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*European University Institute*

Department of Law

**The interplay between the environment and competition law  
in the EU**

**An analysis of environmental agreements and their assessment  
under Article 81 EC**

**MIRIAM LENZ**

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**Supervisor: Professor K.H. Ladeur**

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# 1. INTRODUCTION

The core of the European Union is the establishment of an Internal Market between the Member States, in the confines of which all economic goods can circulate freely. The underlying idea is that in such a market goods and services can be produced and offered wherever it is economically most sensible. Transaction costs are kept at a minimum due to the abolition of measures such as taxes and quotas which favour national industry. The unimpeded movement of economic goods would, however, be seriously hampered if private parties were able to replace government restrictions with the reciprocal allocation of markets through private agreements, whether express or by tacit understanding. Competition law aims, *inter alia*, at controlling and prohibiting such agreements.

The establishment of an Internal Market is, however, not the sole determinant of the Community's activities; as a result of economic integration and development the question of the environment inevitably became important. It is a requirement that environmental considerations be integrated into all policies of the EU,<sup>1</sup> the result being that also in competition law environmental protection concerns play a role.

The interplay between competition and environmental considerations at Community level manifests itself in numerous areas. The interlinking of principles of competition law and environmental policies can, however, best be demonstrated using the example of co-operation agreements between undertakings aimed at setting certain environmental standards or targets for their products or production methods. These types of agreement are often encouraged or initiated by national public authorities who may be a partner to the agreement. They may, however, also be initiated and concluded by a certain branch of industry on its own accord, thus being purely private agreements. What is of interest here is the treatment of the horizontal aspects of such agreements under the competition rules, analysing agreements between private actors rather than the role of the state.<sup>2</sup>

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<sup>1</sup> see Article 23 and 6 of the EC Treaty, as renumbered by the Treaty of Amsterdam. The numbering used in this thesis will be that introduced by the Treaty of Amsterdam (ToA), e.g. Article 81 EC instead of Article 85 and Article 2 TEU instead of Article B, unless certain Articles are referred to in a pre-Amsterdam context.

<sup>2</sup> Environmental agreements, especially those concluded between private parties and the state, may also need to be balanced against Community policies other than competition policy. They may possibly be reviewed under the Treaty provisions dealing with the Internal Market, i.e. Article 30. As this Article concerns barriers to trade in goods, environmental agreements that concern non-product related production or processing methods could not create barriers to intra-Community trade. The remaining agreements may arguably amount to 'measures having equivalent effect'. As such, they may be justified under Article 36, which lists the protection of life of humans, animals and plants as one ground, or under the mandatory rules developed in the *Cassis de Dijon* case (Case 120/78 *Rewe Zentralverwaltung AG v. Bundesmonopolverwaltung für Branntwein* [1979] ECR 649), which include environmental protection. A more detailed discussion of this issue is beyond the scope of this thesis, but can be found in R. Khalastchi and H. Ward, 'New Instruments for Sustainability: An

When a number of firms enter into an agreement, whatever its nature or purpose, it will be void if it affects trade between Member States and has as its object or effect the restriction or distortion of competition within the Common market. This principle laid down in Article 81(1) of the EC Treaty is subject to Article 81(3) which provides that certain agreements may be exempted from the prohibition. In order to assess an agreement under Article 81, the tools of economic analysis are employed: they are adequate for the task of measuring the impact of an agreement on the market, which in turn will show whether it may have a restrictive or distortive impact.

Difficulties arise when an agreement, although restricting competition appreciably, displays certain benefits seemingly not quantifiable in monetary terms, such as the reduction of harm to the environment. The requirement to integrate the environment into all other EC policies would call for an exemption, on condition that the restriction caused by the agreement is proportional to its environmental benefits. Article 81(3), however, seems to allow for an exemption only if the agreement is beneficial from an *economic* point of view. The question thus arises whether positive effects of a meta-economic<sup>3</sup> nature should outweigh the restrictive economic effect an agreement might entail.

The central theme of this thesis is to analyse the interplay between environmental and competition aims, using the example of environmental agreement concluded between firms. Since the way such agreements should be treated hinges on the respective weight given to aims of competition policy and environmental policy, the development of these two will be traced, pointing to areas of conflict and their possible resolution. Following from this, a close examination of the relevant agreements from the perspectives of both environmental and competition policy will be undertaken. The treatment of such agreements under the competition rules depends on whether and to what extent environmental considerations are taken into account when assessing the legality of an agreement under Art. 81 EC. The various options regarding the way in which environmental considerations can be taken into account under Article 81 will be explored. Returning to a more practical level, a detailed analysis of the relevant case law will follow. Finally, the impact of the White paper on the treatment of environmental agreements under the competition rules will be assessed.

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Assessment of Environmental Agreements under Community Law', (1998) *Journal of Environmental Law* Vol 10 No 2, 257- 278

<sup>3</sup> I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, 5. Auflage (Lucius & Lucius, 1996), 25, 29. With reference to competition policy, the term meta-economic thus denotes any aim going beyond the strictly economic aims of competition policy. As will be shown in Chapter 3, the precise boundary between the purely economic and meta-economic may at times be difficult to draw.



The starting point will be to give a brief overview of the fields in which a conflict between competition regulation and the environmental concern may arise, considering legal and economic approaches.

## 1.1. Outline of the areas of possible conflict between competition law and environmental objectives

Article 6 of the Treaty of Amsterdam clearly prescribes that competition policy, as all other Community policies, must take environmental objectives into account, while this is not the case vice versa<sup>4</sup>. The question that arises is how far the two policies can be reconciled and to what extent environmental goals can be taken into account or even pursued by competition policy.

At first sight, aims pursued by competition and environmental policy seem to have little in common. One aims at devising a set of policies and laws which foster economic integration between Member States and ensure effective and undistorted competition<sup>5</sup> while the other seeks to protect the environment from harmful influences which may possibly be caused precisely by the strive for economic efficiency.

Nevertheless the Commission has continuously argued that no fundamental conflict between the two areas exists and that competition policy may even contribute to reaching environmental objectives<sup>6</sup>, thus portraying the relationship as complimentary. It cannot, however, be denied that a careful balancing act is required in order to pay due heed to both goals.

### 1.1.1. The legal perspective

There are a number of areas which serve to illustrate the interplay between the two policies. Under Article 81, as noted above, private actions which are pursuing ecological goals may amount to agreements which affect trade between the Member States and distort or restrict competition within the EU. As such, they will be void unless they are exempted under Article 81(3).

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<sup>4</sup> Regularly, the impact of environmental measures will have on competition matters is, however, taken into account when determining environmental policy - e.g. Fifth EC Environmental Action Programme 'Towards Sustainability: A European Community Programme of Policy and Action in relation to the Environment and Sustainable Development', COM(92) 23 final, Brussels, 27 March 1992, 6, para. 19

<sup>5</sup> see S. Bishop and M. Walker, *The Economics of EC Competition Law* (Sweet & Maxwell, 1999), 3

<sup>6</sup> XXIIIrd Competition Report 1993, paras.s 164-65

Environmental considerations may also play a role in the context of Article 82 which prohibits the abuse of a dominant position insofar as it may affect trade between Member States. An example of such an abuse would be a scenario where a number of jointly-dominant undertakings had put a system into place which increased their environmental efficiency and then denied other parties access to that system. This would be the case if an association of national producers who runs a recycling system as required by national law denies foreign producers access to their recycling system under market conditions where there is no other economically viable means of access to the market.<sup>7</sup>

The role of the state in this context manifests itself in two ways: firstly, Articles 3 (g) and 10 read in conjunction with 81 and 82 have the effect that Member States must not introduce or maintain measures, and this includes environmental laws and regulations, which could deprive Articles 81 and 82 of their effectiveness.<sup>8</sup>

Secondly, the competition rules contained in Articles 81 to 89 also apply to public undertakings or those that have been granted special or exclusive rights or have been entrusted with the operation of services in the general interest. Interestingly, environmental protection in this context represents a factor pointing towards the exclusion of the applicability of competition rules: if the service in the general interest is concerned with the environment, for example anti-pollution surveillance of a harbour, it is considered an essential task of public authorities and thus not an economic activity, with the result that the competition rules do not apply to the activity in question<sup>9</sup>.

Environment and competition may also interact in the context of the Merger Regulation<sup>10</sup>, which states that concentrations with a Community dimension shall be declared incompatible with the Common Market if they create or strengthen a dominant position as a result of which effective competition would be significantly impeded. By virtue of Article 6 of the Treaty, environmental protection requirements must form part of the policy on mergers as of all other competition rules. This may be achieved in a similar

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<sup>7</sup> see the *Spa Monopole/GDB* case (XXIIIrd Competition Report), para. 240. The Commission had commenced proceedings under Article 85 and 86 EC in 1989 but closed them when the German association in 1993 decided to grant access to the pool to foreign producers.

<sup>8</sup> This principle was first established in Case 13/77, *NV GB-Inno.BM v Vereniging van de Kleinhandelaars in Tabak (ATAB)* [1977] ECR 215, primarily in relation to Article 82. In case 229/83, *Association de Centres distributeurs Edouard Leclerc and others v Sàrl 'Au Blé vert' and Others* [1985] ECR I it was confirmed that Article 3(g), 10(2) and 81 are applicable to regulation enacted by Member States. On this issue in general see Ulla B. Neergaard, *Competition and Competences: The Tension between European Competition Law and Anti-Competitive Measures by the Member States* (DjØF Publishing Copenhagen, 1998) and W. Frenz, *Nationalstaatlicher Umweltschutz und EG-Wettbewerbsfreiheit* (Carl Heymanns Verlag, Köln, 1997)

<sup>9</sup> The European Court of Justice in Case 343/95 *Diego Cali v Servizi Ecologici Porto di Genova SpA* [1997] ECR I-1580 at para.23. See further on this issue J.M. Gonzalez-Orus, 'Beyond the Scope of Article 90 of the EC Treaty: Activities Excluded from the Competition Rules', *European Public Law*, Vol.5, Issue 3, 1999

<sup>10</sup> Council Reg. 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1989] OJ L 395/1

way as is hitherto done under article 81 (3), namely by interpreting the Merger Regulation in a way such as to include environmental considerations under the criteria of 'technical and economic progress which benefits the consumer'.<sup>11</sup>

As for State Aid under Article 87 the Commission has since 1974 regularly published guidelines on aid for environmental protection which suggest a balancing of interest with aid 'only being justified when adverse effects on competition are outweighed by the benefits for the environment'.<sup>12</sup>

While the areas described above may raise complex issues similar to those arising in the context of Article 81, (i.e. what weight should be given to competing goals under competition analysis) and may be touched upon in passing the focus will be on Article 81 itself, which seems to be of the greatest relevance for various reasons. One is the fact that, in comparison with other competition rules, most of the pertinent case law embracing competition and environmental considerations seems to have arisen in this context in and continues to do so. Undertakings have realised that voluntary agreements and the possible pre-emption or avoidance of stricter environmental legislation connected therewith may be worthwhile; numerous agreements on the European and international level have recently been concluded. Apart from notifications, there have also been a number of Commission decisions in this area, both under Article 81(1) and 81 (3). The most recent examples are the CECED decision and the CEMEP decisions of February and May 2000 respectively.<sup>13</sup>

The decision-making practice of the Commission and the recent proposals for reform of Article 81 and 82 lead to the next reason for examining Article 81 rather than other competition law rules. In its White Paper<sup>14</sup> of May 1999 dealing with the modernisation of Articles 81 and 82, the Commission proposes the direct effect and thus the decentralised application of Article 81 (3) over which it so far has had a monopoly power. If this provision is to be applied by national courts and competition authorities, this may have implications for the treatment of environmental considerations under Article 81 as will be discussed in Chapter Five.

A third reason is the general topicality of the interplay between competition law and environmental objectives which is reflected in the fact that recent communications by EU organs have expressly dealt with this aspect. In addition to the above-mentioned White paper on competition policy, the Commission has in the year 2000 presented a White paper

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<sup>11</sup> The criteria of technical and economic progress is found in Article 2(1)(b) of the Merger Regulation.

<sup>12</sup> Guidelines on State Aid for Environmental Protection [1994] OJ C72/3-9

<sup>13</sup> These will be discussed in Chapter Five.

<sup>14</sup> White Paper on the Modernisation of the Rules Implementing Article 85 and 86 of the EC Treaty [12.5.1999] OJ C 132/1

on environmental liability<sup>15</sup> and draft guidelines on the applicability of Article 81 to horizontal agreements<sup>16</sup>, including a section on environmental agreements. Both White papers have major implications for companies wishing to conclude environmental agreements or those hoping to obtain an exemption by virtue of an agreement's positive environmental side-effects. Due to its strict liability scheme, the White paper on environmental liability may induce more companies to conclude agreements with an environmental component which may then be governed by the new guidelines and be assessed by national organs under the new regime of the White paper on competition policy.

Before portraying the interplay between environmental protection and competition aims on a legal and policy level, an overview regarding the compatibility of the two aims in the sphere of economic theory will be given.

### *1.1.2. The economic perspective: environmental externalities*

Economic analysis is now an indispensable instrument of competition law analysis<sup>17</sup>. Terms such as geographic and product market, efficiency and price elasticity are commonplace when dealing with competition law. This approach is a necessary consequence of the nature of competition law as an institution concerned with 'economic structures, economic conduct and economic effects'.<sup>18</sup>

The environment on the other hand seems to be far removed from our everyday understanding of the term 'economic'; one has difficulty assigning an economic value to clean air or an unspoilt landscape.<sup>19</sup> Yet, environmental problems are 'essentially of an

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<sup>15</sup> White Paper on Environmental Liability, 9 February 2000, COM(2000) 66 final

<sup>16</sup> Draft Guidelines on the Applicability of Article 81 to Horizontal Co-operation [2000] OJ C 118/14

<sup>17</sup> This is reflected in recent case law of the European Court of Justice, e.g. Case 374, 375, 348 and 388 *European Night Services* [1998] 5 CMLR and the large amount of literature devoted exclusively to the economic side of competition law, e.g. J. S. Bishop and M. Walker, *The Economics of EC Competition Law* (Sweet & Maxwell, 1999). In this respect, R.H. Coase stated that 'Ernest Rutherford said that science is either physics or stamp collecting, by which he meant, I take it, that it is either engaged in analysis or in operating a filing system. Much, and perhaps most, legal scholarship has been stamp collecting. Law and economics, however, is likely to change all that and, in fact, has begun to do so.' (R.H. Coase, 'Law and Economics at Chicago', *Journal of Law and Economics* 36(1), 239, 254)

<sup>18</sup> J. Faull & A. Nikpay, *The EC Law of Competition* (Oxford University Press, 1999)

<sup>19</sup> Environmental economists have devised various methods of calculating the value of the environment. These methods do, however, face some limits. The hedonic prices approach, for example, wherein it is assumed that either wages or housing values reflect spatial variation in public good characteristics may be unavailable under certain circumstances such as extremely scarce population. The alternative approach of directly asking individuals to state their willingness to pay for public goods using survey techniques is subject to the strategic bias criticism. For further valuation methods and their criticism see A. Markandya and J. Richardson, *The Earthscan Reader in Environmental Economics* (Earthscan Publications, 1992), Part II: 'Evaluation methods and applications' and N. Hanley, J. Shogren and B. White, *Environmental Economics* (Macmillan, 1997)

economic nature'.<sup>20</sup>The deterioration of the environment due to pollution is largely caused by the fact that undertakings do not pay for the harm they inflict on the environment as this cost is generally borne by society at large. Economic actors will, however, only have an incentive to produce in an environmentally-aware manner if they themselves bear the cost of their polluting activities. In a world for which the term 'global economy' has become a synonym, environmental problems must at least in part be tackled by taking a market-based approach.

It is thus felt that an analysis of the interplay of environmental considerations and competition policy cannot afford to focus solely on legal and policy issues, ignoring the economic concepts which are at the heart of both environmental and competition considerations. In the following section, an overview will be given of the economics issues involved when dealing with environmental problems in a competitive market setting. This overview will serve as a background against which the legal implications of the interplay between competition law and environmental protection will be portrayed.

Markets are exchange institutions serving society by organising economic activity. A functioning competitive market<sup>21</sup> will allow for the most efficient allocation of resources, with price rationing resources to those who want them most. Although each market participant aims only at his own gain, the allocation of resources will ultimately lead to optimal welfare understood in terms of allocative and productive efficiency.<sup>22</sup> A precondition for reaching such optimal outcome is that markets are complete, i.e. that there are markets covering every possible transaction so that resources can move to their most valued use. If a resource has no owner, there is no-one who can ensure that the price of a resource reflects its full value and will only be given to those who will appreciate it most. Market failure occurs when decisions based on these inadequate prices lead to the inefficient allocation of resources.

Externalities are the classic special case of an incomplete market for an environmental asset.<sup>23</sup> The term "externality" refers to the situation where the consumption or production

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<sup>20</sup> N. Lee, 'Environmental Policy' in M. Artis and N. Lee, *The Economics of the European Union* (Oxford University Press, Oxford, 1994), 237, 240

<sup>21</sup> A market functions perfectly when the so-called pareto optimality is achieved. This is usually understood as a market in which resources are allocated in a pareto optimal manner. In essence, this is said to be reached when no individual loses welfare and at least one gains individual welfare. Note that the use of pareto optimality in the context of internalising environmental externalities has been criticised as being useful only in a static context but not when dealing with real-life problems of public policy, which should rather focus on distributional issues. See H. Kox, 'Environmental Externalities and Welfare: Do we need Pareto?', Tinbergen Institute, Vrije Universiteit Amsterdam, TI 97-002/3.

<sup>22</sup> This phenomenon was described by Adam Smith as the 'invisible hand', which leads an 'individual intending only his own gain to promote an end which was no part of his intention'. See F.M. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company, Boston, 1990), 15

<sup>23</sup> N. Hanley, J. Shogren and B. White, *Environmental Economics* (Macmillan, 1997), 22

activities of one individual or firm affect another person's utility function. Due to failure or inability on the part of institutions to assign property rights<sup>24</sup> to environmental assets<sup>25</sup>, there is no exchange institution where the person pays a price for imposing the external cost or pays for the external benefits. This for example means that a firm does not pay for the cost it is imposing on others by polluting or is not charged a price for the benefit it derives from being able to use the environment as a resource.<sup>26</sup>

Basic economic theory dictates that all scarce goods and resources have a price that undertakings must pay if they wish to purchase or to use them.<sup>27</sup> The environment can be considered such a resource in a number of ways, namely as a public consumption amenity (aesthetic and recreation service for the public), raw material and receptacle for waste from production and consumption.<sup>28</sup> Using the environment in one of these capacities may reduce another's ability to use it in a different capacity, for example, if a firm discharges waste water into a river, this will reduce another party's ability to enjoy angling in the river. As so many demands are placed on the environment, it is becoming a scarce resource. In respect of natural resources used as raw material input into the production process, for example, water or minerals, this scarcity is generally taken into account and at least to some extent reflected in their price.<sup>29</sup> This is not true for the environment in its capacity as public consumption amenity and receptacle for waste from production and consumption. The scarcity of environmental resources in these two capacities is not adequately taken into account; they are considered to be 'free goods' with the result that undertakings do not pay for their use of the environment. The externalities connected to economic activity are therefore borne by society at large, partly in terms of decreased environmental quality and

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<sup>24</sup> G. Calabresi and D. Melamud have devised two different ways to protect these rights once they are assigned, the 'property rule' and the 'liability rule'. The former is designed to prevent involuntary transfers, while the latter allow for such transfers granted a price fixed by the court is paid by those who violate the entitlement. G. Calabresi and D. Melamud, 'Property rules, liability rules, and inalienability: one view of the cathedral', 1972 *Harvard Law Review* 85, 1089

<sup>25</sup> H. Varian notes that if the externality is a public good, then the transfer (and by implication the prior assignment) of property rights may be difficult or impossible. See H. Varian, 'A Solution to the Problem of Externalities and Public Goods when Agents are Well-Informed', EUI Working Paper ECO No. 90/6, 9

<sup>26</sup> Note that in 'environmental economics there is much confusion about the definition of externalities' due to the irresolution on the choice between a naturalistic definition, focusing on the physical interaction, and a full economic definition, framing the definable phenomenon in economic concepts. H. Kox, 'Environmental Externalities and Welfare: Do we need Pareto?', Tinbergen Institute, Vrije Universiteit Amsterdam, TI 97-002/3, 4. The approach to externalities taken here is evidently closer to the first of the two options.

<sup>27</sup> D. Ehle, *Die Einbeziehung des Umweltschutzes in das Europäische Kartellrecht* (Carl Heymanns Verlag Köln, 1997), 4

<sup>28</sup> T. Portwood, *Competition Law and the Environment* (Cameron & May, London, 1994), at 25. For a more comprehensive analysis see N. Hanley, J. Shogren and B. White, *Environmental Economics* (Macmillan, 1997), 3 et seq.

<sup>29</sup> It has been argued that environmental resources, such as water, minerals, forest products etc. are generally underpriced. Ideally, the increased scarcity of particular natural resources should lead to an increase in their price and the eventual development of substitutes. The underpricing of the resources results in a reduction of

partly in monetary terms caused by the need to finance public measures aimed at remedying environmental harm. The externalities are thus imposed on society as 'social costs'.<sup>30</sup> They are not reflected in the end-price of the product, with the result that sensitivity to the environmental cost of the product is aroused neither in consumer nor producer. In this way, there is little incentive for market participants to use environmental resources restrictively. On the contrary, the fact that environmental costs are not borne by the party that caused them, may encourage competition for less environmental protection.<sup>31</sup>

Dealing with environmental externalities is a complex matter. The main difficulty arises from the fact that it is extremely difficult to quantify in economic terms the worth of an unspoilt environment.<sup>32</sup> The only aspect which can be measured with a degree of accuracy is the cost of attempting to remedy environmental damage once it has occurred. When attempting to quantify the harmful impact of production, consumption and disposal on the environment, other problematic issues frequently arise such as the difficulty of proving the causal link between a certain type of pollution and an industrial activity.

The difficulties of assessing the precise costs of externalities apart, the main reason for their persistence is that they are not included (internalised) by market players in their economic decisions<sup>33</sup>.

The argument here is two-fold. Firstly, firms do not take environmental externalities into account. This is not particularly surprising as they have no incentive to do so. Internalising externalities will increase their costs and hence their prices, with the result that consumer demand decreases.

This leads to the second explanation of the persistence of externalities. Consumers fail adequately to take into account the repercussions that their purchasing decisions have on the environment. This failure can be described as a lack of rationality; rational consumers might prefer products which internalise cost as optimal resource allocation will then ensure that the environment is not disproportionately harmed to the detriment of society. It can thus be argued that the 'true' preferences of consumers are distorted and that government

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the capacity to resolve resource conservation problems. (N. Lee, 'Environmental Policy' in M. Artis and N. Lee, *The Economics of the European Union* (Oxford University Press, Oxford, 1994), 237)

<sup>30</sup> R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, New York, 1978), 114. In this respect, Coase noted that if transaction cost were zero, there would be no division between social cost and private cost. Irrespective of the assignment of rights, i.e. whether the polluter has a right to pollute or the victim a right to a clean environment, the parties, being able to negotiate at no cost, would reach the most efficient way of reconciling their respective activities. Hence, the distinction between private and social cost becomes obsolete, of course only on the basis of the unrealistic assumption that transaction cost is zero. (R. Coase, 'The Problem of Social Cost' (1960) *Journal of Law and Economics*, 1-44)

<sup>31</sup> M. Kloepfer, 'Umweltschutz als Kartellprivileg? - Kartellrechtsfragen zum Umweltschutz' (1980) 23/24 *Juristenzeitung*, 781.

<sup>32</sup> See supra fn. 19

<sup>33</sup> I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, 5. Auflage, Lucius & Lucius, 1996, 37

intervention to correct them in accordance with the current political views is justified.<sup>34</sup> Once such intervention has succeeded in altering consumer preferences and external environmental costs are internalised, the competitive process will allow for the adequate allocation of environmental resources.

The traditional approach to deal with market failures in general, and environmental externalities in particular, has been that of state intervention. Generally, the form such intervention takes is the 'command and control approach' of prohibitions and standard-setting. Although it has been argued that there is no foundation for the belief that government intervention is strictly necessary to cope with the harmful effects of pollution on the environment<sup>35</sup>, it is submitted here that, due to the existence of transaction costs, some form of government intervention is necessary.

However, as will be discussed in Chapter 2, the traditional approach is faced with severe criticisms, which calls into question its status as the central form of intervention.

A second, economics-based approach addresses the above issue of failure to internalise environmental costs into the price system. Economic and fiscal instruments aim at creating "an ideal world, [in which] all external environmental costs incurred during the whole life-cycle of products from source to production, distribution, use and final disposal [will be internalised], so that environmentally-friendly products are not at a competitive disadvantage in the market place vis-à-vis products which cause pollution and waste."<sup>36</sup>

Political and legal support for such internalisation is found in the well-established "polluter pays" principle which is contained in Art. 174 (2) of the Treaty. At the root of the polluter pays principle lies the idea that the polluter alone is liable for the damage he has caused.<sup>37</sup> To put this principle into practice means that the cost of the measures necessary

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<sup>34</sup> *ibid.*, 41

<sup>35</sup> see F. Lévêque, 'Externalities, Collective Goods and the Requirement of a State's Intervention in Pollution Abatement', *Nota di Lavoro* 20.97 Fondazione Eni Enrico Mattei who bases his conclusion on the Coasean zero-transaction cost approach (see fn. 35), concluding that state intervention is only necessary if transaction costs are positive, administrative transaction costs are lower than transaction costs of market mechanisms and administrative transaction costs are lower than the benefit that pollution abatement entails. (p.7)

<sup>36</sup> Fifth Environmental Action Programme, Vol. II, 67

<sup>37</sup> Note, however, that R. Coase suggests that it is conceptually impossible to assign victim and offender roles since damage always results from both parties, i.e. a firm is responsible because it is polluting but the person suffering from the pollution is also responsible because he is living in the vicinity of the factory. In theory this may be so, especially as the Coase theorem assumes zero transaction costs and it therefore does not matter whether the 'victim' pays the firm to stop polluting or the firm compensates the 'victim'. If there are prohibitively high transaction costs but at the same time the state is able to correctly assess the lost profits, the question which one of the parties should pay for their respective right becomes one of wealth distribution considerations.

The value of the Coase theorem is that it illustrates that assigning exclusive responsibility to one party and to introduce government measures accordingly may not always be the best option to choose. Rather than assuming that *either* government intervention *or* market processes will solve the problem of social cost, a pragmatic case by case approach will eventually lead to the best mix of state measures and market



to remedy pollution caused by the production or consumption process will be reflected in the cost for the polluter. When bearing the full cost of his polluting activities, the polluter will seek to reduce them just as he will try to reduce the cost of any other factor of production. In this context, the polluter will reduce his 'environmental costs' up to the point where the marginal cost of decreasing pollution exceeds the amount he would otherwise be liable to pay for environmental harm caused. The economic rationale behind the polluter pays principle is thus that environmental damage caused by industry will be mirrored in the firm's costs and eventually in the price of products; it is thus about 'getting the prices right'<sup>38</sup>, i.e. prices should reflect the full cost to society of production and consumption, including environmental costs, giving undertakings an incentive to seek to produce products with an overall less environmentally harmful impact. Eventually, the competitive process will work in favour of those undertakings which manage to reduce their environmental costs and are thus able to offer their products at competitive prices.<sup>39</sup> As such, cost internalisation is not a distortion of competition, but rather it is levelling out the playing field from the environmental point of view.<sup>40</sup>

Although cost internalisation by way of economic and fiscal instruments is attractive in theory, a criticism has been that so far policy instruments have failed to ensure its achievement. In the European context it has been noted that since the coming into force of the Fifth Environmental Action Programme no significant progress has been made with respect to cost internalisation.<sup>41</sup> The reasons are that the processes involved in devising and implementing these instruments are complex and difficult. A further problem, as the Economic and Social Committee has observed, is that there exist 'economic and societal trends including increased demand for environmentally damaging products and services'.<sup>42</sup>

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mechanisms. see further H. Demsetz, 'Ronald Coase' and D. De Meza. 'Coase Theorem', both in *The Palgrave Dictionary of Economics and the Law* (Macmillan, 1998), 262-282

<sup>38</sup> L. Gyselen, 'The emerging interface between Competition Policy and environmental Policy in the EC' in *Trade and the Environment*, ed. Cameron, Demeret, Gerardin: 1994, 242, 244 in reference to the Fifth Environmental Action Programme, para. 7.4

<sup>39</sup> The competitive process will thus work for the environment. Cf. M. Bock, 'Umweltrechtliche Prinzipien in der Wettbewerbsordnung der Europäischen Gemeinschaft', (1994) 2 EuZW 47, 48

<sup>40</sup> T. Portwood, *Competition Law and the Environment* (Cameron May, 1994), 25

<sup>41</sup> The Economic and Social Committee criticises the Commission's Global Assessment of the Fifth Environmental Action Programme, stating that "The reason why so little progress has been made to date with the long called-for internalisation of external costs - and, thus, with the consequent application of the polluter pays principle within the EU - ought, for example, to be listed." (para. 3.4.1.4. of the Opinion of the Economic and Social Committee on the Communication from the Commission - Europe's Environment: What directions for the future? The Global Assessment of the European Community Programme of Policy and Action in relation to the environment and sustainable development, "Towards Sustainability" COM(1999) 543 final, Brussels, 24 May 2000)

<sup>42</sup> Opinion of the Economic and Social Committee on the Communication from the Commission, supra, fn. 41, para. 3.3.

While it may be true that a substantial part of society still ignores environmental costs, a pattern in the opposite direction can also be observed.<sup>43</sup> Consumers seem to be taking the environmental externalities of a product into account to some degree and would generally prefer to purchase and consume 'environmentally-friendly' products. Environmentally-friendly products are those which, in their production or consumption, cause less or no harm to the environment in comparison with traditional products fulfilling the same or a sufficiently similar purpose; this quality is then reflected in their price.

According to economic theory, consumers as rational choice-makers form a set of preferences, ranking certain goods and services over others. Thus, the 'environmental quality'<sup>44</sup> of a product may make it preferable, just as it could be any other attribute such as design or performance which a consumer is looking for. Consumers will make purchasing decisions in accordance with these preferences, aiming at maximising their personal utility by trying to obtain their most preferred consumption bundles.<sup>45</sup> Utility as an unobservable index of preferences finds its manifestation in the individual's willingness to pay for a certain product. If an individual feels he is aiding environmental concerns by purchasing environmentally-friendly products, acting in accordance with this preference will increase his personal utility and thus eventually be reflected in his willingness to pay extra for such a product. Although this argumentation is not entirely unproblematic<sup>46</sup>, the bottom line is that this consumer tendency has clear implications for undertakings. If consumers are willing to spend more on an environmentally friendly product which they consider more desirable because of its low environmental impact than an environmentally harmful product generally fulfilling the same purpose, the conclusion must be that there is a market for firms which adjust their product range to the consumer's wishes. Accordingly, a large

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<sup>43</sup> M. Motta and J-F. Thisse, 'Minimum quality standard as an environmental policy: domestic and international effects' in *Environmental regulation and market power* by Petrakis, Sartzetakis, Xepapadeas (Edward Elgar Publishing, 1999), 27

<sup>44</sup> *ibid.*, 28

<sup>45</sup> N. Hanley, J. Shogren and B. White, *Environmental Economics* (Macmillan, 1997), 358

<sup>46</sup> By preferring environmentally-friendly products, the consumer essentially aims at maximising societal welfare rather than his individual welfare. The decision to opt for an environmentally-friendly product is generally motivated by the concern to preserve environmental resources for present and future generations. It is thus a concern for societal welfare overall. A Paretian approach to welfare assumes that preferences and utility are value free, i.e. that every individual is the best judge of his own welfare, that social welfare is defined only in terms of the welfare of individuals and that the welfare of individuals may not be compared (no interpersonal comparison of utility).

As societal welfare under pareto is the mere numerical aggregation of individual utility, Paretian welfare theory fails to embrace the notion that an individual may increase his *personal* utility precisely by increasing *societal* welfare.

A related point is that the consumer tendency for environmentally-friendly products in terms of preferences and utility in the 'Paretian sense' seems slightly artificial when a time element is introduced: buying an environmentally-friendly product now contributes to a future utility (namely the utility of future generations who must prefer to live in a reasonably clean environment), arguably rendering the concept of personal utility all-embracing and thus so wide as to become meaningless.

eco-industry<sup>47</sup> has developed and the environmental quality of a product has become a major marketing tool.<sup>48</sup>

While such consumer behaviour may be the exception rather than the rule, the lack of progress in dealing with environmental externalities can also partly be attributed to the lack of enthusiasm on part of the industry to take externalities into account. Until now, cost internalisation generally had to be imposed on undertakings by the regulator in the form of taxes reflecting the cost of the negative external effects caused by, for example, the use of a particularly harmful substance in the production process. This traditional way of cost internalisation, as indicated above, has not been very successful. Ideally, in the absence of other measures, firms would change their behaviour and take environmental costs into account on their own volition. They will only do so if they feel that 'polluting' market participants will not gain a competitive advantage.

This can possibly be achieved by permitting economic agents to enter into agreements which aim at lowering the environmental impact of a product and at the same time guarantee that the other parties are not at a competitive advantage.

It is acknowledged that environmental agreements do not internalise externalities<sup>49</sup>. Cost internalisation in its true sense would mean that the product is priced proportionately to the environmental harm caused by the product, i.e. the more harmful a product is, the more expensive it becomes. An environmental agreement will have the opposite effect, i.e. a product will (typically) become more expensive due to its improved environmental quality.

These agreements do, however, involve internalisation in a different sense: the cost of pollution abatement is reflected in the price of the product. While cost internalisation in the classical sense takes the opposite approach, i.e. internalising the negative environmental effects caused by a product, environmental agreements internalise the cost of pollution abatement.

These types of agreement allow through the co-operation of firms the attainment of certain environmental standards which might not be reached without agreement. Whereas a firm

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<sup>47</sup> The turnover in the EU eco-industries is currently estimated at 110 billion EURO (The EU Eco-Industries Export Potential, Final Report to DGXI of the European Commission, September 1999. A Community-wide eco-labelling scheme was introduced in 1992, which is in principle open to all products. Under this programme, a number of schemes have already been established, e.g. Commission Decision 96/461/EC(12) of 11 July 1996 establishing ecological criteria for the award of the Community eco-label to washing machines, which covers energy consumption, water and detergent use as well as consumer information.

<sup>48</sup> T. Portwood, *Competition Law and the Environment*, supra, fn.40 at 75

<sup>49</sup> see e.g. K. Rennings et al., *Nachhaltigkeit, Ordnungspolitik und freiwillige Selbstverpflichtung* (Physica, 1996), 192. For an example of an economic approach to cost internalisation of polluting goods by way of an environmental tax, see O. Orosel and R. Schöb, 'Internalising Externalities in Second-Best Tax Systems', Working Paper No. 9605, March 1996, Department of Economics, University of Vienna

might be reluctant to take unilateral action because raising price might be a risky strategy, if its competitors are also obliged to raise price, a level playing-field is ensured and the risk is reduced. Such agreements therefore facilitate the raising of environmental standards through horizontal action taken by market players themselves. Although cost internalisation is the optimal theoretical solution to the externalities problem, given the practical difficulties in internalising cost on a vertical level through government regulation, environmental agreements might be a second best solution.

Agreements between firms related to environmental standards do, however, pose various problems in terms of competition law. Before attempting to shed light on these problems, an overview of the development of the Community's environmental policy will be given, paying special attention to areas which are relevant for the subsequent analysis of the treatment of environmental agreements under competition law.

## 2. DEVELOPMENT, OBJECTIVES AND INSTRUMENTS OF EC ENVIRONMENTAL POLICY

### 2.1. The environment in the Treaty

The environment finds no mention in the Treaty of Rome of 25 March 1957. This is partly due to the fact that the aims of the European Economic Community (EEC) were intended to be of an economic nature. A second explanation is that the inextricable link between economic progress and environmental pollution was not realised at the time.<sup>50</sup> Only after the occurrence of phenomena such as acid rain and its link to pollution by emissions was there an awareness of the connection between economic development and environmental degradation. Public pressure was then enough to put the environment on the political agenda. Thus, the first environmental action programme was adopted on 19.7.1973, covering the years 1973 to 1976.<sup>51</sup> This programme, and those that followed, constituted a political framework for Community environmental policy without amounting to a legal basis for action on the part of the Community organs. As for the legal basis of Community environmental measures, these could be taken under Article 100 and 235 ECT, but only to the extent necessary for the realisation of the other policies within the Community's sphere of competence.

A turning point was the adoption of the Single European Act in 1987. An explicit legal basis for EC environmental policy and a definition of its objectives was provided for in Articles 130r-t.<sup>52</sup>

Article 130r para 2, the so-called 'Querschnittsklausel' or 'integration clause', for the first time required that the environment be a component of the Community's other policies. The essentially economic nature of the Treaty was not to be exchanged in favour of a more comprehensive one until the Treaty on European Union (TEU) signed at Maastricht on 7 February 1992, which declared economic development of the Community to be only one of a number of aims of the Treaty. The newly phrased Articles 2 and 3 EC as well as the

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<sup>50</sup> S. Ball and S. Bell, *Environmental Law* (Blackstone, 1991), 55

<sup>51</sup> OJ [1973] C 112

<sup>52</sup> The new Article 100a also allowed for the introduction of environmental measures for the purposes of the approximation of legislation which directly affects the establishment or functioning of the Internal Market. On the precise functioning of this Article, see e.g. S. Ball and S. Bell, *Environmental Law* (Blackstone, 1991) at 57 et seq. and A. Ziegler, *Trade and Environmental Law in the European Community* (Clarendon Press, Oxford, 1996), 156 et seq.

overall design of the European Union as consisting of three pillars<sup>53</sup>, only one of which still contained an economic agenda, expressly extended the Community's aims beyond what could be viewed as purely economic.<sup>54</sup> Most notably, Article 2 now included environmental concerns alongside economic and social ones, Article 3k providing that the activities of the Community shall include a policy in the sphere of the environment. Article 174 goes on to stipulate that this policy shall aim at a high level of protection of the environment. The importance given to the environment is emphasized in the Treaty of Amsterdam which enshrined the principle of 'sustainable development'.<sup>55</sup> This, combined with the integration clause, provides a strong basis for environmental protection at the European level.

The most recent addition aiming at further environmental protection in the EC is the White paper on Environmental liability of February 2000<sup>56</sup>, which proposes a civil liability regime in respect of environmental damage. Rather than embracing damage solely to persons and property, the proposed regime covers damage to nature so as to make economic actors feel responsible for the impact their activities have on the environment.<sup>57</sup> It calls for a strict liability regime for damage caused by EC-regulated dangerous activities with possible defences, and fault-based liability for damage to biodiversity caused by non-dangerous activities. The White Paper thus primarily aims at implementing the polluter pays principle and the principle that environmental damage should as a priority be rectified at source, which are two of the main principles of international environmental law.

## 2.2. Principles of Environmental Law

### 2.2.1. Principles in the Treaty

#### 2.2.2.1. Sustainable Development

The core principle in the Treaty regarding Community environmental policy is that of sustainable development, which is also one of the main ideas underlying the Fifth Environmental Action Programme. It is listed as one of the Community's tasks in Article 2

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<sup>53</sup> The Communities (i.e. EC, ECSC, and Euratom) are the first of these pillars, Common Foreign and Security Policy (Title V) and Justice and Home Affairs (Title VI) the second and third.

<sup>54</sup> Indeed, it has been argued that while the instruments of European integration may still be economic, its goal is political. (J. Lodge, 'Towards a political union' in *The European Community and the Challenge for the Future*, J. Lodge (ed.), 2<sup>nd</sup> ed., Printer, 1993, 382)

<sup>55</sup> in both Article 2 and 174 EC as well as Article 2 TEU.

<sup>56</sup> White Paper on Environmental Liability COM(2000) 66 final, Brussels, 9

<sup>57</sup> On the way in which this is to be achieved, see critically Poli, Sara, 'Shaping the EC Regime on Liability for Environmental Damage: Progress or Disillusionment?', *European Environmental Law Review*, November 1999, 299

EC and is also one of the objectives of the Common Provisions of the TEU.<sup>58</sup> Article 2 thus prescribes that the Treaty is to 'promote throughout the Community a harmonious, balanced and sustainable development of economic activities, [...] (and) sustainable [...] growth.'<sup>59</sup> Because they are expressed in very general terms, the principles contained in Article 2 do not establish legally binding obligations for the Community.<sup>60</sup> They are not, however, mere policy programmes since they are drawn upon as an interpretative aid when determining the content of other provisions of Community law.<sup>61</sup> Furthermore, if Community organs benefit from a margin of discretion, they may only act in a manner consistent with the goals of the Community which are notably contained in Article 2.<sup>62</sup> The goals listed in Article 2 therefore possess the effect of being legally binding in their function as guiding principles.<sup>63</sup>

Sustainable development has been defined in the World Commission Report on Environment and Development, generally referred to as the Brundtland Report<sup>64</sup>, as the 'development that meets the needs of the present without compromising the ability of the future generations to meet their own needs'. Characteristics of sustainable development as the paradigm of modern environmental policy are that it maintains the overall quality of life, the continuing access to natural resources whilst avoiding lasting environmental damage.<sup>65</sup> In the words of one commentator, sustainable development aims at 'the maintenance of natural habitats and the existing ecological equilibrium in the interest of a balanced long-term coexistence of natural variety, production, and consumption. It thereby aims also at the preservation of natural production factors for future generations and the ecological equilibrium allowing for economic development. By giving environmental

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<sup>58</sup> Article 2, para 1

<sup>59</sup> Note that before the amendment of the TEU by the Treaty of Amsterdam there was only one reference to 'sustainable and non-inflationary growth' in Article 2. These terms and their different language versions have been criticised for their both in the Brundtland Report and by various authors, see e.g. D. Wilkinson, 'Maastricht and the Environment: Implications for the EC's Environment Policy of the Treaty on European Union' (1992) *Journal of Environmental Law* Vol.4 No.2, 223 and S. Bär and R.A. Kraemer, 'European Environmental Policy after Amsterdam' (1998) *Journal of Environmental Law* Vol. 10 No.2, 316. The main point of criticism were that the concept is ambiguous and can at most be considered a compromise to introducing the stricter concept of sustainable development. Any ambiguities and criticisms regarding the concept of sustainable growth were assuaged by the amendment of Article 2 brought by the Amsterdam Treaty which expressly introduced the promotion of a harmonious, balanced and sustainable development of economic activities.

<sup>60</sup> S. Bär and R.A. Kraemer, 'European Environmental Policy after Amsterdam', *supra*, fn. 59 at p. 317

<sup>61</sup> M. Zuleeg, 'Grundsätze: Artikel 2' in H.v.d.Groeben, J. Thiesing, C.-D. Ehlermann (Hrsg.), *Kommentar zum EU-/EG-Vertrag* (Nomos Verlagsgesellschaft, Baden-Baden, 1999), 1/181

<sup>62</sup> *ibid.*, 1/181

<sup>63</sup> 'rechtsverbindlich steuernde Wirkung', *ibid.* 1/181

<sup>64</sup> World Commission Report on Environment and Development (Chaired by Gro Harlem Brundtland) *Our Common Future* (Oxford: Oxford University Press, 1987)

<sup>65</sup> Fifth EC Environmental Action Programme, 'Towards Sustainability: A European Community Programme of Policy and Action in relation to the Environment and Sustainable Development', COM(92) 23 final, Brussels, 27 March 1992, p.18

resources their just price and value, the principle of sustainability seeks to preserve their production capacity. '66 Defined in this way<sup>67</sup>, economic development and environmental protection are not mutually exclusive but may eventually be reconciled.

This reconciliation is to be achieved by integrating environmental concerns into all other policies falling into the sphere of competence of the Community, which is required by Article 6.

#### 2.2.2.2 *A special case: the Integration Principle*

The Single European Act introduced with Article 130r para 2 the so-called integration clause which required that the environment be a component of the Community's other policies. The vagueness of this principle was criticised and the Article subsequently modified at Maastricht<sup>68</sup> and Amsterdam.<sup>69</sup> Whereas the original clause read 'Environmental protection requirements shall be a component of the Community's other policies', the Treaty of Maastricht strengthened the principle by requiring that 'Environmental protection requirements *must* be integrated into the definition and implementation of other Community policies.'

This shift in emphasis was intensified by the Treaty of Amsterdam which stressed the importance of the integration principle by severing it from the remaining provision contained in Article 174 (ex Article 130r). The new Article 3c (now Article 6) is exclusively devoted to the integration requirement, including it in the Principles contained in Part I of the Treaty. Furthermore, the clause 'with a view to promoting sustainable development' was added. Sustainable development should thus take concrete form by integrating environmental protection requirements into all the policies listed in Article 3 TEC, with the result that sustainable development is not merely an abstract goal to strive for, but the means of how it is to be achieved are also indicated.<sup>70</sup>

The developments portrayed above lead to the question whether the legal status of the integration clause has changed due to its inclusion amongst the Community Principles. Should this be the case, the next question would be whether this change in position leads

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<sup>66</sup> A. Ziegler, *Trade and Environmental Law in the European Community* (Clarendon Press, Oxford, 1996), 2

<sup>67</sup> An alternative interpretation is to construe sustainable development narrower, so that it covers only ecological objectives. (Udo E. Simonis: 'How to lead world society towards sustainable development?' Forschungsschwerpunkt Technik, Arbeit, Umwelt, Wissenschaftszentrum Berlin, 1998)

<sup>68</sup> For a discussion of the impact of the Maastricht Treaty on environmental policy, see D. Wilkinson, 'Maastricht and the Environment: Implications for the EC's Environment Policy of the Treaty on European Union' (1992) *Journal of Environmental Law* Vol.4 No.2, 221

<sup>69</sup> The impact of the Amsterdam Treaty on environmental policy is discussed in S. Bär and R.A. Kraemer, 'European Environmental Policy after Amsterdam' (1998) *Journal of Environmental Law* Vol. 10 No.2, 315



to the conclusion that environmental protection is to be given priority over other Community policies. This question will be addressed in Chapter 4.2 within the context of the possible conflict between competition and environmental considerations.

### *2.2.2.3. The Principles contained in Article 174 EC*

Article 174 EC lists as objectives of Community environmental policy the preservation, protection and improvement of the quality of the environment and the utilisation of natural resources in a rational and prudent way. These aims are to be achieved by reliance on the precautionary principle and on the principle that preventative action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay.

The precautionary principle, like the principle of prevention discussed below, aims at taking steps to avoid environmental pollution before it has arisen, but it goes a considerable step further. The Rio Declaration states that 'where there is threat of serious or irreversible damage to human beings or the environment, the absence of complete scientific evidence shall not occasion a delay of cost-effective precautions to prevent environmental damage.'<sup>71</sup> The precautionary approach in essence demands that a cautious approach to human interventions is the only permissible one, particularly in ecological systems that are characteristically short of scientific understanding and susceptible to irreversible damage.

Environmental damage should, as the so-called 'proximity principle' dictates, be rectified at source, that is as close as possible to the point of origin. This principle endorses the view that pollution can best be combated both as close as possible to the actual source of pollution, namely at the level of the emitter, as well as at its geographical origin.

The principle often conceived as the one central to modern environmental policy is the polluter pays principle which basically means that the producer of goods should be responsible for the costs of preventing or dealing with any pollution which the process causes. By implication, this involves the notion that governments should not as a general principle give subsidies to companies for pollution control purposes<sup>72</sup> and it necessitates the elimination of the 'hidden' subsidies undertakings obtain when the cost of carrying out

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<sup>70</sup> S. Bär and R.A. Kraemer, 'European Environmental Policy after Amsterdam', *supra*, fn. 59 at p. 318

<sup>71</sup> Principle 25, Rio Declaration

<sup>72</sup> This is the so-called non-subsidisation principle, see D. Gerardin, 'EC Competition Law and Environmental Protection', Paper prepared for the Pallas Conference "EC Environmental Law for the New Millennium" Nijmegen, 12 and 13 May 2000, fn. 10

measures required by public authorities is borne by the public<sup>73</sup>. As laid out in the first Chapter, the polluter pays principle also involves the notion of cost internalisation, shifting the cost of pollution control and prevention from the general public to those agents who are the cause of the pollution, i.e. the producers and consumers of the goods in question.

The polluter pays principle has often been criticised as amounting to a 'licence to pollute'. It has been argued that this criticism is misconceived as the principle does not simply cover the costs related to remedying environmental harm, but also the cost of avoiding it.<sup>74</sup> The latter statement is, however, not entirely convincing, especially in view of the fact that state aid is often granted for the purposes of avoiding pollution, with the result that the costs are in the end borne by the State rather than the polluting party.

The principle of prevention addresses the avoidance of environmental harm and suggests that, rather than repairing the harm done, preventive action should be taken in order to avoid such harm in the first place. This principle posits that environmental policy should not be content with remedying existing damage and fending off concrete dangers, but should tackle the creation of environmental damage before the damage can manifest itself. Some consider the principle of prevention, rather than the polluter pays principle, to be the central principle of environmental policy<sup>75</sup>. One way of assessing the debate is to reason that the two principles, rather than being opposed to each other, are simply addressing different issues: in contrast to the principle of prevention, the polluter pays principle does not concern the content of environmental policy but merely the assignment of costs and the selection of measures. The principle of prevention is addressing the foundations of environmental policy and should thus have priority. This view fails to appreciate, however, the common perception that the polluter pays principle also embraces the notion that the polluter should pay the cost of prevention.<sup>76</sup>

### *2.2.3. The Fifth Environmental Action Programme*

The Environmental Action Programmes expand on the aims of environmental policy as laid down in Article 174 and propose means of implementation. The Fifth Environmental Action Programme of 1992, entitled 'Towards sustainability', represents a milestone in environmental policy as it portrays environmental concern not as a self-contained issue but

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<sup>73</sup> T. Portwood, *Competition Law and the Environment* (Cameron & May, London, 1994), 13

<sup>74</sup> S. Ball and S. Bell, *Environmental Law* (Blackstone, 1991)

<sup>75</sup> E. Rehbinder, 'Self-regulation by Industry' in G. Winter (ed.), *European Environmental Law - A Comparative Perspective* (Tempus Textbook Series on European Law and European Legal Cultures, 1996), 129

<sup>76</sup> S. Ball and S. Bell, *Environmental Law*, supra, fn. 74 at p.85

one that touches upon all areas of the Community. The Programme is based on the principles of sustainable development and the integration of environmental law into all other Community policies, as described above. In order to move 'towards sustainability' the Programme furthermore posits the concept of shared responsibility and a shift from command and control instruments towards market-based instruments.

The shared responsibility approach involves a mixing of actors and instruments at the appropriate levels, leaving intact, however, the allocation of competencies between the EU, the Member States, regional and local authorities<sup>77</sup>. Reliance is placed on concerted action from Community, Member States as well as local authorities, the industry and the general public. With particular reference to industry, this principle 'reflects the growing realisation that industry is not only a significant part of current environmental problems, but must also be part of the solution'.<sup>78</sup>

The sharing of responsibility is to be facilitated by expanding the range of instruments to be applied contemporaneously. To this end, the Programme recommends a mix of four different categories of policy instruments, namely legislative instruments, market-based instruments, horizontal supporting instruments and financial support mechanisms. Horizontal, supporting instruments cover a varied selection of instruments whose common purpose is to underpin Community environmental policy. Examples include the improvement of environmental data and public information as well as scientific research and development objectives. Financial Support Mechanisms constitute the various funds made available at Community level in order to meet the environmental policy objectives, such as the LIFE fund. The minimal, yet tangible, competition law implications of these instruments are beyond the scope of this paper, the focus here being on legislative and market-based instruments, which will be discussed in the next section.

### 2.3. Instruments of environmental policy: regulation vs. market-based instruments

"Environmental problems have traditionally been viewed as unwanted side-effects of economic activities which should be controlled by a range of regulatory measures. A less widely held view is that environmental problems stem from failures within economies - and therefore market-based measures are needed to resolve them. Though the former approach

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<sup>77</sup> R. Khalastchi and H. Ward, 'New Instruments for Sustainability: An Assessment of Environmental Agreements under Community Law' (1998) *Journal of Environmental Law* Vol 10 No 2, 257, 258

<sup>78</sup> *Fifth Environmental Action Programmes*, p.6, para. 19

has dominated EC and Member State environmental policies so far, the balance of view is changing.”<sup>79</sup>

This statement accurately reflects the development of European environmental policy. Once environmental concerns were on the political agenda, ways to deal with them in legal terms had to be devised. After initial attempts to use traditional civil or common law principles were abandoned as inadequate, two strategies to deal with environmental problems more comprehensively were suggested.

The first strategy, viewing pollution as ‘releases into the environment beyond the remedial capacity of the natural environment’<sup>80</sup>, opts for setting qualitative environmental standards to be reached by way of direct control on polluting sources. It thus involves a combination of standards, controls and prohibitions. This system of command and control regulation fitted rather well with traditional patterns of government regulation and was thus relatively easy to put into place.

The second strategy started with a concept of environmental damage as an external cost of economic activities, as described under 1.1.2. As these costs are not properly taken into account by market players, mechanisms should be put into place to correct the resulting market failures. There are a number of such market-based mechanisms which aid this process, namely fiscal incentives and economic instruments such as levies, charges, permits, and state aid.

Due to the failure of the first two strategies to provide for optimal environmental protection, a third strategy, based on the concepts of shared responsibility and sustainable development, was devised. It posits that co-operation between those able to influence the reduction of environmental harm is desirable, the relevant instrument being the relatively novel concept of environmental agreements.<sup>81</sup>

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<sup>79</sup> N. Lee, ‘Environmental Policy’ in M. Artis and N. Lee, *The Economics of the European Union* (Oxford University Press, Oxford, 1994), 238

<sup>80</sup> S. Gaines and R.A. Westin (ed.), *Taxation for Environmental Protection - A Multinational Legal Study* (Quorum Books, New York, 1991), 3

<sup>81</sup> Voluntary environmental agreements are expressly included in the list of instruments of Community environmental policy (p.29 of the Fifth Environmental Action Programme and section 1, Article 3(f) of Decision 2179/98, *supra*, fn. 40)

### 2.3.1. Regulation and economic and fiscal instruments

Economic history teaches that government failures are more frequent than market failures<sup>82</sup>, which is not to say that legislation in form of regulation per se is a bad idea. Environmental regulation commonly establishes fundamental levels of environmental care and protection by way of standards, controls and prohibitions.

The positive points of the traditional regulatory approach and its characteristic command and control nature are that it is transparent and that it provides for accountability and review of administrative decisions. It had been seen as an effective way of ensuring that environmental goals are met but criticisms have been voiced in this respect. It is often argued that laws and regulations cannot, on their own, guarantee the level of environmental protection required.<sup>83</sup>

The fundamental criticism of the instrument of regulation per se is that it is reactive and thus fails to give effect to the principles of sustainable development and prevention. Modern environmental policy should be anticipatory<sup>84</sup>, focusing on agents and activities which deplete natural resources and otherwise damage the environment, rather than waiting for problems to emerge.<sup>85</sup> It should thus be geared towards developing mechanisms to anticipate possible adverse environmental consequences of proposed policies and investments for economic regeneration, employment, technological innovation and project implementation.

A concept originally developed in the field of economics<sup>86</sup> is that of 'regulatory failures'. This includes the idea that the regulator may have a specific interest (e.g. to obtain a position in the regulated industry in the future) and consequently fails to act in accordance with the public interest goal, as well as the lack of credibility of the legislator regarding future commitment, causing industry to abstain from irreversible decisions of compliance.<sup>87</sup>

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<sup>82</sup> Pietros Mavroidis in P. Buiges, A. Jacquemin and A. Sapir, *European Policies on Competition, Trade and Industry: Conflict and Complementarities* (Edward Elgar Publishing, 1995) at 120.

<sup>83</sup> e.g. S. Gaines and R. A. Westin (ed.), *Taxation for Environmental Protection - A Multinational Legal Study*, above, fn. 63, 4 and E. Reh binder, 'Environmental Agreements - a New Instrument of Environmental Policy, Jean Monnet Chair Papers, EUI, 1999/45

<sup>84</sup> Anticipatory environmental policy is geared towards developing mechanisms to anticipate possible adverse environmental consequences of proposed policies and investments for economic regeneration, employment, technological innovation etc. and to invest and/or regulate accordingly now in order to save avoidable future expenses. For further elements of this policy see T. O'Riordan, 'Anticipatory environmental policy' in *Präventive Umweltpolitik*, U. Simonis (Hg.) (Campus Verlag, 1988), 65, 70

<sup>85</sup> Fifth Environmental Action Programme, para. 11

<sup>86</sup> The so-called 'new economics of regulation', see F. Lévêque, 'Externalities, Collective Goods and the Requirement of a State's Intervention in Pollution Abatement', *Nota di Lavoro 20.97 Fondazione Eni Enrico Mattei*, 5

<sup>87</sup> *ibid*, 6

Further criticisms relate to the lengthy procedure associated with regulation. Often, a long time may elapse before new measures are finally put into place as the drawing up of legislation is an extremely time-consuming process, requiring the consultation of interested parties and consideration of numerous issues such as the legality of the proposed measures which may be challenged at any point.

Once a measure is implemented, it needs to be enforced. The nature of environmental protective measures means that they involve an additional cost for industry and are thus not particularly welcomed by the latter. Compliance may not be as prompt as would be desirable. Public authorities are responsible for ensuring compliance, but are often ill-equipped to do so due to a general lack of investigative means. The role individuals play in the enforcement process is important but should not be overestimated as the rights granted to them under national environmental law are usually rather limited.<sup>88</sup>

A further criticism of traditional command and control regulation is that it may 'unfairly infringe upon the market and restrict economic development without providing the best environmental protection'<sup>89</sup>. Regulatory measures fail to take into account the costs of pollution control and prevention which industry faces and do not allow for innovative ways of reaching the set goals. Environmental agreements on the other hand allow undertakings to decide how they will reach the set target without being tied to prescribed methods, thus being more likely to innovate.

With regard to Community regulatory measures, particular problems exist in addition to those traditionally associated with regulation. As the majority of EC environmental measures are directives<sup>90</sup>, they need to be implemented into national law before they can take effect. This often develops into a lengthy process<sup>91</sup>, especially considering that the efforts of the Member States are characterised by insufficient, incomplete and late implementation. The Commission, in its role as watchdog of the effectiveness of Community law, has to ensure that Member States properly implement Community

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<sup>88</sup> Of the Member States, only the Spanish, Portuguese and Greek constitutions contain a reference to the environmental rights of the individual. Among the possible constitutions of accession candidates, the Hungarian, Polish and Bulgarian constitution refer to such a right. If such rights are formulated they are very often more similar to policy statements than to actual rights (J. Brunnee, "Common Interest": Echoes from an empty shell?: Some thoughts on Common Interest and International Environmental Law' (1989) ZAÖRV, 791 at 797)

<sup>89</sup> A. Herrup, 'Eco-labels: Benefits uncertain, Impacts unclear?' (May 1999) European Environmental Law Review 145

<sup>90</sup> see L. Krämer, 'Community Environmental Law - Towards a Systematic Approach', in A. Barav, D.A. Wyatt (Eds.), Yearbook of European Law, 1991 (Oxford 1992), 151-184 at 158

<sup>91</sup> The average time from the date of the initial proposal to the entry into force of an environmental directive is two years, on top of which one can count on average two more years for transposition by the Member States. (P. Baily, 'The Creation and Enforcement of Environmental Agreements' (June 1999) European Environmental Law Review 170, 173 )

measures<sup>92</sup>. The Commission does not, however, dispose of any special investigative powers or of environmental inspectors<sup>93</sup>, the only option often being to open Article 226 (ex Art. 169) proceedings before the ECJ. This procedure is however time-consuming and not very effective. Another limited way of ensuring enforcement is via individuals who may be able to rely on a Community directive granted the conditions for direct effect are fulfilled<sup>94</sup>.

The overall impression is therefore that traditional tools of environmental policy alone fail to achieve the environmental objectives they were intended to reach. Let it be remarked here that regulation is nevertheless indispensable as an instrument of environmental policy and cannot be replaced completely by 'new' instruments of environmental policy.<sup>95</sup> Regulation provides a framework with regard to performance standards, ensuring a minimum level of formal equality between undertakings thereby preventing market participants from free-riding. Within this framework, economic instruments such as charges, taxes, tradable permits and state aid, are therefore complementary<sup>96</sup> to traditional regulation. At the same time, the 1996 Progress Report on implementation of the Fifth Environmental Action Programme<sup>97</sup> described market-based instruments as 'the most important tool available for future action'.

Charges, levies and taxes generally aim at the internalisation of the environmental impact of a given product or process, usually by means of added cost. The approach taken is one of pricing, allowing for the internalisation of environmental externalities in an optimal way.<sup>98</sup> The alternative is a quantitative approach. Tradable permits, a relatively new instrument, assign polluting capacities to economic agents, who can then trade their remaining quota if they manage to be sufficiently effective and innovative.<sup>99</sup> State aid is granted in the form of subsidies, soft loans and tax breaks to both producers and

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<sup>92</sup> Article 211

<sup>93</sup> Krämer, *supra*, fn.90, at 169

<sup>94</sup> On the conditions for direct effect in general and for the debate whether individual rights, which are rarely accorded by environmental measures, are a prerequisite for direct effect in particular see M. Lenz, D.S. Tynes, L. Young, 'Horizontal what? Back to basics' (2000) 25 E.L.Rev. 43

<sup>95</sup> In areas of high risk, such as pollution which can have profound influences on human health as well as on the environment, the role regulation plays is indispensable.

<sup>96</sup> In the Fifth Environmental Action Programme, the 'top down' approach of regulation and the 'bottom up' approach suggested in the Programme are described as 'complementary'. (p.9, para. 34)

<sup>97</sup> Communication from the Commission, 'Progress Report on implementation of the European Community Programme of Policy and Action in relation to the environment and sustainable development „towards sustainability, COM(95) 624, Brussels, 1.10.1996 under the 'Summary of Progress', para. 5

<sup>98</sup> Disagreement exists as to what the optimal tax rate of 'green taxes' is, i.e. where they should be set in relation to marginal environmental damage, see O. Orosel and R. Schöb, 'Internalising Externalities in Second-Best Tax Systems', Working Paper No. 9605, March 1996, Department of Economics, University of Vienna, 1

<sup>99</sup> On the viability of an EU-wide CO<sub>2</sub> permit market, see 'Preliminary Analysis of the Implementation of an EU-Wide Permit Trading Scheme on the CO<sub>2</sub> Emissions Abatement Costs Results from the POLES model, Institute for Prospective Technological Studies (IPTS), April 2000

consumers in order to cause an orientation towards environmentally-friendly products and means of production<sup>100</sup>. All of the above market-based instruments may have a considerable impact on competition<sup>101</sup>.

Economic and fiscal instruments have several advantages,<sup>102</sup> such as the allowance for cost internalisation as discussed under 1.1.2. However, apart from the difficulty associated with their practical ability to internalise externalities, these instruments have also been criticised on other accounts.<sup>103</sup> A comprehensive analysis of the criticisms levelled at each individual instrument is not necessary here. It is submitted that these types of market-based instruments may well be effective tools of environmental policy in their own right. Their major shortcoming is, however, that they do not present a sufficient incentive for the considerable changes needed in order to reach sustainable development.

Firstly, economic and fiscal instruments arguably only indirectly encourage a fundamental change in attitude of the industry towards environmental pollution. As their proceeds still partly flow into funds which will be used to remedy environmental harm, their focus is at least partially on already pre-existing damage.<sup>104</sup> Only eventually will these instruments set the signals needed for a sustainable development of the economy.

On the same note, it is worth remarking that the above-mentioned economic and fiscal instruments still involve a top-down approach which is not dissimilar to regulation. They do not allow for the co-operative approach needed in order to speed up the process of integrating the environment into economic processes. This point is addressed by environmental agreements, whose suitability as instruments of modern environmental policy will be discussed below.

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<sup>100</sup> Examples include subsidies to encourage consumers to fit catalytic converters to their cars in, e.g. Germany, Denmark and the Netherlands. The granting of state aid at the Community level is governed by the Guidelines on State Aid for Environmental Protection [1994] OJ C72/3-9

<sup>101</sup> See e.g. M. Hägglöf, *Emissions trading and competition law: refusal to supply marketable pollution permits* (Florence, EUI, 1999) on tradable permits. With regard to state aid, Article 87 and the Guidelines on State Aid for Environmental Protection [1994] OJ C72/3-9 set out which forms of aid are compatible with the Common Market and with competition. see further A. Ziegler, 115-127.

<sup>102</sup> With regard to 'green taxes' it is often argued that they do not only improve the quality of the environment but also reduce distortions of the existing tax system (the so-called 'double-dividend hypothesis'), see O. Orosel and R. Schöb, 'Internalising Externalities in Second-Best Tax Systems', fn. 98 above, at 1

<sup>103</sup> Rehbinder, 258, lists considerable shifts of capital from one economic sector to another, the dislocation of companies to foreign countries and an increase in unemployment among the possible disruptive effects of the new economic instruments.



### 2.3.2. Environmental agreements

There are numerous types of agreement which can be summarised under this heading, ranging from legally binding environmental agreements to non-binding contracts which can be horizontal or vertical in nature and may be concluded at regional, national, Community and international level with or without public authorities as a partner to the agreement. The terminology used to describe such agreements varies, they are often called 'voluntary agreements', 'environmental agreements or covenants' or 'self-restriction agreements' (Selbstbeschränkungsabkommen). In fact, the definition and delineation of the different categories of agreement is not very clear, which makes it difficult to take a stance regarding the substantive policy towards such agreements.<sup>105</sup> What unites the various categories of agreements is that they are voluntarily concluded and generally designed to promote a pro-active approach to environmental policy, an approach which is in tune with both sustainability and the principle of prevention as enshrined in the Treaty. The agreements may concern, for example, the use of certain types of material, the setting of technical product standards and security standards, waste reduction as well as recycling and waste disposal facilities.<sup>106</sup>

The classification adopted here will be to distinguish between two types of agreement.<sup>107</sup> The first type of accord is concluded expressly for the benefit of the environment between undertakings and public authorities. The second type also explicitly aims at the reduction of harm to the environment but is concluded between private parties without any involvement on the part of the state.

The term 'environmental agreement' is generally understood to refer to the most common type of agreement, which is concluded between a public authority and a branch of industry, the former setting targets and the latter being able to self-regulate the achievement of these targets within a certain framework. At the end of 1997, virtually all Member States<sup>108</sup> had concluded such agreements, the numbers varying from less than

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<sup>104</sup> 'Charges and levies...have been developed in the past *primarily* to create the necessary funds for clean-up operations and infra-structures...such charges should be *progressively reorientated* towards discouraging pollution at source and encouraging clean production processes.' (Fifth Environmental Action Programme), 67

<sup>105</sup> see E. Reh binder, 'Environmental Agreements - a New Instrument of Environmental Policy', *Environmental Policy and Law*, 27/4 (1997) 258, at 260

<sup>106</sup> K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997), 126

<sup>107</sup> For further methods of classification see P. Baily, 'The Creation and Enforcement of Environmental Agreements' (June 1999) *European Environmental Law Review* 170, 171 et seq.

<sup>108</sup> except Greece; see COWI Consulting Engineers and Planners, *Study on Voluntary Agreements concluded between Industry and Public Authorities in the Field of the Environment, Final Report for the European Commission, Directorate General III.01 - Industry, Contract No. EDT/95/84043, 1997*

five<sup>109</sup> to over one-hundred<sup>110</sup>. The legal form of these classic environmental agreements used to be mainly non-binding but there has been a move towards a more formal and binding approach.<sup>111</sup> Agreements in this form are mainly considered to be policy instruments allowing public authorities to take a more market-based approach to environmental protection.

Once the deficiencies of both economic instruments and of implementation and enforcement of regulatory measures at national and Community level are exposed, it transpires that agreements amongst undertakings setting certain environmental goals or standards play a valuable role in ensuring effective environmental protection in accordance with the principles of EC environmental policy.

The fact that they are based on consensus means that opposition and reluctance to comply on the part of the firms involved may well take place at the negotiation stage, but not when it comes to implementation and enforcement. Environmental agreements may also contribute to easing the administrative and regulatory burden as they bring about effective measures in advance of legislation. They may, under certain circumstances<sup>112</sup>, also be a means for the Member States to implement legislation, for example EC Directives<sup>113</sup>. Furthermore, they promote a pro-active approach which is needed if a structural change of the economy towards sustainability is ever to be achieved.

In fact, environmental agreements constitute a considerable step towards the realisation of a number of principles of environmental law. They contribute to moving towards a policy of sustainable development as they encourage the integration of environmental concerns into trade and competition policy, and are in line with the polluter pays principle.

The main reason for the efficiency of environmental agreements derives from the fact that they are attractive from the point of view of industry itself. Markets are never stagnant and the flexibility of self-regulation pays heed to this. Undertakings are able to reach the goals they have set whilst acting in a market-orientated manner, being able for example to take previous investments or matters of timing into account. As they are accorded a framework within which they can freely decide on how to attain the set goals, they will act in an innovative and cost efficient way. The arising costs can furthermore be allocated in an equitable way amongst participating firms. The fact that the undertakings can organise

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<sup>109</sup> Finland and Ireland

<sup>110</sup> The Netherlands

<sup>111</sup> Communication from the Commission to the Council and the European Parliament on Environmental Agreements, COM (96) 561 final, recital 11

<sup>112</sup> see R. Khalastchi and H. Ward, 'New Instruments for Sustainability: An Assessment of Environmental Agreements under Community Law' (1998) *Journal of Environmental Law* Vol 10 No 2, 257, 261-272

<sup>113</sup> e.g. Directive 88/609 on limitation of emissions of certain pollutants into the air from large combustion plants, OJ C336, 7.12.1988

themselves does not only present an incentive to compliance but also means that they are able to build a front with common interests when dealing with public authorities.<sup>114</sup>

The avoidance of stricter legislation represents an additional plus from the point of view of the undertakings. In comparison with regulation, environmental agreements are not subject to as much political influence and can thus be taken into account as a rather stable variable in terms of business planning.<sup>115</sup>

In view of at least a nascent tendency of consumers to take environmental considerations into account when making a purchasing decision, environmental agreements are also good publicity for the participants and represent a valuable marketing argument. A related point is that environmental agreements in this way contribute to making consumers more sensitive to the problem of environmental externalities, with the result that eventually a change in consumer preferences and behaviour is effected.

Environmental agreements of this kind, however, have also been criticised. They may well turn out to be a way for undertakings to avoid any substantial action being taken if the negotiations are difficult and lead to the postponement of the implementation of effective measures.<sup>116</sup> In order to prevent this from happening, a general target as well as methods of accountability should be set out by legislation and the negotiation process governed by legally established procedures which set definite time-limits. The procedure should also provide for a sufficient degree of transparency and involvement of the public in order to ensure that the standards are not lowered to an unacceptable level during the negotiation. This is especially necessary in order to be able to meet the criticism that the increasing reliance on environmental agreements leads to a loss of democratic rights<sup>117</sup>. A related concern is that legal certainty and particularly the possibility of judicial control is jeopardised. It is thus desirable that private actions will not fully substitute classical environmental legislation in the future, but that the policy maker is able to find the best mix.

Enforcement is another problematic issue as the absence of enforcement mechanisms and sanctions means that there is no sufficient deterrent to ensure that the parties comply.

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<sup>114</sup> R. Jacobs, 'EEC Competition Law and the Protection of the Environment', (1993/2) *Legal Issues of European Integration*, 37 at 43

<sup>115</sup> P. Baily, 'The Creation and Enforcement of Environmental Agreements' (June 1999) *European Environmental Law Review* 170, 173

<sup>116</sup> P. Baily, *ibid.*, points out, however, that the process of negotiating and implementing an agreement may possibly take longer than regulation would have.

<sup>117</sup> Consulting Engineers and Planners, Study on Voluntary Agreements concluded between Industry and Public Authorities in the Field of the Environment, Final Report 1997, COWI Consulting Engineers and Planners, Study on Voluntary Agreements concluded between Industry and Public Authorities in the Field of the Environment, Final Report for the European Commission, Directorate General III.01 - Industry, Contract No. EDT/95/84043, 1997

This applies mainly to agreements which are not legally binding, although even they may involve incentives for compliance such as the prospect of regulatory measures or public pressure, the latter requiring an adequate degree of transparency from the outset. The trend towards legally binding agreements means that undertakings will be less likely to avoid their responsibilities under the agreement, provided that it contains appropriate deterrent provisions.

The main point of criticism, however, is that the bargaining involved in concluding these agreements works to the detriment of effective environmental protection. The level of protection agreed upon always represents a compromise. At least in theory, regulation guarantees higher standards of protection with a greater degree of certainty. This (theoretical) loss in the quality of protection is not acceptable in areas of high risk, for example the discharge of dangerous substances into the sea, but merely in areas where such a measure can significantly contribute to the general process of giving effect to the concept of sustainable development. The widely held view is therefore that regulation cannot and must not be fully substituted by environmental agreements.<sup>118</sup>

The second type of agreement in this context is that which is concluded purely horizontally between a number of undertakings without any involvement of a public authority beyond that of, at most, initiating the whole process. Most of the above arguments justifying 'classic environmental agreements' are also true for voluntary agreements of a purely horizontal nature as they too aid in complementing traditional regulatory mechanisms.

It has been argued that this kind of 'strictly autonomous self-regulation runs counter to the interests of the relevant actors and is contrary to the logic of the market economy'<sup>119</sup>. Nevertheless, such agreements come into being. It cannot be assumed that the participating undertakings, being presumably economically-rational agents, act out of the kindness of their hearts, although it may well be the case that some undertakings have embraced the concept of sustainable development to such an extent as to base an entire agreement on it or at least to let it play a role in the decision-making process. It is however unlikely that the motivation behind these types of agreement is purely altruistic. What one can safely assume is that market participants base their business decisions on economic considerations. A certain strategy will only be followed if the parties are convinced that it will increase their profits. Undertakings may, in view of expected future regulation, aim at

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<sup>118</sup> In its Communication on Environmental Agreements (27 November 1999 COM(96) 561 final) the Commission maintains that legislation is to 'remain the necessary backbone of Community environmental policy' but may be supplemented by environmental agreements as a means of implementation. (p. 6)

eliminating the head-start more environmentally-friendly undertakings will have once the new standards are implemented. The parties involved may also try to gain the competitive advantages that society's increasing appreciation of environmentally friendly products, and the eventual manifestation of this phenomenon in monetary terms, brings with it. And, striking a cynical note, undertakings may also view agreements of this kind as a possibility which allows them to conclude a restrictive agreement which would otherwise not be deemed permissible.<sup>120</sup>

Other common types of agreements are technology transfer agreements and those concerned with research and development, aiming at developing environmentally-friendly products, ways of production or recycling methods. These agreements do not, however, raise the same competition law problems as the above-mentioned agreements since they will usually fall under either the Research and Development Regulation<sup>121</sup> or the Know-How Regulation<sup>122</sup> with the result that the competition rules will not apply to them at all.<sup>123</sup>

For the present purpose, the term 'environmental agreements' will be understood to embrace both agreements between state and industry which are of a public law character and those concluded between a group of undertakings without any or only indirect involvement on part of the state. These agreements can fulfil three distinct functions<sup>124</sup>, namely as a substitute for an environmental law, e.g. if government withdraws or modifies a legislative proposal, as a device for implementing environmental law and policy and thirdly as a device to achieve targets which go beyond existing policy and legislation<sup>125</sup>.

It must be stressed that of interest here is not the precise classification of the different types of accord, but rather what their implications are under competition law. What unites the categories described above is that they all have a horizontal component, in other words they consist of an agreement between undertakings who normally are competing with each other on their respective market. The agreements may therefore partially endanger or restrict competition.

The questions these types of agreement raise in relation to Article 81 are similar, since Article 81 applies irrespective of the fact that the agreement is or is not concluded with any

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<sup>119</sup> E. Reh binder, 'Environmental Agreements - a New Instrument of Environmental Policy', *Environmental Policy and Law*, 27/4 (1997), 258-269 and Jean Monnet Chair Papers, EUI, 1999/45, 259

<sup>120</sup> see the discussion of the CECED decision in Chapter 5

<sup>121</sup> Regulation No. 418/85, OJ L 53/5

<sup>122</sup> Regulation No. 556/89, OJ L 61/1

<sup>123</sup> see I. Pernice, 'Rechtlicher Rahmen der europäischen Unternehmenskooperation im Umweltbereich unter besonderer Berücksichtigung von Artikel 85 EWGV' *EuZW* 5/1992, 139, 141

<sup>124</sup> Cf. ELNI (The Environmental Law Network International): *Environmental Agreements - The Role and Effect of Environmental Agreements in Environmental Policies*, Cameron May, 1998, 28

<sup>125</sup> Both the EACEM and the CECED agreements discussed in Chapter 5 are of this nature.

involvement of the state. What is of interest here is not the role of the state, but the assessment that must be made as to the compatibility of the agreement with Article 81.<sup>126</sup>

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<sup>126</sup> This approach is also taken in the Draft Guidelines on the Applicability of Article 81 to horizontal co-operation, recital 175

### 3. OBJECTIVES OF EC COMPETITION LAW

The treatment of environmental agreements at the European level depends upon the way they are assessed under Article 81 EC. As this Article prohibits restrictive agreements unless they are exempted under Article 81(3), the issue arises whether the fact that the above agreements have beneficial effects for the environment can be taken into account in their assessment under Article 81. The wording of Article 81 fails to address this point explicitly, rendering a grammatical interpretation of this norm futile for the present purpose. Due to the unique nature of the Community and its constantly developing integration, a historical-genetic approach is not particularly helpful here.<sup>127</sup> Thus, the only sensible approach can be a teleological one.

Ascertaining which considerations can play a role under Article 81 thus raises the more general question as to what the objectives of EU competition policy are. This in turn calls into question the purpose and legitimisation of competition policy in a more general sense. The first step is to give an overview of different theories of competition and the economic models they embrace, laying the theoretical foundations for ascertaining what model the Community subscribes to. Subsequently, the place of the competition rules within primary EC law will be analysed in order to determine what aims it pursues.

Building on this, Chapter Four will then address the conflict between Community objectives in general and the objectives of effective competition and environmental protection in particular.

#### 3.1. Theories of competition

##### *3.1.1. Models of competition and their function*

The competitive process is generally understood to be the antagonistic striving of at least two participants to sell goods or services of the same kind to customers in a given

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<sup>127</sup> Ackermann considers that a historical-genetic approach is of little value for three reasons: 1. There is no material for a backward-looking historical analysis as there has not been a supra-national agreement of comparable depth before 2. As the travaux préparatoires are not published, a historical interpretation seems contrary to the wishes of the founders and 3. The continuous process of integration reduces the relevance of the intentions which the founding Member States had when drawing up the competition rules. (T. Ackermann, *Article 85 Abs.1 EGV und die rule of reason* (Carl Heymanns Verlag Köln, 1997), 59

market.<sup>128</sup> This striving aims at acquiring market power; the more market power an economic agent has, the greater his ability to influence the market price of the goods or services he sells.

The concept of market power is central to the development of different theories about what forms of competition are desirable. Numerous models corresponding to divergent competition theories have been developed. Two extreme models are, however, commonly used as the parameter within which those other models are assessed. The two paradigms, perfect competition and monopoly, bear little relation to reality; they merely aid in describing how real markets function and in devising a conception of competition that will lead to optimal outcomes.

#### *3.1.1.1. Perfect competition and monopoly*

Under conditions of perfect competition, there are so many buyers and sellers that a change in the quantity sold or bought by each economic agent is so small relative to the total quantity on the market that it cannot influence the market price. Further characteristics of a perfectly competitive market are that there is free entry and exit, the product is homogeneous, and all buyers and sellers have perfect information. One of the implications of this model is that the individual firm has no choice as to the price it charges its customers<sup>129</sup>. Seeking to maximise profits, it will thus reduce marginal costs until they equal price. This in turn means that no firm makes positive or excess profits, i.e. it makes just enough to cover all factors of production<sup>130</sup> and to stay in the market. Under these circumstances, firms cannot afford to be inefficient as they will be undercut by others with lower costs and will eventually be driven out of the market. The positive aspect of competition is that firms must use the most efficient means of production (productive efficiency), while the quantity of economic resources allocated to different goods and services precisely corresponds to the wishes of the consumers, those wishes being expressed by the price they are prepared to pay on the market (allocative efficiency)<sup>131</sup>. The combined effect of allocative and productive efficiency is thus that society's overall wealth is maximised.

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<sup>128</sup> Although competition law focuses on competition between sellers, the concept logically also applies to buyers. See D.G.Goyder, *EC Competition Law* (Clarendon Press, Oxford, 1998), p.9

<sup>129</sup> The same is true for the amount it pays to its suppliers and workers. F.M. Fisher, *Industrial Organisation, Economics and the Law* (Harvester Wheatsheaf, 1990), 5

<sup>130</sup> In economic terminology, the firm receives its opportunity cost. Since economic profits are defined as revenues minus opportunity costs, the firm makes no profit in economic terms. See also Faull & Nikpay, at 1.54



In terms of market power, firms acting in a perfectly competitive market are at the lowest possible end. The exact opposite is true for the perfect monopoly, which is characterised by conditions under which one economic agent<sup>132</sup> disposes of the 'power to set prices and exclude competitors'.<sup>133</sup> Under a monopoly, the monopolist is the only one offering a particular good. As such, he is responsible for all the output, and as aggregate output determines the price through the relationship of supply and demand, the monopolist will reduce his output in order to raise the price and maximise his profit. Output is thus lower than under perfect competition and consumers are deprived of products they would have been willing to pay for. There is thus allocative inefficiency<sup>134</sup>, the resulting loss often being referred to as the 'welfare cost of monopoly'.

The perfect competition and the monopoly model, apart from being non-existent in economic reality, are prone to a number of criticisms<sup>135</sup>, one of them being that they depend on the assumption that economic agents act purely rationally and always aim at maximising profit. Other motivations, such as focusing on the growth of the undertaking or even possible non-economic factors, cannot be grasped by these models.

It has also been argued that it is not necessarily correct that perfect competition leads to the reduction of costs to a minimum. It may well result in keeping private costs minimal, but this is generally not true for social costs. A further problematic issue is that perfect competition and monopoly are essentially static while competition evidently takes place in time. Since competition law is a dynamic process, firms have no incentive to innovate as the short-term advantage caused by innovation will be eliminated by other market participants who are free to exploit the discoveries made by the firm to their own advantage. Market imperfections such as patents are indispensable for economic progress, yet are not allowed for under the model of perfect competition. The above criticisms have lead to the development of alternative models.

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<sup>131</sup> R. Whish, *Competition Law* (Butterworths,1993), 1

<sup>132</sup> This may be just one undertaking or an association of undertakings.

<sup>133</sup> F.M. Fisher, *Industrial Organisation, Economics and the Law* (Harvester Wheatsheaf, 1990), 9

<sup>134</sup> Usually, this will go hand in hand with productive inefficiency as there is no competitive pressure forcing the monopolist to keep costs at the lowest possible level ('x-inefficiency').

<sup>135</sup> For comprehensive critical analysis of both theories see e.g. R. Whish, *Competition Law* (Butterworths,1993), 4-10

### 3.1.1.2. *Alternative conceptions of competition*

On the basis of the realisation that market imperfections are necessary, the concept of workable competition was developed as a second-best<sup>136</sup>. In 'Competition as a Dynamic Process'<sup>137</sup> Clark, however, abandons the ideal of perfect competition. The development of what has been termed 'effective competition' aims to integrate Schumpeter's theory of innovation. Competition is defined as a process characterised by incessant 'moves and responses';<sup>138</sup> market deficiencies and monopolistic elements are accepted as part thereof. On the precise definition and content of workable and effective competition there is still no consensus<sup>139</sup>. Their central concern is to determine which market imperfections are permissible in order to allow for effective competition.

In devising a concept of effective competition, the Harvard School in essence focuses on the structure, performance, conduct paradigm, from which it follows that it is not the behaviour of the individual firm but the structure of the market that determines the attribution of market power.<sup>140</sup>

This approach was criticised by the Chicago School which returned to the model of perfect competition, but allowed for certain market deficiencies. Its supporters propose that the competitive process will eventually cause some companies to become superior in terms of efficiency, and thus lead to higher market concentration. Concentration is not deplorable as long as efficiency is maintained, and government interference is thus kept to a minimum.

The so-called Austrian school views the competitive process in essence the way Clark did<sup>141</sup>. It focuses on the concept of 'Wettbewerbsfreiheit' or the freedom to compete, which involves freedom of action on the part of individuals and the wide dispersion of economic power. In contrast to the concepts of competition described above, the Austrian one does not aim at determining market results with the greatest precision possible. Rather, the competitive market itself is viewed as the process leading to the discovery of market results<sup>142</sup>.

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<sup>136</sup> I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, 5. Auflage, Lucius & Lucius, 1996, 10

<sup>137</sup> J.M. Clark, *Competition as a Dynamic Process* (Greenwood, 1961, reprinted 1980), see further I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, 5. Auflage, Lucius & Lucius, 1996, 10 et seq.

<sup>138</sup> J.M. Clark, *Toward a concept of workable competition*, *American Economic Review*, Vol. 30, 1940, 241

<sup>139</sup> compare Whish, *supra*, fn. 131, 10 and V. Emmerich, *Kartellrecht*, 8. Auflage (C.H. Beck München, 1999), 7

<sup>140</sup> For a detailed account, see J. Faull and A. Nikpay, *The EC Law of Competition* (Oxford University Press, 1999), 5 et seq.

<sup>141</sup> V. Emmerich, *Kartellrecht*, *supra*, fn.139, 9

### 3.1.1.3. The function of competition

The above discussion leads to questioning the function of the competitive process itself. The different schools described above have diverging views on this matter.

Under workable or effective competition, the competitive process is perceived as an instrument for the achievement of aims such as optimal resource allocation, technical progress and consumer sovereignty. There are diverging opinions regarding the emphasis that should be placed on the different aims.<sup>143</sup>

According to the Chicago School the main aim of anti-trust policy is the maximisation of consumer welfare<sup>144</sup>. Thus, in contrast to the Harvard school, economic advantages are understood as accruing to individual market participants rather than to the economy overall. Each individual decides for himself what is good in terms of welfare, with the result that welfare maximisation takes place when demand is satisfied in accordance with consumer preferences, i.e. there is optimal allocative efficiency. The only other aim acknowledged by the Chicago School is that of preserving and increasing firms' productive efficiency.<sup>145</sup> Combining allocative and productive efficiency, the sole goal of competition policy is thus to increase overall economic efficiency.

The Austrian school promotes the view that competition as a discovery process is necessarily bereft of any specific aims, as one cannot in advance decide on a result that is yet to be discovered.<sup>146</sup> Freedom of competition as an individual economic advantage and a Schumpeterian stress on innovation are thus the only discernible aims.

While the Harvard School to a certain extent pays heed to objectives other than strictly economic ones, i.e. promoting the meta-economic goal of diffusing economic power<sup>147</sup>, the Chicago School is vehement in its rejection of considerations other than those aimed at increasing economic efficiency. Bork, for example, is of the opinion that welfare losses, such as pollution, are to be remedied not by competition policy and law but by acts of the legislature<sup>148</sup>. This one-sided approach has been criticised and alternative solutions, such as deeming wealth transfers the central concern of competition policy,<sup>149</sup> have been suggested.

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<sup>142</sup> A. Váth, *Die Wettbewerbskonzeption des Europäischen Gerichtshofs - Eine wettbewerbstheoretische Analyse des höchsten europäischen Gerichts anhand ausgewählter Entscheidungen* (Verlag P.C.O. Bayreuth, 1987)

<sup>143</sup> V. Emmerich, *Kartellrecht*, 8. Auflage (C.H. Beck München, 1999), 7 et sequ.

<sup>144</sup> R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, New York, 1978), 51

<sup>145</sup> R. Lande, 'Chicago's false foundations: wealth transfers (not just efficiency) should guide antitrust', *Antitrust Law Journal*, Vol. 58 (1989) 631, 634

<sup>146</sup> S. Váth, *Die Wettbewerbskonzeption des Europäischen Gerichtshofs* (Verlag P.C.O. Bayreuth, 1987), 28

<sup>147</sup> I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, 5. Auflage, Lucius & Lucius, 1996, 25

<sup>148</sup> R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, New York, 1978), 115

<sup>149</sup> R. Lande, 'Chicago's false foundations: wealth transfers (not just efficiency) should guide antitrust'

The perception that competition policy should not concern itself with considerations other than those of a purely economic nature may be frustrated at times. There may be circumstances under which the line between matters of a purely economic nature and those amounting to a meta-economic, and thus political nature, is difficult to draw.

There largely seems to be a consensus on what the *economic* aims of competition policy are. They are generally listed as the distribution of income according to performance, consumer sovereignty, optimal allocation of resources, flexibility of adaptation and technical progress.<sup>150</sup> Any arguments employed in the competition context which are based on anything going beyond these goals can be considered to be of a meta-economic nature.

However, examining the above aims leads to the realisation that, despite being described as purely economic, even they contain the seeds of meta-economic. The meaning and scope of the term 'technical progress', for example, depends on one's understanding of the word 'progress'. The fact that electricity can be generated from wind energy may represent progress to one person, the progress lying in the fact that electricity is produced without harm or danger to human health and the environment. Another person may consider as progress only methods of energy production which increase output at a lower cost and thus lower price, irrespective of possible environmental or health risks.

Questions of a similar nature may arise in particular in the context of the European Community, especially since there is a legal requirement to integrate concerns other than purely efficiency-based ones into competition policy. Before the consequences of this particular aspect of the Treaty will be discussed below, it serves briefly to portray what conception of competition lies at the heart of European competition law.

### *3.1.2. The European conception*

The Treaty does not expressly prescribe that a specific conception of competition be followed. Article 3(g) prescribes a system ensuring that competition in the internal market is not distorted. Other Articles<sup>151</sup> presume a policy of 'an open market economy with free competition' which favours an efficient allocation of resources<sup>152</sup>. Although the latter criterion sounds suspiciously familiar, it is clear that the general choice of words does not allow for the conclusion that the model underlying European Competition policy is that of

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<sup>150</sup> I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, supra fn. 147, 28

<sup>151</sup> Articles 4 (ex 3a), 98 (ex 102a), 105 EC

<sup>152</sup> Article 105 EC

perfect competition.<sup>153</sup> A precise determination of the positive content of 'an open market economy with free competition' is avoided by determining what behaviour is *not* desirable and to instigate the corresponding prohibitions.<sup>154</sup>

The European Court of Justice and the Commission have repeatedly referred to the concept of effective competition,<sup>155</sup> but have failed to commit themselves to a precise definition to this term.<sup>156</sup> It has been stated that 'although the concept of effective competition lies at the heart of E.C. competition law, its precise definition is hard to pin down.'<sup>157</sup>

The Commission, in its role as the central European competition authority, has used competition law to pursue different policy objectives rather than aiming at the maximisation of consumer welfare in the technical sense alone. Consumer protection in the sense of safeguarding individuals against the power of monopolists or firms which have united their forces by an agreement or merger is often mentioned as one of the policy goals pursued by the Commission.<sup>158</sup> Another objective pursued is the protection of small and medium-sized enterprises (SMEs), usually justified by the argument that this will strengthen the position of European firms both within Europe and in the world.<sup>159</sup> It has thus been stated that European competition policy fulfils an additional and quite different function from 'traditional' conceptions of competition.<sup>160</sup>

### 3.2. The competition rules in context

As noted above the precise determination of the positive content of 'an open market economy with free competition' and the concept of effective competition is avoided by determining what behaviour is *not* desirable and to instigate the corresponding prohibitions.<sup>161</sup> The main rules in this context are Article 81 and 82 as well as the Merger

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<sup>153</sup> S. Bishop and M. Walker, *The Economics of EC Competition Law* (Sweet & Maxwell, 1999), 4

<sup>154</sup> K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997), 34

<sup>155</sup> XV. Competition Report 1985. Whish, *supra*, fn. 131 mentions that the Commission has also referred to workable competition, p. 11.

<sup>156</sup> In relation to the ECJ, see Väh, Andreas, *Die Wettbewerbskonzeption des Europäischen Gerichtshofs - Eine wettbewerbstheoretische Analyse des höchsten europäischen Gerichts anhand ausgewählter Entscheidungen* (Verlag P.C.O. Bayreuth, 1987), 263

<sup>157</sup> S. Bishop and M. Walker, *The Economics of EC Competition Law*, 44

<sup>158</sup> D. Neven, P. Papandropoulos, P. Seabright, *Trawling for Minnows: European Competition Policy and Agreements between Firms* Centre for Economic and Policy Research, 1998), 11

<sup>159</sup> D. Neven, P. Papandropoulos, P. Seabright, *Trawling for Minnows*, 14

<sup>160</sup> R. Whish, *Competition Law* (Butterworths, 1993), 14

<sup>161</sup> K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997), 34

Regulation.<sup>162</sup> Article 81 prohibits as incompatible with the single market agreements that 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.” Article 86 prohibits the abuse of a dominant position in so far as it affects trade between Member States. The Merger Regulation deems concentrations incompatible with the common market which create or strengthen a dominant position “as a result of which effective competition would be significantly impeded”.

The above norms are intended to concretise the content of Article 3 (g), which refers to a “system ensuring that competition in the internal market is not distorted”. The activities referred to in Article 3 in turn serve to reach the goals of the Treaty as set out in Article 2. This does not mean that the Communities’ spheres of activity as set out in Article 3 cannot also be goals in themselves, albeit more restricted ones. Thus, competition law can be seen as an instrument aiding in the attainment of the Treaty objectives while also constituting an aim in itself. This view is mirrored in the 1996 Competition Report which states that Community competition policy is both an autonomous policy of the Commission as well as part of the numerous policy areas of the Union with which it contributes to attaining the Community goals laid down in Article 2.<sup>163</sup>

The first discernible role of the competition rules is the promotion of effective and undistorted competition. This goal has also been described as the “economic goal”<sup>164</sup> of EC competition policy. Competition is accordingly appreciated for the economic effects it has, namely the promotion of “industrial efficiency, the optimal allocation of resources, technical progress and the flexibility to adjust to a changing environment.”<sup>165</sup> The benefits of this competitive process are to accrue to the consumer.<sup>166</sup>

When conceived as an instrument, competition law may fulfil two distinct purposes. In the first scenario, competition law may be viewed as an instrument aiding in the establishment of an Internal Market characterised by the four freedoms. This has also been described as the “integration goal”.<sup>167</sup> The competition rules would thus be part of the general economic policy of the Community, but would not play a role in the attainment of the non-economic goals, i.e. those not connected to the Internal Market, contained in Article 2.

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<sup>162</sup> S. Bishop and M. Walker, *The Economics of EC Competition Law* (Sweet & Maxwell, 1999), 4

<sup>163</sup> XXVI. Competition Report, at para. 2 of the Introduction

<sup>164</sup> S. Bishop and M. Walker, *The Economics of EC Competition Law*, supra, fn. 162, p. 3 et seq.

<sup>165</sup> XXIX. Report on competition policy, 1999, para. 2

<sup>166</sup> XXV. Competition Report, 1996, para. 3.

<sup>167</sup> S. Bishop and M. Walker, *The Economics of EC Competition Law*, supra, fn.162

The second possible role of competition law as an instrument can be seen as contributing to the attainment of any of the objectives contained in Article 2, as far as competition by its nature is able to contribute to their achievement. The competition rules would thus not only aid in the accomplishment of the economic aims of the Community, but could also play a part in reaching other policy objectives contained in Article 2,<sup>168</sup> granted that some sort of interrelation between competition and the relevant policy areas exists.<sup>169</sup>

Depending on which one of the perceptions is accepted, different considerations may play a role in competition law decisions. If competition is perceived as a goal in itself, such decisions must be taken exclusively by referring to economic criteria which dictate what course of action to take in order to maintain the effective competitive process. When competition is viewed as the "motor" of integration, considerations other than economic efficiency may play a role. Thus, the recommended course of action resulting from a decision based on the "economic goal" of competition may differ from that reached by taking the "integration" approach,<sup>170</sup> so for example certain practices may run contrary to integration and are thus deemed undesirable despite the fact that they can be shown to improve economic efficiency.

If the competition rules were perceived as an instrument aiding to attain the objectives contained to Article 2, this would entail that these objectives may not be ignored in competition law decisions. While it is not suggested that the aims contained in Article 2 have to, or indeed can always positively be pursued by competition law, it is submitted that the competition rules have to be interpreted with these other policies in mind.

In conclusion, it may be helpful to draw a distinction between the narrow and the wider goals of competition law. The narrow goal of the competition rules would thus simply be the maintenance of competition. Their wider goal would be to ensure that the Internal Market is established, which in turn allows for a development of the Community in accordance with the aims stipulated in Article 2. This approach implies that it would be unrealistic today to demand a "pure" competition law which exclusively serves the securing of effective competition and reinforces the particular nature of the Community, namely the demand that integrational concerns play a role in competition law.<sup>171</sup> It does not, however,

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<sup>168</sup> For a suggestion of this nature see R. Jacobs, 'EEC Competition Law and the Protection of the Environment', (1993/2) *Legal Issues of European Integration*, 37, 48

<sup>169</sup> In the 1996 Report on Competition Policy it is stated that 'competition policy is an integral part of a large number of European Union policies and with them seeks to achieve the Community objectives set out in Article 2 of the Treaty, including...[...].sustainable and non-inflationary growth which respects the environment ....' (para. 2).

<sup>170</sup> S. Bishop and M. Walker, *The Economics of EC Competition Law*, supra, fn. 162, 6

<sup>171</sup> European competition policy also pursues additional goals to those discussed above are, such as the promotion of small and medium-size enterprises (SMEs). These additional goals often have no concrete foundation in the Treaty and are strictly based on the Commission's policy view.

provide a solution in case the goal of effective competition conflicts with one of the goals contained in Article 2, such as environmental protection.



## 4. CONFLICTING OBJECTIVES

### 4.1. The conflict between Community goals

The goals pursued by the European Union are both numerous and wide-ranging, especially after their considerable expansion brought about by the Treaty of Maastricht.

The goals of the Community can be understood to be the tasks enumerated in Article 2, such as the promotion of harmonious, balanced and sustainable development of economic activities and a high level of protection and improvement of the environment. The tasks enlisted in Article 2 are primarily intended as guidance for the political institutions of the EU. They are not, however, of a merely programmatic character<sup>172</sup> as they also serve as an interpretative aid when the content of other Community norms is under scrutiny<sup>173</sup>. Furthermore, they have 'legally-guiding effect' because in situations where Community organs have a margin of discretion they have to use it in accordance with the goals of the Treaty set out, inter alia, in Article 2.<sup>174</sup>

The goals laid down in Article 2 are in the first place to be reached by establishing an Internal Market and an economic and monetary union (EMU). Article 2 thus portrays the Internal Market and EMU as instruments aiding in the attainment of the goals contained therein. The Internal Market and EMU are, however, also perceived as goals in themselves.<sup>175</sup> They are goals which are used as instruments. The objectives in Article 2 are secondly to be attained by implementing the policies or activities referred to in Article 3. As set out above, the goal-instrument paradigm is not a fixed one, so that the activities and policies listed in Article 3 are also perceived as goals in themselves.

Conflicts between these numerous goals are unavoidable.<sup>176</sup> The question thus arises whether the Treaty makes provision for the solution of such conflicts<sup>177</sup> by according

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<sup>172</sup> note that Article 2 has legal effect because in situations where Community organs have a margin of discretion they have to use it in accordance with the goals of the Treaty set out, inter alia, in Article 2. (M. Zuleeg, 'Grundsätze: Artikel 2' in H.v.d.Groeben, J. Thiesing, C.-D. Ehlermann (Hrsg.), *Kommentar zum EU-/EG-Vertrag* (Nomos Verlagsgesellschaft, Baden-Baden, 1999), 1/181

<sup>173</sup> *ibid.*, 1/181

<sup>174</sup> 'rechtsverbindlich steuernde Wirkung', *ibid.*, 1/181

<sup>175</sup> According to Korah, 'market integration has been elevated in competition cases to an aim in itself, particularly in *Consten & Grundig v Commission* (56 & 58/64) [1966] ECR 299. V. Korah, *An Introductory Guide to EC Competition Law and Practice*, 6<sup>th</sup> Ed. (Hart Publishing, Oxford, 1997), 5

<sup>176</sup> Zuleeg in v.d.Groeben/Thiesing/Ehlermann, 1/185, §12

<sup>177</sup> Although such conflicts may entail a simultaneous conflict between the Community and Member, possibly raising questions regarding their respective competences, the focus here will be on the conflict at Community level only.

priority to some goals over others. A literal reading of the Treaty fails to provide a definite answer to this question.<sup>178</sup> A number of views have consequently been formed as to how conflicting goals are to be reconciled.

One approach considers the goals to be of equal importance.<sup>179</sup> The argument is that the additional goals introduced by the Treaty of Maastricht at least cast doubt on the perception that the goal of the Community is primarily the establishment of an Internal Market. Alongside the Internal Market, the goals contained in Article 3 are now explicitly referred to in Article 2, thus elevating their status. Functionally, they are clearly not geared exclusively at the establishment of an Internal Market. The catalogue of goals in Article 3 has been expanded to include goals which constitute 'fundamental principles'<sup>180</sup> such as the strengthening of economic and social cohesion (Article 3k), and notably competition policy (Article 3g) and environmental policy (Article 3k). These fundamental principles are considered to be of equal weight.<sup>181</sup> This means that Community organs are to be obliged to apply a harmonious interpretation of these goals, ensuring as far as possible the realisation of each goal without completely sacrificing any one of them.<sup>182</sup>

A second view is that the Treaty can be interpreted as establishing a hierarchy of norms which can be instructive in the resolution of conflicts.<sup>183</sup> Precedence is usually assigned to the goals aiming at market integration.<sup>184</sup> The hierarchy approach is based on the perception that the interaction between Articles 2 and 3 and the differing precision of the goals portrayed in the latter as well as their degree of independence, enforceability and procedural facilitation allow for a conclusion regarding the precedence of goals of market integration over others.<sup>185</sup>

The conclusions reached by this approach, namely that goals other than market integration can be taken into account by Community organs only up to the point where this will distort or eliminate, rather than promote, those goals which take precedence, cannot be whole-heartedly subscribed to here. Rather, the first approach is endorsed. It is primarily submitted that in the Treaty there is no discernible intention of having a strict

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<sup>178</sup> M. Dreher, 'Der Rang des Wettbewerbs im europäischen Gemeinschaftsrecht' (1998) 7 and 8 WuW 656,657

<sup>179</sup> see e.g. Zuleeg, 'Grundsätze: Artikel 2' in H.v.d.Groeben, J. Thiesing, C.-D. Ehlermann (eds.), *Kommentar zum EU-/EG-Vertrag* (Nomos Verlagsgesellschaft, Baden-Baden, 1999), 1/185

<sup>180</sup> 'Grundsatzcharakter', U. Immenga, 'Wettbewerb contra Industriepolitik nach Maastricht', 16

<sup>181</sup> U. Immenga, 'Wettbewerb contra Industriepolitik nach Maastricht', 16

<sup>182</sup> This approach corresponds to the German legal concept of 'praktische Konkordanz'. See Mestmäcker 'Bedeutung der Wettbewerbsregeln in der Wirtschaftsverfassung der EG (Art. 3 lit.g) in Immenga Mestmäcker, 1, 17 § 52

<sup>183</sup> J. Basedow, Zielkonflikte und Zielhierarchien im Vertrag über die Europäische Gemeinschaft, in Due, Ole/Lutter, Marcus/Schwarze, Jürgen (Hrsg.), *Festschrift für Ulrich Everling*, Band I, Baden-Baden 1995, 49, 50

<sup>184</sup> M. Dreher, *supra* fn. 178, and J. Basedow, *supra* fn. 183, 52

hierarchy favouring aims of economic integration to the detriment of the other aims pursued. The dynamic development of the Treaty from an accord aiming primarily at economic integration to one embracing also social, environmental and political goals has not altered this perception. The arguments employed by supporters of the hierarchy are not convincing, especially because some of them may lead to a conclusion opposite to the one they promote. Stated in simplified terms, it is argued that the repetition of market integrating aims in Articles 3(c) and 4 would be meaningless unless intended to emphasise their importance. This argument can, however, also be employed for the purposes of proving quite the opposite, in other words, why should the integration of certain policies into all other community policies be demanded if not to stress their special status?

While it is not disputed that the core of the Community may still relate to aims of an economic and integrational nature, the increased weight given to 'other' considerations means that the latter may, under certain circumstances, be pursued even where this entails a 'distortion' of the economic goals.

In the following section, it will be analysed why such a view may be particularly valid regarding conflicts between competition and environmental policy.

#### 4.2. Competition and the environment: *competing for priority*

Conflicts between the goals pursued by Competition law and environmental law, as an instance of the rather regular conflict between economic activity and environmental protection in general, are particularly apparent. In practice, they regularly occur in the context of restrictive agreements which aim at decreasing environmental harm, which will be discussed in Chapter Five.

A conflict between two goals raises the question as to their respective legal status. As stated above, a mere reading of the Treaty will not offer a conclusive answer to this question.

Placing the competition rules in their general context has lead some<sup>185</sup> to conclude that competition will take precedence over Community policies which do not aim at the maintenance of a competitive market. The argument starts from the premise that the Treaty, by repeatedly referring to the principle of an open market economy with free competition,<sup>187</sup> explicitly commits to an economic constitution.<sup>188</sup> The central status of

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<sup>185</sup> J. Basedow, *supra*, 183, 50

<sup>186</sup> Notably M. Dreher, *supra*, fn. 178

<sup>187</sup> Articles 4,98,105, 154(2), 157(1)

competition law is deduced from the indispensability of competition for the establishment of such an economic constitution rather than from an analysis of the relation of competition to other Community policies.<sup>189</sup> The consistency with which competition rules prohibit certain behaviour as 'incompatible with the common market' is interpreted as lending support to this view<sup>190</sup>. Even the existence of various integration clauses<sup>191</sup> is said not to detract from the fact that competition is the central principle rather than a mere instrument of the Community's activities.

Such a view seems extreme when considering the position of competition and the environment in the Treaty. Competition finds no mention in Article 2, featuring for the first time in Article 3(g) as one of the policies intended to aid in the attainment of the goals contained in the former. The promotion of environmental concerns on the other hand is listed in Article 2 and is to be achieved by a policy in the sphere of the environment as laid out in Article 3(l). This in itself may not allow for the inference of any definite conclusion<sup>192</sup> but certainly does not point towards competition as the exclusively prevailing goal. The introduction of the integration clause further supports this conclusion.

The requirement to integrate environmental concerns into the other Community policies received special emphasis by being moved from Article 130r para. 2 to Article 6 in the 'Principles' part of the Treaty. This raises the question whether environmental protection goals would now prevail over those pursued by other policies. This view is not endorsed here as according priority to environmental considerations would paralyse the general legislative activity of the Community as virtually every measure of an economic nature has implications for the environment and therefore the overall Treaty objectives would be frustrated.<sup>193</sup> Furthermore, the wording of the clause does not provide for such a far-reaching conclusion: it requires that environmental concerns be 'integrated' into other policies, not that they prevail over them.

In conclusion, while it cannot be denied that the Community is still primarily geared toward goals of market integration in the context of which competition law plays a central

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<sup>188</sup> For a discussion of the economic constitution of the EU with particular emphasis on ordoliberal views, see W. Sauter, 'The Economic Constitution of the European Constitution', *Columbia Law Journal*, Vol. 4, 1998, 27

<sup>189</sup> M. Dreher, *supra*, 178, at p.657-658

<sup>190</sup> M. Dreher, *supra* 178,, at 659

<sup>191</sup> Apart from Article 6, these are notably Article 151(4) dealing with cultural aspects, Article 152(1) on public health, 153(2) on consumer protection and Article 157(3) on industrial policy, although in the latter case the integration requirement is limited by the statement that the measures introduced may not lead to a distortion of competition.

<sup>192</sup> This is especially so in view of the fact that it has been held that one of the goals listed in Article 2 (harmonious development) is said to embrace the competition rules (cf. M. Zuleeg, , 'Gundsätze: Artikel 2', *supra*, fn. 179, 1/182)

role, these goals will not be pursued at any price. The principle of sustainable development requires that economic progress in general take account of the needs of the environment, while the integration clause demands that environmental considerations play a role in competition policy and the rules that give effect to it. To perceive competition as an economic policy exclusively geared toward the achievement of economic goals with other aims being dealt with elsewhere is, not only in Chicago<sup>194</sup>, a common position.<sup>195</sup> However, in the European context and in particular with regard to the increasing emphasis placed on the requirements of sustainable development and the integration principle, such a view can no longer be supported.

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<sup>193</sup> S. Bär and R.A. Kraemer, 'European Environmental Policy after Amsterdam' (1998) *Journal of Environmental Law* Vol. 10 No.2, 315, 319

<sup>194</sup> R.H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (Basic Books, New York, 1978), 115 who is of the opinion that welfare losses, such as pollution, are to be remedied not by competition policy and law but by acts of the legislature.

<sup>195</sup> M. Dreher, *supra*, fn. 178



## 5. ENVIRONMENTAL AGREEMENTS UNDER ARTICLE 81 EC

In Chapter 4 it was established that the Community has ceased to be geared exclusively towards the achievement of goals of an economic nature. The expansion of the aims contained in Articles 2 and 3 of the Treaty has also brought with it the possibility of a conflict between them. While divergent views exist as to how such a conflict should be resolved, it was submitted above that, especially in view of the strengthening of the integration requirement, environmental consideration must be taken into account in competition policy and law and might even entail the use of competition law for environmental purposes. While the previous Chapter focused on the conflict between competition and environmental considerations in the abstract, this Chapter will discuss how the conflict can be resolved in practice.

One manifestation of the conflict between environmental and competition considerations are agreements which on the one hand benefit the environment and on the other hand restrict competition. If these agreements also restrict trade between Member States, they fall to be assessed under Article 81 of the EC Treaty. Article 81 will be outlined before examining how agreements with an environmental component can be dealt with under Article 81.

### 5.1. The functioning of Article 81 EC

#### *5.1.1. Outline of Article 81 EC*

Article 81 is one of the two pillars of the competition rules applicable to undertakings, the other one being Article 82. It is thus central to the establishment of a system ensuring that competition in the Internal Market is not distorted, as required by Article 3(g).

Article 81(1) contains a directly effective<sup>196</sup> prohibition of 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. Pursuant to Article 81(2) such agreements are automatically void.

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<sup>196</sup> e.g. Case 127/73 BRT v SABAM [1974] ECR 51 at 62, para 16 et seq.

Article 81(1) covers both vertical and horizontal agreements, regardless of whether they are legally binding or not.<sup>197</sup> The concept of an 'undertaking' is similarly wide.<sup>198</sup> In order to be caught by Article 81, an agreement must restrict competition to an appreciable extent, a condition which is easily established.<sup>199</sup> The agreement must also have as its object or effect the prevention, restriction or distortion of competition, whereby the term restriction refers to the complete exclusion of competition within a specific market.<sup>200</sup> Articles 81(1)(a-e) contain a non-exhaustive list of agreements that are particularly anti-competitive in nature.

An agreement that falls within Article 81(1) is not necessarily automatically void as stated in 82(2). Rather, it may be exempted under Article 81(3) which explicitly recognises that co-operation between firms may yield productive benefits and thus allows for the exemption of such agreements from the application of Articles 81(1) and 81(2). The agreement, which must first be notified, must fulfil four criteria, two positive and two negative.

Article 81(3) allows for the exemption of an agreement which contributes to the improvement of the production or distribution of the goods or promotes technical or economic progress whilst allowing consumers a fair share of the resulting benefit. However, the agreement must not impose restrictions upon the undertakings which are not indispensable to the attainment of these objectives and which eliminate competition.

The precise content of the above criteria is not determined in the Treaty or any other legal instrument.<sup>201</sup> The practice of the Commission gives, however, an indication of these criteria.

Accordingly, whether any of the benefits, referred to under the heading of improvement of goods or technical or economic progress, are present must be judged objectively rather than from the point of view of the parties to the agreement.<sup>202</sup> Furthermore, the objective advantages must outweigh the detriment to competition caused by the agreement in order to qualify as an 'improvement'. This typically involves the Commission in balancing the relative advantages and disadvantages of the agreement in economic terms.<sup>203</sup> It generally has to be shown that the agreement confers benefits going beyond those which would be expected to result from the competitive process. If market forces alone would not bring

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<sup>197</sup> R. Whish, R. Whish, *Competition Law* (Butterworths, 1993), 191, 192

<sup>198</sup> *ibid* 187-190

<sup>199</sup> R. Greaves, *EC Block Exemption Regulations* (Chancery, 1994), 14

<sup>200</sup> V. Emmerich, *Kartellrecht*, 8. Auflage (C.H. Beck München, 1999), 415

<sup>201</sup> L. Krämer, *Die Integrierung umweltpolitischer Erfordernisse in die gemeinschaftliche Wettbewerbspolitik* in H.-W. Rengeling, *Umweltschutz und andere Politiken der EG* (Carl Heymanns Verlag Köln, 1993), 47, 60, 63

<sup>202</sup> e.g. Cases 56 & 58/64, *Consten and Grundig v Commission* [1966] ECR 299, 348

<sup>203</sup> C. Bellamy and G. Child, *Common Market Law of Competition* (Sweet & Maxwell, 1993), 155



about the desired result, or at least not within an acceptable time-frame, the agreement will be exempted.<sup>204</sup>

Improvements in production have been held to result in numerous circumstances, e.g. where the agreement enables parties to develop a new high technology product, where neither of the parties could have developed the product as quickly and efficiently or where the agreement has led to increased productivity or reduced production costs. Technical progress has been used in a similar context as improvements to production,<sup>205</sup> while economic progress can again embrace a host of agreements.<sup>206</sup> Certain types of agreements, such as joint research and development agreements have been held to contribute to both technical and economic progress.

A fair share of the benefits produced by these agreements must be passed on to the consumer. The term consumer is not to be understood literally. Rather, it embraces all direct and indirect consumers, ranging from those using a good as a production input to those who are the end-users of a product.<sup>207</sup>

With regard to a 'fair share' being passed on, the Commission generally seeks to ensure that the agreement does not merely benefit the parties alone. In practice this means that the parties to the agreement have to show a 'reasonable probability that the benefits to be expected from the agreement will be passed on in reasonable measure to consumers'.<sup>208</sup> Consumers have been said to receive a fair share if they derive a direct benefit under the relevant agreement, such as a new product more quickly or at a lower cost<sup>209</sup> or a product of a higher quality.<sup>210</sup>

Once these criteria are satisfied, it must be shown that the agreement is indispensable for the attainment of the above benefits. This is expressed in the general principle that the parties should adopt the least restrictive approach consistent with reaching the aims the agreement sets out to achieve.<sup>211</sup>

The final requirement of Article 81(3) is that the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question. In essence, the parties thus need to show that there will continue to be lively competition from the other suppliers.

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<sup>204</sup> *ibid.*, 156

<sup>205</sup> *ibid.*, 160

<sup>206</sup> *ibid.*, 161 et seq.

<sup>207</sup> G. Grill, *Artikel 81, C.-O.- Lenz* (ed.) EG-Vertrag, 2<sup>nd</sup> ed. 1999, Bundesanzeiger Köln, §44, 721

<sup>208</sup> C. Bellamy and G. Child, *Common Market Law of Competition*, 163

<sup>209</sup> *Carbon Gas Technology*, OJ 1983 L 376/17

<sup>210</sup> *KSB/Goulds/Lowara/ITT*, OJ 1991 19/25

<sup>211</sup> *ibid.*, 166

The types of exemption that can be granted under Article 81(3) are those applying to an individual agreement and those applying to categories of agreements. The latter are the so-called block exemptions which the Commission may produce with authorisation from the Council<sup>212</sup> and which take the form of Regulations.<sup>213</sup> Agreements within the terms of a block exemption need not be notified to the Commission and are valid without express authorisation. It may thus be extremely worthwhile to draft an agreement so that it satisfies the terms of one of the regulations, even though the latter are rather formalistic.

By virtue of Article 83, directives and regulations to give effect to the principles set out in Articles 81 and 82 may be laid down by the Council. Regulation 17/62<sup>214</sup> provides the procedural framework for the enforcement of these norms. It empowers the European Commission to request information, carry out investigations, impose penalties for transgression of the competition rules and to grant negative clearances and individual exemptions. In order to be able to cope with the large amount of notifications,<sup>215</sup> the Commission produced a number of block exemptions and also took up the practice of concluding cases informally by way of non-binding comfort letters. Additionally, it publishes notices, communications and guidelines which signal 'de facto green light' for certain types of agreement<sup>216</sup>. Nevertheless, a number of procedural criticisms have been raised, centering on the backlog the Commission had run up, the length of procedures, the insufficient transparency, motivation and lack of legal effects of comfort letters.<sup>217</sup>

### 5.1.2. The White Paper

In its White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty<sup>218</sup> of May 1999 the European Commission addresses the above criticisms and suggests the reshaping of the implementation of the European competition rules and, *inter alia*, their decentralised application. Starting point for these considerations was the circumstance that the overburdening of the Commission is already today leading to administrative deficit in the area of enforcement of European competition law. In view of

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<sup>212</sup> Article 83(2)(b)

<sup>213</sup> e.g. Regulation 2779/72, OJ [1972] L 292/23 on Specialization Agreements and Regulation 418/85, OJ [1985] L 51/1 on Research and Development Agreements

<sup>214</sup> Council Regulation OJ 17 /62 Spec. ed. 1959-62, p.87

<sup>215</sup> for a detailed account see D.G.Goyder, *EC Competition Law* (Clarendon Press, Oxford, 1998), 34 et seq.

<sup>216</sup> C.D. Ehlermann, *The Modernization of EC Antitrust Policy - A Legal and Cultural Revolution*, EUI Working Papers, RSC No.2000/17, 7

<sup>217</sup> *ibid.*, 7

the extension of the Community to twenty Member States this situation is likely to intensify. An assessment and prosecution of violations of the competition rules could not feasibly be organised by a central body in an efficient way.<sup>219</sup>

The Commission's central proposal is thus to abandon the current system of notifications and to replace it with a directly applicable exception system, giving direct effect to Article 81(3). Accordingly, the competition authorities and courts of the Member States are to be empowered to effect exemptions. This entails an amendment of Council Regulation 17/62 since it so far prescribes a monopoly to the Commission in this area. It is argued that the decentralised application of the competition rules is feasible because since the implementation of Regulation 17/62 extensive case law has been developed by the Commission and the European Courts which allows for the relinquishment of the concept of exclusive competence as there is sufficient legal certainty concerning the application of the competition rules contained in the Treaty. The Commission may also participate as *amicus curiae* in the proceedings before national courts to ensure a consistent application of the European competition rules.<sup>220</sup>

Especially with regard to possible decentralised exemption decisions it becomes clear that the exact determination of the contents of the competition rules will be the basis for an amendment as promoted by the Commission. In this context the question becomes significant which criteria are to be applied in the process of the assessing an agreement. An interpretation amongst the Member States lacking unity would endanger the future development of the Internal Market and seriously impair legal certainty for undertakings. This risk exists especially with regard to the environmental sector where the legal landscape, and thus national legal traditions which undoubtedly will influence the interpretation of the competition rules by national bodies, of the Member States varies significantly.

The proposals advanced in the White Paper, a comprehensive discussion of which would go beyond the scope of this thesis, has important implications for the assessment of environmental agreements under Article 81. Before these implications can be discussed, the way environmental agreements may to date be dealt with under Article 81 will be analysed.

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<sup>218</sup> White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty, OJ EC No C 132 of 12 May 1999

<sup>219</sup> White Paper, OJ EC No C 132 of May 12 1999, para. 46

<sup>220</sup> White Paper, para. 107

## 5.2. Assessing environmental agreements under Article 81 EC

The potential danger posed by those environmental agreements described in Chapter 2 to effective competition is that they commonly decrease the competitive pressure between the participating parties and may lead to a co-ordination of behaviour which has implications in terms of competition. For instance, agreements could deny access to a market by a non-signatory, prevent a product from penetrating or remaining on a market or fix prices.<sup>221</sup> Any environmental agreement which poses a risk to competition, affects trade between Member States and passes the *de minimis* threshold,<sup>222</sup> falls to be assessed under Article 81 EC.

The structure and functioning of Article 81 potentially provides for a number of diverse options regarding the assessment of agreements which may restrict competition while benefiting the environment.

In the following it will be discussed what these options are and to what extent they allow for environmental considerations to play a role under Article 81.

### 5.2.1. Rule of reason

The rule of reason finds its origin in American antitrust law where it is used to limit the per se prohibition contained in Article 1 of the Sherman Act in case an agreement is deemed 'reasonable'. In essence, it involves a weighing of the expected pro-competitive and anti-competitive effects of an agreement.<sup>223</sup>

It has sometimes been suggested that a rule of reason approach could also play a role in European competition law. This would involve the re-interpretation of Article 81 to include an analysis of the harmful and beneficial effects of an agreement under Article 81(1).

While the merits and demerits of a rule of reason approach under European law cannot be discussed here, it has been suggested that traces of such an approach are to be found in

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<sup>221</sup> This was in fact attempted by the parties to an agreement between undertakings offering tank storage facilities, who decided to increase prices charged by its members to their customers by a uniform, fixed 'environmental charge'. (*Vereniging van Onafhankelijke Tankopstang Bedrijven (VOTOB)* XXII Report on Competition Policy 1992 at paras 177-86.

<sup>222</sup> Commission Notice of 1986 on Agreements of Minor Importance which do not fall within Article 85(1) of the Treaty, OJ 1986 C231/2 based on the legal principles enunciated by the ECJ in *Völk v Vervaecke*, Case 5/69 [1969] ECR 295.

<sup>223</sup> I. Schmidt, *Wettbewerbspolitik und Kartellrecht*, 5. Auflage, Lucius & Lucius, 1996, 144

the case law of the ECJ.<sup>224</sup> This has raised the question of whether environmental considerations can, under a rule of reason approach, be taken into account under Article 81(1). This would mean that agreements between undertakings which are justified for environmental protection reasons and which exhibit substantial environmental benefits in comparison to their restrictive effect on competition would not fall to be considered under Article 81(1) at all.

While some commentators leave open the question of whether the environmental benefits of an agreement may exclude the applicability of Article 81 under a rule of reason,<sup>225</sup> others have denied this possibility.<sup>226</sup> The latter view is to be endorsed. The American rule of reason was developed in the particular context of the per se approach of the Sherman Act which occasioned the need for a rule acknowledging that certain restrictive agreements may nevertheless have pro-competitive effects. As such it is geared exclusively towards competition considerations. While it is left open here whether such an 'economic' rule of reason can be accommodated by Article 81(1), it is submitted that there is no indication that a European rule of reason may embrace environmental considerations.<sup>227</sup> The goals of effective competition and environmental protection are, as submitted above, of equal standing. It is thus submitted, especially in view of the integration principle, that the competition rules are not limited to competition goals. To requiring that environmental considerations play a role in Article 81(1) under a rule of reason approach could lead to a frustration of Article 3 (g). After all, the competition rules still have as their primary aim the maintenance of effective competition within the Internal Market. The sensible solution is thus to subsume environmental considerations under the exemption provided for in Article 81(3), either by way of a block exemption or individual exemptions.

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<sup>224</sup> C. Bellamy and G. Child, *Common Market Law of Competition* (Sweet & Maxwell, 1993), 68 et seq. mention, inter alia, Case 161/84 *Pronuptia* [1986] ECR 353.

<sup>225</sup> I. Pernice, *Rechtlicher Rahmen der europäischen Unternehmenskooperation im Umweltbereich unter besonderer Berücksichtigung von Artikel 85 EWGV*, EuZW 5/1992, 139, 141 and K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997) 161, 162

<sup>226</sup> D. Ehle, *Die Einbeziehung des Umweltschutzes in das Europäische Kartellrecht* (Carl Heymanns Verlag Köln, 1997), 114, 115 and M. Bock, 'Umweltrechtliche Prinzipien in der Wettbewerbsordnung der Europäischen Gemeinschaft', (1994) 2 EuZW 47, fn.16

<sup>227</sup> D. Ehle, *Die Einbeziehung des Umweltschutzes in das Europäische Kartellrecht* (Carl Heymanns Verlag Köln, 1997), 115

### 5.2.2. Block exemption

Article 81(3) EC permits an exemption to be granted not just for an individual agreement but also for a category of agreements. For this purpose, a number of block exemption regulations have been adopted by the Commission. They have the effect that specific forms of behaviour of undertakings are as a rule exempted from the prohibition contained in Article 81(1). Agreements fulfilling the conditions laid down in a block exemption regulation will be deemed automatically exempt and enforceable. The Commission is thus meant to exercise its power to adopt block exemptions only "after sufficient experience has been gained in the light of individual decisions and it becomes possible to define categories of agreements and concerted practices respect of which the conditions contained in Article 85(3) may be considered as being fulfilled", in accordance with Council Regulation 19/65.<sup>228</sup> Once a block exemption is in place, exemptions may legally be granted independently of the fulfilment of the conditions contained in Article 81(3).<sup>229</sup>

To date there is no block exemption for those agreements which have as their aim the protection of the environment but it has been suggested that such an exemption is both necessary and desirable.<sup>230</sup> At present, it is questionable whether the requirement that the Commission shall only adopt block exemptions after sufficient experience regarding the compatibility of a type of agreement with Article 81(3) has been satisfied. There have been a number of Commission decisions which involve agreements benefiting the environment to some extent and which shall be discussed below. As for environmental agreements, there had been a distinct lack of exemption decisions. This was attributed on the one hand to the fact that environmental agreements are not notified to the Commission<sup>231</sup> (this tendency, however, seems to be changing<sup>232</sup>) and on the other hand that 'pure' environmental agreements were rare<sup>233</sup> (this, too, seems to be changing.) Overall, there is an increased awareness of environmental agreements and their implication for competition

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<sup>228</sup> OJ Spec. ed. 1965-66 p.35

<sup>229</sup> K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997), 167

<sup>230</sup> *ibid.*, 172

<sup>231</sup> L. Krämer, 'Die Integrierung umweltpolitischer Erfordernisse in die gemeinschaftliche Wettbewerbspolitik' in H.-W. Rengeling, *Umweltschutz und andere Politiken der EG* (Carl Heymanns Verlag Köln, 1993), 47, 58, 64

<sup>232</sup> e.g. *ZVEI and Arge Bat*, OJ C 172, 6.6.1998, p.13. The parties to the ZVEI and Arge Bat case wish to organise a disposal and recovery scheme for all types of batteries on the German market.

law.<sup>234</sup> On 24 January 2000 the Commission adopted an exemption decision<sup>235</sup> regarding an agreement aimed at reducing energy consumption of domestic washing machines thereby reducing polluting emissions from power generation. Environmental agreements exempted under Article 81(3) may soon become the rule rather than the exception.

Nevertheless, it is questionable whether the decisions taken so far can be considered as amounting to the 'sufficient experience' the Commission should have gained in respect of particular agreements before adopting a block exemption. Admittedly, the number of decisions involving environmental considerations has not been very high and particularly with regard to 'pure' environmental agreements there has been just one exemption decision. Nevertheless it must not be forgotten that only about four exemption decisions are granted each year.<sup>236</sup> Under these circumstances, it would seem difficult to establish a decisional practice that can be considered sufficient. Yet, bearing in mind the low number of exemption decisions effected each year, the fact that the Commission has chosen to exempt an environmental agreement cannot be a coincidence and must be given the weight it deserves. The small number of exemption decisions also raises the question whether cases closed by comfort letter may be considered as part of the Commission's decisional practice for the purposes of meeting the sufficiency criteria. In one recent case closed by a comfort letter, an environmental agreement was considered permissible because it fulfilled the conditions for exemption under Article 81(3)<sup>237</sup> and reported on in the XXVIIIth Report on Competition Policy 1998.<sup>238</sup> Arguably such decisions could be taken into account when determining whether the Commission has built up a sufficiently large decisional practice as a basis for a block exemption regulation.

If the Commission were to adopt a block exemption for environmental agreements in the near future, it must be stressed that the conditions for an exemption must be narrow and precisely defined as the general exemption of these agreements brings with it the risk of abuse.<sup>239</sup>

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<sup>233</sup> K. Rook, *Umweltschutz und Wettbewerb im EG-Recht*, supra, fn. 230, 167

<sup>234</sup> See e.g. Commitment by Japanese and Korean Car Manufacturers to reduce CO2 emissions, IP/99/922, 1 December 1999, which was declared to be compatible with European Competition law.

<sup>235</sup> Case IV.F.1/36.718 *Conseil Européen de la Construction d'Appareils Domestiques (CECED)*, OJ L 187/47, exemption decision of 24.1.2000

<sup>236</sup> V. Korah, *An Introductory Guide to EC Competition Law and Practice*, 6th Ed. (Hart Publishing, Oxford, 1997), 69

<sup>237</sup> Case IV/C-3/36.494 *European Association of Electronics Manufacturers (EACEM) Energy Saving Commitment*, XXVIII Competition 1998

<sup>238</sup> SEC (99) 743 final, para. 130

<sup>239</sup> K. Rook, supra, fn. 230, at p. 172

### 5.2.3. Individual exemption under 81(3) EC

Since the inception of the Treaty, the Community has continuously developed in a direction going beyond the purely economic aims originally intended by the contracting parties. Especially since the amendments undertaken in the Treaty of Maastricht it has emerged that the objective is not merely the development of an economic union, but of a more comprehensive one, embracing, *inter alia*, environmental concerns.

This trend is reflected in the decision-making practice of the Commission which, for want of pertinent cases decided by the ECJ,<sup>240</sup> serves to illustrate the way in which the conflict between competition law and the environment, as manifested in restrictive environmental agreements, has been resolved. In the CECED decision, to be discussed below, a "pure" environmental agreement was exempted for the first time.<sup>241</sup> This development is very recent and was preceded by numerous decisions which demonstrated that environmental considerations could play a role when scrutinising an agreement in order to decide whether it merits an exemption. These cases thus paved the way for the possibility of exempting an environmental agreement under Article 81(3).

From the outset, it is necessary to bear in mind that few exemption decisions have been taken by the Commission overall, let alone exemption decisions in which the grounds were not purely economic. Since the adoption of Regulation 17/62 the Commission has exempted around 230 agreements<sup>242</sup>. In only a handful of these, arguments other than those strictly based on competition considerations, e.g. industrial policy arguments,<sup>243</sup> played a role. Environmental considerations have operated as a factor in favour of granting an exemption in those agreements with positive implications for the environment, but environmental reasons were never the sole or main reason for concluding the agreement. Accordingly, there have been a number of Commission decisions in which, during the examination of an agreement under Article 81(3), environmental benefits incidental to the agreement have been considered alongside the traditional competition concerns.

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<sup>240</sup> D. Ehle, 'Umweltschutz und Wettbewerb', WuW, 1197

<sup>241</sup> Note that the Commission had given negative clearance to an environmental agreement after an Article 81(3) assessment before (Case IV/C-3/36.494 European Association of Electronic Manufacturers (EACEM) Energy Saving Commitment at para. 130 of the XXVIIIth Report on Competition Policy 1998 SEC (99)743 final).

<sup>242</sup> see I. Forrester 'The Modernisation of EC Competition Law', Fordham Corporate Law Institute, 26<sup>th</sup> Annual Conference on International Antitrust Law and Policy, 1999

<sup>243</sup> Recently in Case IV/34.456 *Stichting Baksteen* OJ [1994] L 131/15 which concerned a restructuring agreement of the Dutch brick industry.



It has been pointed out that the assessment of environmental benefits in these decision has been undertaken in such general terms that it is of little analytical use.<sup>244</sup> This is especially true in view of the fact that the recent CECED decision provides comprehensive guidance as to the assessment of environmental benefits under Article 81(3). In the following, there will thus only be given a brief account of some of the more recent decisions.<sup>245</sup>

The *Exxon/Shell*<sup>246</sup> decision concerned a set of agreements between the two parties relating to the establishment of a joint venture specialising in the production of certain chemical substances. In considering whether this agreement would allow a fair share of its benefits to the consumers, the Commission observed that the creation of the joint production venture would permit a reduction in the use of raw materials and plastic waste and the avoidance of certain environmental risks. These factors amounted to something which "will be perceived as beneficial by many customers at a time when the limitation of natural resources and threats to the environment are of increasing public concern."<sup>247</sup>

In the *Assurpol*<sup>248</sup> decision, which concerned a reinsurance agreement for covering certain environmental risks, the Commission considered that this agreement facilitated "the introduction of risk prevention measures which lead to the development of industrial production techniques less hazardous to the environment and conducive to technical and economic progress."<sup>249</sup>

The above decisions fail to address the environment in a systematic way under Article 81(3). In *Exxon/Shell* it is stated that environmental benefits are perceived as beneficial by many consumers. This cannot be equated with the requirement that there is an objective benefit accruing to consumers. Furthermore, the link between the first and the second cumulative conditions of Article 81(3) is not established. In *Assurpol* the Commission summarises risk prevention measures as contributing to technical and economic progress, neglecting the question whether these benefits are passed on to the consumer.

A more comprehensive analysis of the incidental environmental benefits of an agreement is undertaken in the *Phillips/Osram*<sup>250</sup> decision. A joint venture was formed to produce

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<sup>244</sup> L. Krämer, 'Die Integrierung umweltpolitischer Erfordernisse in die gemeinschaftliche Wettbewerbspolitik' in H.-W. Rengeling, *Umweltschutz und andere Politiken der EG* (Carl Heymanns Verlag Köln, 1993), 56

<sup>245</sup> for a comprehensive case analysis see e.g. T. Portwood, *Competition Law and the Environment* (Cameron May, 1994) and K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997)

<sup>246</sup> Decision 94/322, *Exxon/Shell*, OJ 1994, L144/20

<sup>247</sup> para. 71 of the decision.

<sup>248</sup> Decision 92/96, *Assurpol*, OJ 1992, L37/16

<sup>249</sup> para. 38 of the decision

<sup>250</sup> Decision 94/986, *Phillips/Osram*, OJ L 378/37

leaded glass for lamp bulbs, after one of the parents (Osram) decided to close down its facilities which has outlived its economic viability and was not equipped with the necessary means for emissions reduction. Phillips had, however, modern facilities fully equipped for a reduction of air pollution caused by the production of lead glass. The Commission exempted the agreement under Article 81(3), basing its decision on a combination of factors. Under the heading of "improving production or distribution" the Commission considers that the joint venture will result in lower total energy usage and a better prospect of realising energy reduction and waste emission programmes.<sup>251</sup> It also refers to the joint effort of the parties to develop lead-free materials. With regard to the second positive condition of Article 81(3), the decision states that "the use of cleaner facilities will result in less air pollution, and consequently in direct and indirect benefits for consumers from reduced negative externalities. This positive effect will be substantially reinforced when R & D in the field produces lead free material". While the analysis employed by the Commission in this case is technically sound, the result reached has been challenged.<sup>252</sup> It is argued that as the facilities of Osram had reached the end of their economic life, Osram would have had to change the old facilities or build new facilities so as to fulfil the current emission standard requirements. The agreement in fact causes a reduction of environmental harm, but this would have been the case also without the agreement, thus failing to meet the proportionality requirement. This does not, however, invalidate the objective benefits resulting from the development of lead-free materials.<sup>253</sup>

The above cases show a clear tendency on part of the Commission to take the environment into account in the assessment of an agreement under Article 81(3). Environmental protection is seen as accruing to consumers in form of a non-economic benefit. The reasoning employed in the cases differs in its technical soundness and one cannot discern a systematic approach to the assessment of environmental considerations under Article 81(3).

Before embarking upon an analysis of the way in which "pure" environmental agreements are assessed under Article 81(3), it has to be remarked that on numerous occasions, environmental agreements do not fall to be considered under this provision as they are deemed not to cause a restriction of competition as prohibited by Article 81(1) in the first place. One example is the commitment of the Association of European

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<sup>251</sup> para. 25 of the decision

<sup>252</sup> K. Rook, *Umweltschutz und Wettbewerb im EG-Recht* (Schriftenreihe des Arbeitskreises für Europarecht an der Universität Osnabrück, 1997), 208

<sup>253</sup> *ibid.*, 208-209

Automobile Manufacturers (ACEA)<sup>254</sup> to reduce CO<sub>2</sub> emissions from passenger cars by 25% by 2008. The Commission took the view that the agreement did not infringe the competition rules as it sets an average target, leaving each of the members to set its own level, which will encourage them to introduce new CO<sub>2</sub> efficient technologies independently and in competition with one another.<sup>255</sup>

#### 5.2.4. CECED

On 24 January 2000, the Commission for the first time adopted an exemption decision regarding an agreement notified by the *Conseil Européen de la Construction d'Appareils Domestiques (CECED)*. This seminal decision did not come as a complete surprise. The Commission had paved the way for such a decision in the XXVth Report on Competition Policy<sup>256</sup>, where it expressly referred to the way environmental agreements are assessed by the Commission. It was stated that in its assessment the Commission weighs up the restrictions arising out of an agreement against its environmental objectives and applies the proportionality principle<sup>257</sup> in accordance with Article 81 (3). The improvement of the environment counts as a factor under the criterion of 'increase in production or technical and economic progress' contained in Article 81(3). In the XXVIIIth Competition Report the Commission describes two cases<sup>258</sup> which were decided in precisely this manner. These cases were closed by a comfort letter and the CECED was the first published decision in which an exemption was granted primarily for environmental reasons.

This decision concerns an agreement between manufacturers and importers of washing machines who hold in excess of 95% of the European market. The agreement is aimed at reducing energy consumption of domestic washing machines. The principal tool to achieve this is to stop importing and manufacturing the least efficient types of washing machines and to reach a common efficiency standard for the remaining ones. Additionally, the parties have agreed to monitor implementation of the objectives and to promote consumer education and energy-saving technology and techniques. The Commission found that these provisions were unproblematic and that only the production and import restrictions had

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<sup>254</sup> XXVIIIth Report on Competition Policy 1998, para. 131

<sup>255</sup> see also EUCAR, XXVIIIth Report on Competition Policy 1998, para. 132

<sup>256</sup> 1995 Competition Report, paras 83-85

<sup>257</sup> i.e. that the agreement must not impose on the undertakings concerned restrictions which are indispensable to the attainment of these objectives.

<sup>258</sup> EACEM and Valpak, XXVIIIth Report on Competition Policy 1998, para. 130 and 133

the object of restricting or distorting competition<sup>259</sup>. Nevertheless an exemption was granted due to the environmental benefits secured by the agreement.

In the legal assessment of the agreement under Article 81(1), the Commission postulates that by agreeing not to produce or import washing machines belonging to the two least energy efficient categories<sup>260</sup> technical diversity and consumer choice are reduced.<sup>261</sup>

Furthermore, competition between the parties is restricted because the agreement has "the object of controlling one important product-characteristic on which there is competition in the relevant market."<sup>262</sup> Price competition is also distorted as the agreement will "inevitable raise production cost of those manufacturers that used to produce machines which are no longer allowed ... Therefore, in the short term, the agreement is likely to increase the price of those models, and hence the prices of some manufacturers' product ranges, thereby raising their costs and bringing their prices closer to those of competitors."<sup>263</sup> The first condition of Article 81(1) is fulfilled as the agreement has the object of restricting and distorting competition.<sup>264</sup>

The agreement also has an appreciable effect on competition and trade between member states as the number of machines that would not longer be allowed accounts for 10 to 11 % of the Community total in 1997.<sup>265</sup> The geographic effects of the agreement will vary, having the biggest impact in those five Member States where the share of machines with low energy efficiency, and thus the number of machines being phased out, is the highest.

The Commission undertakes a full analysis of the agreement under Article 81(3). It first examines the cumulative conditions of technical or economic progress and a conferment of the benefits on the consumer. It is stated that washing machines which consume less energy are technically more efficient. Reduced electricity consumption indirectly leads to reduced pollution from electricity generation. The Commission then goes on to argue that "the future operation of the total of installed machines providing the same service with less indirect pollution is economically more efficient than without the agreement."<sup>266</sup> This statement is primarily intended to satisfy the proportionality requirement.

Individual economic benefits are said to accrue to the consumer by way of savings on electricity bills. However, the higher price paid by the consumer for the machine will only

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<sup>259</sup> para. 37 of the decision

<sup>260</sup> categories D and G. The categories contained in Directive 95/12/EC (OJ L 136, 21.6.1995, p.1) as amended by Directive 96/89/EC (OJ L 338, 28.12.1996, p.85) range from A to G ('energy categories').

<sup>261</sup> para. 32

<sup>262</sup> para. 33

<sup>263</sup> para. 34

<sup>264</sup> para.37

<sup>265</sup> para.. 45

be recouped after nine to forty months. Under the heading of collective environmental benefits,<sup>267</sup> the Commission invokes the proximity principle. In the same paragraph, it is stated that “although electricity is not a scarce resource and consumption reductions do not tackle emissions at source, account can also be taken of the costs of pollution.”<sup>268</sup> It is not clear why the proximity principle was invoked. The avoidance of external costs could more sensibly be subsumed under e.g. the principle of prevention contained in Article 174. The Commission then goes on to compare the environmental cost avoided with the increased purchasing cost of the individual consumers and concludes that the former are about seven times more than the latter. The conclusion drawn is that “such environmental results for society would adequately allow consumers a fair share of the benefits even if no benefits accrued to the individual consumers.”<sup>269</sup>

The Commission then goes on to consider whether it would be possible to devise less restrictive alternatives capable of producing similar results. With regard to an industry-wide target it concludes that there would be a danger if purchasers with bargaining power could focus their orders on machines in the low energy efficiency categories. This conclusion is sensible as there is, unlike in the CEMEP decision to be discussed below, competition on energy efficiency so that parties will have an incentive to meet the minimum efficiency standard if they are certain that competitors will not meet demand for lower efficiency machines. With regard to information campaigns it is argued that despite the fact that the existing energy label already supplies consumers with the necessary information “external costs are not fully reflected in consumer’s calculations when contemplating a purchase.”<sup>270</sup> The provision of additional information will thus not bring about the desired change in consumer preferences. Eco-labels are also seen as merely complementary as they only apply to those products with the lowest environmental impact in the range. Finally, the agreement does not eliminate competition as various technical means to improve energy efficiency are economically available to all manufacturers, there will continue to be competition on important purchase criteria such as price and about 90% of the market will fall outside the scope of the agreement.

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<sup>266</sup> para. 48

<sup>267</sup> Note that under the recent Draft Guidelines on the Applicability of Art. 81 to Horizontal Co-operation, O.J. C 118/14, 24.4.2000 collective environmental benefits only need to be objectively established if consumers individually do not have a positive return from the agreement under reasonable payback periods.

(para. 186)

<sup>268</sup> para. 55

<sup>269</sup> para. 56

<sup>270</sup> para. 62

When comparing the CECED with a subsequent decision in which the Commission held an agreement not capable of appreciably restricting competition, it emerges that the Commission has now developed a well-structured approach to environmental agreements.

The agreement concluded amongst the members of the European Committee of Manufacturers of Electrical Machines and Power Electronics (CEMEP)<sup>271</sup> aims to increase the energy efficiency of slow voltage motors (SLVs) used for pumps, ventilators and compressors. The instruments involved are the classification and labelling of motors according to efficiency criteria and a commitment by the parties to reduce by at least 50% their joint sales of the least efficient motors. Although not dissimilar to the instruments used in CECED, the ones employed by the parties to the CEMEP agreement differ in one crucial aspect, namely that the parties to the latter agreement retain considerable discretion as to how they contribute to the reaching of the joint target since there is no individual commitment not to import or produce motors belonging to certain energy-efficiency classes. This discretion has led to the conclusion that the agreement does not fall under the prohibition in Article 81(1). Furthermore, the characteristics of the market for washing machines and SLVs differ in one important aspect. While the energy efficiency of washing machines is a product attribute of considerable importance on the market concerned, the same does not apply to the SLV market. Thus, the agreement “actually makes visible a product attribute which allows for product differentiation”<sup>272</sup> and hence has a stimulating impact on the market, with the possible result that the attribute of energy efficiency will become more important in the future. While the CECED agreement is likely to cause a considerable increase in price, the increase in price expected for SLVs is rather low and is not problematic in terms of consumer welfare.

The comparison between the CECED and the CEMEP decision shows that environmental agreements which appear to be very similar in nature may have diverse impacts on competition and may thus fall to be assessed differently in relation to Article 81. The Commission has demonstrated that it has developed a coherent approach to the treatment environmental agreements under Article 81.

The CECED exemption decision illustrates the way in which environmental agreements are examined under Article 81(3) with a view to their possible exemption. The Commission

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<sup>271</sup> Notification pursuant to Art. 19 (3) of Council Reg. 17, OJ C 74 15.3.2000, p.5. Negative clearance by way of comfort letter IP/OO/508 of 23.5.2000.

<sup>272</sup> M. Martínez López, ‘Horizontal agreements on energy efficiency of appliances: a comparison between CECED and CEMEP’, Competition Policy Newsletter, 2000 No.2, 24, 25

clearly “weighs up the restrictions of competition arising out of an agreement against the *environmental* objectives of the agreement and applies the principle of proportionality.”<sup>273</sup>

Such an approach must be welcomed as it corresponds to the general evolution of the Community over time. Since the inception of the Treaty, the Community has continuously developed in a direction going beyond the purely economic aims originally intended by the contracting parties. Especially since the amendments undertaken in the Treaty of Maastricht it has emerged that the objective is not merely the development of an economic union, but of a more comprehensive one, embracing, *inter alia*, environmental concerns.

This evolution is not reflected in the wording of Article 81(3). Originally, this provision was intended to balance the negative effects of restrictive agreements on the Common Market with corresponding economic advantages.<sup>274</sup> These advantages, desirable from the perspective of competition policy, thus found expression in the conditions for exemption from the general prohibition of anti-competitive behaviour.

Just as the Community has progressed from its economic orientation to one embracing societal values, the purpose of Article 81 has not remained static. Whereas restrictions of competition initially could only be justified if they brought about economic advantages, Article 81(3) must today be understood as allowing for restrictions of competition for reasons going beyond the strictly economic, such as environmental protection.

A word of caution must, however, also be raised. The agreement in CECED can be analysed from various angles. At first sight, the decision seems sensible: basically all producers of a good decide to stop the production and import of machines inefficient in energy terms, thus reducing polluting emissions from power generation. The agreement clearly restricts competition but this seems to be outweighed by the environmental benefits of the agreement.

An interesting fact, however, is to be found in para. 10 of the decision which states that “Overall, the situation in the market, which is relatively fragmented, looks depressed compared with both the past and other fast growing markets for other domestic appliances.” The reasons for this are that market “saturation is becoming apparent for washing machines. Equipment to household ratios are becoming stagnant.”<sup>275</sup> Furthermore, “the market is characterised by competition from several large competitors and considerable bargaining pressure from large distribution or buying groups. In previous years, sales of machines have been stable, whilst sales values have dramatically shrunk.

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<sup>273</sup> XXV. Report on Competition Policy, 1995, para. 84

<sup>274</sup> K. Rook, *supra*, fn. 230, 140

<sup>275</sup> CECED, para. 9

Production capacities have been rationalised. On average, production capacities of up to 75% are currently being achieved in the Community.<sup>276</sup>

The product market for washing machines was thus anything but flourishing. One might argue that what the washing machine producers were able to do thanks to the exemption was to give the market a new impulse, to offer only the more environmentally friendly, and more expensive machines, and to push the demand for this product characteristic by means of information campaigns.

It is submitted here, however, that the motivation of the undertakings concluding an environmental agreement should not enter into the assessment of such an agreement under Article 81(3). It serves to remind oneself that firms as rational economic agents will make decisions whose merits will be judged by their success on the market. The central issue of the assessment of an environmental agreement should thus be whether its environmental benefits outweigh its negative impact on competition, irrespective of the precise motivation for concluding the agreement in the first place. What counts is, after all, that it actively contributes to sustainable economic development. This is not to say, however, that environmental agreements may be used to justify excessive raising of prices. Consumer welfare must thus remain central to competition analysis of environmental agreements.

In order to increase the transparency of the functioning of Article 81, the Commission has recently published Draft Guidelines on the applicability of Article 81 to horizontal co-operation.<sup>277</sup> The Draft Guidelines set out to provide an “analytical framework for the most common types of horizontal co-operation agreements”.<sup>278</sup> Amongst them it counts environmental agreements, the definition of which excludes agreements that trigger pollution abatement as a by-product of other measures, i.e. *Phillips/Osram* types of agreement. The Draft Guidelines are exclusively geared at the horizontal aspects of an agreement and are not concerned with the role the state may play in the conclusion of such an agreement. The content of the guidelines draws upon the recent decision-making practice of the Commission as described above. The criteria to be followed under the assessment of an agreement under Article 81(3) are basically identical to those employed in the CECED decision. In fact, the example given at the end of an agreement meriting an exemption is identical to the facts of CECED. The Draft Guidelines make an important contribution towards clarifying how environmental agreements and their potential restrictive effects should be dealt with. Their future usefulness, however, will depend upon which changes the White Paper will bring about, since arguably individual exemptions will

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<sup>276</sup> CECED, para. 10

<sup>277</sup> OJ C 11/14, 27.4.2000

<sup>278</sup> Draft Guidelines, para. 6



not be possible under the new regime. More importantly, the proposed decentralisation may entail that the environmental benefits of an agreement may fail to enter into its assessment.

### 5.3. The future: revisiting the White Paper

The possible options of excluding environmental agreements from the scope Article 81 altogether or to deal with them in Article 81(1) under a rule of reason approach have been dismissed above. Thus, sufficiently beneficial agreements must either be dealt with by way of a block exemption or by individual exemptions, the latter being the approach currently taken by the Commission. The modifications proposed in the White Paper have major implications for the future application of environmental agreements under either of these mechanisms.

The central proposal that the White Paper makes is to abandon the current system of notifications and to replace it with a directly applicable exception system, giving direct effect to Article 81(3), so that any administrative authority, court or tribunal can apply it.<sup>279</sup> This is not unproblematic. The argument is that there is a margin of administrative discretion involved in the application of Article 81(3) by the Commission.<sup>280</sup> The ECJ has held that, as a judicial body, it cannot undertake an assessment of the complex economic facts necessary in the exercise of issuing exemptions, leaving this task exclusively to the Commission.<sup>281</sup> As has become clear from the above analysis of Commission decisions taken under Article 81, the interests to be balanced by the Commission are not necessarily of a purely economic nature, but also involve a policy aspect. While national administrative authorities may be competent to undertake such a balancing act, it is argued that this conclusion is less easily reached in respect of national courts, particularly in view of the fact that the ECJ considers itself incompetent to do so.<sup>282</sup> Thus, Article 81(3) could only be applied by national courts if the Article did not involve a degree of policy discretion. The conclusion reached in this thesis is that this is not the case. The Commission's decisional practice clearly shows that non-competition considerations enter into the analysis,

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<sup>279</sup> C.D. Ehlermann, 'The Modernization of EC Antitrust Policy - A Legal and Cultural Revolution', EUI Working Papers, RSC No.2000/17, 3

<sup>280</sup> R. Wesseling, 'The Commission White Paper on Modernisation of E.C. Antitrust Law: Unspoken Consequences and Incomplete Treatment of Alternative Options', [1999] European Competition Law Review, 421

<sup>281</sup> Cases 56 & 58/64, *Consten and Grundig v Commission* [1966] ECR 299, 341

<sup>282</sup> R. Wesseling, 'The Commission White Paper on Modernisation of E.C. Antitrust Law: Unspoken Consequences and Incomplete Treatment of Alternative Options', [1999] European Competition Law Review, 421, 424

corresponding to the requirement of Article 6 EC that environmental considerations be integrated into the Community's other policies. The impression given by the White Paper, however, is that the Commission endorses a purely economic approach to Article 81(3). It has thus been suggested that "the policy discretion, currently implicit in the application of the paragraph, will gradually dissolve".<sup>283</sup> This development would have implications for the treatment of environmental agreements under Article 81.

Should the national authorities and courts accept the stance taken in the White Paper that Article 81(3) is of a purely economic nature<sup>284</sup> this may entail that considerations of a non-economic nature, such as the aims pursued by Community environmental policy, will not enter into the assessment of an agreement under the said Article. Even if such a "pure" competition policy approach is not endorsed, national courts will not be competent to undertake a balancing of diverging Community goals under Article 81(3).

With a view to environmental agreements, the changes proposed in the White Paper could potentially reduce their chances of exemption under Article 81(3). Despite arguably disposing of a margin of discretion in the same way as the Commission does at the moment, national administrative authorities may be less disposed to take other Community policies into account than the Commission. As the central European competition authority, the Commission is nevertheless not an independent body. Although this fact is not judged favourably by all,<sup>285</sup> it has resulted in the Commission paying heed to the other policies in the pursuit of which it plays a role. A national competition authority, on the other hand, is first and foremost a *competition* authority and thus less likely to integrate environmental concerns into its decision-making processes. If the Commission's view that Article 81(3) aims exclusively at competition concerns, there will be no room for a use of the margin of discretion by national authorities.

It seems therefore that environmental concerns may be even less likely to play a role in decisions of national courts. Considering that the ECJ perceives itself incompetent to assess the content of decisions taken under Article 81(3), it must logically be concluded that national courts also lack the prerequisite competence, so that the positive environmental effects of an agreement may be neglected in its assessment.

Under the system proposed by the White Paper, the assessment of environmental agreements under Article 81(3) may thus be considerably less favourable than it is at present.

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<sup>283</sup> *ibid.*, 425

<sup>284</sup> White Paper, para. 57

<sup>285</sup> M. Dreher, 'Der Rang des Wettbewerbs im europäischen Gemeinschaftsrecht' (1998) 7 and 8 WuW 656-666 is not the only one in favour of the establishment of an independent cartel office at the European level.

Whether positive exemption decisions or even a block exemption for environmental purposes are compatible with the new regime is unclear.

It has been stated that "the direct effect of Article 81(3) will, of course, leave no place for individual exemption decisions or for block exemption regulations in the traditional sense."<sup>286</sup> According to the White Paper, individual positive exemption decisions could be taken by the Commission in exceptional cases in the general interest, notably when a transaction raises a new question. These positive decisions would "confine themselves to a finding that an agreement is compatible with Article 81 as a whole....They would be of a declaratory nature, and would have the same legal effect as negative clearance decisions have at present."<sup>287</sup> It has nevertheless been argued that a positive exemption decision may not only be effective but also have legally binding effect under certain circumstances. This is to be the case if the decision was reached "according to a procedure that allows for a full investigation of the facts and that permits the participation of all interested parties, i.e. also of those who are opposed to a notified agreement."<sup>288</sup> With regard to environmental agreements, this proceduralisation could, for example, mean that the participating parties have to prove that they have actively informed and consulted interested parties.

It has, however, also been argued that under a legal exception system there is logically no place for an exemption.<sup>289</sup> An exemption constitutes a positive administrative act while under a legal exception system only a negative declaration to the effect that there exists no reason to start proceedings with regard to an agreement is possible.

The situation regarding individual positive exemptions can thus at best be described as unresolved. The same is true for group exemptions. According to the Commission these are to play an enhanced role under the new system.<sup>290</sup> The Commission argues that Article 83(2)(e), providing for the adoption of regulations "to determine the relationship between national laws and the provisions contained in this section or adopted pursuant to this Article", allows for block exemptions to continue to be binding. If one takes the view, however, that logically exemptions cannot be effected under the new legal exception system, this would mean that group exemptions in the traditional sense cease to be an

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<sup>286</sup> C.D. Ehlermann, 'The Modernization of EC Antitrust Policy - A Legal and Cultural Revolution', EUI Working Papers, RSC No.2000/17, 33, para. 88

<sup>287</sup> White paper, para. 89

<sup>288</sup> C.D. Ehlermann, *The Modernization of EC Antitrust Policy - A Legal and Cultural Revolution*, EUI Working Papers, RSC No.2000/17, 34, para. 89

<sup>289</sup> A. Deringer, 'Stellungnahme zum Weißbuch der Europäischen Kommission über die Modernisierung der Vorschriften zur Anwendung der Art. 85 und 86 EG-Vertrag' (2000) 1 EuZW 5, 7

<sup>290</sup> White Paper, para. 71, 78, 85, 92b and 95

option, leaving only the option of a 'group negative declaration' which would not be binding on national authorities and courts.<sup>291</sup>

If block exemptions continued to be binding, there may be a case for introducing a block exemption for the environment as discussed above. It is submitted here that any concrete advances in this direction, however, cannot be undertaken unless and until it is clear what type of regime will govern the functioning of Article 81 in the future.

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<sup>291</sup> A. Deringer, *supra*, fn. 289, 7

## 6. CONCLUSION

This paper has set out to examine the interplay between environmental considerations and competition law in the EU, an interplay that involves an examination of the underlying framework behind each policy. Although in the EU competition law has a political dimension, its underlying framework is of an economic nature. On the other hand economic choices are not sufficient to deal satisfactorily with the environment. As emerged from Chapter One, there are inherent difficulties in dealing with the environment from a purely economic point of view since economics can only deal with quantifiable variables whereas environmental externalities are often difficult or impossible to quantify.

Due to these complexities, a number of different ways of dealing with environmental concerns within the framework of a European environmental policy demanding a high level of protection of the environment have been developed. The traditional command and control approach has been supplemented by economic and fiscal instruments which are intended to internalise environmental costs. Despite being valuable environmental policy instruments in their own right, these two approaches face limitations in their success due to problems of implementation and enforcement. A third device has emerged in an attempt to deal with environmental problems, taking an approach which seeks to involve market players more actively. These so-called environmental agreements are generally concluded between firms, with or without the involvement of the state, in an effort to achieve pollution abatement. Such agreements between private parties might, however, have implications in terms of European competition law.

Chapter Three gives an overview of the European conception of competition and the aims pursued by competition law. By placing the competition rules in their legislative context, it becomes apparent that it would be unrealistic today to demand a "pure" competition law which exclusively serves the securing of effective competition. This is especially so due to the requirement contained in Article 6 EC that environmental concerns must be integrated into the definition and implementation of other Community policies, including competition policy. Chapter Four addresses this issue by assessing the relative status of the goals contained in Articles 2 and 3 of the Treaty. It is concluded that the Community goals of environmental protection and effective competition do not stand in a hierarchical relationship. The increasing emphasis that the Treaty places on sustainable development and the integration clause, however, requires that environmental considerations play an important role in competition decisions.

The assessment of environmental agreements in the decision-making practice of the Commission is at the core of Chapter Five. A number of ways of dealing with these agreements within the framework of Article 81 are explored, concluding that such agreements are to be dealt with in terms of an individual exemption, which coincides with the current practice of the Commission. The viability of this approach is, however, called into question in view of the potential impact of the White Paper. It remains to be seen how the White Paper will affect the treatment of environmental agreements by competition law.

The above discourse demonstrates that environmental agreements are a symbol of the interplay between competition law and environmental protection. They allow private actors themselves to engage in reciprocal commitments and in some sense they reintegrate environmental problems into the market sphere. Although the backbone remains regulative, market actors are given a degree of freedom in which to regulate themselves. This freedom is, however, restricted not only by any environmental legislative framework but also from a separate institution since the private action of market players acting co-operatively is itself controlled through competition law. The question then becomes precisely how competition law will deal with such co-operation. Arguably, European competition law is now able and even obliged to accommodate such co-operation within its regulative framework of competition, since according to Article 6 EC environmental policy requirements should be integrated into all of the Community's spheres of activity. It is argued here that EC competition policy should encompass meta-economic principles such as environmental protection in order to facilitate private environmental action that is taken by market players, particularly since private action has certain advantages over conventional approaches to environmental protection.

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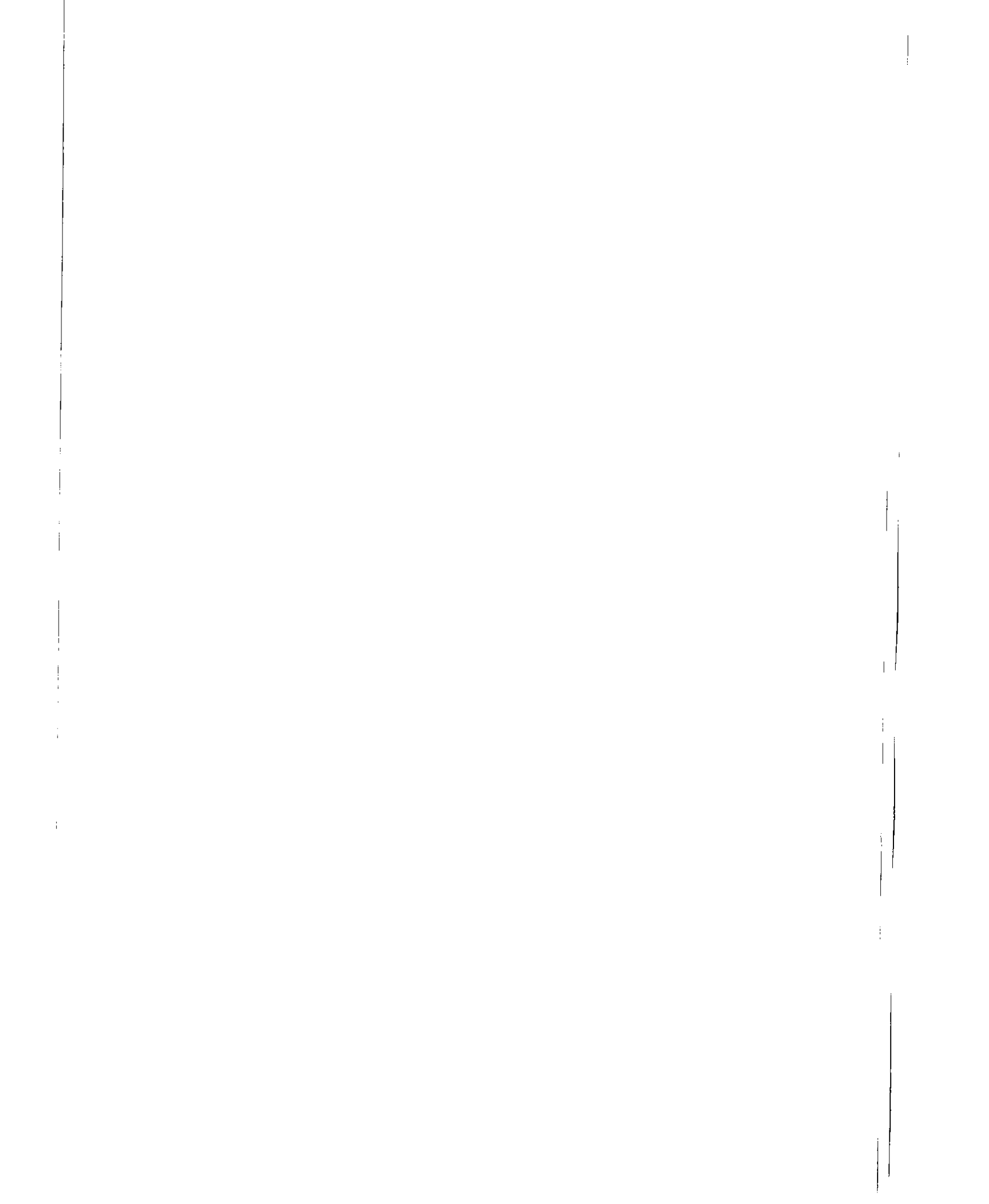
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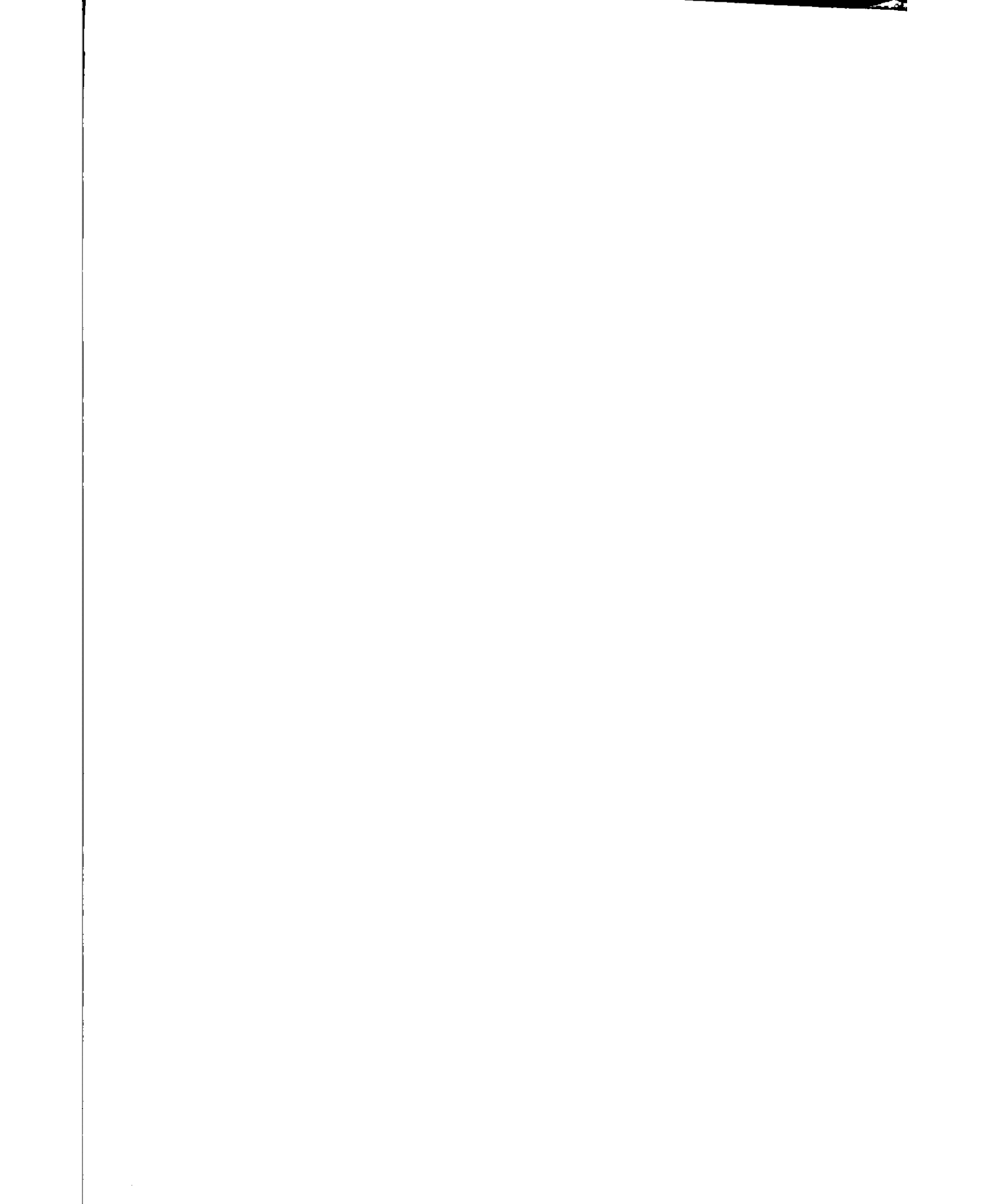


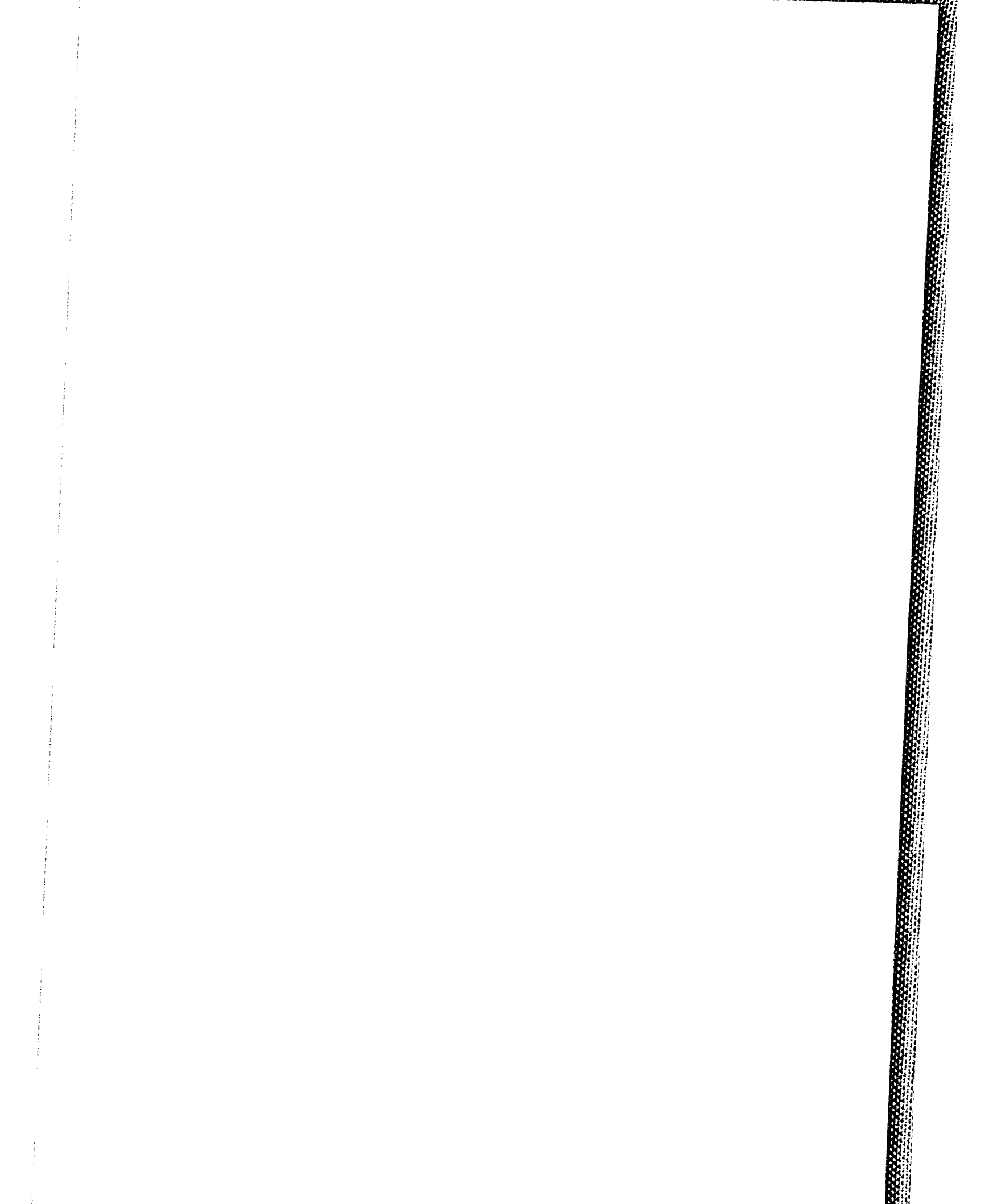


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