

[100] See generally, the speech by Commissioner Dimas "Credible and serious choice about biofuels" (SPEECH/07/473) and Seinen and Bernsel "State aid for biofuels" (2006) 2 EC Competition Policy Newsletter 65.

[101] Decision 2003/238 on the aid scheme implemented by France applying a differentiated rate of excise duty to biofuels OJ 2003 L 94/1. This followed Case T-184/97 *BP* [2000] ECR II-3145, where the CFI partially annulled a decision declaring an aid scheme for biofuels compatible, on the ground that the scheme did not meet the requirements for sustainable biofuel set down in the relevant Community legislation.

[102] *Ibid,* point 337.

[103] *Ibid,* point 371.

[104] Guidelines on environmental aid, note 5 above, point 52. The Commission initially notes that aid to the producer of the waste may also be justifiable, but does not discuss this further, and it is hard to see how this fits with the condition that aid should only be granted for an investment aimed at reducing pollution generated by other undertakings: see point 127. Presumably it is intended that aid granted to the waste generator will be assessed on a case by case basis, and will not benefit from the presumptions set out in section 3 of the Guidelines. On the significance of the polluter pays principle generally for Article 87(3) analysis, see the observations of AG Jacobs in C-126/01 *GEMO*, note 14 above.

pollution generated by other undertakings; if the aid does not indirectly relieve polluters from a burden they should normally bear; if the investment goes beyond the "state of the art"; if the treated materials would otherwise be disposed of in a less environmentally friendly way; and if the investment does not simply increase demand for the materials to be recycled.[105] In expressly accepting that aid may be granted to beneficiaries to reduce pollution caused by other undertakings, the 2008 Guidelines mark a welcome change from the 2001 Guidelines, the scope of which had been limited to aid for cleaning up one's own pollution. This had given rise to some rather counter-intuitive decisions in which the Commission had (rather artificially) been forced to consider schemes with broader environmental clean-up goals under the general provision of Article 87(3)(c), rather than under the Guidelines.[106] Aid intensity is set at 50%, with possible increases for SMEs.[107] In addition, aid for the remediation of contaminated sites may be justifiable if the original polluter cannot be identified and if the cost of remediation is higher than the resultant increase in the site's value.[108] This broadly confirms the approach of earlier cases and previous Guidelines.[109] This aid may be up to 100% of the eligible costs.[110]

Aid involved in tradable permit schemes. The EU's Emissions Trading Scheme (ETS) Directive had expressly indicated that it was without prejudice to the application of the State aid rules. How exactly these rules might apply in the ETS context is a question of some

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[105] Point 127. For an earlier case, see Decision 92/316 concerning aid envisaged by the Netherlands Government in favour of an environmentally-sound disposal of manure, OJ 1992 L 170/34 (scheme for stimulating an environmentally-acceptable disposal of surplus manure, to be financed entirely with the yield of a levy to be paid by animal husbandry units who produce more manure than their land can take, was covered by Article 87(3)(c) as, insofar as the scheme reduces manure pollution it is in the "*interest of the Community as a whole*").

[106] See, for example, the Decision on the UK WRAP (Waste and Resources Action Programme) OJ 2004 L 102/59, which concerned a UK scheme which, where markets for recycled products are not working properly, kick starts the market via a grant or lease guarantee for capital equipment. The case was not dealt with under the 2001 Guidelines as they aimed at reducing "*emission and pollution*" caused by a "*beneficiary in the course of its production process*" - i.e., improving one's own environmental record, not other environmental protection or more general contributions to sustainable development. The Commission initially gave an interim decision clearing SME and regional aspects (IP/03/406) and then issued a final Article 87(3)(c) clearance decision, on the basis that the scheme had a clear environmental benefit, its means were proportionate to its aims and it would not distort competition. See also, Ireland's similar structure (*Ireland - Waste Management Infrastructure* OJ 2003 C 202/5), which was eventually approved after some delay and after having been reclassified as regional state aid, and *UPM-Kymmene Shotton* OJ 2003 L 314/26 (in the case of an individual aid scheme notified under WRAP, only that part of investment which was aimed at reducing the beneficiary's own pollution was exempted, and not the rest of the investment). See further, Holmes "The Environmental Guidelines: Black Smoke or Sustainable Development?" ESTAL 1 (2004) 17, who criticises the Commission's approach on the basis that this situation should have been included within the Guidelines for reasons of certainty and consistency.

[107] Guidelines on environmental aid, note 5 above, point 129.

[108] *Ibid,* point 53.

[109] See, for example, XXVIIIth Report on Competition Policy (1998), p. 221 (Commission refused to authorise aid for investment by a steel producer in measures to prevent pollution from a slag heap used by the undertaking, as under the polluter pays principle the cost of the investment should have been borne by the undertaking itself); IP/03/819 (UK scheme to clean up contaminated sites found compatible with common market, as the polluter pays principle would be respected in giving grants of up to 100% of eligible costs, defined as the costs of work less the increase in value of land). See also, 2001 Guidelines, note 58 above, para 38 and D'Sa, "When is aid not State aid? The implications of the English Partnerships decision for European competition law and policy" (2000) 25 EL Rev 139 and Dirkzwager-de Rijk, "Two Dutch cases on State aid and soil rehabilitation" (2007) 1 EC Competition Policy Newsletter 130.

[110] Guidelines on environmental aid, note 5 above, point 133.

controversy.[111] Though the Commission had indicated to Member States by letter of March 2004 that it would not review Phase I allocations individually for compliance with the State aid rules,[112] no such assurance has been given for Phase II. The Guidelines give some - albeit a rather sketchy - idea of the Commission's view of the matter, both in relation to the ETS and other, national tradable permit schemes.[113] Recognising that tradable permit schemes may involve State aid "*in various ways*", the Commission sets out two methods of State aid assessment for tradable permits.

The first relates to the EU's ETS scheme up to 2012. In this case, the Commission states that, "*to limit the distortion of competition, no over-allocation of allowances can be justified and provision must be made to avoid undue barriers to entry*".[114] This general statement is specified in four requirements:

(1) The Member State measures must be set up to achieve environmental aims going beyond the undertakings' mandatory Community standards;

(2) Member State allocation must be carried out in a transparent way, "*based on objective criteria and on data sources of the highest quality available*", with the total quantity awarded being less than the undertaking's expected needs;

(3) The allocation methodology "*shall not favour certain undertakings or certain sectors, unless this is justified by the environmental logic of the system itself or where such rules are necessary for consistency with other environmental policies*"; and

(4) New entrants shall "*in principle not receive permits or allowances on more favourable conditions than existing undertakings*" and, at the same time, "*granting higher allocations to existing installations compared to new entrants should not result in creating undue barriers to entry*."[115] The Commission will apply these criteria taking into account the allocation criteria set out in the ETS Directive and implementing guidelines.[116]

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[111] See, for example, Merola and Crichlow, "State aid in the framework of the EU position after Kyoto: An analysis of allowances granted under the CO2 Emissions Allowance Trading Directive" 27(1) World Competition (2004) 25, Lorenz, "Emission Trading - the State Aid Dimension" European State Aid Law Quarterly 3 (2004) 399, Rousseaux, "L'allocation des quotas d'émission de gaz à effet de serre: un aspect determinant du future marché européen" 484 Revue du Marché commun et de l'Union européenne (2005) 31, Weishaar, "The European Emissions Trading System and State aid: An Assessment of the Grandfathering Allocation Method and the Performance Standard Rate System" 28 European Competition Law Review (2007) 371, Mace, "The Legal Nature of Emission Reductions and EU Allowances" Journal of European Environmental and Planning Law 2 (2005) 123, Torre-Schaub, "La naissance d'un nouveau marché: le système britannique de commerce d'allocations d'emissions de gaz à effet de serre", Revue Internationale de Droit Economique (2004) 227, Anttonen, Mehling and Upston-Hooper, "Breathing Life into the Carbon Market: Legal Frameworks of Emissions Trading in Europe" (2007) European Environmental Law Review 96, Bazelmans, "De implementatie van Europese handel in emissierechten in Nederland" Milieu & Recht 31(4) (2004) 214.

[112] Letter of 17 March 2004, HNV C2/PV/amh/D (2004) 420149. The Commission warned, however, that, taken as a whole, Phase I NAPs might be found incompatible with the State aid rules.

[113] As regards situations where companies are subject to environmental taxes and tradable permit schemes at the same time, the Commission states that the Guidelines do not apply as it has "*not gathered sufficient experience*" in this area. As a result, such cases will be assessed on a case by case basis under Article 87(3)(c): Guidelines on environmental aid, note 5 above, point 68. See also, points 139-150.

[114] *Ibid,* point 55.

[115] *Ibid,* point 140.

[116] Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community OJ 2003 L 275/32, Annex III, Communication from the Commission on guidance to assist

The second method of assessment concerns the post-2012 ETS period and, more generally, national tradable permit schemes. In this case, the Commission will assess whether measures are "*necessary and proportional*."[117] In particular, in order for aid to be justified:

(1) the choice of beneficiaries must be based on "objective and transparent criteria" and must not favour certain competitors

(2) Auctioning must mean a "substantial increase in production cost" for each sector or category of beneficiaries;

(3) Such increase must not be capable of being passed on to customers "without leading to important sales reductions"; and

(4) Individual undertakings must not be capable of reducing emission levels in order for the price of the certificates to be bearable.118 This may be demonstrated, for example, by providing emission levels using best available techniques in the EEA. As will be clear, this second method of assessment focuses essentially on better implementation of the polluter pays principle in tradable permit schemes.

This, it is submitted, forms one of the weakest parts of the Guidelines. Criticism of the Commission's approach to State aid in the context of tradable permit schemes has already been voiced above. Further critical comment is given below.

Aid in the form of reductions or exemptions from environmental taxes. The Commission recognises that such aid "*may be necessary to target negative externalities indirectly by facilitating the introduction or maintenance of relatively high national environmental taxation*."[119] In order for it to be justifiable, the Member State must show, first, that the exemptions or reductions are necessary for all the proposed beneficiaries and, second, that they are proportional in size. This will be presumed if, where the tax is harmonised, the beneficiaries pay at least the Community minimum tax level (in which case a 10 year exemption will normally be given).[120] In other cases, the aid will be considered necessary where the choice of beneficiaries is based on objective, transparent and non-discriminatory criteria; the tax would otherwise lead to a substantial increase in production costs for the beneficiaries; and this increase cannot be passed on to customers without important sales reductions.[121] The aid will be considered proportionate if the beneficiaries pay a proportion of the tax related to their environmental performance (the better performing the undertaking, the less tax they should have to pay); or if the beneficiaries pay at least 20% of the tax; or if the aid is conditional on the conclusion of voluntary environmental agreements between the State and the undertakings, with targets and periodical review.[122]

Member States in the implementation of the criteria listed in Annex III to Directive 2003/87, COM/2003/830 final and Communication on Further Guidance on Allocation Plans for the trading period 2008 – 2012 of the Emissions Trading Scheme COM (2005) 703 final. See further, Seinen, "State aid aspects of the EU Emission Trading Scheme: the second trading period" (2007) 3 EC Competition Policy Newsletter 100.

[117] Guidelines on environmental aid, note 5 above, point 56.

[118] *Ibid*, point 141.

[119] *Ibid*, point 57.

[120] *Ibid*, point 41.

[121] *Ibid*, point 158.

[122] *Ibid*, point 159.

This approach consolidates and builds on the Commission's practice in a substantial amount of decisions in the area.[123] In the *UK Climate Change Levy* case, for example, the UK introduced a climate change levy on the non-domestic use of energy, which included tax rate reductions and exemptions, including a full exemption for natural gas in Northern Ireland for five years.[124] This was, in the Commission's view, permissible as the levy would create further barriers to the development of the burgeoning Northern Irish gas industry.[125]

Further, aid to incentivise polluting undertakings to relocate to areas where the pollution will have a less damaging effect,[126] and aid for "*environmental studies*" carried out by undertakings, [127] may also be justifiable.

Where any of these types of aid are applied for by the intended beneficiary after the project has started, the Member State must, in addition, demonstrate the incentive effect of the aid, i.e., that the beneficiary has in fact changed its behaviour due to the aid.[128]

c. Article 87(3)(b) - aid for "important projects of common European interest"

In the Guidelines, the Commission states that environmental aid may be permissible under this provision where:[129]

(1) The aid proposal concerns a specific and clearly defined project;

(2) The project is in the common European interest, meaning that it must "*contribute in a concrete, exemplary and identifiable manner to the Community interest in the field of environmental protection, such as by being of great importance for the environmental strategy of the European Union*." This excludes advantages limited to a single Member State; rather, the advantage "*must extend to the Community*

[123] There are far too many to cite exhaustively. See the 2001 Guidelines, note 58 above, points 48-50 and, for example, XXVIth Report on Competition Policy (1996), p. 246 (Swedish law on excise duties for energy approved, which increased the tax of CO2 in fuels, but provided for a temporary reduction in the rate of tax applied to some industries with high energy consumption and to heating for glasshouse farming purposes, to allow such firms to adapt); IP/02/240 (German tax reductions from eco-taxes approved so as not to jeopardise competitiveness of energy intensive industries); IP/96/1129; IP/97/160 (Swedish fiscal measures on CO2 granting exemptions for energy intensive industry approved for a limited 4 year period); XXVth Report on Competition Policy (1995) at 233 (Danish New Energy tax on industry energy consumption, which was aimed at reducing CO2 and SO2 emissions and reducing energy consumption, while providing tax relief for energy intensive firms, approved). See also, Decision of the EFTA Surveillance Authority of July 26, 2002 No 149/02/COL (Norway's tax exemptions for certain sectors from carbon dioxide and sulphur dioxide taxes probably did not satisfy the requirements of the Article 61(3)(c) of the EEA Agreement (the equivalent of Article 87(3)(c) EC), as there was no evidence that the aim of the taxes would ultimately be achieved if the exemptions remained in place).

[124] XXIst Report on Competition Policy (2001) point 382. See also, London, "Concurrence et environnement: une entente écologiquement rationelle ?" RTD 39(2) (2003) 267.

[125] *Ibid*, point 386. See also, Case N 22/2008 *Swedish CO2 tax reduction for fuel used in installations covered by EU ETS* (such a tax reduction was compatible with the Guidelines on environmental aid, as it allowed Sweden to adopt a general CO2 tax on energy consumption which is largely above the Community minima as required by the Energy Taxation Directive).

[126] Guidelines on environmental aid, note 5 above, points 54 and 135-138. See similarly, point 39 of the 2001 Guidelines, note 58 above.

[127] *Ibid*, points 46 and 91-93.

[128] *Ibid*, points 142-146.

[129] *Ibid*, point 147.

as a whole". The Commission will consider applications from undertakings from a "significant" number of Member States more favourably;[130]

(3) The aid must be necessary and offer an incentive to the undertaking, and the project "*must involve a high level of risk*"; and

(4) The project must be of "*great importance*" in terms of size, producing "*substantial environmental effects*."

Clearly, these criteria are stringent and will be difficult to satisfy, even in the case of relatively serious transboundary environmental issues. In early cases, however, numerous Member States tried to argue environmental-related justifications under this provision. An example of one such failed attempt to rely on Article 87(3)(b) was the *Glaverbel* decision, which concerned a Belgian scheme granting investment aid to a Belgian glass producers to improve a production line, which would save energy and improve working conditions. The Commission found that this was State aid, and did not fall within Article 87(3)(b), as this would require it to form part "of a transnational European programme supported jointly by a number of governments of the member sates, or [to arise] from concerted action by a number of member states to combat a common threat such as environmental pollution."[131] This did not include aid which helped improve production conditions which, in reality, amounted to operating aid.[132] However, in the *UK Emissions Trading* decision, the Commission did not exclude the possibility that emission trading systems could be considered as projects of common European interest within the meaning of Article 87(3)(b). If this were accepted to be the case, it is likely that a greater intensity of aid would be permissible than under Article 87(3)(c).[133]

d. Comment

On the whole, the 2008 Guidelines and Block Exemption represent very positive developments in the Community's environmental aid regime.

To begin, the extension of the Community's State aid block exemption regime to environmental aid is eminently sensible. As a category of aid which will, in all likelihood, continue to increase in popularity with Member States, and which, under certain conditions, may be vital in achieving the Community's own environmental goals, it is undoubtedly in the interests of both the Commission and Member States - and of environmental protection - to remove the notification obligation and allow a simplified method of calculating the aid amount.

Nonetheless, it is important to note that the new distinction made by the Commission in the Guidelines between "standard" and "detailed" assessment does not – as one might have

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[130] *Ibid*, point 149.

[131] See Joined Cases 62 & 72/87 *Glaverbel* [1988] ECR 1573, paras 20-26.

[132] *Glaverbel*, *ibid,* para 29. See also, for example, Decision 92/316 concerning aid envisaged by the Netherlands Government in favour of an environmentally-sound disposal of manure, note 105 above (provision of public funds to manure bank to finance some of its operation is aid, because animal husbrandry units must bear the cost (one of their production costs) of environmentally sound disposal of their manure; Article 87(3)(b) does not apply because, although the 1974 and 1980 framework on environmental matters foresees that during a transitional period environmental aid should benefit from a derogation, such aid must be for adaptation by firms to satisfy their environmental obligations - which was not so in that case).

[133] See Facenna, "State Aid and Environmental Protection", in Biondi, Eeckhout and Flynn (eds.) *The Law of State Aid in the European Union* (Oxford, Oxford University Press, 2004).

imagined – correspond to the distinction between environmental aid covered by the Block Exemption and environmental aid not so covered. Though the Block Exemption will make Member States' lives easier to a certain extent, therefore, this may be more than compensated for by the time they will need to spend figuring out how their proposed aid will fit into the Guidelines' framework for assessment. In this regard, the 2008 Guidelines are, strikingly, far more extensive and detailed than their predecessors, running to around four times the length of the 2001 Guidelines. While not in itself necessarily indicating an improvement in quality, this undoubtedly improves transparency and legal certainty. Moreover, it indicates that the Commission is taking this area very seriously, and wished to do a more comprehensive job than last time around. This it certainly has done, and it is arguably at least in part attributable to the raised profile of the Guidelines following, for example, the European Council's express call for them in the context of the EU's hugely important current Energy Action Plan.

From a substantive perspective, the 2008 Guidelines are also, in numerous respects, to be welcomed, for the following reasons.

In the first place, the Commission's adoption of a broad, generally-applicable framework for analysis for all types of environmental aid – in contrast to the more disjointed category-by-category approach – will surely bring extra consistency of analysis to the area. Moreover, the "balancing test" set out as the lynchpin of this framework seems, based on the Commission's description, to correspond broadly to the proportionality analysis propounded by Chapter 6's *systematic* argument.[134] In this sense, the Guidelines are, it is submitted, illustrative of a practical, balanced implementation of the Article 6 EC integration principle. Further, as the proportionality principle is - as has been argued in previous Chapters - destined to play an increasingly important role in other areas of competition law when balancing competition and environmental objectives, this will also bring a welcome boost of consistency in approach between State aid policy and other areas of competition policy. Such consistency of approach is, as argued in Chapter 7, in itself to be valued as a feature of good governance.

In the second place, in terms of the Commission's aim of achieving "*better targeted*" aid as voiced in the State Aid Action Plan, the Guidelines also represent an improvement. Bonuses which had been present in the 2001 Guidelines for aid achieving aims rather unrelated to environmental aims – e.g., for aid to assisted regions, or for renewable energy installations serving all needs in an entire community – have disappeared from the 2008 Guidelines. Conversely, for those specific (and tightly constrained) types of aid which are deemed environmentally beneficial under the Guidelines, the acceptable aid intensities have been increased. Thus, for example, intensities for large undertakings have increased from a range of 30-40% to 50-60%, with a further potential intensity increase for eco-innovation (10%). Some commentators had argued that, in such cases, maximum aid intensity levels should be scrapped, allowing for full reimbursement of the cost borne by an undertaking in providing a public good.[135] However, the Commission's reasons for limited aid intensity – viz. the fact that the calculation of extra investment costs necessary to achieve a higher level of environmental protection does not take potential operating benefits of the investment into

[134] See point 4 of Chapter 6's working hypothesis on the import of the Article 6 EC integration principle, at Figure 1 of Chapter 6.

[135] See, for example, Branton, "Environmental Aid: a Case for Fundamental Reform (1)", European State Aid Law Quarterly (2006) 4, who states that this was the UK's approach to reform of the Guidelines.

account; and the possible commercial value to the undertaking of an environmentally-friendlier image – are in general convincing.

In addition, an intensity of 100% is possible in many instances following a competitive tender process. In this way, the Commission is providing a welcome incentive to Member States to inject procedural competition into the State aid area, even where market failure and externalities may make the substantive competition goals of allocative efficiency and maximising consumer welfare more difficult to achieve. A final positive point is the tightening of policy on the circumstances derogations from eco-taxes are permissible: where undertakings do not pay at least the Community minimum, in the case of long-term derogations, Member States have the burden of proving that the derogation is necessary and proportionate. This is a clear improvement in implementation of the polluter pays principle, insofar as undertakings benefiting from eco-tax derogations are generally significant polluters.

Nonetheless, it is submitted that the Article 6 EC integration principle requires the Commission to go further than this in its cost-benefit analysis, by taking into account where appropriate the environmental costs alleviated where aid is granted for environmentally beneficial behaviour. This, it is argued, follows from Chapter 8's *economic* argument, which sets out the environmental valuation techniques which might be used in making this analysis.[136]

Indeed, the implications of Article 6 EC in this area are, in the present author's view, even more far-reaching. As noted above, Article 6 EC in the State aid area - as with other areas of competition law - has been thought to work only one way. While environmental benefits from aid are relevant to the State aid assessment, the fact that aid that is otherwise compatible with the common market may damage the environment has not led to the conclusion that such aid breaches Article 87 – an approach which has been confirmed by the Court of First Instance.[137] This approach is, it is submitted, incompatible with Article 6 EC. It is admitted that, where a benefit does not satisfy the components of the Article 87(1) definition of aid (and where there is no scope for interpreting such components as extending thus far), such benefit - even if granted for environmentally damaging behaviour - is not prohibited by this Article. This follows from the limits of the integration principle discussed in Chapter 6,[138] as well as from the principle of legal certainty. However, where a benefit granted for environmentally damaging behaviour falls within the Article 87(1) concept of aid, things are different. In particular, to take the Article 6 EC integration principle seriously in this area requires the Commission to take the environmental costs entailed by environmentally damaging aid into account in carrying out any cost-benefit analysis prior to an exemption decision. This follows, once again, not only from Chapter 6's *systematic* argument, but also from Chapter 8's *economic* argument. It would, admittedly, require a major change in the Commission's present thinking. Nonetheless, it is submitted that such a

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[136] See the analogous argument made in Chapter 14, in the context of Article 86(2)'s similar cost-benefit analysis.

[137] See, Case T-158/99 *Thermenhotel Stoiser v Commission* [2004] ECR II-1, note 61 above, where the applicant argued that the hotel project to which aid had been granted contravened EC environmental law. Rejecting this argument, the CFI held that the proper mode of recourse was for the Commission to bring an Article 226 EC action against the relevant Member State for breach of its environmental Treaty obligations.

[138] See point 2 of the working hypothesis on the import of Article 6 EC set out in Chapter 6 at Figure 1.

change is fundamental if internalisation of environmental cost, and economisation of (environmental) State aid policy, is to progress from slogans to reality.

A third reason to welcome the 2008 Guidelines is that they take into account numerous changes which have taken place in the landscape of environmental policy since 2001, recognising trends in Member States' environmental aid policies and shifts in thinking on the type of measure which might incentivise better environmental performance on the part of undertakings.[139] As a result, they contain new categories of permissible environmental aid, such as aid for waste management, aid involved in tradable permit schemes, aid for district heating, aid for environmental studies and aid for early adaptation to standards.

More particularly, the Guidelines' approach to tradable permit schemes deserves special attention. As noted above, the question of which tradable permit allocations by Member States - whether under Phase II of the EU's ETS, or under national schemes - might amount to State aid has given rise to substantial controversy among commentators. In the case of the EU ETS, it has been argued above that the grant of allowances should only constitute State aid insofar as (1) of the "pot" of allowances which is it open to Member States to auction (i.e., 5% of allowances in Phase I and 10% of allowances in Phase II), they grant the allowances for free or below market price; and (2) they allocate such allowance otherwise than in accordance with objective, transparent criteria. A first (critical) comment on this part of the Guidelines, thus, has already been made above: they blur the distinction between Article 87(1) and 87(3)(c), a distinction which is important for reasons of burden of proof.

Putting this criticism aside, however, the Commission's tentative setting out of tests for compatibility with Article 87(3)(c) is a positive step from the substantial uncertainty which had existed in this area.[140] In fact, the tests with which it has come up build on the allocation criteria of Annex III of the ETS Directive, and the way in which the Commission has interpreted these criteria in guidance issued to Member States,[141] and in its decisions on NAPs to date. Thus, for example, the Guidelines' requirement that "*no over-allocation of allowances can be justified*[142] is also a requirement that the Commission has emphasised flows from Annex III of the ETS Directive.[143] In addition, criterion five of Annex III - the requirement that Member States' NAPs "*shall not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities*" - evidently, as discussed above, brings in State aid selectivity analysis. To a certain extent, therefore, the Commission's approach to State aid analysis is intertwined with, and almost indistinguishable from, its general, non-State-aid-specific assessment of NAPs. This is, of course, not in itself a bad thing -

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[139] Indeed, the fast-moving nature of environmental policy and its instruments means arguably that the area is less suited to a Block Exemption than many other areas.

[140] See the 2001 Guidelines, note 58 above, for example, which stated that some of the means adopted by Member States to comply with Kyoto objectives could constitute State aid, but that it was still too early to lay down conditions for authorising such aid.

[141] See, for example, Communication, "Further guidance on allocation plans for the 2008 to 2012 trading period of the EU Emission Trading Scheme", COM (2005) 703 final, at 14.

[142] Guidelines on environmental aid, note 5 above, point 55.

[143] See Communication, note 116 above, at 14, on criteria 1 and 2 of Annex III, for example. See also, the criteria for assessment set out by Seinen, a Commission official, at 101-102 and subsequent discussion, which - though ostensibly on the subject of the State aid assessment of allocations, by and large amounts to a non-State-aid-specific discussion of the Commission's general approach to acceptability of allocations in NAPs: Seinen, "State aid aspects of the EU Emission Trading Scheme: the second trading period" (2007) 3 EC Competition Policy Newsletter 100.

consistency between general NAP assessment and State aid analysis is crucial - but it does beg the question what the "added value" of the State aid rules are in this context. This is a question left in large part unanswered by the Guidelines.

In reality, the answer may be that DG Competition is well aware of the delicacy of the EU ETS environmental policy "experiment" and its centrality to the EU's activities if it is, as is wished, to emerge as a trailblazer in achieving the "sustainable development" paradigm. There is a strong argument that this lies at the root of DG Competition's inactivity - despite repeated warnings - in enforcing the State aid rules to date in proceedings separate from the Commission's examination of NAPs.[144] Indeed, such a conclusion flows from Chapter 7's *governance* argument, as an illustration of the interplay between DG Competition and Directorates-General responsible for other policy areas. As a matter of political reality, therefore, it is submitted that DG Competition would be unlikely to intervene until the ETS is better established. In practice, this means that, if DG Environment's announced plans for Phase 3 of the ETS come to fruition - according to which the Member States are to relinquish control over allocating free allowances - DG Competition's role in bringing State aid proceedings concerning Member States' implementation of the ETS will likely be minimal.

In any event, in its very brief discussion of the treatment of new entrants under the Guidelines, the Commission side-steps one of the most controversial areas of the ETS - by simply stating that new entrants shall, "*in principle not receive permits or allowances on more favourable conditions than existing undertakings*"[145] but that "*granting higher allocations to existing installations compared to new entrants should not result in creating undue barriers to entry.*"[146] The million dollar question is, of course: what constitutes an "*undue*" barrier to entry? As has been well-documented, the "grandfathering" approach to allocation (i.e., whereby undertakings are granted free allowances based on past emissions) creates, by its very nature, barriers to entry for new entrants. Where new entrants are charged for allowances (e.g., by auction), but incumbents are not, this increases such barriers to entry. Yet, the Commission in its guidance on the ETS Directive has expressly authorised Member States to allocate allowances for new entrants by auctioning. Presumably, therefore, such barriers to entry are not what the Commission means by "undue".

The core of the difficulty, however, is hard to avoid: the allocation of allowances for free on a grandfathering basis is inherently distortive of competition.[147] This is, however, too broad

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144 This view is supported, for instance, by the Order of the ECJ of June 19, 2008 in Case C-6/08 P *US Steel Košice*, in which the ECJ rejected the appellant's argument that, by taking a decision that the NAP of Slovakia was incompatible with the allocation criteria set out in the ETS Directive, this amounted to a decision on the question of whether the NAP would entail the disbursement of State aid: para 73.

145 An example of what the Commission may mean by this is the phenomenon of long-term allocation guarantees, proposed for Phase II by Member States such as Germany, the Czech Republic and Hungary, whereby new installations would be guaranteed a certain level of allocations for a fixed time period. In the Commission's view, such guarantees likely constitute aid incompatible with the common market. See Seinen, *ibid*, 103.

146 Guidelines on environmental aid, note 5 above, point 140.

147 See further, the arguments of Weishaar, who contends that a "performance standard rate" system, such as that used by the Netherlands in their nitrogen dioxide tradable permit system, is preferable to a grandfathering method. Under PSR systems, undertaking's CO2 savings are accredited in the form of intangible assets with a market value - ie undertakings that are more CO2 efficient than the benchmark fixed by the governments get benefits, which amount to aid: Weishaar, "The European Emissions Trading System and State aid: An

and systematic a problem with the ETS to be solved on a case by case basis via the State aid rules: a change in legislation is a far more appropriate and effective tool.[148] As such, any Commission attempts to inject undistorted competition into the market via casuistic State aid decisions is inherently a rather thankless task, doomed at a certain point to become discretionary and illogical. In fact, the Commission's plans for Phase III of the ETS - by which auctioning will become the norm and, for free allocation, allocation criteria will be harmonised - are the best way of tackling this problem.

Assessment of the Grandfathering Allocation Method and the Performance Standard Rate System" 28 European Competition Law Review (2007) 371.

[148] An apt analogy may be drawn in this regard with the problems encountered by the Commission in dealing with the issue of slot allocation in the air transport sector. To counter distortionary effects which would follow from varying methods of slot allocation at airports throughout the Community, the solution adopted by the Community legislator was Regulation 95/93 on common rules for the allocation of slots at Community airports OJ 1993 L 221/1 (as amended). By Article 4(2)(b) of Regulation 95/93, the Member State responsible for a coordinated airport "*shall ensure the independence of the coordinator…by separating the coordinator functionally from any single interested party*." Moreover, by Article 4(2)(c) of Regulation 95/93, the coordinator must act in a "neutral, non-discriminatory and transparent manner" in allocating slots. However, Regulation 95/93 allows for a system of "grandfather rights", whereby an air carrier is entitled to claim the same slot in the next scheduling period as it had been operating in the previous period. Where a slot has been used for less than 80% of the time for which it had been allocated in a period, the operator must hand it back to the slot pool to be re-distributed. In this regard, Article 10(6) of Regulation provides that 50% of the slots to be distributed must first be allocated to new entrants (as defined by Article 2(b)), unless requests from new entrants are less than 50%. The Commission has over the past years engaged in a review of the Regulation on slot allocation: see, Commission Communication on the application of Regulation 95/93 COM (2008) 227 (emphasising, *inter alia,* that the obligation that 50% of the slots to be distributed must be allocated to new entrants applies throughout the scheduling period). Slot allocation was covered by a separate block exemption (Regulation 1617/93 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices concerning joint planning and coordination of schedules, joint operations, consultations on passenger and cargo tariffs on scheduled air services and slot allocation at airports OJ 1993 L 155/18), the validity of which was not renewed as it was felt that the slots allocation rules are at present compatible with the competition rules.

Part IV: Summary and Conclusion

Chapter 16: Summary and Conclusion

The aim of this thesis was twofold: first, to consider as an empirical matter whether environmental protection factors presently play any role in Community competition policy; second, to consider as a normative matter whether they should play a role.

The method of the thesis was to consider the issue from three different perspectives: an environmental policy perspective, a perspective from competition theory, and a perspective from competition practice.

Part I. In Part I, taking an environmental policy perspective, we examined the developments in Community environmental policy to date which are of most relevance to competition policy. This part of the analysis was aimed at bridging the gap - at times noticeable in academic writing - between competition policy and environmental policy, to achieve a properly "integrated" analytical perspective in answering the above questions. After considering briefly the principal developments in EU environmental policy since its inception, we focused on two developments which are crucial to competition policy: the adoption of the sustainable development aim as a fundamental goal of the Community and the EU, and the adoption of the Article 6 EC principle, which requires environmental protection requirements to be integrated into the definition and implementation of all Community policies, as an important means of achieving sustainable development and a core principle of Community law. We noted, however, that the main problem with the sustainability goal and the integration principle is, essentially, their indeterminacy: major conflicts between "weak" and "strong" notions of sustainability, and a lack of clarity over the practical significance of the integration principle where environmental goals conflict with other Community goals, have weakened their force in practice.

We then considered another trend in Community environmental policy of great relevance to competition policy: the trend towards use of "market-based" (also known as economic or incentive-based) environmental policy instruments, and away from traditional "command and control" direct regulation. After examining the reasons for this movement, we focused on the three types of market-based instrument used within the Community which are of most relevance to Community competition policy: state subsidies and taxes, tradable permits (looking in particular at the EU's Emissions Trading Scheme), and voluntary environmental agreements. We concluded that these instruments, though not a panacea for all environmental issues, can be vital in increasing the effectiveness of environmental policy - "reaching the parts that direct regulation cannot reach". Part I finished with an introduction to some of the implications of environmental regulation for Community competition policy: in particular, the increase in market-based environmental policy instruments means that Community competition policy applies to large areas of environmental policy to which, had direct regulation been used, it would not have applied. This prepared the ground for the switch in perspective, in Part II, to a perspective from competition theory.

Part II. In Part II, we asked whether, from a theoretical viewpoint, environmental protection factors can and should play a role in competition analysis. Here, we began by examining what the goals of Community competition policy are, surveying the principal schools of competition thought to date. We concluded that, though maximising consumer welfare is an important goal of Community competition policy at present, Community competition policy (unlike US antitrust policy) is considered by many to have other goals not directly related to economic efficiency, which we termed "non-economic" goals. These

certainly include market integration and the achievement of the single market, but many commentators consider them to go further, extending to other important Treaty goals such as that of environmental protection.

Having thus surveyed opinion, we moved to a normative approach. We put forward and examined the merits of three theoretical arguments why environmental goals should play a role in Community competition policy.

The first, which we termed the *systematic* argument, argues that the EC Treaty should be viewed as a system, or a coherent whole, when interpreting any component policy area under the Treaty, including the Community's competition policy. This argument drew on the classic teleological approach used by the Community courts in Treaty interpretation, and argued that, in the environmental context, the Article 6 EC integration principle - which also applies to competition policy - makes a systematic approach imperative. Recognising that the main problem with the integration principle is its indeterminacy, however, the argument went further, and set out the concrete implications of the integration principle in the competition sphere, namely:

(1) As a procedural matter, where environmental considerations could be relevant to a case, the question whether they should be taken into account must be considered in coming to a decision;

(2) Where there is, on their wording, no scope at all for interpreting the Treaty competition provisions in a way that favours environmental protection, the integration principle is not relevant;

(3) Where it is possible to interpret the Treaty competition provisions in a way that favours environmental protection, and there is no conflict with the goals of competition policy, the Treaty provisions must always be interpreted in that manner; and

(4) Where it is possible to interpret the Treaty competition provisions in a way that favours environmental protection, and there is a conflict with the goals of competition policy, then the proportionality principle applies. This means that where a (private or State) measure is suitable to achieve the Community's environmental policy objectives, and there is no way of achieving these objectives that is less restrictive of competition, the measure should be allowed under Community competition law.

Aside from Article 6 EC, a further strand to the systematic argument was that the Treaty competition rules should, where possible, be interpreted consistently with the Treaty free movement rules (the "internal comparative" approach). As environmental protection is a valid justification for proportionate Member State measures otherwise restrictive of free movement of goods, this implies that it should in principle be possible to justify otherwise anti-competitive restrictions on similar grounds.

Our second theoretical argument why environmental goals should play a role in Community competition policy was a *governance* argument. It was divided into two limbs:

(1) the argument that the Community principles of "good governance" demand coherence and interlinkage between institutions applying and enforcing the Community's environmental and competition policies (the "good governance" argument); and

(2) The argument that it is unrealistic to think that Community competition enforcers would, in practice, consistently exclude environmental considerations from their analysis (the "realist's" argument).

After examining the merits of these arguments at each of the three levels of Community competition enforcement - the Commission, the Community courts, and national courts and competition authorities, we concluded that the good governance argument applies across the board to each level of enforcement. However, we admitted that the force of the realist's argument varies. In the case of the Commission, we concluded that the realist's argument might seem *prima facie* weakest, though we examined public choice arguments which suggested otherwise. In the case of the Community courts, we concluded that the realist's argument was strong, using a coherence-based model of judicial reasoning. Finally, we concluded that the realist's argument was also strong in the case of national courts, though potentially slightly weaker in the case of certain national competition authorities.

Our third theoretical argument why environmental goals should play a role in Community competition policy was an *economic* argument. This argument posited that the current drive towards a more "economic approach" at the Commission should not necessarily mean the exclusion of environmental factors, as - at least in some cases - environmental factors may be taken into account in the economic calculus of competition decisions. Using a basic environmental economics approach, we examined the possibility of taking environmental considerations into account in measuring utility, i.e., internalising environmental externalities in competition analysis. We concluded that, in forecasting post-transaction consumer welfare, the post-transaction environmental performance of a product can be taken into account, using environmental valuation techniques developed in the context of environmental cost-benefit analysis. Moreover, we argued that this should be done, not just because of the Treaty's Article 6 EC integration principle, but because the level of post-transaction consumer surplus is ultimately dependent on the level of remaining environmental resources.

Part III. Armed with these theoretical arguments, we moved to our final perspective in Part III: a perspective from competition practice. This Part examined the role of environmental factors in each individual area of Community competition policy from an empirical and, applying Part II's theoretical arguments, normative perspective. Without attempting to repeat the discussion in that Part, our principal conclusions may be summarised as follows.

First, we saw in Chapter 9 that environmental considerations may be relevant to the cross-cutting issues of defining what is meant by an undertaking and defining the relevant market in a given case. On the basis of Part II's *systematic* argument, however, we submitted that undertakings performing an environmental service should only in extreme cases fall outside the definition of an undertaking; in most cases, it is more proportionate for the competition rules to apply in principle, but for any environmental justification to be taken into account in the application of these rules.

Second, we considered in Chapter 10 the ECJ's doctrine whereby proportionate restrictions inherent to certain social and regulatory goals of an agreement fall outside the scope of Article 81(1) EC. We argued that this doctrine should extend by analogy to proportionate restrictions inherent to an agreement's legitimate environmental goals. Further, in Chapter 11 we argued that environmental improvements should be considered to promote "*technical and economic progress*" within the meaning of Article 81(3) and thus, subject to satisfaction of

the other Article 81(3) conditions, lead to the disapplication of the Article 81 prohibition from agreements entailing such improvements. Moreover, the requirement that consumers get a "fair share" of the resulting benefit should be interpreted broadly in the environmental context to include environmental benefits accruing to society at large, including (subject to discounting) future consumers pursuant to the intergenerational nature of the sustainable development aim. We also focused in this Chapter on restrictive practices in waste management systems, an area examined relatively frequently to date by the Commission and Community Courts.

Third, we argued in Chapter 12 that environmental protection objectives should be viewed, in principle, as "defences" to *prima facie* breaches of Article 82 EC, whether in the form of a defence based on objective justification (subject to compliance with proportionality) or, where the environmental benefit is susceptible to valuation, an efficiencies-based defence (subject to satisfaction of the other Article 81(3) conditions, which the Commission has indicated apply by analogy to efficiencies-based defences in the Article 82 EC context). Likewise, we concluded in Chapter 13 that such environmental benefits should be viewed as efficiencies in the Commission's analysis of whether a proposed merger will significantly impede effective competition under the Merger Regulation.

Fourth, we considered in Chapter 14 the relevance of Member State environmental action to competition analysis, for example by reinforcing the effectiveness of voluntary environmental agreements by recognising them in law, or by granting special rights to certain undertakings to perform some environmental services which would not otherwise be profitable. We examined the situations in which undertakings can rely on such State action as a defence to Article 81 or 82 EC proceedings and the scope of Member States' Article 10 EC duty not to enact or enforce national rules which might jeopardise the effectiveness of Articles 81 and 82 EC in the environmental context, focusing in particular on co-regulatory situations where the State provides a legal framework implementing voluntary environmental agreements. We also looked at the operation of Article 86 EC in the environmental context, examining instances where the ECJ has applied Article 86(1) and 86(2) EC to undertakings given environmental duties by the State. We noted, in particular, that the proportionality test used by the Commission and Courts in Article 86(2) analysis has, depending on how it is applied in practice, the potential to implement the Article 6 EC integration principle well.

Finally, we analysed in Chapter 15 the approach of the Commission and Community courts to environmental subsidies and taxation under Article 87 EC. Here, we began with distinguishing State aid control from the rest of competition policy on the ground that, while State aid is in principle prohibited (Article 87(1)), the Article 87(2) and (3) exemptions are premised on a recognition that markets may not always work properly left alone - due, for example, to the presence of externalities - and may need some intervention from the State for non-economic reasons to work more effectively, and ultimately raise consumer welfare. We then examined situations in which environmental subsidies and taxation are not considered to be State aid (for example, when not granted from Member State resources as in the *PreussenElektra* case, or when not considered selective as with some types of environmental taxation). We finished by considering the Commission's approach to exempting environmental State aid, as set out in its 2008 Environmental Aid Guidelines, concluding that, though the Guidelines are overall a positive development, in some respects they do not go far enough. In particular, we argued for a true integration of environmental costs and benefits into cost-benefit analysis in the State aid context, which would require the

environmental costs resulting from environmentally damaging aid to be taken into account by the Commission in carrying out cost-benefit analysis prior to granting an exemption. Finally, we add that the Guidelines' approach to the issue of State aid in the EU's ETS leaves much to be desired.

Conclusion. In the Introduction, we noted that the question of the role of environmental factors in Community competition policy would likely elicit one of two diametrically opposed instinctive reactions: the first, influenced by Chicago School theory, denying any role to such factors; the second insisting they must have some - albeit undefined - role.

It is hoped that this thesis has provided convincing arguments that the first reaction is misplaced both as a matter of Community law and from an economic perspective. On closer analysis, it is submitted that there is no good reason of principle or practice to support the view that competition policy should, uniquely, enjoy a "special" exemption from the imperative to integrate environmental protection requirements. Rather, such a position displays an outdated and, it is submitted, inherently narrow-minded approach to the environment-economy interplay. When examined closely, it is clear that the aims of environmental protection and achieving effective competition have a substantial capacity to be mutually reinforcing. In the environmental policy camp, this has been recognised for some time with the substantial movement towards market-based instruments, dropping the traditional instinctive distrust of the "market", long considered anathema to the environmental protection cause.

In the competition policy camp, however, the equivalent step has yet to be made with conviction or consistency. In particular, Part III's survey of the present approach of the Community Courts and Commission to date has indicated that environmental factors have not yet, with some intermittent exceptions, been given sufficient weight in the Commission's competition analysis. To a lesser extent, the same is true for the Community courts - and here primarily for the Court of First Instance. This is disappointing and represents a failure on the part of competition policy to step up to the mark on what is increasingly viewed as the major issue of our time. Admittedly, however, difficulty in properly implementing the integration principle is by no means a problem specific to competition policy. Though Article 6 EC demands the effective implementation of this principle across all policy areas covered by the EC Treaty, this remains a long way off. More generally, the original prevalence of economic goals in the EC Treaty is still arguably, in large part, reflected in its scheme and structure. For instance, there seems little chance in the near or medium future that the step will be taken - as suggested by the Avosetta Group - of inserting a provision in the EC Treaty prohibiting significantly impairing the environment, subject to imperative reasons of overriding public interest (i.e., mirroring Articles 28 and 30 EC on free movement of goods).[149] To this extent, a certain latent hierarchy of goals remains.

This thesis has sought to demonstrate that, in reality, there is ample scope to integrate environmental protection factors into Community competition policy in practice, while remaining true to the wording of the EC Treaty as well as to the axioms of competition theory. In many cases, this simply requires the sensitive use of a proportionality-based analysis already used by the Commission and Community courts in relation to other, non-environmental factors (as, for example, has been argued in the case of Articles 81(1), 81(3),

[149] On the proposal, see Krämer, "Thirty years of EC environmental law: perspectives and prospectives" (2000) Yearbook of European Environmental Law 155, at 157.

82 and 86(2) in particular). In other cases, it requires a recognition and, to the extent reasonably possible, quantification of environmental costs and benefits in the context of cost-benefit and efficiencies analysis (as, for example, has been argued in the case of Articles 81(3), 82 and 87 EC, as well as in merger analysis).

It is not denied that adoption of this approach will necessitate a conscious, and significant, shift in thinking by those enforcing competition law within the EU. Nor is it denied that such adoption will be without difficulties, such as the difficulty, in the present state of development of environmental valuation techniques, in valuing with reasonable accuracy certain more diffuse forms of environmental benefits or costs. It would be naïve to ignore such drawbacks, and the problems of legal certainty which may sometimes result, and indeed the present research has not shied away from highlighting them. On balance, however, it is submitted that the arguments for a shift in approach are significantly stronger, and demonstrate that such a shift is crucial if Community competition law is to be truly "modernised".

De rol van milieubescherming in het communautaire mededingingsrecht en -beleid.

Samenvatting

Het doel van dit proefschrift is tweeledig: ten eerste om in empirische zin te bezien of milieubeschermingsfactoren momenteel een rol spelen in het communautaire mededingingsbeleid; ten tweede om in normatieve zin te bezien of deze factoren een rol zouden moeten spelen.

In dit proefschrift wordt het onderwerp vanuit drie verschillende perspectieven behandeld: vanuit het perspectief van het milieubeleid, vanuit het perspectief van de mededingingstheorie en vanuit het perspectief van de mededingingspraktijk.

Deel I.

In Deel I, waar het perspectief van het milieubeleid wordt genomen, worden de ontwikkelingen in het communautaire milieubeleid behandeld die het meest relevant zijn voor het mededingingsbeleid. Dit deel van de analyse heeft tot doel het gat tussen het mededingingsbeleid en het milieubeleid, het bestaan waarvan zo nu en dan wordt opgemerkt in de literatuur, te overbruggen. Zodoende kan bij het beantwoorden van bovenstaande vragen een voldoende 'geïntegreerd' analytisch perspectief worden bereikt. Nadat kort de voornaamste ontwikkelingen in het milieubeleid van de EU zijn besproken, richten wij ons op twee ontwikkelingen die cruciaal zijn voor het mededingingsbeleid: de opneming van duurzame ontwikkeling als een van de fundamentele doelstellingen van de Gemeenschap en van de EU, en de opneming van het beginsel in artikel 6 EG Verdrag, dat voorschrijft dat de vereisten van milieubescherming worden geïntegreerd in de omschrijving en uitvoering van ieder beleid van de Gemeenschap. Dit beginsel is een belangrijk middel bij het bereiken van duurzame ontwikkeling en is een van de kernbeginselen van het Gemeenschapsrecht. Hier wordt echter opgemerkt dat het grootste probleem met de duurzaamheidsdoelstelling en het integratiebeginsel in wezen hun onbepaaldheid is: hun kracht is in de praktijk verzwakt door grote tegenstrijdigheden tussen een 'sterke' en een 'zwakke' definitie van duurzaamheid en door een gebrek aan duidelijkheid over de praktische betekenis van het integratiebeginsel, waar milieudoelinstellingen botsen met andere Gemeenschapsdoelstellingen.

Vervolgens wordt een andere trend in het communautaire milieubeleid behandeld die zeer relevant is voor het mededingingsbeleid: de trend om meer gebruik te maken van 'marktconforme' (ook wel economische- of *incentive-based*) instrumenten in het kader van het milieubeleid en zich steeds meer te verwijderen van traditioneel, rechtstreeks *command and control* beleid. Nadat de redenen voor deze tendens zijn besproken, richten wij ons op de drie verschillende soorten marktconforme instrumenten die in de Gemeenschap worden gebruikt en welke het meest relevant zijn voor het communautaire mededingingsbeleid: overheidssubsidies en belastingen, verhandelbare vergunningen (waarbij in het bijzonder is gekeken naar de regeling voor de handel in broeikasgasemissierechten van de EU) en vrijwillige milieuovereenkomsten. Geconcludeerd wordt dat deze instrumenten, hoewel geen oplossing voor alle milieuproblemen, van noodzakelijk belang kunnen zijn ter versterking van de effectiviteit van het milieubeleid - "reaching the parts that direct regulation cannot reach" ('om die gebieden te bereiken die rechtstreekse regulering niet kan bereiken').

Deel I wordt afgesloten met het aankaarten van een aantal manieren waarop milieuregulering van betekenis kan zijn voor het communautaire mededingingsbeleid: vooral de toename van het aantal marktconforme instrumenten voor het milieubeleid

betekent dat het communautaire mededingingsbeleid van toepassing is op grote delen van het milieubeleid, wat niet aan de orde zou zijn als rechtstreekse regulering was toegepast. Dit maakt het ons mogelijk om in Deel II van perspectief te wisselen naar dat van de mededingingstheorie.

Deel II.

In Deel II wordt de vraag gesteld of vanuit een theoretisch perspectief milieubeschermingsfactoren een rol kunnen en zouden moeten spelen in de mededingingsanalyse. Hier wordt begonnen met het onderzoeken van de doelstellingen van het communautaire mededingingsbeleid, waarbij wordt gekeken naar de voornaamste visies op mededinging tot nu toe. Geconcludeerd wordt dat, hoewel het zorgen voor een maximale consumentenwelvaart momenteel een belangrijke doelstelling is van het communautaire mededingingsbeleid, velen van mening zijn dat het communautaire mededingingsbeleid (in tegenstelling tot het mededingingsbeleid van de VS) vele andere doelstellingen heeft die geen betrekking hebben op economische efficiëntie. Deze doelstellingen noemen wij de "niet-economische" doelstellingen. Hieronder vallen in ieder geval marktintegratie en de totstandbrenging van een interne markt, hoewel velen van mening zijn dat ze veel verder gaan en zelfs andere belangrijke Verdragsdoelstellingen zoals milieubescherming raken.

Nadat aldus de bestaande visies zijn onderzocht, wordt overgegaan op een normatieve aanpak. De verdiensten van drie theoretische argumenten waarom milieudoelstellingen een rol zouden moeten spelen in het communautaire mededingingsbeleid worden hier uiteengezet en onderzocht.

Het eerste argument, dat wordt aangeduid als het *systematische* argument, stelt dat wanneer enig beleid van een deelgebied - dus ook het communautaire mededingingsbeleid - wordt geïnterpreteerd, het EG Verdrag moet worden gezien als een systeem, of een coherent geheel. Dit argument wordt ontleend aan de klassieke teleologische aanpak die wordt gebruikt door de gemeenschapsrechters bij het interpreteren van het Verdrag. Het stelt dat, in het licht van het milieubeleid, het integratiebeginsel van artikel 6 EG – welk beginsel ook van toepassing is op het mededingingsbeleid – een systematische aanpak noodzakelijk maakt. Het argument gaat echter verder dan het erkennen dat het belangrijkste probleem van het integratiebeginsel haar onbepaaldheid is. Het zet de concrete implicaties van het integratiebeginsel op het gebied van mededinging uiteen, namelijk:

(1) In procedurele termen moet de vraag worden gesteld of afwegingen op het gebied van milieubescherming, waar zij relevant zouden kunnen zijn voor een zaak, betrokken moeten worden bij het komen tot een beslissing;

(2) Voor zover de bewoordingen van de mededingingsbepalingen in het Verdrag geen ruimte laten voor een interpretatie die gunstig is voor de milieubescherming, is het integratiebeginsel niet relevant;

(3) Waar het mogelijk is de mededingingsbepalingen van het Verdrag te interpreteren op een manier die gunstig is voor de milieubescherming, en waar geen strijd is met de doelstellingen van het mededingingsbeleid, moeten de Verdragsbepalingen ook altijd op zodanige wijze geïnterpreteerd worden; en

(4) Voor zover het mogelijk is de mededingingsbepalingen van het Verdrag te interpreteren op een manier die gunstig is voor de milieubescherming, maar waar strijd is met de doelstellingen van het mededingingsbeleid, is het evenredigheidsbeginsel van toepassing. Dit betekent dat wanneer een (private of overheids-) maatregel geschikt is om de doeleinden van het communautaire

milieubeleid te realiseren, en er geen manier is om deze doelstellingen te realiseren op een wijze die de mededinging minder beperkt, de maatregel onder het communautaire mededingingsrecht toegestaan moet zijn.

Naast artikel 6 EG is een ander element van het systematische argument dat de verdragsregels inzake mededinging waar mogelijk consistent met de verdragsregels over de vier vrijheden moeten worden geïnterpreteerd (de "intern vergelijkende" aanpak). Aangezien milieubescherming een legitieme rechtvaardiging is voor proportionele maatregelen van lidstaten die zonder deze rechtvaardiging het vrij verkeer van goederen zouden belemmeren, betekent dit dat het in beginsel mogelijk moet zijn anderszins mededingingsverstorende beperkingen op gelijke gronden te rechtvaardigen.

Het tweede theoretische argument waarom milieudoelstellingen een rol zouden moeten spelen in het communautaire mededingingsbeleid is een *governance* argument. Het is opgedeeld in twee elementen:

(1) Het argument dat de communautaire beginselen van "good governance" vragen om samenhang en koppeling, *interlinkage*. tussen de instellingen die het communautaire milieu- en mededingingsbeleid toepassen en handhaven (het "good governance" argument); en

(2) Het argument dat het niet realistisch is te denken dat de handhavers van het communautaire mededingingsbeleid in de praktijk consequent milieutechnische overwegingen zouden uitsluiten van hun analyse (het "realistische" argument).

Nadat de voordelen van deze argumenten op alle drie de niveaus van communautaire mededingingshandhaving – de Commissie, de gemeenschapsrechters en de nationale rechters en mededingingsautoriteiten – zijn onderzocht, wordt geconcludeerd dat het argument van goed bestuur van toepassing is op alle niveaus van handhaving. Het zij echter toegegeven dat de kracht van het realistische argument varieert. Geconcludeerd wordt dat in het geval van de Commissie het realistische argument *prima facie* het zwakste lijkt, hoewel wij *public choice* argumenten onderzochten die iets anders suggereren. In het geval van de communautaire rechters wordt geconcludeerd dat het realistische argument sterk is, waarbij een model van rechterlijke toetsing gebaseerd op coherentie is gebruikt. Tenslotte wordt geconcludeerd dat het realistische argument ook sterk is in het geval van nationale rechters, hoewel potentieel zwakker in het geval van sommige nationale mededingingsautoriteiten.

Het derde theoretische argument waarom milieudoelstellingen een rol zouden moeten spelen in het communautaire mededingingsbeleid is een *economisch* argument. Dit argument stelt dat de huidige tendens tot een meer "economische aanpak" bij de Commissie niet noodzakelijkerwijs zou leiden tot het uitsluiten van milieutechnische factoren, aangezien – tenminste in sommige gevallen – milieutechnische factoren mee mogen wegen in de economische berekening van besluiten inzake mededinging. De mogelijkheid overwegingen omtrent het milieu mee te laten wegen bij nutsmetingen, dat wil zeggen het doorberekenen van externe kosten betreffende het milieu in mededingingsanalyses, wordt onderzocht door gebruik te maken van een basale milieueconomische aanpak. Geconcludeerd wordt dat, om consumentenwelvaart *post-transaction* te voorspellen, de milieuvriendelijkheid van een product in overweging kan worden genomen, door gebruik te maken van milieutechnische waarderingstechnieken die zijn ontwikkeld met het oog op het analyseren van kosten en baten betreffende het milieu (*cost-benefit analysis*). Bovendien wordt gesteld dat dit niet alleen moet worden gedaan vanwege het integratiebeginsel van artikel 6 EG, maar ook omdat het niveau van het *post-transaction* consumentensurplus uiteindelijk afhankelijk is van de omvang van resterende natuurlijke bronnen.

Deel III.

Gewapend met deze theoretische argumenten wordt in Deel III overgegaan tot het laatste perspectief: het perspectief van de mededingingspraktijk. Dit deel bekijkt vanuit een empirisch en normatief perspectief – waarbij de theoretische argumenten uit Deel II worden toegepast – de rol van milieutechnische factoren op ieder individueel terrein van het communautaire mededingingsbeleid. De voornaamste conclusies kunnen als volgt worden samengevat.

Ten eerste: Hoofdstuk 9 toont aan dat milieuoverwegingen relevant zouden kunnen zijn voor de transversale, *cross-cutting,* problemen van het definiëren van het begrip onderneming en het definiëren van de relevante markt in een bepaalde zaak. Op basis van de *systematische* argumenten die in Deel II zijn besproken wordt echter betoogd, dat ondernemingen die een milieudienst verlenen slechts in uitzonderlijke gevallen buiten de definitie van een onderneming zouden moeten vallen; in de meeste gevallen is het meer proportioneel om in beginsel de mededingingsregels toe te passen, maar bij de toepassing van deze regels iedere milieutechnische rechtvaardiging te overwegen.

Ten tweede wordt in Hoofdstuk 10 de rechtspraak van het Hof behandeld, volgens welke proportionele beperkingen die inherent zijn aan bepaalde sociale en regelgevende doelstellingen van een overeenkomst buiten het bereik van artikel 81 lid 1 EG vallen. Betoogd wordt dat deze rechtspraak *mutatis mutandis* ook van toepassing zou moeten zijn op proportionele beperkingen inherent aan legitieme milieudoelstellingen van een overeenkomst. Verder wordt in Hoofdstuk 11 betoogd dat milieuverbeteringen "technische en economische vooruitgang" in de zin van artikel 81 lid 3 bevorderen en zodoende, voor zover aan de andere vereisten van artikel 81 lid 3 is voldaan, leiden tot het buiten toepassing laten van artikel 81 voor overeenkomsten die dergelijke verbeteringen behelzen. Bovendien moet het vereiste dat consumenten een "eerlijk deel" van de voordelen krijgen op het gebied van het milieu ruim worden geïnterpreteerd. Dit betekent dat voordelen voor het milieu die de samenleving kan behalen, waaronder (behoudens kortingen) toekomstige consumenten als gevolg van het intergenerationele karakter van de doelstelling van duurzame ontwikkeling, er ook onder vallen. Ook wordt in dit hoofdstuk de nadruk gelegd op beperkende praktijken bij afvalbeheerssystemen, een gebied dat tot nu toe vrij regelmatig wordt onderzocht door de Commissie en de gemeenschapsrechters.

Ten derde: in Hoofdstuk 12 wordt betoogd dat milieubeschermingsdoeleinden in beginsel gezien dienen te worden als "defences" tegen *prima facie* inbreuken op artikel 82 EG. Dit kan zijn in de vorm van een verweer op basis van objectieve rechtvaardiging (mits conform het evenredigheidsvereiste) of, in het geval het milieuvoordeel berekend kan worden, een verweer op grond van *efficiencies* (mits voldaan wordt aan de andere voorwaarden van artikel 81 lid 3, waarvan de Commissie heeft aangegeven dat ze analoog toepasbaar zijn op verweren op grond van *efficiencies* in de context van artikel 82). Evenzo wordt in hoofdstuk 13 tot de conclusie gekomen dat in de analyse door de Commissie van de vraag of een voorgestelde fusie de daadwerkelijke mededinging op significante wijze zou belemmeren in de zin van de Concentratieverordening, deze milieuvoordelen moeten worden beschouwd als *efficiencies*.

Ten vierde wordt in Hoofdstuk 14 gekeken naar de relevantie voor de mededingingsanalyse van optreden van de lidstaten inzake het milieu, bijvoorbeeld door het versterken van de werking van vrijwillige milieuovereenkomsten door deze juridisch te erkennen, of door bijzondere rechten aan bepaalde ondernemingen toe te kennen zodat zij alsnog milieudiensten verlenen die anders niet rendabel zouden zijn. De situaties worden onderzocht waarin ondernemingen als verweer in een artikel 81 of 82 procedure

een beroep mogen doen op dergelijk staatsoptreden, en de reikwijdte van de verplichting van de lidstaten zich als gevolg van artikel 10 EG te onthouden van het aannemen of handhaven van nationale regelgeving die het nuttige effect van artikel 81 en artikel 82 op het gebied van het milieu in gevaar zou kunnen brengen. Hierin wordt het zwaartepunt gelegd op situaties van mederegulering (*co-regulatory situations*] waarin de lidstaat een juridisch kader aanlevert voor de implementatie van vrijwillige milieuovereenkomsten. Gekeken wordt ook naar de werking van artikel 86 EG op het gebied van het milieu, waarbij zaken worden onderzocht waarin het Hof van Justitie artikel 86 lid 1 en artikel 86 lid 2 heeft toegepast op ondernemingen aan wie milieuverplichtingen zijn opgelegd door de staat. In het bijzonder zij opgemerkt dat de evenredigheidstoets zoals gebruikt door de Commissie en de gemeenschapsrechters in hun analyse op grond van artikel 86 lid 2, potentieel, afhankelijk van hoe dit in de praktijk gebeurt, het integratiebeginsel van artikel 6 EG kan implementeren.

Tot slot wordt in Hoofdstuk 15 een analyse gemaakt van de manier waarop de Commissie en gemeenschapsrechters met milieusubsidies en belastingen omgaan onder artikel 87 EG. Om te beginnen wordt een onderscheid gemaakt tussen de controle op steunmaatregelen en de rest van het mededingingsbeleid, omdat, hoewel staatssteun in principe verboden is (art. 87 lid 1), de uitzonderingen van artikel 87 lid 2 en lid 3 gebaseerd zijn op erkenning van het feit dat markten op zichzelf niet altijd goed werken - bijvoorbeeld wegens het bestaan van externe effecten - en misschien interventie van staatswege op niet-economische gronden behoeven om effectiever te werken, en uiteindelijk consumentenwelvaart te verhogen. Daarna wordt gekeken naar situaties waarin milieusubsidies en belastingen niet als staatssteun beschouwd worden (bijvoorbeeld omdat ze niet uit staatsmiddelen gefinancierd worden, zoals in de zaak *PreussenElektra*, of omdat ze niet aan het selectiviteitscriterium voldoen, zoals het geval is met bepaalde types milieubelasting). Als laatste wordt ingegaan op de benadering van de Commissie bij het vrijstellen van steunmaatregelen op het gebied van het milieu, zoals uiteengezet in haar "Richtsnoeren Milieusteun 2008", concluderend dat, hoewel de richtsnoeren als geheel een positieve ontwikkeling zijn, zij in sommige opzichten niet ver genoeg gaan. In het bijzonder wordt gepleit voor echte integratie van milieukosten en voordelen in een kosten-baten analyse in de context van de lidstaat. Dit zou betekenen dat de Commissie bij het maken van een kosten-baten analyse ook rekening zou moeten houden met de milieukosten voortvloeiend uit steunmaatregelen met schadelijke gevolgen voor het milieu voordat een vrijstelling verleend wordt. Ten slotte voegen wij hieraan toe, dat de benadering van de Commissie inzake steunmaatregelen in de communautaire regeling voor de handel in broeikasgasemissierechten verre van bevredigend is.

Propositions relating to the dissertation *The Role of Environmental Protection in EC Competition Law and Policy* by Suzanne Kingston

1. The goal of sustainable development, and the integration principle set out in Article 6 EC, apply just as forcefully in the field of EC competition policy as in other EC policy fields.
2. Developments in environmental regulatory techniques in the EU since the 1970s, such as the greater use of market-based instruments and reliance on voluntary environmental initiatives, have meant that competition law is increasingly relevant to EU environmental regulation.
3. The indeterminacy of the sustainable development and integration principles has hindered the effectiveness of these principles in practice, including in the competition law field. Greater effectiveness demands relatively precise identification of the implications of these principles for competition policy.
4. For some schools of competition theory, it is perfectly acceptable to take environmental protection requirements into account in formulating and applying competition policy. For others, including the Chicago School, environmental protection requirements should not be considered in competition policy.
5. The aims, and theory underlying, EC competition policy are different to those underlying US competition policy. For that reason (amongst others), the Chicago School has carried less influence in the EU, and the goals of EC competition policy extend beyond economic efficiency.
6. Even if one takes economic efficiency to be the overriding goal of EC competition policy, there are strong arguments based on good governance principles, and environmental economics, that the notion of efficiency should allow environmental damage and benefits to be taken into account in competition law and policy.
7. The above theoretical arguments demonstrate that it is not only legitimate, but also obligatory, for environmental protection requirements to be taken into account in EC competition policy.
8. Analysis of EC competition law to date shows that, though environmental protection factors have played a role in some cases, in many they have been given insufficient weight, ignored entirely, or taken into account in an indirect and unclear fashion - creating significant problems of legal certainty for undertakings in environment-related areas.
9. Environmental protection factors have been taken into account in an insufficient, or insufficiently clear, manner in virtually all areas of EC competition policy, but particularly in the application of Articles 81 and 82 EC, Article 86(2) EC and Article 87 EC.

Curriculum Vitae

Suzanne Kingston was born on December 12, 1977 in Dublin, Ireland. She is a graduate of the University of Oxford (BA in Law) and the University of Leiden (LL.M. in European Community Law, *cum laude*).

From 2002-2004, she practised as a lawyer in the Brussels office of the US law firm, Cleary Gottlieb Steen & Hamilton, prior to which she was a *stagiaire* at the European Commission (DG Competition). From 2004-2006, she served as a *référendaire* (legal secretary) for Advocate General Geelhoed at the Court of Justice of the European Communities, Luxembourg. From 2006-2007, she was an affiliated lecturer and tutor in law at the University of Cambridge. Since 2007, she has been a lecturer in law at University College, Dublin.

Suzanne is a barrister at the Irish Bar (2007) and at the Bar of England and Wales (1999).

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