



UNIVERSITÀ
DI PAVIA

**DEPARTMENT OF ECONOMICS AND
MANAGEMENT MASTER PROGRAMME
IN ECONOMICS, DEVELOPMENT AND
INNOVATION**

**The Welfare Gains and Foreclosure Risks of Vertical
Mergers: A Competition Policy Perspective**

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Thesis

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Academic Year 2025-2026

Abstract

Vertical merger control is becoming increasingly crucial in EU competition policy, as regulators face the challenge of examining transactions that bring together different layers of the supply chain under one roof, rather than directly excluding competitors from the market. The EU Guidance on Non-Horizontal Mergers serves as the fundamental analytical framework in this study. This article treats vertical merger control as an independent regulatory area, demonstrating how this framework functions in different sectoral and regulatory contexts through two selected case studies. The merger between Essilor International and Luxottica Group was approved by the European Commission in March 2018. This transaction, bringing together the world's largest eyewear manufacturer and the world's leading ophthalmic lens manufacturer, raised concerns about vertical monopolies at various levels of the optical supply chain. The first case study covers the Commission's review process of this merger. In this assessment, the Commission examined the risks of input and customer monopolies across multiple links in the supply chain. Ultimately, the Commission concluded that the combined entity would largely lack the capacity and motivation to adopt an exclusionary strategy; this was largely due to the purchasing power of the counterparty, particularly large retail chains and purchasing groups, and the availability of reliable alternative suppliers in the market. The review of Meta's acquisition of Giphy was conducted by the UK Competition and Markets Authority (CMA) and culminated in a full divestment obligation, which was confirmed in a reassessment in 2022. This transaction forms the focus of this second case study. Although the review was conducted under UK merger control legislation, the CMA's analytical approach largely aligns with the EU's non horizontal merger framework. The CMA determined that Giphy held a near-duopolistic position in the searchable GIF library market and served as a critical upstream input for competing social media platforms. Furthermore, the merger was deemed to have given Meta both the capacity and the motivation to restrict these competitors'

access to this input. All proposed behavioral remedies were deemed insufficient and rejected, ultimately resulting in a full divestment obligation.

Abstract in Italian

Il controllo delle concentrazioni verticali sta diventando sempre più cruciale nella politica della concorrenza dell'UE, poiché le autorità di regolamentazione si trovano ad affrontare la sfida di esaminare operazioni che riuniscono sotto un unico tetto diversi livelli della catena di approvvigionamento, piuttosto che escludere direttamente i concorrenti dal mercato. La Guida dell'UE sulle concentrazioni non orizzontali costituisce il quadro analitico fondamentale del presente studio. Il presente articolo tratta il controllo delle concentrazioni verticali come un'area normativa indipendente, dimostrando come tale quadro funzioni in diversi contesti settoriali e normativi attraverso due casi di studio selezionati. La fusione tra Essilor International e Luxottica Group è stata approvata dalla Commissione europea nel marzo 2018. Questa operazione, che ha riunito il più grande produttore mondiale di montature per occhiali e il principale produttore mondiale di lenti oftalmiche, ha sollevato preoccupazioni riguardo a monopoli verticali a vari livelli della catena di approvvigionamento del settore ottico. Il primo caso di studio riguarda il processo di esame di questa fusione da parte della Commissione. In tale valutazione, la Commissione ha esaminato i rischi di monopolio degli input e della clientela lungo più anelli della catena di approvvigionamento. In definitiva, la Commissione ha concluso che l'entità risultante dalla fusione sarebbe stata in larga misura priva della capacità e della motivazione per adottare una strategia escludente; ciò era dovuto in gran parte al potere d'acquisto della controparte, in particolare delle grandi catene di distribuzione al dettaglio e dei gruppi d'acquisto, nonché alla disponibilità di fornitori alternativi affidabili sul mercato. L'esame dell'acquisizione di Giphy da parte di Meta è stato condotto dalla Competition and Markets Authority (CMA) del Regno Unito e si è concluso con un obbligo di dismissione integrale, confermato in una nuova valutazione nel 2022. Tale operazione costituisce il fulcro

del secondo caso di studio. Sebbene l'esame sia stato condotto ai sensi della normativa britannica sul controllo delle concentrazioni, l'approccio analitico della CMA si allinea in larga misura al quadro dell'UE sulle concentrazioni non orizzontali. La CMA ha stabilito che Giphy deteneva una posizione di quasi-duopolio nel mercato delle librerie GIF ricercabili e fungeva da input critico a monte per le piattaforme di social media concorrenti. Inoltre, la fusione è stata ritenuta idonea a conferire a Meta sia la capacità che la motivazione per limitare l'accesso dei concorrenti a tale input. Tutti i rimedi comportamentali proposti sono stati giudicati insufficienti e respinti, con il risultato finale di un obbligo di dismissione integrale.

Acknowledgments

First and foremost, I would like to express my deepest gratitude to my family, who accompanied me throughout this journey with their unconditional love, patience, and unwavering support. Especially during the most uncertain moments of my studies, their belief in me was my greatest source of strength and motivation. No matter how far away I was, I always felt their support and encouragement. I am eternally grateful to my older brother, who greatly contributed to my coming to Italy. My brother had a huge influence on my dream of pursuing this master's degree. Therefore, I owe my greatest thanks to my brother. I also would like to express my endless thanks to my mother and father, who always believed in me and helped me achieve my goals. My dearest family, thank you for supporting me and for being my home wherever I was. This achievement would not have been possible without them, and I dedicate a significant part of this accomplishment to my family.

Furthermore, I would like to sincerely thank my thesis supervisor, Prof. Cavaliere for his guidance, valuable feedback, and support throughout the development of my thesis. His academic advice and encouragement were invaluable in completing this work.

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Introduction

This thesis examines how regulators and courts evaluate vertical integration within the EU's legal framework. Its primary objective is to explore how regulators and courts balance potential efficiency gains against competitive harms, anticompetitive effects and inefficiencies arising from foreclosure. In order to achieve this, this study will examine vertical mergers and vertical integration from the perspective of two selected case studies, one approved by the Commission and the other not, and will provide a detailed analysis for each case. One of the two selected cases is Essilor/Luxottica, which was approved by the European Commission, and the other is Meta/Giphy, which was not approved by the Commission. In this way, the study will reveal the economic impact of vertical integration by focusing on the legal dynamics of EU competition policy, considering both the competition effects and the regulatory frameworks that shape the outcomes. It will examine the main economic and legal issues that contributed to the successful solution in the Essilor/Luxottica case and will explain in detail the key aspects that were correctly addressed. Additionally, the study will also examine the reasons behind the rejection of the Meta case and identify the weaknesses that ultimately led to its failure. This comparative analysis will reveal the essential component of the thesis structure.

In Essilor/Luxottica, the analysis focuses on the impact of the vertical merger on both the wholesale and retail markets, particularly in terms of potential price increases and foreclosure risk. Subject to the background, the Meta case in the UK highlighted different issues. Platform conduct and potential data misuse played a key role in the Competition and Merger Commission (CMA) investigation into Meta's use of advertising data. Especially in terms of competition in digital advertising, the Meta/Giphy merger also increased concerns about foreclosure risks.

The structure of the thesis is as follows: Chapter 1 provides a historical perspective and significance of vertical mergers; Chapter 2 outlines theoretical foundations of vertical mergers;

Chapter 3 presents case studies and analysis; and the Conclusion discusses implications for policy and concludes.

Research Objectives and Questions

The study aims to critically assess how vertical mergers and vertical restrictions are treated within the EU's legal frameworks, particularly in light of the dangers associated with market foreclosure. More specifically, the objectives of the research are:

- How do vertical mergers foreclose market access for competitors?
- How do European competition policies regulate vertical foreclosure?
- What are the economic justifications vs. anti-competitive risks?
- How does EU competition law address foreclosure risks compare to the UK?

Methodology

The methodology of the thesis will involve the following:

- From a theoretical framework, the study will evaluate industrial organization theory, welfare economics and antitrust law. Legal analysis of EU competition rules will also be addressed in terms of competition policy (Articles 101 and 102 TFEU).
- Selected empirical case studies of European Commission decisions on vertical mergers. As I emphasized in the introduction of the thesis, this study adopts a qualitative method by focusing on the market foreclosure effects of vertical mergers and analyzes two cases. One of the two cases selected is Essilor/Luxottica, which was approved by the European Commission, and the other is Meta/Giphy, which was not approved by the Commission.

- The foreclosure effects on consumer prices and market entry will be examined in terms of economic modeling.

Chapter 1: Understanding Vertical Mergers and Vertical Restraints

1.1 Description of vertical mergers and vertical restraint

Vertical mergers and vertical restraints undertake the crucial role of vertical integration approached by EU competition policy. A vertical merger is the merging and integration of two or more companies involved in different stages of the supply chain in the production of goods or services (Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2008/C 265/07, 2008.). It is a form of merger that occurs when one of the two merging companies produces part of the goods and services inputs of the other company and/or evaluates the product output (such as marketing). Vertical mergers, which occur by organizing interchangeable activities under the same control, involve combining complementary activities in a pecking order, unlike horizontal mergers (Organisation for Economic Co-operation and Development, 2007).

As a theoretical example, let's assume that there are two firms, B and C. B is a steel producer, and C is an iron or coal mine. The merger of these two firms provides a concrete example of a vertical merger. The merger of an airline company with a travel agency can be shown as another concrete example of a vertical merger as well.

Vertical mergers can occur in two ways: backward integration and forward integration. In the vertical backward merger type, the process of merging with companies that are involved in the stages from the production of the raw material of the product a company produces to its delivery to itself is referred to.

When the vertical forward merger type is considered, the opposite situation occurs. In this type of merger, it is meant that the product as an input merges with companies that are involved in the stages from the production of the product to the end user. The merger of a supplier and a producer can be given as an example of this merger type. For example, the merger of a publishing house with a paper factory implies backward growth. The reasons for preferring backward vertical growth include the fact that the company has sufficient resources to produce its input and that the suppliers work with a high profit rate. In forward vertical mergers, companies benefit from the synergy effect in the marketing function. In this way, they provide some advantages in the marketing of the goods and services they produce. The merger of a producer and a retailer is among the known examples of this forward merger. A clothing company selling the products they produce through dealers or stores are examples of forward vertical growth. In this way, they provide some advantages in marketing the goods and services they produce. Other reasons include delays in distribution channels.

1.1.1. The policy Argument: balancing efficiency-boosting effects with foreclosure concerns

There are two different views in the literature on vertical mergers. The view that vertical mergers can affect the price determination policies of the final producers and therefore will negatively affect competition is largely dominant in literature. According to the other view, there is no consensus on whether vertical mergers also affect competition regarding the selection of suppliers.

Krattenmaker and Salop (1986) emphasized in their study that vertical mergers may initially seem innocent and harmless because firms generally merge without any intention to limit competition. However, they also emphasized that such mergers can eventually lead to a dominant position in the market and cause harmful results. They emphasize that mergers can

facilitate price coordination among final producers. For this reason, it is emphasized that they can reduce competition and lead to an increase in prices (Krattenmaker & Salop, 1986).

Arslan (2007) highlights the existence of two different views in terms of competition in vertical mergers. The first view argues that there is no element that will affect the competition in the market. The dynamics of this view are explained as the companies that will continue their production in the market share will be the same after the merger, so the competition will not be affected by the merging parties. According to the second view, it is stated that it will create negative results in terms of competition. According to this view, it is emphasized that it is more likely for them to operate in better conditions in the market than other companies. The mechanism behind this view is explained as the result of the merger of two different companies, which will complement each other by guaranteeing their production resources. (Arslan, 2007, pp. 82-83).

The views of the Chicago School, which shaped competition policies in the second half of the 20th century, shaped the "market share is unchanging" argument. Single Monopoly Profit is the central thesis of this school. According to this thesis, the maximum profit a monopolistic firm can achieve from a given product is already determined at a single pricing point. More precisely, even if a firm with monopolistic power in a market expands vertically to control different stages of the production chain, it cannot increase its profits. Therefore, the primary purpose of vertical mergers is not to increase profits, but to eliminate inefficiencies in the process of generating existing profits. According to this view, because the merger does not create a new competitor in the horizontal market, the same number of companies is assumed to remain in existence after the merger, and their market share rankings are essentially unchanged (Şeref, 2022). To take a theoretical example, let's say the upstream firm has a 30% market share and the downstream firm has a 40% market share. Even though these two firms merge after the merger, other competitors maintain the same production and sales capacity, so the total market

share distribution theoretically does not change. Competition authorities consider these two differing perspectives within the framework of competition policy to determine the impact of each vertical merger on consumer welfare.

Chen (2001) created a balancing theory in his study that includes these strategic views on vertical mergers. According to the results of the study, he determined that under fair general conditions, a vertical merger both provides efficiency gains and has anti-competitive consequences. They can also cause competitors to foreclose by preventing them from accessing downstream customers (customer foreclosure) or necessary input (input foreclosure) (Rey & Tirole, 2007). There are significant risks to market competition arising from this risk of foreclosure, which could either restrict the supply of needs or prevent competitors from reaching end users.

Besides their risks, vertical mergers can also yield significant efficiencies because firms' activities or products are often complementary (European Commission, 2008). Mergers involving complementary or related products can provide one-stop shopping or enhanced convenience for customers. Integration in vertical mergers allows a firm to internalize upstream and downstream profits, a process known as eliminating double margins, and can lead to lower prices, higher output, and greater incentives to improve service or innovate. Furthermore, vertical integration can reduce transaction costs and improve coordination in product design, production, and distribution (European Commission, 2008). These efficiency gains can offset potential negative competitive effects, making it important to carefully balance efficiencies and risks when evaluating the impact of vertical mergers (European Economic and Marketing Consultants, 2005). These effects will be discussed in more detail in Chapter 2.

Under the EU Merger Regulation and Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), the European Commission (EC) has set strict standards to ensure that vertical integration does not lead to monopolistic structures or distort competition.

1.2 Research Focus: Foreclosure Effects on Vertical Mergers

1.2.1 What is Foreclosure?

In the EU competition perspective, foreclosure generally refers to any situation where integration results in the denial of access to essential resources or markets for actual or potential competitors (European Economic & Marketing Consultants, 2005). In simple terms, foreclosure is defined as the prevention of entry or exclusion of competitors from the market. This situation is usually associated with vertical mergers, vertical restrictions or monopolistic practices. Foreclosure causes competitors to have a negative impact on their ability and incentive to compete effectively in the market. This may be due to the possibility of reducing or eliminating market access. (European Union ,2008).

Foreclosure is a prominent factor in vertical integration, especially when considered in terms of anti-competitive behavior and market power. The reasons why foreclosure is important for vertical integration are as follows: The first reason can be shown as Increasing Market Power and Reducing Competition. Firms have the ability to manually control different stages of production or distribution thanks to vertical integration. Actually, firms are able to manipulate a specific part of the supply chain in order to decrease competition in another part, thus increasing its market power. At the end, consumers get the short end of the stick, because less competitors and limited competition comes with raised prices, little to no innovation and fewer variety of products (Rey & Tirole, 2007, p. 2148). For instance, if the production and distribution channels of a product are owned by a vertically integrated firm, it is able to manipulate the fees and refuse to distribute competitors' products, thus limiting the competition.

In the end, the firm will have little to no incentive for setting reasonable prices or any innovation, since it now dominates the market.

The second reason could be to discourage the entry of potential competitors. A vertically integrated firm can use foreclosure as a manipulative tool to dissuade the other firms who are eyeing to enter the market, by making entry to the market challenging or very costly. It can block the access of potential competitors to specific and vital distribution channels or prominent inputs. If the market is difficult to enter, now the more-than-ever dominant firm makes it much more challenging for the others. For example, a firm can block other competitors' access to essential facilities if it has power and control over vital infrastructure, hence discouraging and intimidating the newcomers (Rey & Tirole, 2007).

1.2.2 Types of Foreclosure

Dewulf, Klein, Mell, and Shchepetova (2023) discuss input and customer foreclosure as key concerns in vertical mergers. Also, the EC Guidelines distinguish between two types of foreclosure:

a) Input Foreclosure → Blocking competitors' access to crucial inputs.

Input foreclosure is generally considered a prominent harm in vertical mergers. Input foreclosure can lead to the upstream firm completely ceasing to supply essential inputs to its downstream competitors. This possibility can be considered the most important consequence of input foreclosure. As a result, the access chain to the input is damaged. A disruption in the access chain reveals different results. Limiting the amount offered to competitors is one of them. Other examples of this can be increasing the price of the input or decreasing its quality (partial input foreclosure) (Dewulf et al., 2023). It can be realized in these ways. In its most basic form, input foreclosure occurs when a vertically integrated upstream firm that controls access to

crucial inputs blocks the supply of inputs to its downstream competitors (Total input foreclosure). This may have the effect of increasing downstream competitors' costs (Dewulf et al., 2023).

Raising Rival Cost makes it more difficult for competitors to access critical input by making it more expensive (Dewulf et al., 2023). This makes the integrated firm less competitive against its own downstream operations. This can lead to increases in competitors' selling prices. There can even be price increases that are large enough to drive them out of the market. Increasing input costs have an essential role in Raising Rival Cost (RRC) in terms of input foreclosure. To explain it simply, the mechanism of this theory explains how a vertically integrated firm gains an unfair competitive advantage over a non-integrated firm in the market, weakening competition. In other words, increasing input costs is the possibility of strategically weakening its competitors in the downstream market. Let's consider a theoretical example. Let's assume that there are 3 firms in the market. Firm A is a TV manufacturer, Firm B is a display panel manufacturer (also a supplier to Firm A), and Firms C, D, and firm E are other independent TV manufacturers in competition. In our scenario, Firm A acquires Firm B as part of a vertical merger. This means that display panel production is now under the control of Firm A. If we consider what has changed, Firm A can now use the display panels produced by Firm B only for itself. Or it can continue to supply display panels to its competitors. But it can do so at a higher price, lower quality or longer delivery time. The consequences of all this can be listed as follows: Other television manufacturers such as Firms C, D and E can no longer find display panels at a reasonable price or on time. Production costs increase, product quality may decrease, or production may be delayed. Or product variety may decrease. In this case, it weakens their market competitiveness and provides an unfair competitive advantage in favor of Firm A. The theoretical example is inspired by the real-life scenario where a television

manufacturer and panel supplier merger occurred, the merger of AT&T and Time Warner in the U.S.

The potential gains in downstream profits are determined by the losses in upstream profits resulting from reduced sales to competitors and whether the integrated firm can profitably direct sales to the downstream unit as a result of its foreclosure strategy (European Economic & Marketing Consultants, 2005). This makes the downstream subsidiary more competitive because it can create an incentive for the upstream firm to increase input prices to third parties, which can lead to a more competitive environment. Having significant market power in the market for a key input is important for the upstream firm. Whether the integrated firm can profitably direct sales to the downstream unit as a result of its foreclosure strategy is also an important consideration. The ability and incentive to engage in foreclosure and increase competitors' costs are necessary conditions typically observed in a vertically integrated firm (European Economic & Marketing Consultants, 2005).

The degree of market power of an upstream firm in an input market is an important factor in assessing the likelihood and potential impact of input foreclosure (European Economic & Marketing Consultants, 2005). In the context of protecting competition, practices such as input foreclosure may lead to an undertaking that is dominant in vertical relations unfairly strengthening its own position in the market by making it difficult for competitors to produce and operate. Especially if the input in question is non-substitutable, it is inevitable that this behavior will have a market foreclosure effect (European Economic & Marketing Consultants, 2005). Higher prices or fewer options for consumers are among the expected results. Moreover, the foreclosure strategy may harm competition in the downstream market and as can be expected, will lead to harm to consumers after this stage. Firms that are being foreclosed are one of the most crucial actors in the competition process in order to obtain significant dominance over the market due to their exclusion or increased costs.

Academic literature and economic models are crucial actors in analyzing input foreclosure and increasing competitors' cost strategies. According to literature, on one side, the well-known Chicago school's "single monopoly profit" theory, which suggests that a monopolist already makes profits from the final product, thus the absence of a need to exclude efficient downstream (i.e. intermediate goods or input) competitors. In the end this absence of the need limits the incentive for vertical foreclosure (Claici, Basalisco, De Michiel, Okholm, & Maier, 2020). On the other hand, the modern industrial economics literature based on the game theory of the post-Chicago school has critically evaluated the theory in question, arguing that this approach contains assumptions that are too rigid to always hold true in real-world conditions (Claici, Basalisco, De Michiel, Okholm, & Maier, 2020). In other expression, this theory widely varies on different market structures and competitive conditions, as argued over and criticized for. It is observed that vertical foreclosure is both possible and has actually occurred when empirical studies based on real market data are considered. Empirical evidence suggests that it can affect market structure, competition in the market, and consumer welfare, among other factors (Claici, Basalisco, De Michiel, Okholm, & Maier, 2020). As a theoretical example, let's assume that there are two companies in the market, A and B. Company A is a printer manufacturer and has a monopoly in this field (i.e., it is the only printer manufacturer in the market). Ink cartridges are needed for printers to work. Company B produces ink cartridges. Company B is an effective and competitive downstream company in this market. Since Company A sells printers as a monopoly, it already maximizes the profit that can be obtained throughout the entire chain. Therefore, trying to foreclose Company B (for example: producing printers that only work with its own ink cartridges) does not provide any additional profit to Company A. Because the profit obtained from the sale of ink cartridges is already indirectly returned to Company A through printer prices. Therefore, Company A has no incentive to foreclose Company B.

However, in the real world, there may be several different scenarios that could occur for this situation. For example: If Company A chooses to produce printers that only work with its own ink cartridges (performs vertical foreclosure), Company B may have to exit the market. In this case, Firm A then becomes a monopoly in the ink cartridge market and profits from both the printer and the ink. This behavior also prevents potential competitors from entering (strategic barrier to entry). In this case, the theory of single monopoly profits loses its validity because the firm both increases its market control and increases its total profit in the long run.

b) Customer Foreclosure → Restricting competitors' access to retail/distribution channels.

According to EU competition law and vertical integration, if a downstream firm that has vertically integrated with an upstream supplier either stops or reduces purchasing inputs from competing upstream suppliers, customer foreclosure emerges (European Economic & Marketing Consultants, 2005). The integrated downstream firm can potentially damage the viability and competitiveness of the upstream rivals by specifically sourcing its needs from its own upstream division following the merger (European Economic & Marketing Consultants, 2005). Customer foreclosure is generally used as a tool to handicap upstream rivals and dissuade their competitive advantages, by damaging their revenues or multiplying their costs (Schneider & Greenfield, 2007). When we consider a theoretical example scenario for customer foreclosure, there are 3 companies, namely A, B and C. Let's assume that Company A is a food product manufacturer, Company B is a large retail chain such as supermarkets and finally Company C is among other independent food producers. According to our theoretical scenario, within the scope of a vertical merger, a food producer company (Company A) acquires a large retail chain (Company B). After the merger, Company A has the advantage of offering its products directly to consumers through Company B's store network. There are also independent producers such as Company C in the market. These companies were previously able to deliver their products to consumers through Company B. When we consider the Customer Foreclosure

Effect, there are two possible scenarios. First, after the merger, Company B (retailer) may completely remove Company C's products from the shelves (complete exclusion). Second, it may partially exclude them by offering less shelf space, worse location and higher shelf fees.

As a result, Company C cannot reach consumers or has difficulty reaching them. For this reason, its sales may decrease and even exit the market. In this case, Company A becomes unrivaled in stores and increases its sales. There will be fewer brand options in the market for consumers and prices may increase. This example is a customer foreclosure scenario that is frequently encountered in real life but formulated within a theoretical framework.

There are two main reasons why customer foreclosure is seen as less harmful compared to input foreclosure. The first is that it takes a certain period of time for the pricing of non-integrated upstream firms to be affected by the changes. The second factor is that the efficiencies gained from integration are reflected in the prices of the integrated firm. It can lead to lower prices for firms (European Economic & Marketing Consultants, 2005). However, customer foreclosure also has negative effects in terms of competition in the market. Since the target market is smaller, it can make it harder for them to cover their fixed costs. This can also lead to restricted market access for upstream firms (Competition and Markets Authority, 2015). This situation can increase the market power of the remaining firms, including the vertically integrated organization. Because this situation can also lead to non-integrated upstream firms exiting the market. It can also create an infrastructure for price increases. Potentially, consumers are inevitably affected by these price increases (Competition and Markets Authority, 2015).

The key to a successful strategy of customer foreclosure relies on exploiting the market power (Competition and Markets Authority, 2015). In particular, the downstream firm must have a key position in the downstream market to gain market power. The fact that customer foreclosure causes significant competitive harm is linked to the presence of a certain level of

market power at the downstream level. Because customer foreclosure needs to have an impact on the market in order to cause significant competitive harm. Accounting for a large proportion of sales will be sufficient to make it a significant market driver for upstream suppliers. Because of this reason, when a downstream firm involved in vertical integration has significant market power, from an EU competition policy perspective, customer foreclosure is likely to raise concerns (Competition and Markets Authority, 2015).

Some economic literature suggests that customer foreclosure can lead to single-stage firms being displaced by vertically integrated competitors (Salop & Culley, 2014). On the one hand, the theory of "single monopoly profit" suggests that vertical integration alone may not increase market power, while also suggesting that it has limitations in scenarios involving imperfect competition or strategic behavior. Two factors that determine the profitability of the strategy can be shown as prominent. One factor can be shown as potentially higher input costs in the upstream market. The efficiency of the strategy can be evaluated according to the balance between any potential decrease and increase in downstream profits resulting from reduced competition (Salop & Culley, 2014). In general, it can be a strategic step used by firms to create market power in the upstream, which will then play an important role in increasing input prices.

Chapter 2: Theoretical Foundations of Vertical Mergers

2.1 Economic Justifications for Vertical Mergers

2.1.1 Elimination of Double Marginalization

Double marginalization arises when firms with some market power operating at each stage of the value chain independently price themselves based on their own marginal revenues and costs (Gabrielsen, Johansen, & Shaffer, 2018). In other words, it is a vertical externality that arises when two firms in a supply chain that are not perfectly competitive add a profit margin to their prices (Gabrielsen, Johansen, & Shaffer, 2018).

Double marginalization arises from sequential pricing and was studied by economists such as Cournot (1838) and Spengler (1950). Cournot did encounter a similar occurrence to sequential pricing in a previous theoretical study of his, though Spengler who was the first to study sequential pricing (Motta, 2003, p.419).

To illustrate with a concrete example, a monopolist manufacturer sells a product to a monopolist distributor or retailer at wholesale prices, adding a profit margin to its own marginal cost. The retailer then considers this wholesale price as its own marginal cost and adds its own profit margin to determine the final consumer price. Since both firms tend to limit output to maximize their profits, these successive markups raise the final price above the optimal monopoly price, increasing the welfare loss compared to a pure vertically integrated monopolist.

Creation of deadweight loss is already possible with a single vertically integrated monopolist because of its market power and the set above-average marginal cost. This results in the quantity produced and consumed being lower than the efficient market outcome. Low efficiency means that certain transactions that could benefit both consumers and the firm are

not taking place. The value of these lost transactions is the inefficiency loss caused by the monopoly power. This welfare loss exists even when the same firm controls both production and distribution.

The OECD (2007) highlights the tangible efficiency gains of eliminating double marginalization. According to the report, vertical mergers generally pave the way for eliminating double marginalization, provided both upstream and downstream market power exist before the merger. This, in turn, leads to lower prices. Because the integrated firm can access inputs at marginal cost, it no longer has to pay wholesale prices set above marginal cost. This allows the firm to benefit consumers by increasing downstream production. These efficiency gains can be seen as an important counterbalance to the potential negative effects of vertical mergers, such as input seizure.

Consequently, firms can mitigate the negative effects of double marginalization by coordinating their upstream and downstream pricing strategies. By achieving better coordination through vertical mergers, they reduce the inefficiencies resulting from cascading price increases, increase production, lower final consumer prices, and improve overall economic welfare (OECD, 2007).

2.1.2 Supporting Investment and Innovation

Vertical mergers offer the potential to encourage firms' R&D investments and create new value through technological integration. However, this process also involves complex dynamics that can lead to reduced competition and a decrease in innovation motivation.

Vertical mergers have been observed to significantly increase individual R&D investments (Karbowski & Prokop, 2019). This phenomenon may at first glance seem contradictory to predictions that reduced competition would weaken innovation. However, this

effect is closely related to a fundamental problem in economics known as the "hold-up problem." In the supply chain context, unique investments made by an independent raw material producer to provide a specific input to the final producer are essentially valued through dependence on the final producer. In this context, the final producer's ability to use its bargaining power to impose lower prices following the investment can lead to a partial transfer of the supplier's expected returns (Whinston, 2003). This risk limits the supplier's initial willingness to invest. Vertical integration has the capacity to eliminate these internal costs and uncertainties. Whinston (2003), emphasizing the importance of a transaction cost approach in shaping a firm's organization, emphasizes the critical role of vertical integration in internalizing the value of specific investments and reducing hold-up risk. This creates a stronger incentive mechanism for high-risk and large-scale innovation projects. Furthermore, merging firms often acquire strategic assets such as patents, resources, and emerging technologies while gaining control of the supply chain; this increases the firms' competitiveness and strengthens their future growth potential (Teece, 1986; Pisano, 1990).

The potential for vertical mergers to foster innovation is offset by the potential for anti-competitive outcomes frequently emphasized by regulatory authorities (Varney, 2013). Such mergers can hinder innovation and product quality by making it harder for competitors to enter the market or by increasing their costs (Varney, 2013).

For example, vertical integration can lead to a firm preventing its competitors from accessing critical inputs needed for production ("foreclosure") or artificially raising the costs of accessing these inputs ("raising rivals' costs"). One of the most serious consequences is that a new firm is forced to establish an entire vertically integrated structure rather than operating solely in a single market. This can significantly increase the capital and operational costs required for market entry, discouraging potential competitors from innovating, resulting in fewer choices and lower quality for consumers. Therefore, determining whether vertical

mergers will have positive or negative impacts on consumer welfare must be carefully considered, taking into account the specific circumstances of each case.

2.1.3 Market Power and Bargaining Leverage

Vertical mergers are an important strategic tool that allows companies to strengthen their market position and gain leverage in their relationships with supply chain partners. This approach gives the merged company greater bargaining power over external suppliers and customers (Hendrik Döpper et al., 2023). When a manufacturer acquires a critical supplier through a vertical merger, its dependence on external suppliers decreases. This internalization gives the manufacturer significant flexibility and leverage in negotiations with external suppliers. In short, while a horizontal merger merely reduces the number of competitors in a market, a vertical merger provides the firm with a strategic commitment tool. This internalization also serves as a strategic deterrent. Vertical integration can create a structural barrier to prevent potential competitors from entering the market. If the merging firm maintains monopoly control over critical inputs, new entrants will have to establish their own supply chains to enter the market. This increases entry costs and operational complexity, reducing competitors' incentives to enter the market (Sapi, 2012). Vertical mergers allow companies to gain significant strategic advantages by controlling critical stages of the value chain (Sapi, 2012). This control provides the company with market stability and a more resilient structure against competitive pressures. Acquiring a critical supplier or distributor can restrict competitors' access to necessary inputs or increase the cost of those inputs, creating high barriers to entry for new entrants (Ordover, Saloner, & Salop, 1990). Therefore, this mechanism is one of the most obvious anti-competitive effects of vertical mergers.

The power gained through vertical mergers can allow a firm to capture the market more effectively and increase its profitability. However, the risks associated with this situation must

also be considered. Concentration of market power can lead to the emergence of cartel-like behavior after the merger and the restriction of overall competition (Ordover, Saloner, & Salop 1990). Therefore, vertical mergers must be carefully evaluated to maintain the delicate balance between the firm's operational objectives and public welfare.

2.1.4 Enhancing Efficiency and Reducing Transaction Cost

One of the most obvious and frequently researched benefits of vertical mergers is their increased operational efficiency and reduced associated transaction costs. This leads to significant savings in both internal and external processes. Transaction Cost Economics and Vertical Integration Transaction cost theory explains the fundamental economic logic behind vertical mergers (Whinston, 2003). According to theory, when the complexity of market relationships stems from factors such as high costs and asset specificity, vertical integration is often considered the most effective solution (Whinston, 2003). Asset specificity, such as specialized machinery or designs, reflects the fact that investments in a specific business relationship have limited use value outside the relationship. Such investments create significant quasi-rents between the parties, creating the possibility that one party will capture these rents by forcing the other into less advantageous conditions after the investment is completed.

This risk undermines firms' incentive to use market-based transactions. In other words, it discourages firms from making specific and productive investments. Vertical mergers eliminate the risk of quasi-rent capture by bringing the different stages of the production process under a single firm, eliminating potentially costly and problematic relationships in the market and a significant reduction in transaction costs. (Whinston, 2003). This structure provides a significant reduction in transaction costs. This is because it paves the way for eliminating potentially costly and problematic relationships in the market. This allows both parties to

confidently make the necessary investments to optimize processes and increase overall efficiency.

2.1.5 Market Coordination and Supply Chain Control

Through vertical integration, a company can increase operational security, more effectively control product quality, and adapt more quickly to market conditions. Vertical integration is based on the fundamental goal of enhancing a company's control over its supply chain. The strategy's implementation is divided into two three categories, depending on which phase of the production process the company chooses to incorporate (see section 1.1)¹.

a) Backward Integration:

Supply chain security is one of the primary motivations for backward integration. A manufacturer partners with a supplier to ensure the continuous and reliable availability of critical raw materials or components. This minimizes the risk of supply chain disruptions, such as strikes, supply shortages, or sudden price fluctuations. For example, consider a theoretical example. In this scenario, there are two companies, A and B. Assume that Company A is a pharmaceutical manufacturer and Company B is a chemical raw material supplier. To ensure a continuous, high-quality supply of active ingredients, Company B might acquire Company A. This is an example of backward integration designed to prevent production disruptions and price fluctuations.

Cost control can be considered the second key factor. Backward integration aims to reduce costs by eliminating supplier margins. As a real-world example, consider IKEA's

¹ For more information, see section 1.1. for a detailed discussion of vertical merger types.

purchase of forested land in Romania and the Baltic countries for furniture production. This allows IKEA to both secure raw material supplies and control costs (Obi Tabansi, 2025).

Finally, quality control can be considered a key factor. With backward integration, a company can more effectively test the quality of its products. In the food industry, purchasing its own farms is a common way to ensure product quality and safety. A classic real-world example is Apple's decision to design and manufacture key components like its own M1 chips instead of sourcing them from Intel. This gave Apple greater control over its production process and reduced its reliance on external suppliers (Backward Integration: Definition, Implementation Process, and Competitive Advantages, 2024).

b) Forward Integration:

Distribution control is a key motivator for forward integration. This strategy can increase profit margins by eliminating intermediaries, as it provides greater control over how a company's products reach the end consumer (Kenton, 2021).

Forward integration contributes to brand and customer experience. By opening their own retail stores or e-commerce platforms, companies can more closely manage their brand image and customer experience (*Forward Integration - Financial Edge*, 2024).

Market Entry and Data Collection can be cited as another driving force for forward integration. Acquiring retail or distribution channels facilitates entry into new markets and offers the opportunity to obtain valuable data about consumer preferences (Bongdap, 2024). Considering a real-world example, Apple can be cited again. By opening its own retail stores, it has improved the presentation of its products and customer experience to a certain standard.

c) Balanced Integration

Balanced integration refers to a company combining both backward and forward integration strategies to establish control over its entire supply chain (Harrigan, 1984). This means that a company builds the entire process within its own supply chain, from controlling raw materials to delivering the finished product to the end consumer. A real-world example would be Inditex. By managing the entire value chain from fabric production to retail stores, Inditex made the "fast fashion" model possible (Yasmina, 2025).

2.2 Articles 101 & 102 TFEU and Vertical Restraints

European Union competition policy implements a comprehensive and layered legal framework to examine vertical relationships. Three fundamental instruments play a crucial role within this framework: Articles 101 and 102 of the TFEU and the EU Merger Regulation (EUMR) (*European Commission, 2023*). According to the European Commission (2023) the implementation of these rules falls primarily within the European Commission's responsibility. When assessing the competitiveness of undertakings, the Commission places the concept of market definition at the center of its analysis and systematically applies this framework in its decisions.

Article 101 of the TFEU prohibits all agreements and concerted practices that have the purpose or effect of preventing, restricting, or distorting competition (European Union, 2008). While this article does not provide a direct legal basis for merger control, the economic framework developed to apply to vertical agreements has significantly shaped the European Union's approach to vertical mergers. Vertical relationships, while not horizontal, carry significant risks such as market exclusion (foreclosure) and distortion of competition. Unlike older approaches, European Union (EU) competition policy focuses on assessing risks through

more careful economic analysis, rather than issuing an infringement decision only when a significant exclusion is detected (Pitofsky, 1997). The primary objective of modern policy is to examine the actual effects of exclusion on competition.

A vertical merger transforms a contractual relationship between a manufacturer and distributor under Article 101 TFEU, or a behavioral problem under Article 102 TFEU, into a permanent structural change, which is subject to the European Union Merger Regulation. Competition analysis of such mergers primarily draws on the economic principles contained in Articles 101 and 102. These principles include market power, the likelihood of exclusion, and efficiency considerations.

Article 101 of the Treaty on the Functioning of the European Union (TFEU) provides an economic basis for contractual vertical restrictions (e.g., exclusive agreements) that restrict competition (Blewett & Kennis, 2023). The economic concerns under Article 101 become structural issues after a merger. For example, when an undertaking chooses a merger, the market emerges with the highest possible level of "single branding."

Article 102 Treaty on the Functioning of the European Union (TFEU) addresses exclusionary behaviors that lead to an abuse of a dominant position, such as refusal to supply or margin squeezing. The examination of vertical mergers assesses the likelihood that the undertaking will profitably engage in such abuses within the scope of Article 102 after the merger. This analysis is an ex-ante risk assessment (European Commission, 2008).

The same economic principles apply to both remedial and preventive instruments. In other words, this allows policymakers to use the same economic frameworks used under Articles 101 and 102 to define structural competitive harm within the European Union Merger Regulation.

The EUMR offers the opportunity to assess whether mergers reaching Community scale are compatible with the single market European Commission. (2024). This regulation is an

important tool, particularly in providing ex-ante control over structural changes and market concentrations. With the entry into force of Regulation 2004/139, mergers began to be examined according to the criterion of whether effective competition is significantly impeded (SIEC) (Röller & De La Mano, 2006). This method allows for a more comprehensive analysis of the merger's effects on competition. This method allows for a forward-looking and comprehensive analysis of the merger's effects on competition. These three tools play a key role in maintaining competitive, transparent, and innovative markets. It also contributes to the EU's broader strategic objectives, such as green transformation, digitalization, and increasing the resilience of the single market.

A significant development in EU competition policy is the updated guidance on market definition. The Commission's revised Market Definition Communication confirms that competition assessment must now formally include non-price dimensions (European Commission, 2024). When assessing foreclosure capability, the EU can now define relevant market boundaries based on non-price factors, such as the quality of data access or the degree of API interoperability, rather than being limited solely to the price of a component input. The quality of data access and the degree of API interoperability can be important factors in vertical integrations. APIs allow different software systems to exchange data and communicate (European Commission, 2018). Therefore, a vertically integrated firm may have the ability and incentive to restrict or reduce its competitors' access to APIs. This could make it difficult for competitors to access important digital services and create a risk of foreclosure (European Commission, 2022).

Factors such as innovation, product and service quality, reliable supply, and sustainability are central to this new approach (European Commission, 2024). Some parameters often overlooked in traditional competition analysis are now considered more comprehensive. This regulatory change is particularly important for multi-sided platforms and digital

ecosystems. Usage metrics, such as the number of active users, play a significant role in market share calculations (European Commission, 2024). This facilitates forward-looking analysis to accurately capture dynamic market transitions. The traditional method, however, relied solely on sales and capacity. Therefore, the traditional method of competition analysis remains limited to innovative and rapidly changing markets. This policy broadens the scope of potential losses in vertical lien analysis, allowing for a more holistic assessment that considers both market dynamics and modern competitive dimensions such as innovation and sustainability.

2.2.1 Article 101 Treaty on the Functioning of the European Union: Prohibitions on anti-competitive vertical agreements

The concepts of purpose and effect play a significant role in policies regarding vertical agreements. Vertical agreement policies are fundamentally based on the distinction between market share thresholds and the implications of the concepts of "purpose" and "effect" (Blewett & Kennis, 2023). The fundamental basis of this approach is the economic assessment of inter-brand competition. Article 101 TFEU regulates agreements or concerted practices that restrict competition.

Article 101(1) covers agreements between businesses, decisions taken by the decision-making bodies of organizations, and harmonized practices between organizations (European Commission, 2023). This regulation targets only agreements that may affect competition; that is, the presence of elements such as interference with trade and restriction of competition is required (Giacalone, 2025). As a true example of the usage of Article 101(1), the agreements made between Hungarian banks in 2009, which were to set credit card transaction fees (MIF), were perceived as restrictor of competition and thus caused the Hungarian Competition Authority to act by the way of fining the banks under Article 101(1) (Hausfeld, 2020).

Even if an agreement significantly restricts competition, it can still qualify for an individual exemption under Article 101(3) TFEU; however, there are several criteria that must be met. There are four key conditions. Each is equally important (European Commission, 2004). First, the agreement must provide efficiency in production or distribution processes and provide tangible market benefits by promoting technical or economic progress. Second, it is crucial that these gains are reflected fairly in consumers; the benefits must reach the end user, not just the parties involved (European Commission, 2004). As a theoretical example, let's assume two companies, A and B. Company A establishes a new distribution network with Company B. This network allows products to reach consumers faster and at lower costs. Considering these two conditions, this cooperation increases production and distribution efficiency (efficiency gain), and the resulting cost savings are passed on to consumers in the form of price reductions or faster delivery (consumer benefit).

Third, if the same benefits cannot be achieved without restrictions, the condition is met. The restrictions included in the agreement must be genuinely necessary for achieving these benefits. Finally, the agreement should not allow the parties to eliminate competition in a significant portion of the market for the products; thus, the basic level of competition is maintained, and consumer choice is secured. Considering all these conditions together, individual exemption is granted only to agreements that both increase economic efficiency and secure consumer benefit, and do not threaten competition (European Commission, 2004). To illustrate these two conditions, let's again consider firms A and B. Let's assume firm A has entered into an agreement with firm B on a specific technology standard. The adoption of this standard ensures the compatible operation of products and contributes to technical progress in the market. However, the agreement does not completely prevent other firms from entering the market. Thus, both parties benefit. Considering these last two conditions, the applied restriction

is necessary (a condition of necessity) for achieving the benefits and does not eliminate competition. Therefore, the agreement may receive an exemption under Article 101(3).

2.2.2 Perspective of Vertical Block Exemption Regulations (VBER 2022)

If both the supplier and the buyer hold less than a 30% share of the relevant market and the agreement does not contain provisions that severely restrict competition, such agreements are directly excluded from the EU's Article 101 non-competition clause. The European Union's Vertical Block Exemption Regulation No. 2022/720 provides a form of protection, a "safe harbour," for vertical agreements that meet certain conditions.

At market shares below 30%, competition between brands is considered to largely limit the potential negative effects of vertical restrictions (*European Commission, 1998*). According to the European Commission (1998) Economic theory, however, suggests that competition concerns may arise when this competitive pressure weakens and a company gains significant market power. The agreement must be carefully evaluated separately for both the supplier and the customer. There are two criteria for this evaluation: if the agreement controls more than 30% of the market or imposes one or more significant restrictions, it must be evaluated.

The review first assesses whether the agreement is subject to Article 101(1) TFEU. Once this step is verified, if it is subject to Article 101(1), the next step is to determine whether the conditions for an exception under Article 101(3) TFEU are met. Potential gains in efficiency and consumer welfare play a significant role in this process (European Commission, 2022). The need to direct competition authorities' resources to truly risky cases form the basis of this policy. In this context, the 30% threshold serves as a practical and cost-effective filter before engaging in complex analyses. This threshold aims to reduce the number of unnecessary investigations. It also represents an economic approach that enables more efficient use of supervisory capacity. This is because the potential for limited consumer harm in markets with intense competition is

taken into account. However, it is recognized that these harms cannot justify the monitoring and enforcement costs of a detailed individual assessment under article 101(3).

2.2.3 Enforcement of Vertical Merger: Retail Price Maintenance and Contractual

Foreclosure

Resale Price Fixing (RPM) remains one of the European Commission's key tools for establishing strict restrictions on vertical relationships. To summarize with a real-world example, in 2025, the fines imposed on major fashion companies for fixing resale prices prove that RPM practices are still feasible (Mandel Benichou & Oster, 2025). Other contractual restrictions also play a significant role in competition. For example, Most Favored Nation (MFN) clauses and platform parity provisions have attracted attention in recent years. Such clauses affect the price level. In other words, they prevent suppliers from offering worse terms than those offered through other channels. This creates the potential to limit the market entry of other platform operators or prices (*Monopolkommission, 2015*). These limitations can indirectly lead to increased sales commissions and higher end-user prices. On the other hand, they can act as a buffer against opportunistic pricing and unfair competition. More importantly, parity clauses can also protect contract-specific investments. Considering these factors, it is accepted that instead of absolutely prohibiting such restrictions, they should be evaluated on a case-by-case basis, taking into account market characteristics (*Monopolkommission, 2015*).

Let's say company A is a manufacturer and company B is a distributor. Company A requires company B to sell its products only within a specific price range (RPM practice). This situation could be examined under Article 101 as a vertical agreement. If company B had set an independent price, prices in the market could have fallen and consumer welfare could have increased. However, the agreement between A and B raises the question of whether it is unilateral conduct or concerted practice, and the legal tests developed by the European Court of Justice in different contexts play a critical role here. This example demonstrates how vertical

restrictions can functionally resemble horizontal price fixing in practice and the complexity in policy implementation.

In other words, the difficulty of distinguishing unilateral conduct (potentially Article 102) from concerted practice (Article 101) remains a characteristic feature of vertical cases. This dichotomous understanding can create a risk of inconsistencies in policy implementation, especially when some vertically strict restrictions (e.g., RPM) are functionally similar to horizontal price fixing in terms of their ultimate impact on consumer welfare (Nagy, 2025).

2.2.4 Ex-ante Foreclosure Assessment (EUMR) on Vertical Mergers

2.2.4.1 Significant Impediment to Effective Competition (SIEC)

The European Union Merger Regulation (EUMR) plays a major role in protecting an internal market where competition functions effectively. From another perspective, it provides a framework for the prior control (ex-ante control) of mergers. Within this framework, the European Commission is responsible for examining the potential impact of a reported merger on the market structure. In particular, it assesses whether the transaction weakens or weakens competitive pressure. The Significant Impediment to Effective Competition (SIEC) test aims to determine whether a merger significantly weakens competition in the market structure. Under the EU Merger Regulation (EUMR), the SIEC test is the primary assessment criterion (Röller & De La Mano, 2006). A merger may be prohibited under SIEC, particularly if it results in the creation of a dominant position or the strengthening of an existing one (Röller & De La Mano, 2006).

To illustrate this more concretely, let's say company A is a manufacturer with a strong position in the production of a particular product, and company B is a distributor with a significant distribution network for the same product to the end consumer. At first glance, a merger between these two companies might not create horizontal concentration, as the parties do not operate at the same level of production or distribution. However, the resulting

undertaking could restrict competitors' access to company B's distribution channel. This could weaken competitive pressure by increasing competitors' costs or making it more difficult for them to access the market. In such a scenario, even if the merger does not directly create a dominant position, it can create a significant barrier to effective competition.

The SIEC test aims to capture precisely these kinds of situations. The competent authority assesses, through a prospective analysis, how the merger will affect the behavior of competitors and the potential consequences for consumer welfare. This approach goes beyond the classic dominance test, taking into account the indirect and potential effects of non-horizontal mergers on competition (Council of the European Union, 2004).

2.2.4.2 The Eu Non-Horizontal Merger Guidelines: How to analyze the competitive impact of a vertical merger?

The European Commission, when assessing mergers where the parties operate in different but vertically linked markets, refers to the Guidelines on Non-Horizontal Mergers (European Commission, n.d.). Furthermore, it assumes that if the parties' market share in the relevant markets generally remain below 25%, the likelihood of serious competition issues arising is low (Council of the European Union, 2008, Arts. 25, 27). This provides a general analytical framework for addressing competition concerns that may arise from vertical mergers.

However, assessing whether the merger will have exclusionary effects is a key focus of the guidelines. In this context, the Commission examines in detail the possibilities of input exclusion, meaning the restriction of competitors' access to essential inputs, and customer exclusion, meaning the prevention of competitors' access to a significant customer base (Council of the European Union, 2008, Art. 30). The guidelines provide comprehensive guidance on how to analyze these two types of exclusion, shaping the Commission's future competition assessment.

This framework attempts to systematically examine the potential impacts of a merger on competitors. From this systematic perspective, it uses a three-stage economic analysis approach to assess the competitive risk of vertical mergers (Dewulf et al., 2023).

First, the merger's capacity to deprive competitors of competition is evaluated. This reveals the extent to which the merger can control its competitors after the merger. For example, let's say company A is a manufacturer and company B is a distributor with a significant distribution network. The merger of these two companies could increase A's capacity to restrict competing manufacturers' access to B's distribution channel.

Second, the analysis examines whether the merging entity has the economic and strategic motivation to engage in depriving behavior after the merger. For example, after the merger, company A might be motivated to restrict the sale of competing products through B's channel; this is based on economic incentives such as cost advantages and market control gained from the merger.

Finally, the third element involves evaluating how competitive indicators such as pricing, quality, innovation, and consumer welfare in the market will be affected by the merger. For instance, the merger of A and B could lead to price increases and reduced consumer choices by making it more difficult for competitors to enter the market. In short, the effects of the merger on overall competition are considered (see section 1.1.2)².

2.2.5 Article 102: Abuse of dominance through vertical foreclosure

According to the European Commission (2009), Article 102 applies only to undertakings that hold a dominant position in the relevant market. This means that, to detect an infringement, the existence of a dominant position must first be established. However, this establishment alone is not sufficient; it must also be shown that the position has been abused.

² For more information, see section 1.1.2 for a detailed discussion of the types of foreclosure.

A dominant position refers to an undertaking's ability to act largely independently of the behavior of its competitors, customers, and end consumers. Generally, market share below 40% do not constitute a strong presumption of a dominant position (European Commission, 2009). However, factors such as the existence of barriers to market entry, the level of vertical integration, and the structural characteristics of the market are considered as complementary factors in assessing dominance.

To illustrate, let's assume there are two companies, A and B. Company A is an undertaking that supplies an essential input for operating in the downstream market and holds a dominant position in that market. Company A also operates at the retail level using this input. The limitations on market entry due to high fixed costs, intellectual property rights, and long-term contracts allow Company A to operate largely independently of competitive pressures. Company B, on the other hand, is an independent undertaking that attempts to compete in the downstream market by obtaining the input from Company A. Company A keeps its wholesale price high while setting its own retail prices low. This pricing structure prevents Company B from operating effectively and creates the risk of its exclusion from the market. This situation exemplifies how a dominant undertaking can create exclusionary competition through pricing.

2.2.5.1 Perspective of Exclusionary Abuses on Vertical Mergers

Traditional vertical dominance abuses generally involve classic forms of monopolism (European Union, 2008, Art. 102). Several important factors play a role. These include the denial or restriction of access to critical inputs or infrastructure. Such situations are only examined under exceptional circumstances and within the scope of the Bronner test (European Commission, 2023).

European Union courts have adopted strict criteria in competition law to avoid hindering investments by dominant companies. A company forced to share its facilities with a competitor will lose motivation to invest in infrastructure, innovation, and capacity. Therefore, the

economic logic behind this approach, which aims to balance short-term competition with long-term investment incentives, is crucial. The main issue is whether realistic alternatives can be created. A facility is not considered indispensable simply because it is the cheapest, most suitable, or most efficient option for a competitor. To prevent this loss of motivation, the "indispensability" condition necessary for opening systems to competitors, has been applied very strictly.

The Bronner test, exemplified above and shaped by the European Court of Justice case (C-7/97), was developed to assess claims of abuse of dominant position under Article 102 of the TFEU. The application of the test requires that three fundamental conditions be met simultaneously: the input or facility in question must be in an indispensable position for the competitor to operate in the market; Denial of access must carry the risk of completely eliminating effective competition in the relevant sub-market; finally, the denial must not be based on a justifiable objective reason (Bronner, 1998, para.41; European Commission,2023, para.4). The claim that the merger will provide greater efficiency to a competitor has never been sufficient to overcome this three-stage structure and strict criteria. Foreclosure scenarios can make the process of implying these principles more complex than before. To illustrate with a concrete example, if a firm with a critical input operating in an upstream market enters a downstream market or acquires a competitor there, it may tend to withhold supplies from other downstream companies. This tendency could lead to their elimination from the market by increasing their costs or weakening their competitiveness. At the same time, depriving competitors of a key input would consolidate the merger's own market power. While the Bronner test, based on Article 102 of the TFEU, focuses on whether a dominant entity can legally share a facility, the main focus in general vertical merger reviews is whether the newly formed entity has the ability and incentive to exclude competitors and whether this will lead to

anti-competitive effects. Therefore, Bronner is not a general rule that automatically applies to every vertical joint operation.

Among these three factors, two possibilities exist: the input is indispensable, and the denial eliminates all competition in the adjacent market (European Commission, 2023). In addition, price abuses such as predatory pricing or profit margin squeezing are also assessed under Article 102 (European Union, 2008, Art. 102). To illustrate this concretely, consider a scenario where firm A, as a dominant producer, supplies a specific input while simultaneously selling its own products in the retail market. Firm B attempts to compete by purchasing inputs from A, but firm A sets its wholesale price high while keeping its retail prices low. This makes it difficult for firm B to operate profitably because its profit margin is “squeezed”.

Similarly, types of exclusive agreements are also important in terms of the dominant firm's effects on limiting competition. Exclusive agreements, particularly those implemented by a dominant undertaking, are more likely to create exclusionary effects when they have the potential to deprive customers of alternative choices.

2.2.5.2 Perspective of EU Merger Control and Article 102

Merger control under the EUMR is based on a prospective assessment from a competition law perspective. Intervention takes place before concentration occurs. The primary aim is to prevent the emergence of lasting competition harm in the market structure (Eben & Reader, 2023). In contrast, Article 102 of the TFEU has a retrospective function. The investigation focuses on behavior occurring within an already established market order. This tool is used to identify and sanction anti-competitive practices. The EU Market Regulation (EUMR) and Article 102 of the EU Treaty have different underlying methods for controlling vertical power. Despite these methodological differences, the fundamental economic driving force in both tools is the same: the prevention of vertical foreclosure. Consistent economic

principles, particularly the Raising Rivals' Cost (RRC) theory, play a significant role in the assessment process.

Both assessments require a precise analysis of the firm's market power. In this context, Article 102 focuses on dominance, while the EUMR relies on the SIEC test³. The likelihood that the firm's behavior or structural arrangement will lead to significant competitive harm is a key factor (European Commission, n.d.).

2.6 Importance of Remedies in Preventing Foreclosure

The fundamental function of merger remedies is to be a key factor in realizing the efficiency gains and economic benefits brought about by the merger. This key factor is used as a tool to ensure the preservation or restoration of competition in the market. In vertical mergers, this process creates a complex balance between the need to maximize integration benefits and the necessity of preventing foreclosure or abuse of market power. The stage at which remedies are applied encompasses many factors; their form and scope are determined by considering the structural effects of the merger, the intensity of competition in the relevant market, and the market power of the parties. This approach aims to both preserve the potential economic advantages of the merger and guarantee the long-term presence of competition (U.S. Department of Justice, Antitrust Division, 2020).

2.7 Types of Remedies

2.7.1 Structural Remedies

Structural remedies are generally implemented through divestiture, which in practice involves the sale of physical or intangible assets (Wong-Ervin, 2019). Such measures are important for creating permanent and one-off changes in the market structure. These remedies

³ For more information, see section 2.2.4.1. for a detailed discussion of Significant Impediment to Effective Competition (SIEC).

can eliminate the need for continuous regulatory intervention and monitoring. Historically, competition authorities such as the United States and the European Commission (EC) have preferred structural solutions. However, one of the downsides of this approach is its cost. It is often considered a high-cost regulatory intervention. Assistant Attorney General Delrahim stated that these could replace competition with regulation, criticizing behavioral solutions in the process. Ultimately, he emphasized that these methods lead to costly regulatory mechanisms (Wong-Ervin, 2019).

However, two significant limitations stand out for the use of structural solutions in vertical mergers. First, such solutions risk eliminating or ignoring the merger-specific efficiencies that constitute economic justification for the transaction (International Competition Network, Merger Working Group, 2018). For example, when company A merges with company B, which provides a critical input in its production process, the vertical integration efficiencies provided by the merger translate into lower costs and faster delivery to the consumer. If the benefits of this merger are based on the aggregation of assets, the divestiture of some assets often negates these consumer welfare gains. Therefore, the application of a structural solution may conflict with the fundamental economic objectives of the merger, thus limiting potential efficiency gains.

Secondly, structural remedies can sometimes have a paradoxical effect in vertical mergers (Motta, 2004, p. 361). Economic analyses show that divesting certain parts of a company can, under certain conditions, reinforce the incentive for non-integrated foreclosure with assets units still owned by the remaining integrated firm (Motta, 2004, p. 361). To understand this case more clearly, let's illustrate it with an example. Suppose firm A merges with a firm owning a distribution channel and divests a specific warehouse or logistics unit. In this case, the remaining integrated assets could be used to restrict the entry of competitors like firm B into the market or to limit competition.

This situation calls into question the assumption that structural remedies always produce less anti-competitive results. Therefore, authorities should adopt a more factual and case-based approach and consider behavioral solutions if necessary (OECD, 2012). Besides being more effective, many jurisdictions believe that structural solutions are generally easier to implement because they do not require continuous monitoring by the competent authority (OECD, 2012, p.19).

2.7.2 Behavioral Remedies

Behavioral remedies allow a merging firm to continue its integration process, but subject to specific business rules. The fundamental principle behind this approach is to prevent the firm from undermining competition in the market (Kwoka & Moss, 2011). These solutions regulate the business and strategic behavior of the merger firm. They typically guarantee access to a service or input for third parties under certain conditions (Kwoka & Moss, 2011).

For example, let's say firm A merges with a distribution company. Under a behavioral remedy, firm A can no longer prevent competitors like B and C from accessing the distribution service. This reduces the potential anti-competitive effects of the merger and keeps competition alive in the market without forcing the sale of assets (divestiture).

Vertical mergers often offer efficiencies that enhance competition (European Commission, 2008). This shows that, in some cases, behavioral solutions, when used in conjunction with structural solutions, are the most appropriate option as a limited and targeted measure that allows for the preservation of merger-derived efficiencies (OECD, 2025). For example, a merger between company A and company B can create Efficiencies Derived from Merger (EDM) in production processes. This advantage can be passed on to the consumer by reducing costs and increasing production efficiency. Therefore, authorities try to protect the economic benefits of the merger by acknowledging the potential risks posed by behavioral control (OECD, 2025). This highlights the complexity of securing both the economic gains

provided by integration and the preservation of competition in the market in merger reviews. In other words, it shows how much effort is required.

The biggest criticism of behavioral remedies is that they are extremely difficult to implement and monitor (OECD, 2020). Complying with such non-structural measures is a resource-intensive process for both the competition authority and the merging company. Typically, the monitoring task is delegated to specialized independent trustees, and the majority of the costs incurred in this process are borne by the merging parties (Wong-Ervin, 2019).

For example, in a vertical merger between company A and company B, let's say a behavioral solution has been implemented to protect access rights to a specific input. In this case, the merging companies would have to both comply with these provisions and support the independent auditors' reports. This process constitutes a significant burden in terms of both time and cost.

Competition authorities have evolved over time to develop more narrowly focused and targeted tools. This is because the difficulties in implementing and monitoring behavioral solutions are noteworthy (Motta, 2004). The main purpose of these tools is to preserve the economic rationale of the transaction, and especially the efficiencies specific to the merger, as much as possible. In doing so, they also aim to limit the competitive risks that may arise after the merger (OECD, 2020).

Theoretically, the merger of company B, which provides a critical input, and company A, which uses that input, could put competitor company C at a disadvantage. If it takes time for company C to turn to alternative suppliers, this leads to a temporary weakening of competitive pressure (Motta, 2004, p.364). In such a scenario, the merging undertaking providing technical support to company C for a certain period or maintaining access to the input under existing conditions may offer a more proportionate solution compared to a permanent divestment obligation. As the example shows, the aim of a vertically integrated undertaking resulting from

a merger is to minimize the risk of exclusion that competitors may face in the short term. Furthermore, this example demonstrates that, in some cases, temporary and behavioral measures can have less disruptive effects on competition than structural solutions.

Similarly, the importance of behavioral solutions is even more pronounced in digital markets. The competitive harms in these markets are different. Price increases are generally not observed. Instead, restrictions on access or technical incompatibilities can create problems. To illustrate with a concrete example, the merger of company A, which operates a digital platform, and company B, a large-scale data provider, could indirectly threaten the data access of independent developers operating on the platform. In such a case, interoperability or access commitments aim to ensure the survival of competitors in the market. However, these commitments cannot be limited solely to existing technical conditions. Otherwise, technological updates made after the transaction could render access virtually meaningless.

As this situation illustrates, the effectiveness of behavioral solutions largely depends on their specifics. The commitments must clearly regulate the scope, duration, and technical content of access. Furthermore, access must not only be legally recognized but also economically viable for the actual continuation of competition. At this point, examples demonstrate that behavioral solutions are not simply an alternative to structural remedies; rather, they should be considered as complementary and contextually sensitive tools for balancing integration benefits with competitive concerns in vertical mergers.

Chapter 3: Empirical Evidence on Foreclosure Effects on Vertical Mergers

3.1 Approved Case by the European Commission: Luxottica / Essilor (M.8394)

The merger brings together Essilor International S.A., a global leader in optical lens manufacturing, and Luxottica Group S.p.A., a pioneer in the design and distribution of eyeglass frames and sunglasses (European Commission, 2018). The concentration of the parties' activities in different but complementary stages of the optical value chain has resulted in strong vertical links within the transaction. Furthermore, the companies' broad product portfolios and brand assets have raised the potential for significant conglomerate effects. These structural characteristics necessitated a detailed assessment of the potential impact of the transaction on competition.

In this context, the European Commission subjected the merger to a comprehensive Phase II investigation (European Commission, 2017). During the investigation, the Commission did not limit itself to market structure indicators. It also considered the behavioral incentives of the parties and market dynamics. The assessment was supported by empirical market data, advanced economic analyses, and various modelling techniques. Thus, the potential impact of the merger on competition was addressed using an impact-based approach. The European Commission's assessment follows the rigorous application of the "Significant Impediment to Effective Competition" (SIEC) test (Council of the European Union, 2004). This approach reflects a modern understanding of merger control that goes beyond simple structural assumptions and focuses on concrete market effects. In this context, the Essilor/Luxottica decision provides an instructive case study of how the SIEC test applies to non-horizontal mergers (European Commission, 2018).

Ultimately, the merger was formally decided upon by the European Commission on 1 March 2018. The Commission found the transaction to be compatible with the internal market under the Merger Regulation (European Commission, 2018). This decision is considered a

significant milestone in the application of European Union merger control practices, particularly in terms of the concretization of directives relating to non-horizontal mergers (European Commission, 2018).

3.1.1 Strategic Positions and Market Dynamics of the Parties

It can be said that Essilor follows a strategic integration towards the upper stages of the optical value chain. To this end, Essilor's field of activity is not limited solely to ophthalmic lens production. In 2008, the company entered the market for ophthalmic production machinery and consumables by acquiring 80% of Satisloh's shares. Thus, the company has established a significant market presence not only in final products but also in production infrastructure and technologies (European Commission, 2018).

Essilor operates through group companies that it directly controls, often referred to in the literature as the "Blue Network" (European Commission, 2018)⁴. In parallel, there is a separate subsidiary structure organized under the BBGR brand, referred to as the "Red Network" (European Commission, 2018). In addition, relatively independent entities such as Shamir, Signet Armorlite, and Novacel are important components of the company's global operations (European Commission, 2018). This control mechanism is supported by a multi-layered and complex corporate structure.

Within this corporate and structural framework, Essilor International operates as a publicly traded French limited liability company. The production and wholesale distribution of ophthalmic lenses is the company's core area of expertise. Essilor follows a strategy to meet diverse consumer needs and solutions. Globally recognized brands such as Transitions, Eyezen,

⁴ For more information, see European Commission (2018), Case M.8394, Recital (39) - Definition of the "Blue" and "Red" distribution networks, p.13.

Varilux, Crizal, and Xperio make up the Essilor product portfolio (European Commission, 2018)⁵.

Luxottica's strategic strength stems from both its registered brand portfolio and prestigious licensed brands. Well-known brands such as Ray-Ban, Oakley, Vogue Eyewear, Persol, and Oliver Peoples demonstrate the company's design and manufacturing capabilities (European Commission, 2018). Additionally, Luxottica's product diversity and brand value are enhanced through other means. Distribution rights for prestigious licensed brands like Giorgio Armani, Ralph Lauren, Valentino, Prada, and Versace play a significant role in increasing brand value (European Commission, 2018). The Company's product design and manufacturing takes place in a total of 12 global facilities: six in Europe, three in China, one each in the USA and Brazil, and one in India (European Commission, 2018).

The company's business model focuses on the design, production, and distribution of prescription eyeglass frames and sunglasses. This focus strengthens its complementary role globally and thus defines Luxottica's strategic position in the market.

Luxottica operates a vast retail network of approximately 8,000 stores worldwide, exhibiting a vertically integrated structure within the retail sector (European Commission, 2018). Its presence in Europe is primarily represented by the Salmoiraghi & Viganò brand in Italy and the David Clulow brand in the United Kingdom. This vertical integration allows the company to control the value chain from production to the end consumer. This has enabled it to increase its market influence (European Commission, 2018).

The strategic merger was accomplished through a series of steps. These steps consist of the transfer of shares, a public exchange offer, and the creation of a new holding structure (European Commission, 2018, recital 13). In the first stage, Delfin's stake in Luxottica was

⁵ For more information, see European Commission (2018), Case M.8394, Recital (1) - Introduction of the parties and the creation of EssilorLuxottica.

transferred to Essilor. The second stage involved a mandatory public exchange offer. Finally, a new holding company, EssilorLuxottica, was established.

The resulting EssilorLuxottica structure has an integrated logistics and production center. For example, the Sedico laboratory in Italy allows for the simultaneous processing of lenses and frames. This development triggered initial concerns from the European Commission regarding the potential foreclosure effects of the merger (European Commission, 2018, recitals. 18, 56).

3.1.2 A Framework for Market Definition and Structure

The sector is acknowledged to have different production and distribution stages. The main idea behind this assessment is the European Commission's desire to understand both market boundaries and competitive dynamics. In this context, the Commission has carried out a comprehensive analysis based on a detailed description of products and geographical markets.

3.1.3 Optical Value Chain and Upstream Substrate Market

A fundamental distinction has been made between the wholesale supply of ophthalmic substrates and finished ophthalmic lenses (European Commission, 2018, recital 99). The raw material is produced in a form referred to in the industry as a "hockey puck." In the first stage of production, it is cast as a semi-finished product (European Commission, 2018, recital 35)⁶.

This semi-finished product is commonly defined in the optical industry as "ophthalmic substrate." Following the casting process, these semi-finished ophthalmic products are transferred to laboratories. Here, they undergo various processing steps to become the final product. The fundamental goal of these processes is to make the product suitable for its intended use. The processes carried out in prescription laboratories essentially consist of three main

⁶ For more information, see European Commission. (2018). *Case M.8394 - ESSILOR/LUXOTTICA*. Recital (35) – Providing the technical definition of the "hockey puck" as a semi-finished product (ophthalmic substrate) that requires surfacing and treatment in a prescription laboratory to transform into a finished single-vision or multifocal lens.

stages: surface treatment, coating, and/or coloring applications (European Commission, 2018, recital 35). As a result of these processes, the semi-finished products are transformed into monofocal or multifocal final ophthalmic lenses (European Commission, 2018, recital 35). The European Commission has determined that there is no substitution option on the demand side between these two stages. Similarly, no substitution option exists on the supply side. The main reason for this is that each stage requires different equipment and serves different customer groups. This shows that neither stage is interchangeable (European Commission, 2018, recital 99)⁷.

Considering low transportation costs and the multinational presence of all major competitors, it has been concluded that the geographic market for substrates is at least within the European Economic Area (EEA) (European Commission, 2018, recitals. 143, 145). Whether the market is worldwide has not been definitively determined, but effective competition has been found within the EEA. However, the market for finished lenses is limited at the national level (European Commission, 2018, recitals. 146, 149, 152). Several key factors underlying this situation. Among these, the importance opticians place on local sales and services is a significant factor. Furthermore, fast delivery times are a decisive factor in the preference for these products in national markets.

Another reason for the national market can be illustrated with examples from France or the United Kingdom. The national regulatory and reimbursement schemes in these two countries mandate that finished lenses be distributed only within their respective national markets. In other words, health insurance systems and reimbursement mechanisms in specific countries play a significant role in shaping the geographic market within national borders (European Commission, 2018, recitals. 146, 149, 150).

⁷ For more information, see European Commission. (2018). *Case M.8394 - ESSILOR/LUXOTTICA*. Para. (99) – Establishing the formal product market definition, which distinguishes the wholesale supply of finished lenses from the upstream supply of ophthalmic substrate due to a lack of demand-side and supply-side substitutability.

3.1.4 Downstream markets: Frames and Sunglasses

The Commission, in its geographical assessment, considered both the European Economic Area (EEA) as a whole and national market sizes. It showed that brand value is significantly more important in the sunglasses segment than in the frame segment.

In this context, the Commission concluded that the wholesale supply of frames and sunglasses should be analysed as separate product markets. While both categories fall within the broader eyewear sector, frames primarily play a functional role in vision correction, while sunglasses are often influenced by fashion trends and are typically marketed with non-corrective "shaded plano lenses" (European Commission, 2018, recital. 99). The research also observed that although branding strategies are often coordinated at a global level, local consumer preferences and distribution channels continue to play a decisive role.

The ophthalmic machinery market presents a more complex structure, as it includes surfacing, coating, and edging equipment (European Commission, 2018, Section 1.5, recital 18). Edging machines are further divided into two sub-segments: industrial units used by laboratories and desktop edging machines used by retail opticians.

Finally, the optical retail market was defined at the national level, reflecting the presence of physical stores and the local nature of eye examination and fitting services.

The geographic scope of these machines was considered to be at least at the level of the European Economic Area (EEA), since production is centralized and shipments are made globally.

Table 1: Summary of Relevant Market Definitions

Market Segment	Product Delineation	Geographic Scope	Key Players / Factors
Ophthalmic Substrate ⁸	Semi-finished "pucks"	EEA / Global	Essilor, Hoya, Zeiss
Finished Lenses	Single-vision, Progressive	National	Local service, Insurance
Frames	Prescription frames	EEA / National	Luxottica, Safilo, Marchon
Sunglasses	Branded plano eyewear	EEA / National	Ray-Ban, Oakley, Maui Jim
Machinery	Surfacing, Coating, Edging	EEA / Global	Satisloh (Essilor), Schneider
Optical Retail	Brick-and-mortar, Online	National	GrandVision, Specsavers

3.1.5 The Theoretical Framework for Assessing Foreclosure

The 2008 Guiding Principles on the Assessment of Horizontal Mergers provided the basic framework for examining the Essilor/Luxottica merger. The Commission adopted an approach that considers both horizontal and vertical mergers in assessing such transactions. Horizontal mergers generally bring a higher risk of competition because they often lead to the exit of direct competitors from the market. In contrast, horizontal mergers can often have

⁸ Product: These are the semi-finished "pucks" (often called "hockey pucks") that serve as the raw material for prescription lenses (para. 35). Geography: Defined as EEA/Global because these items are easily shipped worldwide with low transportation costs, and major players like Essilor, Hoya, and Zeiss operate on a global scale (para. 143, 145).

positive effects that support competition. These positive effects include eliminating double marginalization and creating more efficient supply chains. However, the European Commission has also found that horizontal mergers can significantly restrict competition. In this context, two main risk areas have been identified: uncoordinated effects and coordinated effects.

In case M.8394, the Commission's examination focused particularly on uncoordinated effects. Among these effects, foreclosure plays a significant role. Anti-competitive behavior occurs when a merging undertaking restricts competitors' access to inputs (input restrictions) or customers (customer restrictions). The Commission has stated that three key criteria must be met simultaneously for an intervention decision to be based on a risk of anti-competitive behavior. These are: the ability to foreclose, the incentive to foreclose, and the overall negative impact on competition and consumers.

3.1.6 Potential Competition in the Lens Market

One of the most closely examined areas was Luxottica's entry into the lens market. Essilor's internal documents revealed concerns about this entry, characterizing Luxottica as a potentially significant competitor in the "prescription sunglasses" niche. Luxottica had recently launched the "Ray-Ban Rx" project, offering pre-fitted frames with branded prescription lenses manufactured at the Sedico facility. However, the Commission's investigation determined that Luxottica's lens activities remained marginal. Market shares across all European Economic Area countries consistently remained below 1%, and production capacity was insufficient to meet the extensive requirements of ophthalmologists needing thousands of different lens types, which Luxottica could not supply. Consequently, it was found that the merger did not eliminate a significant existing or potential competitor in the lens market.

3.1.7 Potential Competition in Frames and Sunglasses

The Commission's assessment found that this share often remains below 1% across the European Economic Area. This indicates that Essilor's market share in the eyewear segment is quite limited. This finding played a significant role in concluding that any horizontal effects in the eyewear sector would not be significant. During the review process, the Commission also analyzed whether Essilor's Bolon and Costa brands posed competitive pressure on Luxottica. Market research revealed that these brands are only marginally competitive against Luxottica's broad portfolio of brands positioned in the upper segment. Therefore, these brands were considered "distant competitors."

The Bolon brand was found to have low brand awareness in Europe. However, it was acknowledged to have achieved some success in the Asian market. Nevertheless, it was also determined that it faced significant challenges in entering the premium segment.

The Costa brand primarily targets a narrow consumer group focused on sports and performance. In other words, its positioning is different. Therefore, it has a limited impact on the premium fashion segment aimed at a wider audience.

3.1.8 Vertical Merger Assessment

The merger generated multiple vertical connections, specifically concerning raw materials and the integration of lens production with retail. The primary vertical concern in the merger was that the combined entity would leverage Essilor's upstream dominance in the lens and ophthalmic machinery space to exclude rival eyewear manufacturers or independent retailers from the market.

3.1.8.1 Input Foreclosure in Substrates and Machinery

Essilor's dominant position in ophthalmic substrates and surfacing/coating machines (30-40% share) increased the likelihood that it would restrict essential inputs to rival lens

manufacturers such as Hoya and Zeiss. However, it was discovered by the commission that these rival lens manufacturers had access to multiple alternative suppliers, which represented the other 60-70% of the market. Essilor's financial strategy was centered on selling substrates and equipment to external partners to offset R&D expenses. Any disruption to supply conditions would have caused a sharp decline in high-margin wholesale revenue; a loss that the merged entity would be unable to offset via its internal downstream operations (European Commission, 2018, Recitals 189, 348, 349, 356)⁹.

The Commission also found that the incentive to conduct foreclosure sales was insufficient. According to the assessment, Essilor's internal sales to its own laboratories account for approximately 80% to 90% of its total raw material revenue. This indicates that internal demand dominates the company's revenue structure. In this context, implementing a foreclosure strategy targeting third-party customers was not considered economically rational. Such a strategy would also have to consider Luxottica's internal lens demand through its Sedico laboratory. However, this internal demand was deemed insufficient to offset the potential loss of upstream sales volume.

Consequently, such a strategy would potentially risk approximately 10% to 20% of Luxottica's total revenue. In contrast, the expected gain would be quite limited. Therefore, the Commission concluded that the incentive to prevent competition was inadequate.

⁹ **Recital 349**

European Commission. (2018). *Case M.8394 - ESSILOR/LUXOTTICA*. Recital (349) – Providing the specific market share data for ophthalmic substrates, which Essilor estimated to be [30-40] % at both the EEA and worldwide levels, serving as a basis for the input foreclosure assessment.

Recital 356

European Commission. (2018). *Case M.8394 - ESSILOR/LUXOTTICA*. Recital (356) – Detailing market shares for ophthalmic machinery in the EEA, including coating machines ([30-40] %), surfacing machines ([40-50] %), and consumables ([30-40] %), used to evaluate potential constraints on rival manufacturers.

3.1.8.2 Ophthalmic Machines and Consumables

Essilor's acquisition of Satisloh, a global leader in surface treatment and coating machinery, has raised concerns that it could restrict access to critical technology for competing laboratories. Surface treatment machinery provides optical durability to lenses, while coating machinery performs anti-reflective and anti-scratch applications.

The Commission addressed its assessment of surface treatment and coating machinery under three headings. First, the capability factor was examined. It was found that alternative suppliers, such as Schneider and OptoTech, exerted strong competitive pressure. However, Essilor was determined to have approximately 40-50% market share in surface treatment machinery and 30-40% in coating machinery (European Commission Section 11.2, recital 356). These percentages were considered significant. It was particularly emphasized that these competitors are not vertically integrated into lens manufacturing (European Commission Section 11.2, recital 358). This suggests that these companies have strong incentives to supply machinery to competing laboratories.

Second, the incentive factor was analyzed. Essilor derives significant profits from the sale of machinery to third-party laboratories. Therefore, a total or partial discontinuation of supply was deemed economically illogical. This type of strategy could lead to customers switching to Schneider or OptoTech, resulting in permanent losses in high-margin machine sales. Furthermore, it was considered impossible to offset these losses with the lower-level operations of the combined entity (European Commission Section 12.6, recital 787).

3.1.8.3 Customer Foreclosure

The inverse theory of harm involved customer foreclosure. In this context, the Commission assessed whether Luxottica, through its extensive retail network, could hinder competing lens manufacturers from reaching a sufficient customer base.

For such a risk to be considered realistic, Luxottica would be expected to assume a "gatekeeper" role in the retail market (European Commission, 2018, recital 192)¹⁰. Therefore, the investigation focused on whether the company's retail power was sufficient to restrict competing manufacturers' market access.

The Commission's reasoning against customer foreclosure:

- **Incentive Trade-offs:**

The European Commission investigated whether Luxottica could leverage its retail presence to effectively eliminate Essilor's competitors from the market. This inquiry focused specifically on the Salmoiraghi & Viganò chain in Italy and David Clulow in the United Kingdom. At its core, the Commission's concern was whether the merged entity might impose a boycott of rival lens manufacturers in its own retail outlets. However, the empirical evidence suggested that this concern was unlikely to materialize (European Commission, 2018, section 11.4 recitals 375-376).

- **Lack of Ability:**

In both countries, these specific retail chains held a modest market share of only 5% to 10% (European Commission, 2018, section 11.4 recitals 380-381). Such a limited foothold was deemed insufficient to block competitors, as they would still retain access to over 90% of the market through independent practitioners and major rival retailers like Specsavers or GrandVision (European Commission, 2018, section 11.4 recitals 380-381).

¹⁰ For more information see European Commission (2018), Case M.8394 Section 11.4. It states that for customer foreclosure to be a concern, the firm must be an "important customer" with a "significant degree of market power" in the downstream market.

3.1.9 Conglomerate Effects: The Leveraging of "Must-Have" Eyewear Brands

The investigation centred on the conglomerate theory of harm: the concern that the merged entity might utilize Luxottica's extensive portfolio of dominant eyewear brands to shut out competing lens producers.

3.1.9.1 The Empirical Deconstruction of "Must-Have" Brands

One of the commission's main concerns was whether brands like Ray-Ban and Oakley were indispensable to opticians (European Commission, 2018, Summary decision, Recital 39). The underlying theory was that if an optician could not remain commercially viable without stocking Ray-Ban products, the merged entity might pressure that optician into purchasing Essilor lenses as a condition for access to those frames.

To examine this possibility, the Commission carried out a large empirical study based on responses from 3,366 opticians representing both independent stores and retail chains (European Commission, 2018, Summary decision, Recital 25). The findings were unexpected and ultimately rejected the "must-have" hypothesis. Around 40–50% of optical stores in the European Economic Area do not carry any Luxottica brands, indicating that a significant portion of the market is not exposed to potential leveraging (European Commission, 2018, Section 12.3.1, Recital 38)¹¹. In addition, fewer than 40% of Luxottica's own customers considered Ray-Ban to be a must-have brand for driving store traffic. Opticians consistently ranked service quality, store appearance, and lens pricing as more important factors for attracting customers than the availability of specific frame brands (European Commission, 2018, Summary Decision Recital 38).

¹¹ For more information see Case M.8394 – Essilor / Luxottica, Summary of Commission Decision (2018/C 335/08), Official Journal of the European Union, C 335/08.

Altogether, the evidence suggested that although Luxottica's brands are strong, they do not confer sufficient market power to trigger large-scale changes in lens purchasing behaviour (European Commission, 2018, Summary Decision Recital 38).

3.1.9.2 The Incentive Analysis: Margin Imbalances and Strategic Risk

The Commission further found that, even assuming the merged entity had the ability to exercise leverage, it would not have a clear economic incentive to implement a tying strategy¹². This conclusion stemmed from an analysis of variable profit margins across product categories. In particular, Luxottica historically earned much higher margins on frames and sunglasses; several times those achieved by Essilor in the lens segment. From an economic standpoint, a tying strategy would imply that opticians are required to purchase Essilor lenses in order to access Luxottica frames. However, such an approach would likely lead to customer diversion, as opticians could shift their demand toward competing eyewear suppliers such as Safilo. Given the structure of margins, the financial trade-off becomes unfavourable. The loss associated with a single foregone frame sale is considerably larger than the gain from one lens sale. As a result, for the merged entity to break even, it would need to offset each lost frame transaction by selling multiple additional pairs of lenses, making the strategy economically unattractive. Mathematically, if $M_{frame} > n \cdot M_{lens}$ (where n is the number of additional lens sales captured)¹³, the strategy is inherently loss-making unless the capture rate is exceptionally high and the churn rate exceptionally low (European Commission, 2018, section 11.4 recitals 460-

¹² The Commission employed a rigorous analysis of the profit sacrifice required for a tying or bundling strategy.

- **Upstream (Lenses):** Higher volumes but moderate margins.
- **Downstream (Eyewear):** Highly branded, high-margin products.

¹³ This formula represents the "break-even" point for a tying strategy. For more information see European Commission (2018), Case M.8394 Section 12.2.2.2., recital (460). It explicitly states that Luxottica's margins are "several times higher" than Essilor's and explains that the merged entity would need to sell multiple pairs of lenses to compensate for the loss of a single frame sale. Section 12.2.2 (Incentives to Foreclose): Provides the overarching economic framework used to assess whether tying frames and lenses would be profitable (paras. 454-460)

471). Given that opticians place significant value on their professional independence and on their ability to tailor lens choices to the needs of their patients, the Commission concluded that a mandatory tying arrangement would not make economic sense (European Commission, 2018, section 11.4 recitals 459-471).

3.1.9.3 Mixed Bundling and Scale Economies

The Commission acknowledged that the merged entity would likely have incentives to introduce mixed-bundling, meaning it could continue selling frames and lenses separately while also offering them together as a discounted “one-stop shop” solution (Section 8.3.3.3.3, recital 583). However, mixed-bundling is generally viewed as pro-competitive because it reflects the elimination of double marginalization and can pass cost savings on to customers (Section 8.3.3.4, Paragraphs 593–594). The investigation indicated that any potential shift in volume away from rival lens manufacturers resulting from such bundles would likely remain limited, with estimates suggesting an impact of less than 5% of total market volume (Section 8.3.3.5.3, para. 624). At the same time, strong global competitors such as Zeiss and Hoya would remain well positioned to compete on quality and innovation (Section 8.3.3.6.1, Paragraphs 631- 633), and large retail chains would continue to exercise countervailing buyer power Section 8.3.3.6.1, para. 640).

3.1.10 National Market and Member State Analysis

Since the lens market has a national dimension, the Commission needed to verify its findings across each region of the European Economic Area (EEA), with particular attention given to Member States where Essilor held strong market shares.

3.1.10.1 France: The Power of OCAMs and Buying Groups

In France, Essilor holds a dominant position in the lens market, with a share estimated at around 70–80% (European Commission, 2018, Recital 532). However, this strength is

counterbalanced by the distinctive structure of the French health insurance system, where the “Organismes Complémentaires d’Assurance Maladie” (OCAMs) manage healthcare networks. Covering roughly 94% of the population, these networks run tender procedures to select lens suppliers and impose price caps, which limits Essilor’s ability to fully exercise its pricing power (European Commission, 2018, Recital 542). Also, with a major purchasing group named Krys’ vertical integration into lens manufacturing, opticians get a trustworthy alternative to Essilor if they wish to not choose any undesirable offer, they may encounter. (European Commission, 2018, Recital 540).

3.1.10.2 Italy: Consolidation vs. Local Fragmentation

In Italy, which is Luxottica’s core market, the company accounts for approximately 40-50% of frames and 60-70% of sunglasses (European Commission, 2018, Recital 566). By contrast, Essilor’s share in lenses remains around 30-40%, which is below the average observed across the European Economic Area (European Commission, 2018, Recital 567). About 90% of the opticians in the Italian market are independent operators, though they are brought together under purchasing groups that focus on product procurement, such as Vision Group and Green Vision. With the presence of many local laboratories and the credible international competitors like Rodenstock, all aforementioned issues were considered as valid deterrents for any possible market foreclosure. (Section 11.4.1, recital 373)

3.1.10.3 Germany: The Fielmann Constraint

Fielmann is not only a dominant retailer but one that manufactures a significant amount of its own frames and lenses, multiplying its competitiveness in the German market that it leads, which is notorious for having a high level of consolidation in the retail sector. (European Commission, 2018, para. 548). This form of “private label” competition creates downward pressure on both Essilor and Luxottica. With Ray-Ban having a less-than-average market share in Germany, alongside Luxottica's limited frame share of 5-10%, the possibility of the merged

entity's leveraging power carrying itself from the eyewear segment into the lens market is viewed as highly unfeasible. (European Commission, 2018, recital. 547).

3.1.10.4 Eastern Europe: Romania, Slovakia, and Poland

Compared to the markets such as Romania and Slovakia, in which Essilor has high shares in multifocal lenses (around 70-80%), Essilor encounters tough competition from low-cost Asian imports and local companies like Interoptik in the single-vision segment (European Commission, 2018, recital 760). The Commission concluded that an attempt to increase prices or block competitors' availability of choice to customers would result in the merged entity losing customers to rival companies, since these markets were still developing and price sensitivity was high.

3.1.11 The Impact of Scale Economies on Competitive Dynamics

One of the complaints the Commission had faced regularly was the possibility of the merger preventing the rivals from growing to a crucial scale in order to be able to compete. The Commission's technical analysis deconstructed the role of scale economies in the lens industry.

3.1.11.1 Global Production vs. National Distribution

The investigation unveiled the difference between the distribution of the lenses and the production; the former is national, while the latter is global (European Commission, 2018, paras.130-142). Asia is the main place for the big-scale facilities where Essilor and its competition manufacture the majority of the lenses. Even if a competitor loses a small share of its volume in the European Economic Area, its global production costs will remain largely unaffected (European Commission, 2018, Summary Decision, Recital 41). This is because these facilities have achieved economies of scale based on total global volume rather than national market shares.

3.1.11.2 The Profitability Correlation

To test the economies of scale hypothesis, the Commission conducted a comprehensive empirical analysis. This analysis focused on the relationship between manufacturers' market size and profitability levels (European Commission, 2018, Recital 487 (a))¹⁴. The study was designed to cover different European Economic Area (EEA) countries. The data obtained did not reveal a significant correlation. It was observed that lens suppliers were able to achieve high profitability even in countries where they had small market shares. This profitability level was largely similar to their performance in countries where they were market leaders. This finding indicates that scale is not a determining factor for profitability (European Commission, 2018, Recital 487 (b)). It also concludes that marginalization theory is not supported by the economic reality of the sector. Therefore, the economic basis of the related foreclosure concerns is weakened.

3.1.12 The Horizon of Competition Policy: Merger Guidelines Review

Case M.8394 was assessed under the “impact-based” regime developed after the 2004 reform of the EU Merger Regulation. This regime focuses on economic impacts rather than abstract structural analyses in competition policy applications. The Essilor/Luxottica decision continues to be considered an important reference point in this context. It is seen as playing a decisive role, particularly in addressing conglomerate concerns. Such concerns constitute approximately 5% of the cases in which the Commission intervenes (European Commission, 2018, section 8.3, paras.193-199.). The Commission is conducting a review process to adapt the current guidelines to contemporary market conditions. Digitalization is a key area of assessment in this process (Armengod et al., 2025). Economic resilience and the increasing strength of integrated ecosystems are also included in the analysis. These elements demonstrate that modern market structures are becoming more complex.

¹⁴ For further information, see European Commission (2018, Case M.8394 recitals 487(a)-487(b)).

It is considered that this ongoing review process may lead to some significant changes. In particular, stricter indicators to facilitate the detection of harmful concentrations in digital markets may be introduced. Furthermore, strengthening the system of rebuttable presumptions is under discussion (Armengod et al., 2025). Nevertheless, the current analytical framework has not been completely abandoned. The Ability-Incentive-Effect framework is still considered the cornerstone of non-horizontal merger assessment (European Commission, 2008, Section V, para.94)¹⁵. This framework continues to play a central role, particularly in the analysis of vertical and conglomerate mergers.

3.1.13 Synthesis and Conclusion of the Commission's Decision

Before the European Commission approved the merger of Essilor and Luxottica, one of the comprehensive evidence-gathering processes outlined in the history of the Directorate-General for Competition was provided. This process is considered important in demonstrating how far the evidentiary standard for competition policy applications can be expanded. The Commission did not give prominence to theoretical exclusion models in its assessment process. Instead, it adopted an analytical approach based on market dynamics. In this respect, the difference between economic reality and model ranges becomes more apparent.

The analyses revealed that imbalances in unit profit margins played a critical role. These imbalances were assessed as economically distancing the merger. Therefore, the theoretical claims regarding potential seizure risks were not considered sufficiently strong. At the same time, the Commission conducted extensive field studies based on empirical data. Surveys collected from opticians formed an important part of this process. The results of these surveys

¹⁵ European Commission. (2008). Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2008/C 265/07), Section V (Conglomerate Mergers), Paragraph 94 (explaining the Ability-Incentive-Effects framework).

did not support the continuation of the "indispensable" brand theory. Therefore, this theory was empirically expanded.

The decision has revealed several key insights from a modern competition policy perspective. These insights focus particularly on how to conduct competition analysis in complex and multi-brand markets. First, it has been found that consumer awareness is asymmetric. Strong brand preferences for frames are not reflected to the same extent in brand preferences for lenses (European Commission, 2018, Recital 674). This disconnect weakens the continuity of the vertical leverage effect. Second, it has been assessed that market fragmentation serves a protective function for competition. The existence of numerous independent optician structures supports this conclusion. Furthermore, the role of sophisticated purchasing groups in the market is considered an important balancing factor. This structure creates a structural buffer mechanism against supplier leverage (European Commission, 2018, Recital 425). Third, it has been emphasized that vertical integration is not inherently harmful. Internalization of margins alone does not lead to an anti-competitive outcome. If competitors are not reduced below a critical scale globally, this structure can lead to “complete offerings” that benefit consumers.

In the conclusion, case M.8394 clarifies the European Commission’s approach. The Commission confirmed that it would not block mergers based solely on the abstract possibility of exclusion. Instead, it demanded convincing evidence that such a strategy was both feasible and profitable. The merger was assessed as compatible with the internal market. This was primarily because the conditions described as the “foreclosure triad” were not met (European Commission, 2018, Recitals 419-493)¹⁶. The entity lacked the capacity to forcefully establish its brands in a large part of the market. The incentive to forgo high frame margins in exchange for lower lens profits was also weak. Finally, the existence of strong competitors capable of competing globally, regardless of changes in the European market, supported this assessment.

¹⁶ For more information, see European Commission (2018), Case M.8394, Recital (419-493)

3.2 Unapproved Case by the European Commission: The Meta-GIPHY Merger and the Frontier of Vertical Foreclosure: A Comprehensive Competition Policy Analysis

Facebook, Inc.'s (now Meta Platforms, Inc.) acquisition of GIPHY, Inc. is considered a concrete and instructive example of contemporary competition policy practices in the digital economy. The transaction is particularly noteworthy as it is one of the first instances where a completed merger between two major technology companies was successfully reversed by an antitrust authority. Examining the horizontal competition aspect of the case lays the groundwork for developing new legal theories that point to the risk of eliminating or weakening dynamic competition in the display advertising market. However, the primary justification for the intervention is based on vertical competition analyses, particularly the risk of input foreclosure.

The UK Competition and Markets Authority (CMA), following an initial review, appeals process, and subsequent remand assessment, concluded that Meta's control over the world's largest searchable GIF library created a disadvantage for competing social media platforms and strengthened the incentive for them to act in that direction (Competition and Markets Authority, 2022, para. 29). In this context, the CMA assessed that control of the entity in question could have exclusionary effects on the competitive process, particularly limiting competitors' access to the market and necessary inputs for user interaction. Thus, the decision has become an important precedent regarding the potential foreclosure risks that vertical integration can create within the framework of modern competition policy.

3. 2. 1 The Structural Background of the Meta-GIPHY Transaction

To properly evaluate the results of competitive bidding policies, it is first necessary to establish the structural relationship between the parties and the strategic position of the GIF market within the social media ecosystem. In this context, it is accepted that this market is not merely a supplementary content area, but a significant digital input shaping cross-platform user

interaction. Founded in 2013, GIPHY has operated as an online database and search infrastructure enabling the discovery, indexing, and sharing of Graphic Interchange Format (GIF) content and animated stickers (Competition and Markets Authority, 2022, para. 2.1). Thanks to its large-scale content archive and API-based integration model, the platform has become an intermediary providing infrastructure to numerous digital service providers (Competition and Markets Authority, 2022, para. 4.1).

These digital assets have not only been limited to producing visual aesthetics; they have also become a functional communication tool transforming users' online communication practices (Competition and Markets Authority, 2022, para. 2.2). GIFs offer a silent yet continuously cyclical visual narrative that text-based expressions or static emojis cannot provide, allowing for the rapid transmission of emotions and reactions (Competition and Markets Authority, 2022, paras. 2.2 - 4.6). Because of these characteristics, GIFs have become one of the essential tools for increasing user engagement on social media platforms and have gained strategic importance as an input in terms of cross-platform competition (Competition and Markets Authority, 2022, para. 4.6). This situation necessitates their consideration in competition policy analyses of the relevant market.

On the other hand, Meta is considered an undertaking operating through an “application family” consisting of Facebook Blue, Instagram, WhatsApp, and Messenger, and holding a dominant position in the downstream market of social media and messaging (Competition and Markets Authority, 2022, para 2.17). Within this market structure, Meta is seen to have gained a significant network effect advantage in terms of user reach and distribution power. This situation emerges as a structural feature that strengthens the company's competitive position.

Before the merger, GIPHY was a key supplier of GIF content to both Meta's own platforms and Meta's direct competitors, such as TikTok, Snapchat, and Twitter. In this respect, GIPHY functioned as a critical input provider at the upstream market level. The transaction,

valued at approximately \$315 million to \$400 million, led to the restructuring of this supply relationship through vertical integration (Competition and Markets Authority, 2022, para. 2.28). Thus, the market relationship, previously based on an independent input, transformed into an integrated hierarchical structure. In this new structure, the undertaking controlling the downstream distribution channels gains decisive control over the critical upstream input (Competition and Markets Authority, 2022, Summary, paragraph 14(b) and paragraph 8.7). This situation is significant from a competition policy perspective for its potential foreclosure risks.

The judicial basis for this intervention rests on the “share of supply” test¹⁷ applied in UK competition law. This test differs from traditional approaches in that it focuses not solely on financial turnover, but on shares determined by supply relationships in the market. Although GIPHY did not generate direct turnover in the UK, the Competition and Markets Authority (CMA) found a supply-side overlap between applications and web-based services that allow UK users to search for and share GIF content. This assessment revealed that the combined entity held approximately a 50–60% share of GIF search and sharing activity in the UK market. This high level of concentration provided a sufficient basis for regulatory intervention.

This jurisdictional approach demonstrates a departure from competition policy that relies solely on traditional turnover thresholds. Instead, the nature of activities in digital markets, user interaction, and cross-platform supply relationships are analysed in greater detail. In this context, the CMA's approach points to a new regulatory framework in the digital economy that takes into account economic efficiency and user behavior in a more nuanced way when determining jurisdiction.

¹⁷ Competition and Markets Authority (2022), *Completed acquisition by Facebook, Inc (now Meta Platforms, Inc) of Giphy, Inc: Final report on the case remitted to the CMA by the Competition Appeal Tribunal*, Paragraph 3.21: Formally introduces the share of supply test under section 23 of the Act as the basis for jurisdiction when the turnover test is not met.

3. 2. 2 Upstream Market Power and GIF Supply Chain

In vertical integration analysis, the evaluation process begins with defining the boundaries of the upstream market (Competition and Markets Authority, 2022, para.5.38)¹⁸. In this context, the market under examination encompasses economic activities related to the supply of searchable GIF libraries. This upstream market structure is found to exhibit a high degree of concentration and significantly high barriers to entry (Competition and Markets Authority, 2022, paras.5.84-5.88)¹⁹. This is considered a structural characteristic that makes it difficult for new players to enter the market. It is observed that multiple structural elements have contributed to GIPHY's global leadership position. One of the most important factors is the platform's extensive and diversified GIF library. In addition, GIPHY's advanced search algorithm allows users to access content quickly and efficiently, strengthening its competitive advantage.

Finally, the company's extensive Application Programming Interface (API) and Software Development Kit (SDK) distribution partnership network has increased its ability to integrate with various digital platforms, further solidifying its position in the upstream market (Competition and Markets Authority, 2022, paras.5.92-5.95). The combination of these elements is considered the fundamental structural factor determining GIPHY's market power.

¹⁸ CMA Final Report (2022) Paragraph 5.38 (formal conclusion on the market definition)

¹⁹ CMA Final Report (2022): Paragraphs 5.84-5.88 (market concentration analysis) and Paragraphs 5.91-5.101 (barriers to entry and expansion).

Table 2: Global API/SDK Search Volume Shares of GIF Providers (2020 and H1 2022)²⁰

GIF Provider	2020 Global API/SDK Search Share	H1 2022 Global API/SDK Search Share
GIPHY	60-70%	50-60%
Tenor (Google-owned)	30-40%	40-50%
Gfycat (Snap-owned)	0-5%	0-5%
Holler	0-5%	N/A
Total	100%	100%

Source: CMA analysis of data provided by GIPHY and third parties.

3. 2. 3 Downstream Market Dynamics: Dominance in Social Media

The downstream markets directly affected by the merger are considered to be social media services and display advertising markets (Competition and Markets Authority, 2022, paras. 5.102-5.193)²¹. These two markets are closely linked in terms of both user engagement and advertising revenue generation. Analyses conducted specifically in the United Kingdom reveal that Meta's platforms direct the largest share of users' social media usage time (Competition and Markets Authority, 2022, Summary, para.19). This indicates that a significant portion of user attention and engagement time is concentrated within the Meta ecosystem. This concentration points to Meta's structurally strong position in the social media services market. This structure also allows for the scaled collection of user data and the more effective execution of display advertising activities. In this context, the interdependent relationship between social media services and display advertising becomes one of the key elements considered in

²⁰ Note. Adapted from Completed acquisition by Facebook, Inc. (now Meta Platforms, Inc.) of Giphy, Inc.: Final report on the case remitted to the CMA by the Competition Appeal Tribunal (paras. 5.84 and 5.87), by the Competition and Markets Authority, 2022.

²¹ CMA Report (2022) Paragraph 5.102 (social media definition) and Paragraph 5.193 (display advertising definition).

competition policy analyses. The interaction between these two markets plays a critical role in evaluating the economic impacts of the merger.

Table 3: Shares of Supply by User Time Spent on Social Media, UK²²

Platform	2020 UK User Time Share	Jan-Mar 2021 UK User Time Share
Facebook Blue & Messenger	52.7%	48.8%
WhatsApp	12.3%	13.9%
Instagram	7.8%	8.7%
Meta Platforms Total	72.8%	71.5%
TikTok	9.9%	12.4%
Snapchat	7.1%	4.7%
Twitter	5.4%	6.5%
Pinterest	1.6%	1.7%

Regulatory authorities have determined that Meta's market power is supported by strong network effects. Each new user joining a platform increases its value to other users, making this effect even more pronounced. This dynamic structure creates a significant structural barrier that hinders the entry of new social media applications into the market. For new ventures to become a competitive alternative, reaching a large and sustainable user base becomes essential. Meta has also been found to have a strong position in the UK display advertising market. The company's market share consistently hovering around 40-50% indicates the continuity of its dominance in this area (Competition and Markets Authority, 2022, para. 5.195). Meta's ability to utilize the detailed user data it collects across the social media ecosystem for advertising targeting creates a competitive advantage on a scale unmatched by most competitors.

²² Note. Adapted from Completed acquisition by Facebook, Inc. (now Meta Platforms, Inc.) of Giphy, Inc.: Final report on the case remitted to the CMA by the Competition Appeal Tribunal (para. 5.144, Table 4), by the Competition and Markets Authority, 2022. Data originally sourced from CMA analysis of Comscore MMX Multi-Platform data supplied by Facebook. Total Digital Population, Desktop aged 6+, Mobile aged 13+, UK.

Facebook Group includes Facebook Blue, Messenger, Instagram, and WhatsApp. With the exception of January and February 2020, data for Tumblr was not available to the CMA; we have therefore used data for equivalent months from 2019 as a proxy.

An assessment within the framework of vertical damage theory reveals that Meta's acquisition of the upstream GIPHY library could further strengthen its dominance in the downstream market. In this context, Meta's ability to degrade the quality of GIF content provided to competing platforms or to completely restrict access to it is seen as a significant risk in terms of competitive dynamics. Such a strategic intervention has the potential to reduce the attractiveness of competing platforms like TikTok or Snapchat to users (Competition and Markets Authority, 2022, paras.8.7-8.12). Considering that most social media users exhibit multi-homing, even small changes in feature quality could direct user attention to dominant "essential" platforms (Competition and Markets,2022, paras.8.95-8.96). This indicates that foreclosure risks may be strengthened from a competition policy perspective.

3. 2. 4 Vertical Merger Assessment: The Framework of Foreclosure

The CMA's (Competition Market Authority) assessment framework for vertical integration analysis is based on three main elements: Ability, Incentive, and Effect (Competition and Markets Authority, 2022, para. 8.7). This approach allows for a systematic analysis of the potential consequences of vertical integration on competition. This analytical tool examines how a firm uses its market power across different levels of its supply chain. Specifically, it assesses whether a vertically integrated undertaking can use its power at either the upstream or downstream market level to influence competitive conditions at other levels.

This assessment approach analyzes not only the firm's structural market position but also its behavioral capacity. Thus, it can more comprehensively reveal whether vertical integration has restrictive consequences for competition. In this context, this model functions as a critical analytical tool in determining whether an undertaking creates foreclosure risk, an important concept in competition policy, by using its position in the supply chain.

3.2.4.1 Ability to Foreclose Rivals

The “ability” assessment focuses on the market significance of the input and the extent to which substitutable alternatives exist. In this context, CMA has determined that GIF content is a “clearly significant” element that significantly drives user interaction (Competition and Markets Authority, 2022, paras. 8.11-8.16). User interaction is considered a fundamental determinant of the social media ecosystem. This element is a critical variable that determines the time users spend on the platform, the frequency of their return to the platform, and indirectly, the total volume of advertising inventory. Therefore, the level of interaction is considered a factor that directly affects the economic performance of platforms. CMA’s analyses show that Meta has the capacity to impose exclusionary effects on competing platforms through various mechanisms. This capacity can manifest through different operational channels.

The first of these mechanisms is the “Total Foreclosure” scenario. In this scenario, it is assumed that Meta has the ability to terminate GIPHY’s API and SDK agreements with competing social media platforms. In such a case, competing platforms’ access to the primary GIF source is cut off, indicating a significant foreclosure risk (Competition and Markets Authority, 2022, para. 8.12 (a)).

The second mechanism is described as “Partial Foreclosure.” In this case, Meta can indirectly reduce service quality rather than directly eliminate it. For example, slowing down API response times, limiting content variety, or offering a more limited (“light”) version of the API to competitors falls under this scope. Conversely, it is possible to reserve more advanced features only for Meta’s own applications (Competition and Markets Authority, 2022, para. 8.12 (b)).

The third mechanism is expressed as “Reprioritization of Innovation.” After the merger, the possibility of directing GIPHY’s technical development capacity primarily to Meta’s strategic needs instead of multiple business partners is considered. In this case, feature requests

from competitors such as TikTok or Snap may be relegated to the background in favor of Instagram's priorities (Competition and Markets Authority, 2022, para. 8.12 b (ii)).

The fourth mechanism is "Data Extraction." In this scenario, Meta can change GIPHY's terms of service, making it mandatory for competing platforms to share more user data as a condition of access (Competition and Markets Authority, 2022, para. 8.12 (c)). This data may include sensitive usage information such as individual search history or device identifiers. The limited availability of alternative supply sources creates a critical multiplier effect in this assessment. While an alternative like Tenor exists in the market, the fact that such a solution is largely dependent on Google creates a structure where competitive pressure is weak. This is considered a high-risk dependency relationship for third-party platforms. Smaller-scale providers have also been excluded from consideration as viable alternatives due to both their limited content libraries and inadequate technical infrastructure (Competition and Markets Authority, 2022, para. 8.111). Therefore, the absence of effective substitutes in this market structure is one of the key factors that strengthen the potential foreclosure risk.

3.2.4.2 Incentive to Foreclose Rivals

The "incentive" assessment focuses on analyzing whether the strategic benefits a firm would gain from abandoning competition outweigh the potential costs associated with doing so. This analytical framework considers not only short-term revenue losses but also long-term market positioning. Meta argued that GIPHY is offered as a free service and, therefore, excluding competitors would not result in a direct revenue loss. Based on this reasoning, the company maintained that there was no rational incentive to abandon competition (Competition and Markets Authority, 2022, paras.8.117-8.121).

In addition, Meta claimed that GIPHY's value creation mechanism largely relies on its extensive distribution network to attract brand partnerships and content creators. This argument highlights the platform's open access model as critical for sustainability.

However, regulatory authorities have not limited their assessments to only immediate financial impacts; they have stated that long-term strategic gains should also be analyzed. This approach aims to make visible the dynamic market impacts of abandoning competition. From Meta's perspective, the primary potential benefit of abandoning competition is the preservation and eventual expansion of its market power in social media and digital advertising. In particular, even small shifts in user attention from competing platforms to the Meta ecosystem can have disproportionately large impacts on advertising revenue. This, combined with Meta's higher average revenue per user compared to its competitors, further amplifies the financial impact of user shifts (Competition and Markets Authority, paras. 8.127-8.135). Thus, even small-scale changes in engagement can translate into significant revenue increases. In this context, the CMA has evaluated Meta's potential "strategic benefits" under three main headings.

Firstly, the "Marginalizing Competitors" mechanism is considered. In this scenario, it is stated that Meta could indirectly weaken the user experience on emerging platforms like TikTok, delaying their access to critical user groups and slowing down their growth processes. This is considered a behavioral example of a potential foreclosure risk (Competition and Markets Authority, paras. 8.136-8.140).

Secondly, the "Ecosystem Strengthening" effect is examined. Controlling a widely used interaction tool across the web enhances Meta's capacity to transform its "family of applications" structure into a central platform for digital communication. This creates an ecosystem effect that strengthens inter-platform interdependence (Competition and Markets Authority, paras. 8.141-8.148).

Thirdly, the "Information Advantage" mechanism is evaluated. Usage data obtained through GIPHY can provide Meta with real-time information about user trends, trending content, and interaction behaviours in competing applications. This data advantage creates a

significant asymmetric information structure within competitive dynamics ((Competition and Markets Authority, paras. 8.149-8.155).

In conclusion, the CMA has determined that these strategic advantages far outweigh the short-term, relatively limited costs of restricting access to the GIPHY service, particularly in protecting and strengthening its business model, which relies on billions of dollars in advertising revenue. This assessment is central to the potential foreclosure analysis within the scope of competition policy (Competition and Markets Authority, paras.30-8.156).

3. 2. 5 Effect of Foreclosure on Competition

Regulators have previously clarified the scope of the "Impact" concept under review. This assessment focuses on whether the exit of specific competitors from the market significantly weakens the overall level of competition. The analysis concluded that the combined effect of full or partial market exits is significant. It was found that the total impact of such exits reduces competitive pressure on Meta within the social media ecosystem. This problem becomes even more pronounced for new entrants. The market structure is dominated by established firms with strong network effects (Competition and Markets Authority, 2022, paras.8.162-8.170). Historically, it has been difficult for a new application to compete in such structures. It has been observed that new ventures need all possible competitive advantages to attract and retain users. Standardized user expectations also influence this process. The inability to deliver a seamless and expected GIF experience is a significant disadvantage. Such a deficiency makes it even more difficult to attract user attention. Consequently, GIPHY's vertical market exit has an effect that increases barriers to entry. This also leads to Meta becoming more isolated from competitive pressures.

The effects of reduced competition are not limited to social media. These effects are directly reflected in the display advertising market. Advertisers generally benefit from environments where multiple platforms compete. This competition contributes to lower prices

and increased innovation in advertising formats. Conversely, when social media platforms are marginalized, the alternative options available to advertisers decrease. This leads to a narrowing of effective competitive options. As a result, Meta is able to maintain higher price levels thanks to the weakened competition environment (Competition and Markets Authority, 2022, para. 8.168). Simultaneously, it becomes possible to maintain high profit margins.

3. 2. 6 Data- Related Foreclosure and the Intelligence Gap

One of the key risks considered within the scope of vertical assessment is identified as the “data-related exclusion” mechanism. This mechanism refers to the combined entity’s capacity to gather intelligence on competitors through GIPHY Competition and Markets (Authority, 2022, para. 8.12 (c)). This has been assessed as a significant vertical risk category from a competition policy perspective. GIPHY’s API and SDK infrastructure is integrated into thousands of third-party applications. This extensive integration network has enabled a continuous and uninterrupted data flow. The system has evolved from a structure that merely provides content to a channel that generates data. When users search for GIFs in an application other than Meta, this process takes place through GIPHY’s technical infrastructure. Information regarding the search process is transmitted through this system. As a result of this transmission, both GIPHY and Meta can obtain data derived from user interactions. This demonstrates that the platform is not merely a tool for distributing content; it also functions as a data channel capable of monitoring activities in external ecosystems. This structure creates systematic visibility into competing platforms. Therefore, regulators have assessed concerns that this integration could pose a potential foreclosure risk.

3. 2. 6. 1 The Mechanism of Surveillance

GIPHY collected various data categories through integrations with third-party applications. This data flow was considered part of a broader information system from which

competitive insights could be generated. This structure raised discussions about strategic data access from a competition policy perspective. Search queries constituted a significant portion of these data categories. These queries provided real-time signals about user intent across different demographic groups. They also allowed for the monitoring of cultural trends. App usage patterns were another dataset analyzed. This data revealed which competing platforms experienced an increase in GIF-related searches. This served as an indirect indicator of overall app growth and user engagement. Interaction data also played a critical role. Which GIFs were clicked and shared was systematically tracked. Based on this information, it was possible to deduce which content types were more effective in increasing engagement on competing platforms. Thus, Meta could develop an indirect understanding of the mechanisms that sustain user activity. This structure is also important from the perspective of a potential foreclosure risk assessment.

3. 2. 6. 2 Strategic Implications of the Intelligence Gap

Access to data had long been treated in competition policy as a fundamental input, and Meta already held one of the world's largest repositories of social data. Through the acquisition of GIPHY, an additional layer of "observational" capability over competitors would have been obtained, one that rival firms did not possess in relation to Meta (Competition and Markets Authority, 2022, para.8.114). This informational asymmetry would have allowed competitive threats to be identified at an earlier stage, potentially even before they became visible to the public. In response, Meta could have replicated emerging features or deployed aggressive marketing strategies to counteract those threats as they developed. According to the CMA's findings, this type of data accumulation would have reinforced Meta's already substantial market power and would have made it increasingly difficult for competitors to compete on equal terms. Because this advantage would have arisen directly from Meta's control over a vertically integrated input used by rivals, it was viewed as creating a clear risk of foreclosure.

For that reason, behavioral remedies, such as establishing a “firewall” between GIPHY-derived data and Meta’s advertising operations, were considered unlikely to effectively address the issue in a dynamic market environment (Competition and Markets Authority, 2022, paras. 11.284-11.286).

3. 2. 7 Horizontal Unilateral Effects and the Dynamic Competition Theory

The foundation of this theory is the concept of "dynamic competition." This concept analyses the impact of initiatives aimed at transforming established market structures on competition (Competition and Markets Authority, 2022, paras. 7.1-7.25). This approach is particularly important in the competition policy literature, especially in the context of innovation and market transformation. The assessments made within this framework have been addressed along two separate axes. The horizontal assessment focuses on examining the effects on the display advertising market. This analysis aims to reveal the competitive dynamics within the advertising ecosystem. The vertical assessment, on the other hand, has a different focus. This assessment primarily analyses the effects on the social media ecosystem. Thus, the consequences of the same merger on both the social media and advertising markets are considered separately (Competition and Markets Authority, 2022, para. 7.21).

3. 2. 7. 1 GIPHY as a Disruptive Competitor

According to the CMA, GIPHY was considered one of the few players that could challenge Meta's strong position in display advertising. This assessment was based on the company's potential to develop a truly new advertising format. This potential was considered particularly important from a competition policy perspective, especially in the context of dynamic competition.

Prior to the merger, GIPHY had launched its "Paid Alignment" service²³. This service enabled branded GIFs to appear in the search results of messaging platforms, thus integrating advertising content into the user search experience. This advertising approach differs significantly from traditional banner advertising. It offers brands the opportunity to reach users in one-on-one communication environments, often considered areas where traditional advertising is ineffective or blocked. Campaigns have been run under this model with major US brands such as Pepsi and Dunkin' Donuts (Competition and Markets Authority, 2022, para.7.45)²⁴. These campaigns have demonstrated the commercial viability of the system. Furthermore, it was anticipated that the model would not be limited to the local market; expansion to international markets, including the United Kingdom, was planned (Competition and Markets Authority, 2022, paras.7.46-7.50).

3. 2. 7. 2 Securing the Duopoly: Blocking GIPHY's Entry into Digital Advertising

Regulatory bodies have considered Meta's withdrawal of GIPHY from the advertising market, despite its continued protection of the GIF library, as essentially a "killer buy." This assessment is based on economic impact rather than the literal meaning of the word. This approach relies on a holistic analysis of market dynamics within the framework of competition policy. Shortly after the merger was completed, Meta terminated its Paid Alignment business (Competition and Markets Authority, 2022, paras. 7.51-7.55). Simultaneously, the revenue team for this business unit was disbanded. These decisions led to the elimination of a potential competitor and the removal of a source of price-reducing pressure (Competition and Markets Authority, 2022, paras. 7.56-7.70). The CMA's finding of horizontal SLC played a critical role in this process. This finding was based on applying a "balance of probabilities" test to a market

²³ For further information CMA Report (2022) Paras. 7.30-7.35.

²⁴ para. 7.45 explains Pepsi and Dunkin' Donuts as case studies/examples of GIPHY's US Paid Alignment pilot campaigns.

that did not yet exist in the UK. This method made it possible to include future competitive structures in the assessment. This approach was later endorsed by the court. The court adopted the view that competition policy should protect not only existing markets but also potential competition and innovation. In this context, it has been accepted that innovation and future competition can be legally protected even if uncertain.

Consequently, this decision has set an important precedent for future technology mergers. According to this precedent, the elimination of emerging innovations alone can constitute sufficient grounds for preventing a transaction.

3. 2. 8 The Roadmap for an Independent GIPHY: Platform Fees and Investor Resilience

The most likely market outcome in the absence of the merger, known as the “counterfactual”, is a central element in merger review. Meta’s core defense rested on the claim that, without its intervention, GIPHY would have been forced to exit the market as a failing firm.

According to Meta, GIPHY was in a financially damaging position, which was considered a significant risk to its sustainability. Furthermore, serious difficulties in securing additional venture capital financing were highlighted. In addition, it was argued that the economic slowdown triggered by the COVID-19 pandemic had a significant impact on GIPHY (Competition and Markets Authority, 2022, para. 8.78 (b)). This external shock was claimed to have continued to negatively affect the company's revenue generation. Meta also noted that the Paid Alignment model was an unproven business model. Attention was drawn to the timeframes regarding the long-term commercial performance of this model. Furthermore, according to Meta's assessment, no other potential buyer had shown genuine interest in the company. This was used to support the conclusion that alternative acquisition options for GIPHY were limited.

3. 2. 8. 1 The CMA's Counterfactual Assessment

In this context, Meta presented the merger not as the elimination of a viable competitor from the market, but as a “life-saving” transaction that preserved GIPHY’s services for the broader internet ecosystem. This narrative was based on the company’s counterfactual assessment (Competition and Markets Authority, 2022, para.6.2). The CMA, however, used a different weighting in its counter-scenario analysis. The institution assessed that it was more likely for GIPHY to continue operating as an independent firm (Competition and Markets Authority, 2022, Summary, para.25). Alternatively, it stated that acquisition by a less dominant firm was also a likely scenario. It was argued that these two possibilities would better protect innovation incentives and equal service delivery across platforms. Looking at the period before the merger, a steady increase in GIPHY’s revenue was observed. In particular, its Paid Alignment advertising model attracted interest from large corporate advertisers. These indicators revealed that the company’s economic trajectory did not necessarily point to a decline. In addition, alternative acquisition possibilities were already present in the market. Several large social media companies had previously shown interest in GIPHY, and some had conducted financial due diligence processes before the pandemic. This situation was considered a factor supporting the idea that another buyer might have emerged if Meta's acquisition had not taken place (Competition and Markets Authority, 2022, para. 6.53). Furthermore, GIPHY's need for external financing was not considered, in itself, an indicator of failure. It was noted that investors were prepared to continue financing at a lower valuation even if the sale had not occurred (Competition and Markets Authority, 2022, paras. 6.35,6.64,6.66). Considering all these factors together, the CMA rejected the argument that failure was inevitable. Instead, it concluded that the merger was central to the harm done to competition. This assessment strengthened the crucial role of counterfactual analysis in terms of competition policy.

3. 2. 9 Remedying the SLC (Substantial Lessening of Competition): The Structural vs. Behavioral Debate

The CMA shifted its focus of review to the proposed solution packages after concluding that the merger would significantly reduce competition (Competition and Markets Authority, 2022, paras. 11.1-11.5). This stage clearly highlighted the growing regulatory skepticism toward behavioral commitments in digital marketplaces (Competition and Markets Authority, 2022, paras. 11.6-11.9). Under competition policy, the long-term effectiveness of such commitments has been increasingly questioned. Meta proposed an “open access” behavioral solution package to address concerns regarding vertical marketplaces (Competition and Markets Authority, 2022, para. 11.213). This package includes maintaining non-discriminatory access to GIPHY’s API and SDK infrastructure for five years. This commitment is designed to cover both existing partners and new entrants. In addition, Meta committed to not using GIPHY data for its own advertising activities in the UK. This limitation aims to mitigate potential risks associated with data usage. The company also explicitly stated that GIPHY access would not be tied to competing platforms sharing user data. This element was presented as a safeguard against data conditionality risk. Meta argued that these behavioral commitments were “self-enforceable”. According to the company, these measures are capable of completely eliminating foreclosure risks. It is also argued that users can benefit from Meta's investments in GIPHY.

3. 2. 9. 1 Reasons for Rejection: The "Zombie" GIPHY Problem

The CMA has rejected Meta's proposed behavioral commitments as ineffective and insufficient (Competition and Markets Authority, 2022, para. 11.278). According to the agency's assessment, such measures under competition policy are inadequate to eliminate competition risks. Therefore, the behavioral solution approach was deemed inappropriate.

Firstly, serious concerns were raised regarding innovation incentives. It was stated that a behavioral solution cannot force a company to innovate in a way that is contrary to its strategic interests (Competition and Markets Authority, 2022, para. 11.282). It was assessed that if Meta owned GIPHY, there would be no economic incentive for it to develop features that would give an advantage to competing platforms like TikTok or Snapchat. This could lead to GIPHY losing its competitive edge over time. This process was described as the risk of GIPHY becoming a "zombie" business. Secondly, monitoring and implementation issues were highlighted. In the technology sector, quality decline is often not sudden. On the contrary, this decline occurs gradually and at a technical level. Therefore, it was stated that the CMA would need to continuously monitor Meta's code structure and search algorithms. The organization stated that it did not have the appropriate capacity to assume a long-term oversight role of this scale. Thirdly, the risk of breaching behavioral restrictions was assessed. Regulators anticipated that Meta could degrade the quality of its public API over time while integrating the GIPHY library into its internal services. It was concluded that such indirect strategies could weaken the effectiveness of commitments. This was treated as a significant foreclosure risk.

Finally, it was noted that the dynamic and independent competitive structure that existed prior to the merger could only be re-established through a structural solution. Therefore, the CMA decided that a full divestment was the only effective and proportionate solution. This decision was implemented, and GIPHY was sold to Shutterstock in June 2023. Thus, a critical input was structurally separated from the downstream platform (Competition and Markets Authority, 2022, para. 11.330).

3. 2. 10 Theoretical and Policy Implications: A New Era of Enforcement

The Meta-GIPHY case is considered a significant turning point in global competition policy. This decision has sent a strong signal that digital ecosystems can be regulated more intensively and in a more interventionist manner.

The ecosystem lens approach is clearly evident in this case. Traditional competition policy often focuses on narrowly defined market boundaries (Competition and Markets Authority, 2022, para. 5.4).

In contrast, the CMA acknowledged that in the digital age, market power arises from the interconnectedness of multiple services. Controlling data flows was seen as a fundamental element of this power. Preventing the vertical integration of a key interaction tool was interpreted as a step towards ensuring the competitiveness of internet infrastructure. This approach aims to preserve the necessary space for new ecosystems to emerge. Protecting emerging and potential competition is the second important dimension of the case. The decision clearly confirmed that potential loss of competition alone can lead to a significant reduction in competition. This represents a significant departure from traditional analysis that focuses solely on existing market shares. Regulators have thus strengthened their authority to prevent future innovation from being eliminated through acquisition by dominant firms.

The priority of structural solutions has also become evident in this case. The rejection of behavioral commitments points to a strong trend. In digital marketplaces, software and data are considered fundamental assets. Therefore, behavioral promises are seen as fragile in protecting competition. This decision demonstrates that structural decoupling will be the preferred tool for addressing competition concerns in major technology mergers. The issue of international courtesy and global reach has also generated debate. The UK regulator's *de facto* disruption of a transaction between two US companies has drawn criticism. Some commentators have argued that the CMA exceeded its authority. In response, the CMA and the court have highlighted the global nature of digital platforms, arguing that competition risks are therefore also global. This case clearly demonstrates that mergers can face scrutiny in any jurisdiction with a significant user base, regardless of the location of the company headquarters.

3. 2. 11 Data- Driven Technologies and Content Moderation in Foreclosure

One of the more technical and final stages of the vertical evaluation process has been the analysis of GIPHY's technological and moderation capabilities and content exclusion. At this stage, it was not possible to evaluate it simply as a visual data repository in the form of GIF search. This finding further highlights the technical complexity of the system. Searchable GIF libraries do not function like simple image collections. These models consist of agreements on data organization. Tagging components are considered one of the critical parts of these components. In addition, predicting user intent is a protection that stands out as an important function of this technological infrastructure. The systems try to maintain the preference for certain GIF types in certain contexts. This predictive process makes user actions more efficient. At the same time, content access is also increased.

Furthermore, filtering harmful content is a critical function. The moderation block ensures the detection of inappropriate content or content that does not comply with platform policies. This process consists of a fundamental control layer in terms of content policy. In conclusion, systems like GIPHY are not merely structures that store content. They are also considered technological infrastructures that actively process and manage content. This characteristic leads to a shift in the platform's competitive policy analysis (Competition and Markets Authority, 2022, paras. 4.30-4.31, 9.33).

3. 2.11. 1 Content Moderation as a Brand-Safety Input

Content moderation on social media platforms is not a matter of open debate in competition policy but is considered a fundamental requirement. These mechanisms are directly related to the overall operational efficiency of the platforms. The appearance of a racist or sexually explicit GIF as a result of a well-intentioned search query can have serious consequences for the platform (Competition and Markets Authority, 2022, para.4.24). Such

consequences can manifest both reputational damage and potential financial penalties. GIPHY's competitive advantage stems significantly from its investments in content moderation platform (Competition and Markets Authority, 2022, para.4.25). These investments encompass both human-based moderation processes and automated moderation systems. This structure plays a critical role in ensuring content safety.

One of the main concerns regarding the risk of vertical competition is the possibility that Meta, after gaining control over GIPHY, might reduce these moderation investments for third-party integrations. In such a case, the quality of content streams could become asymmetrical between platforms. Meta's own services might provide access to the safest and "cleanest" GIF content, while competing platforms might encounter less filtered content streams. This could increase quality differences between platforms. This resulting imbalance creates significant brand safety risks for competing platforms. User trust perception can also be negatively affected. This type of technical input control creates a structure that makes it difficult to directly detect from the outside. Nevertheless, its effects on competition can be quite serious, particularly in terms of potentially weakening the long-term reputation of competing platforms.

3. 2. 11. 2 Search Algorithm Bias²⁵

In a similar assessment, the CMA also examined the risk of "search bias." This risk stems from GIPHY's search algorithm determining the ranking of results (Competition and Markets Authority, 2022, para. 4.26). The algorithm directly influences which GIFs are shown to the user first. It was assessed that if Meta owned GIPHY, subtle and indirect changes could be made to the algorithmic structure. These changes could have indirect effects on competing platforms. For example, GIFs supporting Meta's own brands or cultural initiatives could be

²⁵ For further information see Competition and Markets Authority (CMA), *Completed acquisition by Facebook, Inc (now Meta Platforms, Inc) of Giphy, Inc.: Final report on the case remitted to the CMA by the Competition Appeal Tribunal* (18 October 2022), paras 4.26–4.29.

made more visible. This could lead to Meta content being more prominent on competing applications. Conversely, it could also be possible for low-quality content, which could negatively impact the user experience of competing platforms, to be displayed higher in the search results. Such a scenario could lead to competing applications being perceived as less professional.

The fact that GIPHY's algorithm is proprietary and constantly updated makes it difficult to detect such interventions. At the same time, completely preventing such fine-tuning through behavioral solutions is quite difficult in practice. Therefore, the CMA assessed that the risk of search bias could constitute an important foreclosure mechanism from a competition policy perspective.

3. 2. 12 Synthesis and Conclusion of the Commission's Decision

The Meta-GIPHY merger investigation represents a significant paradigm shift in the assessment of mergers in the digital age. The CMA identified GIFs as a fundamental input for social media engagement. It also recognized Meta as a platform that could potentially offer various download incentives that might be disadvantageous to competitors. This combined approach highlights the significant number of instances of interference based on the blocking of entry. The vertical assessment broadened to address traditional competition policy concerns. It didn't simply address classic issues like "increasing competitors' costs." Instead, it considered more complex theories of harm. The possibility of this capability being assessed as a significant risk area. Other elements analyzed included the redirection of innovation and the monitoring of competitors. Horizontal findings also supported this assessment. The loss of dynamic competition, particularly in display advertising, emerged as a significant risk. Considering these two findings together, attention was drawn to the potential for dominant platforms to strengthen competition through entry into neighboring markets. The possibility of hindering the

development of next-generation digital competition was also emphasized. This framework provides a comprehensive roadmap for comprehensive intervention.

In conclusion, the decision for a complete divestment and the rejection of behavioral “Open Access” commitments sent a clear message to the sector. The competition authority’s priority was not the internal efficiency of dominant systems, but the preservation of structural diversity. Maintaining a dynamic and multi-firm market structure emerged as a key objective. This case not only addressed concrete competition solutions but also reshaped the evidence and theoretical standards used for vertical merger scrutiny in the 21st century.

Conclusions

The analysis of competition policy cases makes reference to the same framework. This framework comprises three cumulative elements: ability, incentive, and influence. However, the two cases differ significantly in their outcomes. This framework evaluates three interrelated factors: the merging firm's capacity to implement anti-competitive strategies, its motivation to do so, and the extent to which these strategies can weaken competition in the market. However, despite applying similar analytical principles, the authorities reached different conclusions because the underlying market conditions differed significantly.

In Essilor/Luxottica, the European Commission cleared the concentration unconditionally. Luxottica's market share in the eyewear market was only 40-50% in sunglasses and 10-20% in frames, and many opticians did not sell Luxottica products at all. This shows that it was not strong enough to create a real leverage effect. Luxottica’s profit margin on eyeglass sales exceeded Essilor’s profit margin on lens sales. Therefore, the incentive criterion also failed. It would be economically illogical to replace a transaction with a higher profit margin than Luxottica’s with a transaction with a lower profit margin. Even in a hypothetical exclusion scenario, established competitors such as Hoya, Zeiss, and Rodenstock would maintain sufficient scale and competitive strength. Therefore, the final criterion, the incentive

criterion, also failed. Since all three criteria failed independently, unconditional approval was naturally granted.

Facebook (now Meta Platforms, Inc) /GIPHY decision goes in the opposite direction. Competing platforms did not truly possess a range of alternative suppliers. Tenor, the only comparable supplier, was found to be dependent on GIPHY's independence to remain competitive; therefore, the capability criterion was met. According to the authority, rendering GIPHY unusable would diminish Tenor's incentive to innovate. Therefore, the Commission concluded that Facebook had sufficient power to foreclose rivals.

Partial monopolization meant minimal cost for Facebook. Factors such as increased user engagement and consolidation of existing market power were important. Thus, the incentive criterion was also met. The regulatory body determined that making GIPHY's API less accessible would yield low-cost but significant benefits for Facebook. This could increase user engagement on its own platforms and help maintain its competitive position. The regulatory body also found that Facebook could use other blocking strategies, such as reprioritizing product development and imposing conditional data-sharing terms.

In this instance, the effect criterion was decisive. Facebook already possessed significant market power in social media and display advertising. The authority's investigation focused on how foreclosure behavior would strengthen Facebook's existing market power in the social media and display advertising markets. The authority (CMA) concluded that the monopoly would not redistribute market share but rather further solidify this pre-existing position. The finding that this effect would occur was a key feature that distinguished the Facebook/GIPHY decision from traditional monopoly analyses that only consider market share redistribution.

As all three criteria were jointly satisfied, only a structural remedy, full divestiture, was deemed adequate.

From a competition law perspective, even if the vertical relationship in the infrastructure appears structurally similar, a vertical acquisition by a non-dominant company is not equivalent to a vertical acquisition by a dominant company. The main factor shaping the resulting regulatory outcome is not merely the existence of a vertical relationship, but the market power held by the parties. The key difference between the decisions lies in whether the transaction creates new market power or consolidates existing market power. In the Facebook example, it becomes clear that the company already held significant market power long before the transaction. Therefore, the acquisition of GIPHY did not create market power from scratch; rather, it created a foundation that allowed it to preserve and further expand its existing market power. In contrast, Essilor and Luxottica have not approached the threshold of dominance in any of their respective markets and hold more fragmented, mid-level market positions. No pre-existing power position could be consolidated through a vertical leverage mechanism. The fact that making binding moves on behalf of the merging companies would not be profitable also supported this situation in terms of the economic dimensions of the transaction. In conclusion, a comparison of these two case studies clearly demonstrates that a highly consistent analytical pattern operates in the background of the cases.

The most comprehensive conclusion from merger control practice is that vertical integration is not inherently problematic. The fundamental question is whether an already dominant entity will further consolidate its position at the expense of competition. If no pre-existing dominance exists, as in the Essilor/Luxottica case, vertical concerns are more likely to be dismissed after a thorough economic review. However, where dominance already exists, as in the Facebook/GIPHY case, a vertical acquisition of critical inputs will require much stricter oversight. Essentially, these two decisions represented two completely opposite poles of the investigation: in the first case, unconditional approval was granted because the conditions for the test were not met; in the second, a prohibition and structural divestment were ordered

because all criteria were fulfilled. The three-stage capability, incentive, and impact framework applied in both jurisdictions under review offers a structurally stable methodology. However, applying this framework is highly sensitive to case-specific circumstances; factors such as market share, margin structure, and the availability of reliable alternatives will each shape the final outcome.

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