

ALLEGION RESPONSE TO ASSA ABLOY / NZ FIRE DOORS SOI

22 June 2021

Context

- 1 Allegion outlined the significant competition concerns it has with Assa Abloy's proposed acquisition of NZFD in its response to the Commission's "statement of preliminary issues".¹
- 2 Allegion is concerned that, if the proposed acquisition proceeds, Assa Abloy's control over New Zealand's two largest fire door manufacturers would:
 - 2.1 give Assa Abloy the ability and incentive to materially restrict and hinder Allegion's ability to compete effectively in New Zealand's commercial door hardware market; and
 - 2.2 see New Zealand's commercial door manufacturing market become an effective duopoly for large-scale projects (between Assa Abloy and Hallmark), resulting in:²
 - (a) higher downstream commercial door prices for end-consumers; and
 - (b) less incentive for Assa Abloy and Hallmark to compete hard against each other.
- 3 Allegion does not repeat its concerns in this submission. Rather, Allegion responds to the factual questions raised in the Commission's SOI that Allegion is best-placed to answer.
- 4 [].
- 5 Allegion opposes the proposed acquisition because of the substantial and irreversible effect the transaction would have on Allegion's business and buyers of New Zealand fire doors and commercial door hardware.
- 6 Allegion offers its view based on first-hand, expert knowledge of how the market operates and its understanding of the powerful position Assa Abloy would be in if this transaction proceeds.
- 7 To that end, Allegion would welcome further discussions with Commission staff and/or we would be very happy to answer any requests the Commission has in writing.

¹ *Allegion response to NZCC SOPI, 29 April 2021.*

² [].

Response to the Commission's SOI

8 In this section we respond to the key questions asked by the Commission's SOI.

How do procurement decisions relating to fire doors and commercial hardware relate?

- 9 Standard industry practice is for the architect to first specify doors and then hardware. The appointed main contractor (the construction company) will then award a contract first to the door manufacturer and then, at a later date, to the hardware supplier.
- 10 The doors are always a primary selection for an architect and the construction company because they are structural building components and typically have long manufacturing and supply lead times. By contrast, commercial door hardware is a finishing component and is usually tendered for several months after the doors. Hardware is installed at the very end of the project and supplied with short lead times.³
- 11 It follows that a construction company will not delay constructing a building in the event that an architect's first-choice of hardware is not tested with a fire door. Instead, and keeping with the fact that hardware is a finishing component, the construction company would substitute the architect's hardware choice for hardware that is approved for use in the contracted fire door manufacturer's products.
- 12 Assa Abloy's submission that "it is standard practice in the construction industry for the architect to make decisions on the type and brand of hardware that will be used in a project well before the fire door supplier is awarded the contract" confuses the fact that architect specification and procurement are two distinct and unrelated activities of the construction process.
- 13 An architect's design wishes will only go so far if their choices are not, in practice, available.
- 14 **Schedule A** contains a selection of examples where an architect's first-choice in hardware has not been approved on the contracted fire doors. In each case, new hardware was selected; not new fire doors.

³ [].

Must a fire door supplier ensure the widest range of hardware is approved for use on its door to avoid exclusion from tender participation?

- 15 No. Because the contract for doors is awarded first, the construction company will not typically review hardware compatibility until they tender for hardware in due course.
- 16 So, in those circumstances, fire doors are never excluded from participating in tenders based on how much hardware is approved for use on the doors concerned. To the contrary, it is only ever non-approved hardware that is excluded from participating in tenders after fire doors have been chosen.
- 17 It follows that Assa Abloy's submission that "a supplier of fire doors must ensure that the widest possible range of hardware is approved for use on its doors, or it will be excluded from participation in tenders where non-approved hardware is specified" is not correct.
- 18 To prove that point, Pacific Door Systems ("PDS") has never proactively approached Allegion to have their products tested.
- 19 Indeed, if Assa Abloy's view of the world was correct, then one would expect PDS to pay for the hardware testing process. But that is not the case: hardware manufacturers always pay for the fire testing, which demonstrates where the balance of commercial power lies.

Are construction companies likely to sponsor new fire door manufacturers to enter the market?

- 20 It is highly unlikely that a construction company would ever sponsor entry of a new fire door manufacturer because architects rarely specify unproven brands.
- 21 Under the New Zealand Building Code, construction companies carry all the liability if they alter an architect's specification. That potential liability is very likely to be too great for a construction company to run the risk of sponsoring new entry from an unknown and untested product range.
- 22 Allegion records too that there would be significant costs involved in testing, purchasing, shipping and providing maintenance/warranties over the new entrant products. There would also be significant time constraints where construction companies and developers typically face material penalties for late delivery of a construction project.

What is the magnitude of likely customer demand for bundles of fire doors?

- 23 Bundling doors and hardware has become more common in other countries, in particular the USA and recently in Australia driven largely by Assa Abloy.
- 24 Construction companies do see some value in combining two sub-trades as it simplifies coordination and accountability for major projects where doors and hardware supply can be time-intensive for construction companies to manage. Construction companies just pass on the higher costs. If the merger proceeds, Allegion expects high uptake of bundled packages over time. In support of that view, Allegion has provided the Commission with recent examples of Assa Abloy securing three significant Christchurch tenders through bundled door and hardware offers.
- 25 Allegion acknowledges that, in isolation, those timing and “ease of dealing” benefits have value for the construction companies. But Allegion submits that the short term value to construction companies would be outweighed over time by the proposed acquisition’s negative effects on Allegion and Dormakaba’s ability to compete in the New Zealand hardware market. The merger will suppress competition resulting in higher prices and reduced choices in the New Zealand hardware market, with passed on price hikes and fewer options being contrary to consumer interests.
- 26 Indeed, Assa Abloy is already leveraging new proprietary software (Opening Studios) that allows architects to create, as a standard function, a PDS and Assa Abloy hardware bundled door schedule.
- 27 That software exaggerates Allegion’s concerns that Assa Abloy’s vertical ownership of PDS allows it to leverage off PDS’s significant market presence to preclude other hardware manufacturers from being specified in architect’s schedules. That concern will only be further enhanced and entrenched if Assa Abloy is allowed to acquire NZFD too – the country’s second largest commercial door manufacturer.
- 28 It bears emphasis again that architects prefer specific proven brands, and PDS and NZFD are New Zealand’s leading commercial door manufacturers.

What is the size of the market that would remain contestable for rival hardware manufacturers?

- 29 Allegion estimates that if it was excluded from just the top []% of commercial construction projects by value, it would be excluded from []% of the market by revenue. Leaving, in turn, just []% of the market contestable in those circumstances.

30 Or, if Allegion was excluded from the top []% of commercial construction projects by value, it would leave just []% of the market contestable for it and Dormakaba.

31 The following table summarises Allegion’s estimates.

% of projects excluded from (sorted largest to smallest by value)	% of market excluded from (by revenue)	% of market contestable

Would the remaining contestable portion of the hardware market would be sufficient for rival hardware manufacturers to remain effective competitors in the commercial hardware market?

32 Allegion has invested heavily in local New Zealand manufacturing.

33 Approximately []% of its New Zealand commercial hardware revenues are earned from products engineered, manufactured and assembled by Allegion’s team in Auckland. By comparison, Assa Abloy and Dormakaba import all their commercial hardware.

34 [].

Would rival hardware manufacturers be able to assemble bundles to compete with the merged entity?

35 Rival hardware manufacturers would not be able to assemble bundles to compete with the merged entity for the top []% of projects by value (representing []% of the total market).

36 Only PDS, NZFD and Hallmark have the manufacturing capacity to supply larger commercial projects. Doors typically comprise []% of the total value of door and hardware bundle.

37 We note too that there would seem to be reduced incentives for Assa Abloy and Hallmark to compete hard against each other post-transaction as they would become the only two manufacturers capable of supplying larger commercial projects. That reduced competitive tension might limit Hallmark’s incentive to develop capacity to support bundled Allegion and Dormakaba offerings in competition with Assa Abloy.

Would customers choose hardware based on the doors they have chosen, or vice versa?

- 38 Due to the standard sequence of procurement by construction companies, doors are selected first and hardware later. So the hardware specified does not influence the selection of doors but once the door is selected it can enforce a change of hardware if the specified hardware is not approved for the selected doors.

Would the merged entity be likely to limit access to testing of competitors' hardware with its fire doors?

- 39 Yes. Without a regulatory body or universal independent testing standard, Assa Abloy would be in the prime position to set costs, procedures and time frames for product testing approvals.
- 40 At any point in time, Assa Abloy could alter those factors to give itself a competitive advantage. The merged entity's substantial range/market share will only enhance and entrench Assa Abloy's current vertically integrated position to control the New Zealand testing process to meet its commercial objectives.

Would the merged entity be likely to take steps to limit the use of competitors' hardware that is currently approved on its fire doors, for example, by altering some of its fire doors so that existing approvals are no longer applicable?

- 41 Yes. [].
- 42 The Building Code's stringent testing requirements mean any changes to existing fire doors, or new fire door ranges, would require all currently approved hardware products to be re-tested. The lead times and costs for re-testing would be in Assa Abloy's hands.
- 43 Allegion predicts that Assa Abloy would have the ability and incentive to cause substantial delays (months if not years) in Allegion's ability to have its products tested on Assa Abloy's fire doors. Assa Abloy would, of course, be incentivised to give its own hardware products testing preference over Allegion and Dormakaba products, effectively excluding competition for a substantial period of time – if not indefinitely.

[CONFIDENTIAL SCHEDULE A]