ESG and Antitrust: More Focus but No Consensus - Recent Developments, Pitfalls and Mitigating Risk

March 3, 2023

Introduction

Companies, banks, insurers and asset managers are increasingly working together within their industries on environmental, social and governance ("ESG") initiatives to achieve shared goals on climate change, labor rights and other social issues. In the eyes of many, collective action is necessary to move the needle on systemic issues (such as phasing out unsustainable technologies) that individual effort has yet to achieve. As with all collaboration between industry participants, however, ESG initiatives are subject to antitrust laws. Regulators and legislators have recently reinforced this point. Given their focus on this issue, it is important that businesses engaged in joint ESG activities be mindful of attendant antitrust risks. This update provides an overview of recent developments in this space in the United States, United Kingdom and European Union; how antitrust laws may be implicated; and what practical considerations firms can keep in mind as they move to implement ESG policies and initiatives.

Developments in the United States

In the last six months, ESG initiatives and antitrust have come to the forefront of legislative and regulatory policy. In August 2022, 19 state attorneys general wrote to the CEO of BlackRock. Among the activities cited were BlackRock's ESG activities, including its participation in Climate Action 100+, an investor-led initiative that aims to ensure that the world's largest corporate greenhouse gas emitters act on climate change. The cited concerns included the attorneys general's belief that BlackRock's "coordinated conduct with other financial institutions to impose net-zero" emissions commitments could be a violation of Section 1 of the Sherman Antitrust Act.

A month later, during a U.S. Senate subcommittee hearing on antitrust enforcement, Federal Trade Commission ("FTC") Chair Lina Khan and Assistant Attorney General Jonathan Kanter of the Department of Justice's Antitrust Division (the "DOJ") both

confirmed that there is no ESG exception to the antitrust laws. Khan further stated that ESG cooperation or agreements, "in as much as they can affect competition, are always relevant" to the FTC.

In October, 19 state attorneys general issued civil investigative demands to the six largest U.S. banks, seeking documents and information relating to the banks' participation in global climate change initiatives such as the Net-Zero Banking Alliance and the Glasgow Financial Alliance for Net Zero ("GFANZ") based on purported antitrust and consumer-protection concerns. GFANZ subsequently announced that it would no longer require members to participate in the United Nations-backed Race to Zero climate initiative, citing antitrust concerns.

On November 3, 2022, five Republican U.S. senators advised dozens of large law firms to inform clients of "the risks they incur by participating in climate cartels and other ill-advised ESG schemes." The letter emphasized that ESG initiatives could violate federal antitrust law and expressed particular concern about potential anticompetitive effects ESG initiatives may have on the energy sector. Democrats in turn sent letters to law firms challenging the Republicans' stated concerns. Shortly after, D.C. Attorney General Karl Racine and 17 other Democratic state attorneys general wrote to members of Congress, pushing back on Republicans' claims that certain ESG activities violated the antitrust laws.

Following this back and forth, legislators turned their attention to the U.S. antitrust agencies. In December, Republican members of Congress sent a letter to FTC Chair Khan inquiring whether the FTC is using ESG as a factor in merger reviews. The letter asserts two main concerns: First, that the FTC replaced its policy interpreting its statutory mandate to root out unfair methods of competition with one that "relies on a much broader, more amorphous, reading of [its mandate] that can easily be manipulated by the political whims" of the FTC, and second, that merging companies have reported inquiries from the FTC outside the traditional scope of whether consumers have been harmed, including how a deal would affect ESG issues. The letter contends that the FTC's Policy Statement and its reported promotion of ESG criteria in merger reviews could make it less likely that the FTC would "address collusive activities supporting ESG."

Chair Khan recently authored an op-ed in the *Wall Street Journal*, seemingly in response to the congressional inquiry. Khan wrote that the FTC will not refrain from challenging a transaction that it otherwise believes is illegal even if the deal will have positive ESG impact. Khan stated: "The antitrust laws don't permit us to turn a blind eye to an illegal deal just because the parties commit to some unrelated social benefit. The laws we enforce are explicit: They prohibit mergers that 'may substantially lessen competition or

tend to create a monopoly.' They don't ask us to pick between good and bad monopolies."

Most recently, Republican members of Congress sent a letter in December 2022 to executives of the Steering Committee for Climate Action 100+. The letter requested information about ESG-related conduct or agreements that, according to the authors, could be unlawful under U.S. antitrust laws.

Potential Antitrust Liability for ESG Initiatives in the United States

Antitrust laws in the United States are designed to protect competition and prevent companies from engaging in practices or agreements that unreasonably restrict competition. Not all conduct is equally likely to restrain competition. Unilateral conduct—that is, independent conduct undertaken by a single firm—is generally less likely to raise antitrust concerns, particularly where that business entity lacks "market power," which is typically defined as the ability to price at a supra-competitive level. Firms that may have market power should consult with counsel, but most *bona fide* unilateral ESG initiatives are unlikely to create antitrust issues. In the ESG context, an example of unilateral conduct would be a company's independent decision to implement a code of sustainable conduct for its vendors or to choose not to work with any suppliers that do not meet the company's labor rights goals.

ESG antitrust risk instead arises primarily when companies act together. Section 1 of the Sherman Act, Section 5 of the FTC Act and many corollary state laws prohibit horizontal agreements and combinations that unreasonably restrain trade. Whether such coordinated conduct amounts to an unreasonable restraint of trade typically requires a balancing of a restraint's procompetitive benefits with its anticompetitive effects. A select few types of agreements are deemed "*per se*" illegal and not subject to balancing because they are deemed to always be anticompetitive. These include agreements between competitors to fix prices, to allocate markets or customers, to rig bids or to restrict output—coordination that is unlikely to be part of typical ESG initiatives.

Coordinated ESG initiatives are subject to these standard antitrust principles. The types of agreements and collaborations that are likely to create antitrust risk as a matter of U.S. antitrust law and the equivalent competition laws in operation in Europe and elsewhere include:

- **Improper Information-Sharing.** Joint ESG initiatives may involve participants sharing performance information for the purposes of tracking shared goals or

increasing accountability. Firms may also wish to share such information to assist in establishing industry best practices. Companies should be alert to whether the information to be exchanged is competitively sensitive information ("CSI") that will be shared with a competitor. CSI includes—but is not limited to—current and future price information, strategic plans, costs, future product and sales plans and certain customer-specific information such as customer lists and individual discount or rebate levels. Antitrust regulators are likely to scrutinize any collaborations that permit or require the exchange of CSI because such sharing can harm competition and facilitate collusion.

- **ESG Initiatives that Amount to an Unlawful Group Boycott of a Rival.** Firms generally have the right to choose with whom they do business. That is particularly the case when such decisions are made independently. However, a coordinated decision among competitors not to do business with another firm, such as an upstart competitor, or with certain customers or suppliers, may be unlawful in some cases. In the ESG context, this may be the case where adoption of stricter industry standards is a *de facto* method of excluding new competition because only incumbents have the resources to meet such standards. Antitrust laws also prohibit companies from jointly boycotting a competitor indirectly by, for example, collectively pressuring suppliers in the market not to engage with that competitor. In the ESG context, participants in a joint initiative that may have the effect of excluding another firm should ensure that the initiative is undertaken for bona fide, procompetitive purposes in line with objective group goals, rules or guidelines and should consult antitrust counsel before proceeding.

- **ESG Coordination as a Pretext for Collusion.** ESG collaborations may also invite antitrust scrutiny if there is a likelihood that the collaborations may serve as a pretext for competitors to collude and engage in *per se* illegal conduct. For example, detractors have alleged that ESG initiatives offer a forum to participants to improperly agree to not invest in fossil fuels, with the anticompetitive effect of raising prices for consumers. Whether such a claim is cognizable under Section 1 of the Sherman Act remains to be seen, but the cited example reflects how ESG conduct may invite antitrust scrutiny. This may occur particularly in industries that have a history of collusion. Ultimately, the underlying purpose of the collaboration and its legality will be evidenced by factors such as whether it was agreed openly and with stakeholder engagement, economic analysis of whether there has been a market failure needing collective action and the statements of the parties involved.

Overseas Antitrust Regulators' Approach to ESG

In contrast to the United .States, a number of European authorities have developed, or are in the process of developing, guidelines and guidance to actively encourage genuine ESG-focused initiatives and provide comfort to businesses that their agreements will not fall foul of antitrust rules.

At the EU-level, the European Commission has added a separate chapter on sustainability agreements to its revised horizontal block exemption regulations and guidelines (expected to enter into force in July 2023) (the "Guidelines"). The term "sustainability agreement" refers to "any type of horizontal cooperation agreement that genuinely pursues one or more sustainability objectives, irrespective of the form of cooperation… encompassing activities that support economic, environmental and social (including labor and human rights) development." Conscious of attempts at "green-washing," it remains the case that sustainability agreements that restrict competition "by object" (i.e., those that are *per se* illegal) will continue to be prohibited. That would catch, for example, an agreement between competitors on how to translate the increased costs resulting from their mutual adoption of an ESG standard into increased sale prices. However, the Guidelines contain helpful examples of agreements that either are incapable of raising competition law concerns or that will benefit from a newly created "soft safe harbor" (where certain cumulative conditions are met) and agreements that may be exempted because the procompetitive benefits outweigh any negative impact on competition.

The new "soft safe harbor" is to apply to sustainability standardization agreements, such as those intended to reduce or phase out nonsustainable production processes or products. However, the conditions that must be met for an agreement to benefit from the safe harbor are strict (in particular the requirement that there be "no appreciable increase in price nor an appreciable reduction in choice of products"), and it remains to be seen how easy to meet they will be in practice. Most agreements between competitors that genuinely pursue sustainability goals will therefore still need to be self-assessed by balancing any appreciable negative effects against the anticipated efficiency gains and sustainability benefits to determine whether the agreement can be exempted.

A key requirement for exemption under the EU rules is that "consumers [receive a] fair share of the resulting benefit," which is particularly controversial in the ESG space where the wider environmental or social gains brought by a sustainability agreement may result in higher prices or less choice for the individual consumer purchasing the product. While it is not enough under EU law for businesses to claim that the sustainability agreement overall benefits society as a whole—they must show that the effect on consumers in the relevant market is "at least neutral"—the recognition of

"collective benefit" represents a more flexible approach from the European Commission.

At the national level, an increasing number of competition authorities are issuing guidance to clarify their approach to ESG initiatives and are encouraging businesses to submit their collaboration plans for discussion and review. Leading the way is the Dutch Authority for Consumers and Markets (the "ACM"), which has taken a more flexible approach to exemption on sustainability grounds and has actively encouraged dialogue about potential initiatives that pursue genuine sustainability objectives, assuring businesses that it would not impose fines for agreements that were found to be incompatible with antitrust laws provided businesses followed the guidelines in good faith. The ACM has also specifically called out "environmental damage agreements"—initiatives intended to address serious "negative externalities" such as global warming and reduced biodiversity—where benefits for society as a whole can be taken into account in the analysis of whether an agreement should be exempted (provided the direct consumers are a constituent part of that society).

Following concerns raised most recently by groups led by the GFANZ that the risk of breaching antitrust laws was preventing them from working on initiatives to combat climate change, the CEO of the UK Competition and Markets Authority (the "CMA"), Sarah Cardell, stated in January 2023 that one of the CMA's areas of focus going forward is to ensure "that competition law is not an unnecessary barrier to companies seeking to pursue environmental sustainability initiatives." The CMA has now published for consultation its Draft Guidance on Environmental Sustainability Agreements (the "Draft Guidance") setting out how such initiatives may be exempted from the UK rules. (The consultation is open for responses until 11 April.) The Draft Guidance applies to (i) agreements aimed at "preventing, reducing or mitigating the adverse impact that economic activities have on environmental sustainability" (such as those promoting the sustainable use of raw materials or improving air or water quality) and (ii) agreements that "contribute towards the UK's binding climate change targets under domestic or international law" (such as those aimed at phasing out production processes involving the emission of carbon dioxide or stopping the provision of financing or insurance to fossil fuel producers). It provides guidance on when initiatives are unlikely to be anticompetitive, as well as the circumstances in which they may be restrictive but on balance are capable of exemption.

The CMA is therefore making good on its public commitment to promote environmental sustainability and has proposed an innovative approach to assessing the benefits of these agreements by considering the possibility of future and non-monetary benefits. The Draft Guidance also shows an innovative departure from the traditional "fair share" assessment, in particular for climate change agreements where it provides for "a more permissive approach" to assessing who the relevant customers are by

including "'the totality of the benefits to all UK consumers" as a relevant factor. The Draft Guidance reiterates the CMA's "open-door policy" to discussing environmental sustainability agreements with parties and provides protection from fines for those who discuss their proposed initiatives in advance.

Mitigating ESG Antitrust Risk

While antitrust regulators globally will continue to scrutinize ESG initiatives, businesses can generally be confident about participating in such collective action as long as they attend to antitrust risks and adopt certain safeguards. Below are a few considerations to keep in mind:

- When planning ESG initiatives, consult antitrust counsel to identify any competition concerns that may be presented.
- When engaging in a joint ESG initiative, do not share competitively sensitive information. To the extent information must be shared to achieve the ESG objective, antitrust counsel can help ensure that it is properly aggregated and anonymized.
- Stick to formal, scheduled meetings with a distributed agenda that ideally is reviewed by antitrust counsel in advance and in any event raises no concerns about improper information exchange or requests to impermissibly coordinate on pricing, sales, output, markets or product strategies.
- Keep written minutes of ESG initiative meetings to demonstrate that discussions did not stray from permissible topics.
- Properly document your stated sustainability goals and the positive effects the initiative is intended to achieve.
- Establish compliance trainings for company representatives that will be involved in joint ESG initiatives.
- Ensure that membership to joint ESG initiatives is open to all or is based on relevant and objective criteria that do not selectively disadvantage other market participants.

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Please do not hesitate to contact us with any questions.

WASHINGTON, D.C.

Ted Hassi
thassi@debevoise.com

NEW YORK

Michael Schaper
mschaper@debevoise.com

Erica S. Weisgerber
eweisgerber@debevoise.com

Ulysses Smith
usmith@debevoise.com

Brian Desmarais
bndesmarais@debevoise.com

LONDON

Timothy McIver
tmciver@debevoise.com

Megan MacDonald
mmacdonald@debevoise.com