
Proposed acquisition by Assa Abloy AB of Paddock Holdings Limited

ME/4544/10

The OFT's decision on reference under section 33(1) given on 27 July 2010. Full text of decision published 4 August 2010.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Assa Abloy (AA)** is an international manufacturer and supplier of locks and associated products. It was created in 1994 from the merger of the Swedish company Assa and the Finnish company Abloy and is listed on the Stockholm stock exchange. In the UK AA's total sales in 2009 were SEK 1,753 million (approximately £147 million); sales of door locks were £[] million and sales of multi-point door locks were around £[] million. AA operates a number of brands in the UK with activities related to locks or associated products of which the most well-known is Yale.
2. **Paddock Holdings Limited (Paddock)** is a UK-based manufacturer and supplier of multi-point door locks and associated door and window hardware, with total sales in the UK of £26 million for the year ending 31 December 2009. Paddock supplies multi-point door locks under the Millenco and Lockmaster brands (having acquired Millenco Hardware in 2005). It also supplies lock cylinders, multi-point patio and window locks, door and window furniture and hinges under a number of different brands. Its UK sales of multi-point door locks in 2009 were around £[] million.

TRANSACTION

3. On 27 May 2010 AA's wholly-owned subsidiary, Assa Abloy Limited, agreed to purchase Paddock's entire issued share capital for a provisional consideration of £[] million. The transaction is conditional on the OFT deciding not to refer the merger to the CC.
4. The OFT received a satisfactory submission from the parties on 28 May 2010 and the administrative deadline is 27 July 2010.

JURISDICTION

5. The proposed transaction will result in Paddock and AA ceasing to be distinct enterprises for the purposes of section 26 of the Enterprise Act 2002 (the Act).
6. Paddock's turnover in the UK is less than £70 million, so that the turnover threshold under section 23(1)(b) is not met. However, the parties' post-merger share of the supply of door locks in the UK exceeds 25 per cent so that the transaction qualifies for review under the Act.

FRAME OF REFERENCE

7. Both AA and Paddock manufacture and sell door locks. Specifically, they overlap in the manufacturing and sale of multi-point door locks (MPLs). Paddock does not manufacture any other type of lock but AA does.
8. MPLs are a type of lock mechanism that have more than one locking point, typically activated by a cylinder. MPLs usually have a minimum of three locking points spread over the length of the door. They are often used on PVCu or composite doors due to the inherent flexibility of those materials (as opposed to wooden-framed doors). AA estimates that MPLs accounted for around 40-45 per cent of total sales of door locks in the UK in 2009.
9. Given the complexity of fitting an MPL to a door frame (as opposed to fitting single-point locks), the parties note that MPLs are not typically purchased by individual final customers, and therefore that

they are not generally sold through retail DIY stores. Instead, manufacturers of MPLs tend to sell either directly to OEM customers (that is, door and window fabricators) or via distributors. Distributors generally sell MPLs to smaller door and window fabricators. In addition, foreign manufacturers without a UK presence also sell in the UK through distributors. For example, the parties submit that various distributors such as Mila Hardware (part of the Arran Isle group), Kenrick and Fab & Fix source door locks from abroad (for example, China) and then sell them in the UK under their own brands.

10. AA estimates that around 40 per cent of all UK MPL sales in 2009 were made through distributors. As shown in the Table below, however, the parties' split of revenues by distribution channel is different. In particular, [] per cent of AA's sales (in terms of revenue) are made directly to OEMs, whereas the majority of Paddock's sales (around [] per cent) are to distributors.

Table 1: Parties' revenues (in £m) from sales of MPLs in the UK in 2009 – by distribution channel

Channel	Paddock	Assa Abloy	Total
Direct sales to OEMs	£[]m	£[]m	£[]m
Sales to distributors	£[]m	£[]m	£[]m
Both channels	£[]m	£[]m	£[]m

Source: Parties

11. This split reflects the different business models adopted by the parties. In particular, AA mainly focuses on direct sales to large OEMs and has appointed only one (exclusive) distributor in the UK. Paddock, instead, has four main distributors in the UK (although two of them, Mila Hardware and Window Ware, are part of the same group, Arran Isle), but also sells directly to OEMs.

Product scope

MPLs and 'all locks'

12. The parties submitted that it is not necessary for the OFT to determine the precise scope of the relevant product market in this case because the proposed acquisition does not give rise to competition concerns regardless of how the market is defined. For completeness, however, the parties submitted market share data both for the broader door lock market and for the narrower 'MPLs only' segment.
13. The results of the OFT's market investigation suggested that MPLs are in a separate market from other types of door lock. Firstly, from a demand-side perspective window and door fabricators specifically require MPLs and not other types of locks. This is because MPLs appear to be the best (or in some case the only) type of locks which meet certain security standards that have recently been introduced (or will be introduced in late 2010¹). Final customers (that is, residential customers and local authorities) also appear to demand MPLs because of their additional security specifications. In addition, according to third parties, final customers are also moving away from wooden-framed doors towards PVCu and composite doors and the latter type of doors is more suitable to accommodate MPLs.
14. From a supply-side perspective the OFT has received no evidence that suppliers of other types of door lock (for example, single-point locks) could quickly and at very little, or no, cost start producing MPLs in the event of a price increase. In fact, the OFT notes that, although some manufacturers such as AA produce both single-point locks and MPLs, some of the players who have a sizeable presence in the manufacturing and sale of single-point locks (for example, Ingersoll Rand and Banham) do not produce MPLs.
15. Given the above, therefore, the OFT has adopted a cautious approach and examined the proposed acquisition using a narrow frame of reference, that is on the basis of MPLs forming a distinct product market from other types of door lock.

¹ These are the new Building Regulation L and NHBC standards

The manufacturing and distribution levels

16. In presenting their market shares the parties distinguish the manufacturing level from the distribution level, because in their view the two levels have 'different competitive dynamics'.
17. The OFT, however, does not consider that distinguishing between the manufacturing and distribution levels is appropriate in this case. This is because its market investigation has revealed that distributors and manufacturers do not (generally) compete for the same customer base and they do not appear to exert a competitive constraint on one another.
18. Specifically, this conclusion is supported by what third parties told us. For example, [], a non-exclusive Paddock distributor [] informed the OFT that it does not have much price flexibility in respect of Paddock's MPLs and that, whenever they consider it necessary to offer a discount to existing or potential customers (for example, to retain an account or secure a new one), this is done in agreement with Paddock. In these cases Paddock also offers 'price support', that is, it absorbs the discount. This rebate mechanism is also used by AA in respect of its major distributor IFI.² In other words, the relationship between manufacturers and their distributors does not appear to be entirely at arm's length, with distributors being instead more of a 'channel' for manufacturers to reach smaller OEMs. Moreover, the OFT's market investigation also revealed that customers who buy MPLs from distributors are in general different (for example, in terms of size) from those who buy directly from manufacturers (a fact which the parties themselves acknowledged). As a result, there is limited, if any, competition between distributors and manufacturers to sell MPLs to the same customer (see also the next subsection).
19. The lack of competitive constraint on lock manufacturers by distributors is also supported by Paddock's internal sales reports provided to the OFT, which show that Paddock works together with its distributors in 'winning' a customer account through these distributors. Several third parties also confirmed that direct sales and

² In particular AA informed the OFT that []

sales through distributors are complementary routes to the market for manufacturers of door locks, rather than substitute ones.

20. On this basis, the OFT considers that a more appropriate distinction may be between the supply of MPLs to OEMs and the supply of MPLs to distributors rather than between the manufacturing and distribution levels. This is considered below.

Customer groups

21. The OFT considers that it is sometimes appropriate to define relevant markets for separate customer groups.³ This may be the case when, for example, suppliers can target higher prices at customers willing to pay more or when competition for customers differs significantly between different customer groups.
22. In their submission, the parties focused on the distinction between manufacturing and distribution levels (as explained above) and did not address the question of whether direct sales to OEMs belong to a separate market from sales to distributors (who in turn resell MPLs to smaller OEMs). While the OFT acknowledges that the final customer at the downstream level is the same in both cases (that is, door and window fabricators), it considers that it is possible that each of these sales channels is a distinct market. The reasons for the OFT's approach are the following:
 - firstly, the pricing mechanisms are different in the two channels as there are list prices for distributors and individual quotations for direct sales. AA, for example, informed the OFT that []. This is because each direct customer is buying a specific, tailored range of locks and components making direct comparisons very difficult. Each individual customer therefore receives a separate price quotation that establishes their net prices for a particular product range
 - secondly, larger fabricators tend to buy directly from manufacturers because they buy 'a specific, tailored range of locks' and also are able to negotiate better terms than with

³ *Review of Merger Assessment Guidelines, A joint publication of the Competition Commission and the Office of Fair Trading, draft of 14 April 2010*

distributors. In contrast, small and mid-sized fabricators usually buy from distributors

- thirdly, OEMs buying from distributors tend to buy a bundle of products (that is, including, but not limited to, MPLs) which may or may not be manufactured by the same company. Instead, direct customers usually place orders with manufacturers for door locks (and MPLs, in particular) only, and
- fourthly, some manufacturers (Winkhaus, for example) only sell directly to OEMs, that is door fabricators. On the other hand, Paddock has relationships with four main distributors (and obtains most of its revenues through this channel), whereas AA has appointed one exclusive distributor in the UK and obtains less than [] per cent of its revenues through distributors.

23. The OFT is aware that there are some limited exceptions to this distinction between sales channels. [], for example, [] is in a position to buy directly from manufacturers, given the volume of their purchases, and has indeed considered doing so in the recent past. [].

24. Notwithstanding these few exceptions, however, the OFT considers that the majority of evidence received from third parties (as well from the parties themselves) suggests that direct sales to door and window fabricators are in a separate market from sales to distributors.⁴ This also indicates that, to the extent the parties sell MPLs which are also sold directly by manufacturers to OEMs,

⁴ The OFT has also considered the strength of indirect downstream constraints in this case. These would arise from the fact that because at the downstream level OEMs compete with each other to provide doors and windows to final customers, manufacturers of MPLs selling directly to OEMs might be constrained by sales of MPLs to distributors (who also sell to OEMs), and vice versa. Conceptually, indirect constraints could be taken into account either at the market definition stage (that is, including in the relevant market products that are not directly substitutable at the upstream level) or at the competitive assessment stage (that is, assessing the extent to which the merged entity is constrained in practice by products outside of the relevant market). In principle, either way is appropriate if indirect constraints are correctly reflected in the analysis. In practice, however, and in line with previous cases, the OFT considers it more appropriate to include sources of indirect constraints at the market definition stage (see, for example, paragraph 16 of the OFT's decision in *Completed acquisition by Nufarm of AH Marks, of 29 August 2008*). In this case, however, as explained in paragraph 22 of the text, the evidence received by the OFT did not suggest that at the upstream level direct sales of MPLs are in the same market as sales of MPLs to distributors.

distributors do **not** compete with manufacturers, as explained in the previous subsection.

25. On this basis, the OFT considers that it is possible that direct sales to OEMs and sales to distributors are each a distinct market. For completeness, however, the OFT has also considered the proposed transaction without making such distinction between sales channels. Given the OFT's conclusions in this case, however, it is not necessary to precisely conclude on the precise product scope.

Geographic scope

26. The parties submitted that the scope of the relevant geographic market may differ, depending on whether the manufacturing level or the distribution level is considered. In particular, the parties argued that at the manufacturing level the geographic market is very likely to be wider than the UK. They also submitted that at the distribution level a local presence in the UK is important and accordingly the geographic market is likely to be UK-wide in scope. Ultimately, however, the parties submitted that it is not necessary to come to a definitive conclusion on the scope of the geographic market because no substantial lessening of competition arises regardless of how this is defined.
27. Although several suppliers active in the UK (including one of the parties) either import MPLs from their manufacturing plants located abroad or procure components from abroad which are then assembled to manufacture MPLs in the UK, what matters for geographic market definition principally is whether customers import MPLs not whether manufacturers do. In this regard, the OFT understands that a few distributors import finished MPLs (typically, from China) and sell them in the UK.
28. The vast majority of third parties, however, indicated that the scope of the geographic market is UK-wide in this case. They pointed out that imports of locks from outside the UK involve longer lead times and are also riskier because they are subject to currency fluctuations. Moreover, the logistics of importing MPLs into the UK is also complex, for example, in terms of stock. For example, the amount of locks exported by Paddock is limited at present. In addition, even foreign manufacturers of MPLs who sell in the UK

usually have a sales office in the country, which suggests that an element of local presence is important.

29. On this basis, the OFT considers it appropriate to adopt a cautious approach and assess the proposed acquisition on a narrow basis, that is on the basis of a UK geographic market. This does not necessarily mean that imports of finished locks (as opposed to components or semi-finished locks) by distributors located in the UK do not play a role in the market for MPLs in the UK: it is just an acknowledgment that imports are likely to be made by firms that already have some base (for example, a warehouse, sales office or contacts with local distributors) in the UK.⁵ A point to note in this respect, is that locks imported by UK manufacturers from abroad do comply with the relevant security standards⁶ so that locks manufactured abroad can be and are supplied in the UK. The extent to which the parties are constrained by imports is considered further detail in the 'competitive assessment' section below.

Conclusion on frame of reference

30. As explained above, Paddock and AA overlap in the supply of MPLs in the UK. In addition, the OFT considers that it is appropriate to consider direct sales of MPLs to OEMs (that is, door and window fabricators) and sales to distributors as distinct markets (although, for completeness, the OFT has also assessed the effects of the proposed transaction without making such a distinction).

COMPETITIVE ASSESSMENT: UNILATERAL EFFECTS

31. The parties submit that, irrespective of how the market is defined in this case, no competition concerns arise, since:
- a) a number of well-established players will remain operating in the UK and strong German manufacturers already have sales operations in the UK

⁵ Importers of locks from abroad may have their own local warehouses in order to stock the product and reduce lead times, or operate through distributors (that hold the stock) or both.

⁶ The relevant security standards in this respect are the European CEN standard, the UK 'Secured By Design' standard and the PAS door set standards issued by the British Standards Institution (BSI)

- b) the level of import penetration from low-cost countries (for example, China) is high
- c) the parties are not close competitors
- d) a multiplicity of own-brand products compete with proprietary brands
- e) barriers to entry are low
- f) the customer base has considerable buyer power, and
- g) the switching costs are very low.

32. These arguments are discussed in further detail below.

Market shares

33. The parties note that, although some industry sources contain data on door lock market shares, there is no definitively reliable third-party data source on this sector, and specifically on MPLs, in the UK. Accordingly they provided us with their own estimates of market size, based on a combination of information sources, ranging from third-party publications and competitor financial statements to customer intelligence and bottom-up calculations.

34. The OFT was concerned that the parties' calculations (which resulted in a market size of approximately £[] million in 2009) may have overstated the size of the market for MPLs in the UK and has therefore also had regard to estimates of the market size in the parties' internal documents, which referred to a market size for MPLs in the UK of approximately £[] million in 2009. The OFT also used additional information gathered during its market investigation to corroborate its market share estimates. The OFT's analysis is summarised in the table below:

Table 2: MPL market shares in 2009 by distribution channel, per cent

Manufacturer	Direct sales	Sales to distributors	Both channels
Paddock	[10-20]	[30-40]	[20-30]
Assa Abloy	[10-20]	[0-10]	[10-20]

Parties' combined share	[25-35]	[35-45]	[30-40]
ERA	[0-10]	[20-30]	[10-20]
Avocet	[10-20]	-	[10-20]
Winkhaus	[10-20]	[0-10]	[10-20]
GU	[0-10]	[10-20]	[0-10]
Fullex	[0-10]	-	[0-10]
KFV	[0-10]	[0-10]	[0-10]
Fuhr	-	[0-10]	[0-10]
Others	[10-20]	[0-10]	[0-10]

Source: OFT analysis of parties' data and of the results of its market investigation

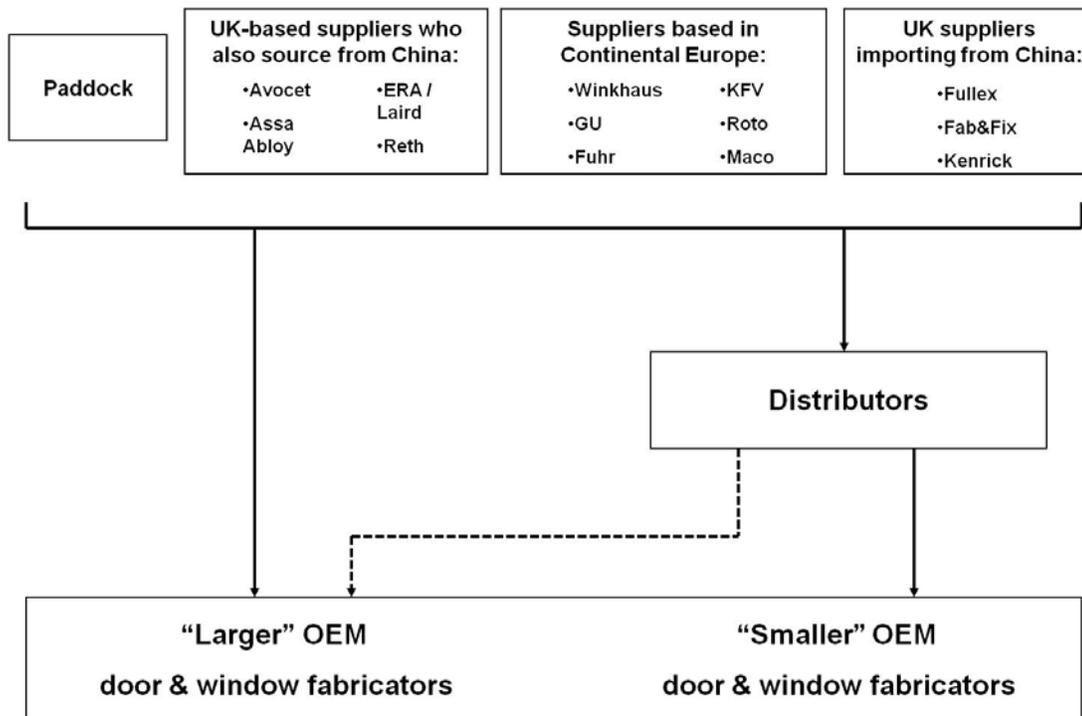
35. In general, the OFT considers that market shares of the order of 30 to 40 per cent (as those held by the parties together in direct sales), taken in isolation, are not often high enough to give rise to prima-facie competition concerns. However, given the level of uncertainty of the above estimates of the market size in this case, the OFT proceeded on a cautious basis.⁷

36. The OFT's concerns as to the accuracy of the market share data were bolstered by concerns it received from third parties (in both the direct sales and distribution channels). Specifically, third-party complaints focused both on the post-merger ability of the parties to increase prices as well as on any reduction in quality that could occur post-merger. Furthermore, the OFT notes that in markets with differentiated products, market shares may not necessarily be the best indicator of the competitive constraint exerted by the merging parties on one another. Accordingly, the OFT considered it necessary to further examine elements of product differentiation and direct competition between the parties in the market for MPLs, as discussed below.

⁷ For example, some third parties also provided lower estimates for the market size than the parties.

Closeness of competition

37. The OFT understands (both from the parties and from its market investigation) that suppliers of MPLs in the UK use a number of different supply-chain models.
38. Paddock, uniquely, does not source either components or complete locks from outside the UK: all MPLs sold by Paddock are entirely manufactured in the UK. Other suppliers have a manufacturing presence in the UK (as opposed to only a sales office) but for a variety of reasons (including cost advantages) source components and/or complete MPLs from their own subsidiaries located abroad (for example, China). These suppliers include Avocet, ERA/Laird, Reth and AA.
39. There are also UK suppliers that are based in Continental Europe, where they manufacture MPLs or assemble MPL components sourced from other countries (for example, Romania, Turkey, but also China), but who have a sales office in the UK. This set of suppliers includes Winkhaus, GU, KFV, Fuhr and Roto (all from Germany) as well as Maco (Austria).
40. Lastly, there are suppliers who source complete MPLs from abroad (usually, from China) without owning a factory there (that is, they source locks from trading partners) and sell such MPLs in the UK using their own brands. These suppliers include Avanco (a relatively new entrant, according to the parties), Fab&Fix, Fullex, and Kenrick (as well as other importers with a very small presence in the UK, for example, []).
41. This taxonomy, together with a schematic representation of the possible routes to market, is represented in the following diagram:



Source: OFT's analysis

Note: the solid lines represent typical patterns of supply (that is, larger OEMs buy directly from manufacturers, whereas smaller OEMs tend to buy from distributors), whereas the dotted line indicates less typical cases (that is, larger OEMs buying from distributors).

42. Third party views were mixed on the degree of substitutability between MPLs supplied using each type of supply-chain. A number of third parties indicated that MPLs imported from China are on the 'low end' of the quality spectrum and are cheaper than the parties' locks, although other third party comments did not support this view. Some third parties mentioned that German locks are of higher quality and are more expensive than the parties' locks (especially given the recent movements in exchange rates) although again other third parties did not share this view. Some parties with a preference for UK-based suppliers of 'mid range' MPLs even went as far as stating that that they perceived this merger as reducing the number of possible suppliers from three to two, with ERA being the only other possible mid-range supplier.
43. A related concern raised by a small number of third parties is that the combination of Paddock's customer based with the Yale brand would put the merged entity in a unique competitive position, to the

detriment of other competitors and, ultimately, customers. The OFT notes, in this respect, that its market investigation has not generally shown that door fabricators or indeed final purchasers of doors with fitted MPLs place particular value on the Yale brand.⁸ While quality is important to customers, the large majority of the respondents to the OFT market investigation did not indicate that the Yale brand made the Assa Abloy lock particularly attractive. Given the absence of evidence that branding is particularly significant in respect of MPLs, the OFT does not consider that adding the Yale brand to Paddock locks (if that is indeed the commercial strategy that the parties pursue) would lead to any unilateral effects.

44. Given the mixed evidence emerging from third party views, however, the OFT therefore sought to obtain further information on the substitutability between different MPLs by examining the parties' data that tracks business won and lost (win-loss data) and internal Paddock documents prepared in the ordinary course of business.

Win-loss data

45. AA submitted win-loss data to the OFT and Paddock submitted 'win-only' data.⁹ As a general point, the OFT considers this data to be particularly probative of the competitive interaction between the parties, as it is an objective indication of customers' revealed (rather than stated) preferences.
46. The parties argued that these data showed that they are not close competitors to each other.

AA's win-loss data

47. AA primarily sells directly to door and window fabricators (OEMs) and its win-loss data reflects this, comprising 17 tenders to OEMs and one to a distributor from the beginning of 2008.
48. The AA data for tenders for direct sales to OEMs shows that Paddock has been the **sole** (known) competitor in [] of the 17 tenders accounting for potential revenues of only £[], just [0-10] per

⁸ The Yale brand appears to have strength in channels where consumers directly purchase a lock, which is not generally the case for MPLs that are fitted by door fabricators.

⁹ Paddock does not record 'loss' data.

cent of the total potential revenues across all 17 tenders. AA's most frequent competitors have been Winkhaus and Paddock¹⁰ (both recorded as competitors in [] out of 17 cases, individually or together with other manufacturers), followed by Fullex ([]) and ERA ([]). In terms of revenue, AA's most prominent competitor has been Paddock (£[]m, or [55-65] per cent of the total potential revenues), followed by ERA (£[]m), Winkhaus (£[]m) and Fullex (£[]m).

49. As to lost tenders for direct sales to OEM (that is, tenders to which AA participated, but did not win), AA lost six tenders, worth £[] million in total. Of these, [] tenders were lost to Paddock (for £[], or [20-30] per cent of the total), [] to Winkhaus (for £[], or [50-60] per cent of the total), and [] to ERA (for £[], or [10-20] per cent of the total).
50. The AA bidding data comprises a relatively small sample of its sales since most negotiations are conducted informally. However, the pattern that emerges from it is corroborated by both the Paddock 'win' data and by Paddock's internal documents, as discussed in the following two sections.

Paddock's win data

51. Paddock provided the OFT with a sample of 104 tenders for 2009. Of these, six referred to instances where Paddock acquired new customers without competing with rivals and three referred to instances where a customer decided to buy MPLs directly from Paddock, rather than through one of its distributors. The OFT therefore excluded these tenders from its analysis.
52. Of the remaining 95 tenders with known competitors, 83 refer to sales through distributors and 12 refer to direct sales to OEMs. As shown in the Tables below, AA was the incumbent supplier in [] of the former and [] of the latter instances respectively, accounting (respectively) for [10-20] per cent and [20-30] per cent of total revenues.

¹⁰ On a conservative basis and consistent with the results of its market investigation, the OFT has attributed [] wins to Paddock for this purpose on the basis that [] is one of Paddock's largest distributors of MPLs and does not have much flexibility in the terms at which it sells them (see paragraph 18)

53. By contrast, in terms of the number of wins, Paddock's most prominent competitors in sales through distributors have been Fuhr, GU and Maco (in competition with whom Paddock won [], [] and [] accounts, respectively), whereas ERA and Fuhr were the most frequently reported rivals in direct sales, in [] and [] (the same number as AA) instances, respectively. In terms of estimated revenues, Paddock's most prominent competitors have been Fuhr and ERA in the distribution channel ([20-30] per cent and [10-20] per cent, respectively) and ERA ([50-60] per cent) in the direct channel.

Table 3: Paddock's wins in sales to distributors

Competitor	Number of wins	Value of wins (£000s)	Percentage of number of wins	Percentage of value of wins
'German' locks	[]	[]	[60-70]	[60-70]
Assa Abloy	[]	[]	[0-10]	[0-10]
ERA	[]	[]	[0-10]	[10-20]
Avocet	[]	[]	[0-10]	[0-10]
Kenrick	[]	[]	[0-10]	[0-10]
TOTAL	83	[]	100	100

Source: OFT analysis of parties data

Table 4: Paddock's wins in direct sales to OEMs

Competitor	Number of wins	Value of wins (£000s)	Percentage of number of wins	Percentage of value of wins
'German' locks	[]	[]	[30-40]	[10-20]
Assa Abloy	[]	[]	[10-20]	[20-30]
ERA	[]	[]	[40-50]	[50-60]
Fulllex	[]	[]	[0-10]	[0-10]

TOTAL	12	[]	100	100
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Source: OFT's analysis of parties' data

54. The above data indicates that, although the parties do compete to some extent, they are far from being each others' closest competitors and appear to be no closer competitors than their comparatively modest market shares would suggest. The parties are also competing against German lock manufacturers, ERA and Chinese lock importers.

Internal documents

55. The OFT has also examined Paddock's internal monthly sales reports for 2009. These sales reports were prepared by Paddock's salespeople in the ordinary course of business and most of them pre-date the announcement of the merger.¹¹

56. These internal documents show limited monitoring by Paddock of AA. While Paddock did target some AA accounts, the vast majority of the accounts it targeted were not of AA customers. The documents also make particular reference to German manufacturers (Winkhaus, Fuhr), ERA and importers of Chinese locks (Fullex, Avocet and Kenrick).

57. These reports show that quality and service issues are important for MPL customers. There is nothing in these internal documents to suggest, however, that AA is the only company with a lock of comparable quality to Paddock's. On the contrary, reports on German and Chinese locks are varied and do not show a clear quality/price differentiation picture between Paddock and AA locks on the one hand, and German and Chinese locks on the other. It is clear from the internal documents that Paddock competes with both German and Chinese lock manufacturers/importers. In addition, there are few references to exchange rates having an impact on the ability

¹¹ Specifically, the OFT examined documents from 2009 and early 2010. Some of the later documents post-date the announcement of the merger.

of German or Chinese locks to compete in the UK.¹²

58. Paddock's internal documents further show that customers can and do switch and that AA is no more a source or destination for those switching than are other suppliers. This is discussed below.

Switching costs

59. The parties submit that switching costs for OEMs are very low. In particular, AA estimates that it would cost a medium-sized door fabricator producing 500 doors a week around £25,000 to switch to an alternative multi-point door lock supplier. They submit that these costs represent less than 0.5 per cent of the fabricator's annual revenues (assuming an average door price of £250) and that door lock manufacturers increasingly offer to pay a contribution towards some or all of the costs in order to facilitate switching. In addition, the parties note that the low switching costs are confirmed by customer churn. In particular, AA estimates that each year [] per cent of its business is new, and [] per cent is lost.
60. Several door fabricators informed the OFT that they would incur some costs to switch to a new manufacturer of door locks. In particular, these costs include adapting the design of door profiles to the new locks and receiving accreditation for the modified doors in line with current security standards. However, according to these OEMs, all things considered (for example, running down the stock of locks of the incumbent supplier), the switching process is not cumbersome and would require a few weeks or months (and in any case the longest switching time mentioned to the OFT was six months). Competitors also confirmed that the switching process is easy and this is also corroborated by Paddock internal documents and by the parties' 'win-loss' data which confirm that they can convince customers to switch to their locks.
61. On this basis, the OFT considers that switching of MPLs by door fabricators is relatively easy and commonplace.

¹² The OFT notes that the values against Sterling of both the Yuan and the Euro have fluctuated in approximately the same way over recent years, so that if currency exchange rate movements had been a particularly important factor in the competitiveness of Chinese or Continental European locks then this would have affected both equally.

Spare capacity

62. The OFT has received limited information from competitors in respect of whether they had spare capacity. One manufacturer, in particular, indicated that it could expand production by up to 25 per cent with additional shifts and no additional capital expenditure and another indicated that it would have no problems increasing its levels of supply in response to increased demand. One manufacturer, however, indicated that it would have to incur significant investment costs to increase capacity.
63. The Paddock internal documents reviewed by the OFT do not indicate that capacity constraints form a particular concern for manufacturers nor that the parties have a particularly large share of any available spare capacity in the supply of MPLs in the UK and this was also borne out by the OFT's market investigation.
64. In addition, given that switching requires some planning from the customer and manufacturer perspective, this enables manufacturers to plan capacity increases.
65. Given its findings above, however, the OFT does not need to conclude on the issue of spare capacity.

Conclusion

66. Despite the fact that the OFT had preliminary concerns as to the accuracy of the market share data, and in particular in view of third party concerns over price and quality received during the course of its market investigation, a closer examination of the parties' win-loss data and of Paddock internal documents has shown that the parties are no closer competitors than their market shares would suggest and face competition from a number of other MPL suppliers. The OFT, therefore, considers that post-merger, there will be sufficient competitive constraints on the parties to preserve competition both on prices and quality.

BARRIERS TO ENTRY/EXPANSION

67. The parties submitted that there are no significant barriers to entry at the manufacturing level and that the capital costs of new entry are

also very low. In particular, AA estimates that it would cost around £300,000 to begin producing and supplying a range of three alternative multi-point door lock designs. The parties note that examples of recent entry in 2008 include Fab and Fix, IFI (which is, in fact, AA's main distributor) and Avanco Design.

68. The parties also submitted that at the distribution level there are no barriers for (say) a hardware distributor or similar firm to extend its product range (including through imports) and enter the supply of door locks and cylinders. They note, for example, that in 2008, Kenrick introduced a new range of locks into the UK which it sourced from China as an alternative to sourcing from Paddock and that in 2007 Avocet switched from GU and Roto to Chinese manufactured locks.
69. In addition, there is some evidence that door and window fabricators can import their own locks. For example, Securistyle – a window and door fabricator [] – informed the OFT that they have designed their own MPLs and will start production during [].
70. The OFT is not able to exclude that, going forward, the possibility that entry or self-supply, combined with the pressure to lower costs, could intensify competition in the supply of MPLs in the UK. Given the findings above, however, it is not necessary for the OFT to conclude on whether these instances of entry into the supply of MPL would avert any finding of substantial lessening of competition in this case.

BUYER POWER

71. The parties submitted that distributors represent a strong competitive constraint, as they are both customers and competitors of traditional branded manufacturers, selling to door fabricators in competition with manufacturers, using both manufacturer-branded and own-brand products. They also submitted that distributors are able to shift large volumes between different manufacturers and can substitute towards imports from low-cost countries that they then sell under their own brands.
72. The parties provided examples of distributors that have sourced products from China including Kenrick (which introduced a new

range of locks into the UK in 2008 in substitution for locks sourced from Paddock) and Avocet, which switched from GU and Roto to Chinese-manufactured locks in 2007.

73. The parties submit that OEM customers also enjoy buyer power. They submit that these customers are by definition large enough to justify a manufacturer selling directly to them, and are typically experienced businesses who are adept at playing off different suppliers in order to negotiate the best possible price.¹³ The parties have also provided evidence of a number of instances where customers have exercised buyer power in order to resist price increases.
74. The OFT's market investigation has provided mixed support for the parties' proposition that buyer power exists in this market, especially considering that AA's prices have increased recently, whereas Paddock's prices have mostly gone down. Competitors, however, have mentioned that this is very much a 'buyer's market' (especially given the current economic climate where there are fewer sales of door locks due to the housing market decline). Some customers have also indicated that they consider themselves as being in a position to resist price increases or at least to negotiate down from a suggested price increase.
75. Paddock internal documents also show how difficult it has been for it to push through any price increases and how it has had to justify price increases due to commodity price increases very precisely to its customers.
76. On balance, therefore, the OFT considers that there is scope for at least some customers to have buyer power, although it does not need to reach a final view on this issue given its conclusions above.

¹³ AA's major OEM customers include []. The parties also note that the AMA Report writes (at page 53) that '[r]elated markets such as window and door fabrication and DIY retailing have become more consolidated. Larger clients have more buying power and have put pressure on prices, and are more likely to use imported and own brand products'.

COORDINATED EFFECTS

77. The OFT received concerns from a limited number of third parties that the proposed transaction might give rise to a reduction of competition through coordinated effects. The OFT, however, considers that this is not the case. In particular, a number of suppliers will remain active in the market after the merger and this will make it difficult for lock manufacturers to agree on the terms of a collusive conduct (whether this is explicit or tacit collusion) and also monitor such conduct.
78. Specifically, the OFT considers noteworthy, in respect of coordinated effects, the presence of several importers of MPLs from abroad (in particular, the Far East) and the fact that price negotiations between lock manufacturers and OEMs are not transparent.

THIRD PARTY VIEWS

79. Third party views have been discussed above where relevant. In general, there were mixed views regarding this merger from competitors and customers.
80. Some competitors thought that the merger would result in a dominant MPL supplier (also considering the combination of Paddock's strong position with AA's Yale brand). One distributor was also concerned that the merger would cement Paddock's position in MPLs when combined with the Yale brand. Other distributors, however, were not concerned, noting that there are a number of other alternatives to the parties in the supply of MPLs in the UK, such as ERA, Winkhaus, Fuhr, Roto, Maco, GU, Fullex and Avocet. Other competitors had no concerns.
81. Some customers were also concerned that the merger would result in an increase in prices and decrease in quality. Other customers, however, considered that they have buyer power and that there are a number of alternative suppliers of MPLs they could turn to should the parties try to impose a price increase.
82. Third party concerns were considered in detail above in the unilateral effects section. The OFT sought to obtain further information to

assess third party concerns and, in this respect, the additional evidence examined by the OFT set out in detail in the 'closeness of competition' section.

ASSESSMENT

83. The parties overlap in the supply of MPLs in the UK to distributors and directly to door and window fabricators.
84. The OFT examined the parties' combined market shares in the supply of locks to all customers and, separately, in the supply of locks to distributors and door and window fabricators. While the parties' combined market shares would not necessarily give rise to preliminary concerns in direct sales to OEMs, the OFT had some customer complaints that the parties were particularly close competitors. Specifically, some third parties argued that both parties have good quality locks at a mid-range price that do not compete closely with imported 'low end' locks from Asia or 'high end' locks from Continental Europe. In addition, some customers argued that the merger would result in an increase in prices and a reduction in quality.
85. The OFT, however, did not find these customer concerns to be supported by further examination of the evidence provided to it by the parties. In particular, the OFT examined the parties' 'win/loss' data. This indicated that, although the parties did compete directly, they were not each others' closest competitor and that there was significant (implied) diversion from them to ERA and to German lock manufacturers. In addition, the OFT examined Paddock internal sales reports prepared in the ordinary course of business prior to the merger. These confirmed that Paddock faced significant competition from a number of lock manufacturers and that while it did target some AA accounts, its primary focus was on accounts of other MPL suppliers.
86. In light of the above, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

87. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

ENDNOTES

88. In respect of paragraph 38, the parties informed the OFT that it is the **majority** of Paddock's component parts that are entirely manufactured in the UK.
89. In respect of paragraph 48, the OFT notes that in fact Paddock featured in one more tender than Winkhaus. This is a minor change and therefore has no impact on the OFT's conclusions in this case.
90. In respect of paragraph 48, the OFT notes that the revenue for which AA has competed with Paddock for is £[] million and [55-65] per cent of the total potential revenues and the revenue for which Winkhaus competed is £[] million. These amendments are minor and as such have no impact on the OFT's conclusions in this case.
91. In respect of paragraph 49, the OFT notes (for clarification) that it has, on a conservative basis also attributed AA losses to Paddock's distributors to Paddock, for the reasons discussed in footnote 10.
92. In respect of Table 3 and Table 4, the OFT notes that the reference should be to 'Continental European locks' and not 'German locks'.
93. In respect of paragraph 67, the OFT notes, for clarification, that IFI is a recent UK door lock entrant but not an MPL entrant.