4. Dessert Wines

462. Between 1957 and 1967, the volume of dessert wines entering distribution channels in the United States has fallen and risen but overall has shown a decline. Since 1968, dessert wine shipments (including vermouth and other special natural still wines over 14 percent alcohol by volume) have continued to decline from 102,377,600 gallons in 1968 to 94,566,000 gallons in 1976 (CX 273U, 295J; Wine Institute Bulletin, March 24, 1978, No. 78-3, Table 2, officially noticed September 27, 1978).

463. In 1968, domestic and imported dessert wines (including vermouth and other special natural still wines over 14 percent alcohol by volume) were the largest selling wine type, accounting for 47.9 percent of all commercially produced wine entering distribution channels in the United States (CX 295J, 373E, N).

464. In 1976, dessert wine shipments declined to 21 percent of all wine shipments entering distribution channels in the United States (Wine Institute Bulletin, March 24, 1978, No. 78-3, Table 2, officially noticed September 27, 1978).

5. Sparkling Wines

465. In 1960, shipments of commercially produced sparkling wine entering distribution channels in the United States totaled 4,321,000 gallons, accounting for 2.6 percent of all wine shipments. In 1968, sparkling wine shipments had grown to 12,513,000 gallons or 5.9 percent of all wine shipments entering distribution channels in the United States (CX 295J). **[96]**

466. Shipments of sparkling wine peaked in 1971, totaling 23,970,000 gallons, or 7.8 percent of all wine shipments (CX 295J, 373J, Z-12).

467. From 1971 through 1976, sparkling wine shipments entering distribution channels in the United States have declined and leveled off, ranging between 20 and 22 million gallons annually. In 1976, shipments of sparkling wines were 21.8 million gallons, or 5.8 percent of total wine shipments entering distribution channels in the United States (CX 366I).

468. After increasing over 500 percent between 1960 and 1971, sparkling wine shipments went into a period of decline as cold duck sales collapsed. The sparkling wine shipment decline leveled out in 1975 and in 1976 sparkling wine shipments grew 7 percent over 1975 shipments (CX 366T).

B. Concentration and Concentration Trends

469. The four firm concentration ratio of the all wine market in the United States was 47.4 percent in 1967, 47.9 percent in 1968, 50.9 percent in 1969, 53.6 percent in 1970, 56.7 percent in 1971 and 54.6 percent in 1972 (CX 373B, D, F, H, J, K).

470. The eight firm concentration ratio of the all wine market in the United States was 55.9 percent in 1967, 57.4 percent in 1968, 60.3 percent in 1969, 63.6 percent in 1970, 67.0 percent in 1971 and 66.0 percent in 1972 (CX 373B, D, F, H, J, K).

471. The four firm concentration ratio of the United States table wine market, consisting of still wines not over 14 percent alcohol by volume (excluding refreshment wines), was 49.7 percent in 1967, 48.1 percent in 1968, 47.4 percent in 1969, 47.4 percent in 1970, 47.0 percent in 1971 and 43.5 percent in 1972 (CX 373V, Y, Z-2, Z-4, Z-6, Z-7; RX 15A-B, 27A-B).

472. The eight firm concentration ratio of the United States table wine market, consisting of still wines not over 14 percent alcohol by volume (excluding refreshment wines), was 61.0 percent in 1967, 60.0 percent in 1968, 59.6 percent in 1969, 60.5 percent in 1970, 59.4 percent in 1971 and 57.4 percent in 1972 (CX 373V, Y, Z-2, Z-4, Z-6, Z-7; RX 15A-B, 27A-B).

473. The four firm concentration ratio of the United States dessert wine market, consisting of still wines over 14 percent alcohol by volume, was 49.0 percent in 1967, 50.4 percent in 1968, 51.3 percent in 1969, 52.4 percent in 1970, 54.6 percent in 1971 and 52.4 percent in 1972 (CX 373L, N, P, R, T, U). [97]

474. The eight firm concentration ratio of the United States dessert wine market, consisting of still wines over 14 percent alcohol by volume, was 56.1 percent in 1967, 58.5 percent in 1968, 59.5 percent in 1969, 61.2 percent in 1970, 63.7 percent in 1971 and 63.5 percent in 1972 (CX 373L, N, P, R, T, U).

475. The four firm concentration ratio of the United States sparkling wine market was 37.0 percent in 1967, 41.9 percent in 1968, 54.9 percent in 1969,[21] 56.8 percent in 1970, 59.6 percent in 1971 and 61.0 percent in 1972 (CX 373Z-8 thru Z-13).

476. The eight firm concentration ratio of the United States sparkling wine market was 56.5 percent in 1967, 62.7 percent in 1968, 71.9 percent in 1969, 73.7 percent in 1970, 75.2 percent in 1971 and 78.0 percent in 1972 (CX 373Z-8 thru Z-13).

[21] Until November 1969, Lancers met the definition of and was taxed as a carbonated wine and thus fell within the sparkling wine submarket. In that month, Heublein stabilized the carbonation of Lancers at a level below that required of a carbonated wine, thus changing its position to that of a table wine (Tr. 8705-14). As of that time, Heublein could no longer market Lancers as an effervescent wine, whether by packaging, advertising or otherwise (CX 309Z-25). Statistics for 1969, however, do not reflect the change and include Lancers as a sparkling wine for the entire year.

477. These concentration ratios narrated above follow in tabular form:

ALL WINE MARKET SHARE

	Top 4	Top 8
1967	47.4%	55.9%
1968	47.9	57.4
1969	50.9	60.3
1970	53.6	63.6
1971	56.7	67.0
1972	54.6	66.0

TABLE WINE MARKET SHARE

	Top 4	Top 8
1967	49.7%	61.0%
1968	48.1	60.0
1969	47.4	59.6
1970	47.4	60.5
1971	47.0	59.4
1972	43.5	57.4 [98]

DESSERT WINE MARKET SHARE

	Top 4	Top 8
1967	49.0%	56.1%
1968	50.4	58.5
1969	51.3	59.5
1970	52.4	61.2
1971	54.6	63.7
1972	52.4	63.5

SPARKLING WINE MARKET SHARE

	Top 4	Top 8
1967	37.0%	56.5%
1968	41.9	62.7
1969	54.9	71.9

	Top 4	Top 8
1970	56.8	73.7
1971	59.6	75.2
1972	61.0	78.0

478. Professor Scherer has written that when 40 percent of a market is concentrated in the top four firms, inter-firm interdependence and coordination become increasingly probable. Professors Kaysen and Turner have found that when the top eight firms have 50 percent of the market, there is a Type 1 oligopoly where there is a great likelihood that the firms will recognize their interdependence and act in a non-competitive manner. They have classified as a tight oligopoly the situation where the top four firms have 50 percent (Tr. 5679–81). These are generally accepted benchmarks of a concentrated industry and are being applied in this case.

479. Measured both by four firm and eight firm concentration ratios, the all wine market and the table wine and dessert wine submarkets were concentrated in the period 1967 through 1972 (CX 373).

480. Measured by four firm concentration ratios, the sparkling wine submarket was concentrated in the period 1968 through 1972 (CX 373).

481. Measured by eight firm concentration ratios, the sparkling wine submarket was concentrated in the period 1967–1972 (CX 373).

482. Measured both by four firm and eight firm concentration ratios, the all wine market and the dessert and sparkling wine submarkets were characterized by increases in concentration over the period 1967 through 1972 (CX 373). **[99]**

483. Four firm and eight firm concentration ratios in the all wine market and in the table and dessert wine submarkets may be understated due to the inclusion of United States taxpaid withdrawals of all bulk wine in the universe figures for each market but exclusion of taxpaid withdrawals of bulk wine, except taxpaid withdrawals of bulk wine shipped to franchised bottlers, from individual firm shipments (CX 373A). There is no evidence that sparkling wines are, or can be, shipped in bulk form.

484. In 1968, the year before the merger, the all wine market eight firm concentration of 57.4 percent exceeded the 50 percent threshold at which Professors Kaysen and Turner deemed industry interfirm coordination and interdependence likely. In 1968, the all wine market four firm concentration of 47.9 percent exceeded the 40

percent threshold at which Professor Scherer deemed industry interfirm coordination likely (CX 373D; Tr. 5681, 5684-85).

485. In 1972, the all wine market four firm concentration of 54.6 percent exceeded the 50 percent threshold at which Professors Kaysen and Turner characterized an industry as a tight oligopoly within which interfirm coordination and interdependence is extremely likely (CX 373K; Tr. 5681-82).

486. In 1968, the United States table wine market was concentrated. By Professors Kaysen's and Turner's four firm concentration standards, in 1968, the table wine market approached tight oligopoly in which interfirm coordination and interdependence is extremely likely. The four firm concentration in this market in 1968 also exceeded the 40 percent threshold at which Professor Scherer deemed interfirm coordination and interdependence likely (CX 373Y; Tr. 5680-81, 5684). In 1972, the table wine market remained concentrated, exceeding Professor Scherer's 40 percent threshold (CX 373Z-7; Tr. 5681-82).

487. In 1968, the United States dessert wine market was concentrated. By Kaysen and Turner's, four firm concentration standards, in 1968, the dessert wine market qualified as a tight oligopoly in which interfirm coordination and interdependence is extremely likely to occur. The four firm concentration in this market in 1968 also exceeded the 40 percent threshold at which Professor Scherer deemed interfirm coordination and interdependence likely (CX 373N; Tr. 5681-82, 5687). In 1972, the dessert wine market remained a tight oligopoly by Kaysen and Turner's four firm concentration standards (CX 373U; Tr. 5681-82).

488. In 1968, the United States sparkling wine market was concentrated. The four firm concentration in this market in 1968 exceeded the 40 percent threshold at which Professor Scherer deemed interfirm coordination and **[100]**interdependence likely. In 1968, the eight firm concentration in this market exceeded the 50 percent threshold at which Professors Kaysen and Turner deemed interfirm coordination and interdependence likely (CX 373Z-9; Tr. 5680, 5686). In 1972, the sparkling wine market four firm concentration ratio exceeded the 50 percent threshold at which Professors Kaysen and Turner characterized a market as a tight oligopoly in which interfirm coordination and interdependence is extremely likely (CX 373Z-13; Tr. 5681-82).

489. No data beyond calendar year 1972 exists in the record of the share of the top four and top eight companies of the United States all wine market, measuring individual company shares by taxable withdrawals of bottled wine and of franchised bulk wine plus

imports for consumption. However, the record contains data beyond 1972 on wine shipments by the ten largest United States wineries.

490. Domestically produced wine of the ten largest United States wineries, as a percentage of total wine shipments entering distribution channels, measured by domestic taxable withdrawals of bottled wine and of all bulk wine plus imports for consumption, accounted for 71 percent of all wine shipments in 1973. The domestically produced wine of the ten largest United States wineries dropped to 68 percent of total wine shipments in 1974, recovered to 69 percent in 1975, and rose to 69.4 percent in 1976. Over the period 1970 through 1976, the share of the ten largest United States wineries increased from 66 percent to 69.4 percent of total wine shipments entering distribution channels in the United States (CX 366U-Z; see also CX 295J; Wine Institute Bulletin, March 24, 1978, No. 78-3, Table 2, officially noticed September 27, 1978, for universe figures).

491. In the all wine market, the four firm concentration ratio during the period 1973 through 1976 remained beyond the 50 percent threshold level at which Professors Kaysen and Turner considered the industry interfirm coordination and interdependence extremely likely to occur. The four largest United States wineries (Gallo, United Vintners, Almaden, and Mogen David/Franzia), not including their affiliated imported wine operations, alone accounted for 56 percent in 1973, 53 percent in 1974, 53 percent in 1975 and 53 percent in 1976 of the universe of all domestic and imported wine shipments entering distribution channels in the United States. The eight largest United States wineries (the four named above and Canandaigua, Guild, Taylor and Monarch), not including their affiliated imported wine operations, alone accounted for 69 percent in 1973, 66 percent in 1974, 67 percent in 1975 and 66.8 percent in 1976 of the universe of all domestic and imported wine shipments entering distribution channels in the United States (CX 366Y-Z; Tr. 5681-82). **[101]**

492. Beyond calendar year 1972, no record data exists of the share of the top four and top eight firms in the dessert wine market measuring individual firm share by taxable withdrawals of bottled dessert wine and of franchised bulk dessert wine plus dessert wine imports for consumption. However, the record contains data with respect to dessert wine shipments by California producers.

493. In the period 1973 through 1976, the dessert wine market remained concentrated. The four largest California producers of dessert wines (Gallo, United Vintners, Guild and Bear Mountain), not including their affiliated imported wine operations, alone accounted for 50 percent in 1973, 45 percent in 1974, 48 percent in

1975 and 49.6 percent in 1976 of total domestic and imported shipments of dessert wines. Four firm concentration in the period 1973 through 1976 in the dessert wine market, measured by shipments of the top four California producers alone, exceeds the 40 percent threshold at which Professor Scherer deemed industry interfirm coordination and interdependence likely. The eight largest California producers of table wines (the four named above and Franzia, Christian Brothers, California Wine Association and Paul Masson), not including their affiliated imported wine operations, alone accounted for 60 percent in 1973, 53 percent in 1974, 56 percent in 1975 and 58.0 percent in 1976 of total shipments of domestic and imported dessert wines entering distribution channels in the United States. The eight firm concentration in the period 1973 through 1976 in the dessert wine market, measured by shipments of the top eight California producers alone, exceeds the 50 percent threshold at which Professors Kaysen and Turner consider industry interfirm coordination and interdependence likely to occur (CX 366Z-1; Tr. 5681-82).

494. Beyond calendar year 1972, no record data exists of the share of the top four and top eight firms in the United States sparkling wine market, measuring individual firm share by taxable withdrawals and franchised bulk wine (if any) plus imports for consumption. However, the record contains data beyond 1972 with respect to the share of the sparkling wine market held by the ten largest California wineries, not including their affiliated imported wine operations. As a percentage of the total universe of sparkling wine shipments entering distribution channels as measured by domestic taxable withdrawals of bottled sparkling wine and franchised bulk sparkling wine (if any) plus sparkling wine imports for consumption, the ten largest California sparkling wine producers, not including their affiliated imported wine operations, accounted for 68 percent in 1973, 70 percent in 1974, 72 percent in 1975 and 69.3 percent in 1976 of total shipments of sparkling wines entering distribution channels in the United States. Over the period 1970 through 1976, the share of the ten largest California sparkling wine producers increased from 59 percent to 69.3 percent of total domestic and imported sparkling wine [102]shipments entering distribution channels in the United States (CX 366Z-2; see also CX 295J; Wine Institute Bulletin, March 24, 1978, No. 78-3, Table 2, judicially noticed September 27, 1978, for universe figures).

495. In the sparkling wine market, the four firm concentration during the period 1973 through 1976 remained beyond the 50 percent threshold level at which Professors Kaysen and Turner consider

industry interfirm coordination and interdependence extremely likely. The four largest California producers of sparkling wines (Gallo, United Vintners, Almaden and Franzia), not including their affiliated imported wine operations, alone accounted for 58 percent in 1973, 57 percent in 1974, 56 percent in 1975 and 54.7 percent in 1976 of total shipments of domestic and imported sparkling wines entering distribution channels in the United States. The eight largest California producers of sparkling wines (the four named above and Paul Masson, Guild, Korbel and Weibel), not including their affiliated imported wine operations, alone accounted for 67 percent in 1973, 67 percent in 1974, 68 percent in 1975 and 66.2 percent in 1976 of total shipments of domestic and imported sparkling wines entering distribution channels in the United States (CX 366Z-2).

496. The all wine market and the table, dessert and sparkling wine submarkets were concentrated at the time of the merger and remained concentrated through 1972. And concentration increased during that period in the all wine market and in the dessert and sparkling wine submarkets. As further demonstrated above, in the period 1973 through 1976, the all wine market and the dessert and sparkling wine submarkets remained concentrated.[22]

The trends towards increasing concentration over the period 1967 through 1972 in the United States in the all wine market and in the dessert and sparkling wine submarkets increase the probability of recognized interdependence among wine producers and hence the probability of interfirm coordination. The effects of the merger, therefore, must be evaluated in the light of this concentrated state of the industry.

C. Skewness

497. In the period 1967 through 1972, the size distribution of market shares among the top four and top eight firms in the all wine market and in the table and dessert wine submarkets was skewed (Tr. 5699-5701). In the period 1969 through 1972, the size distribution of market shares among the [103]top four and top eight firms in the sparkling wine market was skewed (Tr. 5701). This skewness increases the probability of interfirm coordination among the competitors in the all wine market and the three submarkets (Tr. 5696-5701).

498. The size distribution of the market shares of firms within the top eight competitors in the United States all wine market in the

[22] There is no record evidence covering the post 1972 period for table wines excluding refreshment wines.

period 1967 through 1972 was as follows (CX 373D, F, H, J, K; Tr. 5698):

ALL WINE MARKET

	1967 % *Market*	*1968* % *Market*	*1969* % *Market*	*1970* % *Market*	*1971* % *Market*	*1972* % *Market*
E. & J. Gallo Winery	22.9	24.0	25.8	29.2	32.7	32.4
United* Vintners, Inc.	18.7	17.9				
Heublein, Inc.			18.9	18.3	16.9	14.5
Schenley Industries, Inc.	2.9	3.0	3.1	3.2		
The Taylor Wine Co., Inc.	2.8	3.1	3.1	2.9	2.9	2.9
Joseph E. Seagram & Sons, Inc.	2.3	2.5	2.4	2.3	2.1	2.3
Mogen David Wine Corp.	2.1	2.5	2.2	2.5	2.9	3.6
Guild Wineries and Distilleries	2.0				3.9	3.8
National Distillers & Chemical Corp.	2.0	2.3	2.4	2.8	3.2	3.9
Franzia Bros. Winery		2.2	2.4	2.3	2.3	2.6

*Effective 1969, United's figures are included with Heublein's. **[104]**

499. The size distribution of the market shares of firms within the top eight competitors in the United States table wine market in the period 1967 through 1972 was as follows (CX 373V, Y, Z-2, Z-4, Z-6, Z-7; RX 15A-B, 27A-B):

TABLE WINE MARKET*

	1967 % Market	1968 % Market	1969 % Market	1970 % Market	1971 % Market	1972 % Market
E. & J. Gallo Winery	24.2	24.6	25.5	23.9	21.7	20.4
United** Vintners, Inc.	17.4	14.6				
Heublein, Inc.			13.7	14.6	14.1	12.5
Mogen David Wine Corp.	5	5.4	4.5	4.5	4.3	3.6
National Distillers & Chemical Corp.	3.1	3.5	3.8	4.5	5.7	7.0
Guild Wineries and Distilleries	3.1	2.9	2.9	3.2	5.5	5.2
Schenley Industries, Inc.	2.9	3.1	3.3	3.8		
Joseph E. Seagram & Sons, Inc.		2.9	2.7	2.7	2.5	3.1
Monarch Wine Co., Inc.	2.6				2.2	1.8
Franzia Bros. Winery	2.6	2.9	3.3	3.3	3.4	3.8

*Excluding refreshment wines.

**Effective 1969, United's figures are included with Heublein's. [105]

500. The size distribution of the market shares of firms within the top eight competitors in the United States dessert wine market in the period 1967 through 1972 was as follows (CX 373L, N, P, R, T, U):

DESSERT WINE MARKET

	1967 % *Market*	*1968* % *Market*	*1969* % *Market*	*1970* % *Market*	*1971* % *Market*	*1972* % *Market*
E. & J. Gallo Winery	22.9	22.9	22.9	22.0	21.1	20.6
United* Vintners, Inc.	20.1	21.0				
Heublein, Inc.			21.2	22.5	24.6	22.7
Schenley Industries Inc.	3.0	3.2	3.5	3.8		
Taylor Wine Co., Inc.	2.9	3.3	3.8	4.1	4.6	4.7
Canandaigua Industries Co., Inc.	2.3	2.6	2.5	2.8	3.0	3.9
Joseph E. Seagram & Sons, Inc.	1.6	1.9	2.0	2.1	2.1	
California Wine Association	1.6	1.8	1.8			
Renfield Importers, Ltd.	1.6	1.7		2.1		2.4
The Christian Brothers			1.8	1.8	2.0	2.0
Mogen David Wine Corp.					2.0	2.8
Guild Wineries and Distilleries					4.3	4.4

*Effective 1969, United's figures are included with Heublein's. [106]

501. The size distribution of the market shares of firms within the top eight competitors in the United States sparkling wine market in the period 1967 through 1972 was as follows (CX 373Z-8 thru Z-13):

SPARKLING WINE MARKET

	1967 % *Market*	*1968* % *Market*	*1969* % *Market*	*1970* % *Market*	*1971* % *Market*	*1972* % *Market*
E. & J. Gallo Winery		11.3	18.0	27.9	32.8	33.1
United* Vintners, Inc.	10.6	10.7				
Heublein, Inc.	6.0	7.2	20.9	16.4	15.0	14.5
The Taylor Wine Co., Inc.	14.1	12.7	10.5	7.3	6.9	7.6
Joseph E. Seagram & Sons, Inc.	6.4	6.0	4.6	4.2	4.0	4.5
National Distillers & Chemical Corp.	5.8	6.3	5.6	4.9	4.8	5.8
Monarch Wine Co., Inc.	4.6	4.6	4.9	5.2	4.6	4.2
Robin Fils & Cie., Ltd.	4.5	3.9	4.1	4.2	3.1	

*Effective 1969, United's figures are included with Heublein's. **[107]**

	1967 % *Market*	*1968* % *Market*	*1969* % *Market*	*1970* % *Market*	*1971* % *Market*	*1972* % *Market*
Weibel, Inc.	4.5					
Guild Wineries and Distilleries	2.0					
Franzia Bros. Winery			3.4	3.7	3.9	5.8
Gold Seal Vineyards, Inc.						2.6

502. Measuring the skewness of the market share distribution among the top four and top eight firms in the United States all wine market by the skewness of market share distribution among the top four and top eight United States wineries, the all wine market remained skewed during the period 1973 through 1976 (CX 366Y, Z–1).

503. Measuring the skewness of the market share distribution among the top four and top eight firms in the United States dessert wine market by the skewness of market share distribution among the top four and top eight California wineries, the dessert wine market remained skewed during the period 1973 through 1976 (CX 366Z–1).

504. Measuring the skewness of the market share distribution among the top four and top eight firms in the United States sparkling wine market by the skewness of market share distribution among the top four and top eight California wineries, the sparkling wine market remained skewed during the period 1973 through 1976 (CX 366Z–2).

D. Gallo and United Vintners Dominance

505. While United had a smaller market share than Gallo, United was still a dominant factor in the industry. This is reflected in the appraisal of the industry conducted for Heublein by the McKinsey study where, in its analysis of "Competitive Structure", it was stated, "Except For United Vintners And Gallo, Industry Is Composed Of Many Small Competitors" (See Finding 338, *supra*). This is confirmed by analysis of the industry.

506. In the all wine market in 1968, the second ranked competitor, United, shipped more than six times the wine gallonage of the third ranked competitor (CX 373D). In 1969 and 1970, the pattern was repeated with the second ranked competitor, now Heublein, shipping more than six times the annual wine gallonage of the third ranked competitor (CX 373F, H). In 1971, second ranked Heublein's annual wine gallonage shipments exceeded the third ranked competitor's shipments by a ratio of better than 4 1/2 to 1 (CX 373J). In 1972, second ranked Heublein continued to ship wine at a rate of nearly four to one in comparison to the third ranked competitor (CX 373K).

507. Subsequent to 1972, United, the second ranked domestic winery, continued to maintain a significant margin in wine shipments in comparison to the third ranked domestic winery in the all wine market. In 1973, United shipped 54 million gallons of wine in comparison to third place Almaden's 14 million gallons. In 1974, United shipped 49 million gallons in comparison to Almaden's 15 million gallons. In 1975, United's wine shipments jumped to 59 million gallons in comparison to Almaden's 16 million gallons, and in [108]1976, United shipped 56 million gallons in the all wine market in comparison to Almaden's 18.7 million gallons (CX 366Y).

508. United Vintners and Gallo are the dominant domestic producers of wine. In 1960, United produced 18.5 percent and Gallo produced 20.1 percent of all domestically produced wines entering distribution channels in the United States. By 1968, United accounted for 22.1 percent of all domestically produced wine entering distribution channels in the United States and Gallo accounted for 26.7 percent, totaling 48.8 percent of all domestically produced wine entering United States distribution channels (CX 330K). In 1976, United and Gallo combined produced 49.8 percent of all domestically produced wine entering United States distribution channels, accounting for 17.6 percent and 32.2 percent respectively (CX 381). From 1960 to 1976, United's and Gallo's combined share of all domestically produced wines entering United States distribution channels rose from 38.5 percent to 49.8 percent (CX 330K, 381).

509. In 1966, United produced 11.3 percent and Gallo produced 2.4 percent of all domestically produced sparkling wines entering distribution channels in the United States. (Data is not available for earlier years.) By 1968, United accounted for 12.8 percent and Gallo accounted for 13.6 percent, totaling 26.4 percent of all domestically produced sparkling wine entering United States distribution channels (CX 330M). In 1976, United produced 12.2 percent and Gallo produced 39.7 percent of all domestically produced sparkling wines

(CX 381). Between 1966 and 1976, the combined share of United and Gallo of all domestically produced sparkling wine entering distribution channels in the United States rose from 13.7 percent to 51.9 percent (CX 330M, 381).

510. Gallo and United are the dominant producers in the all wine market. The combined all wine market share of these two companies was 41.6 percent in 1967 and 41.9 percent in 1968. The combined all wine market share of Gallo and Heublein/United was 44.7 percent in 1969, 47.5 percent in 1970, 49.6 percent in 1971 and 46.7 percent in 1972 (CX 373B, D, F, H, J, K).

511. The combined dessert wine market share of Gallo and United was 43.0 percent in 1967 and 43.9 percent in 1968. The combined dessert wine market share of Gallo and Heublein/United was 44.1 percent in 1969, 44.5 percent in 1970, 45.7 percent in 1971 and 43.3 percent in 1972 (CX 373L, N, P, R, T, U).

512. The combined table wine market share of Gallo and United was 41.6 percent in 1967 and 39.2 percent in 1968. The combined table wine market share of Gallo and Heublein/United was 39.2 percent in 1969, 38.5 percent in 1970, 35.8 percent in 1971 and 32.9 percent in 1972 (CX 373V, Y, Z-2, Z-4, Z-6, Z-7; RX 15, 27). **[109]**

513. As explained above, I have excluded refreshment wines from the table wine submarket. Yet, volume-wise, refreshment wines constituted a substantial proportion of wine production, especially in the years 1970-1972. The following concentration ratios and universe figures for refreshment wines show that this segment of the all wine market was even more concentrated and skewed than any of the relevant submarkets; and that Gallo and United were the leading producers:

REFRESHMENT WINES
(% of market, 000 gals.)
(RX 15A-B, 27A-B)

	1967	*1968*	*1969*	*1970*	*1971*	*1972*
Gallo	56.2%	63.03%	58.30%	75.41%	82.39%	78.80%
	1563	3354	8321	22087	42562	50634
United	38.26	32.92	38.97	21.54	10.95	7.07
	1063	1752	5562	6310	5655	5440
Robinson-Lloyds	2.7	1.82	1.08	.36	.16	.30
	75	97	154	107	83	196
Monsieur Henri	.9	1.03	.77	1.50	2.35	3.30
	25	55	110	440	1212	2119

	1967	1968	1969	1970	1971	1972
Mogen David	.86	.48	.26	.14	2.22	6.10
	24		38	42	1148	3921
Monarch	.86	.6	.38	.63	1.65	3.51
	24	32	54	187	853	2255
Leonard Kreusch	.14	.07	.04	.04	.03	.03
	4	4	6	12	16	18
Gibson		.02	.16	.15	.08	.01
		1	23	45	41	9
Guild			.02	.19	.02	.11
			3	58	11	68
Seagram						.14
						88[**110**]

REFRESHMENT WINE
CONCENTRATION RATIOS
(derived from prior table)

	Universe (000 gals.)	*2 firm*	*4 firm*	*8 firm*
1967	2,778 gals.	94.46%	98.06%	99.92%[23]
1968	5,321 gals.	95.95%	98.80%	99.97%
1969	14,271 gals.	97.27%	99.12%	99.99%
1970	29,288 gals.	96.95%	99.08%	99.92%
1971	51,657 gals.	93.34%	97.91%	99.96%
1972	64,251 gals.	85.07%	95.48%	99.63%

Refreshment wine is not one of the submarkets involved in this matter, and Heublein was not engaged in this submarket at the time of the acquisition. Nevertheless, it is significant that when a new area for opportunity arose in the wine industry, the same two dominant companies, Gallo and United, were in a position to secure the lion's share and bring about an extremely concentrated submarket.

514. In 1967, Taylor Wine Co., Inc. ("Taylor") and United were the top two companies in the United States sparkling wine market,

[23] 1967 concentration ratio is for seven firms.

with a combined share of 24.6 percent. In 1968, Taylor and Gallo were the top ranked companies with a 24 percent combined share of the sparkling wine market; United ranked third with 10.7 percent of that market. Heublein/United and Gallo were the top two ranked companies in the United States sparkling wine market during the period 1969 through 1972. The combined sparkling wine market share of these two companies was 38.9 percent in 1969, 44.3 percent in 1970, 47.8 percent in 1971 and 47.6 percent in 1972 (CX 373Z-8 thru Z-13).

515. Gallo's great period of growth between 1970 and 1972 was connected in large measure with sharp gains in sales of its Boone's Farm line of refreshment wines. Since its peak in 1972, Boone's Farm has suffered erosion and Gallo has deemphasized refreshment wines. Gallo's emphasis in [111]advertising has shifted to Gallo's higher priced table wines and its Carlo Rossi brand of table wine (CX 366Z, Z-5, 367P).

516. As noted, Finding 489, *supra,* the record contains no individual company market share data subsequent to 1972. However, the record does show United increased its share in the all wine market in each of its calendar years 1973, 1974, 1975, 1976 and 1978. The record is silent as to 1977 (CX 361F, 543F).

E. Trend Towards Mergers and Acquisitions

517. The wine industry has been characterized by a significant trend towards mergers and acquisitions of wine suppliers from 1940 through 1977 (RX 485Q, 533A-D, 1216A-D; CX 209F, 299A-C; Tr. 4190, 5129-30, 6564, 6576, 8465-66, 9887).

F. Conclusions, Discussion of Impact of Merger and Case Law

Based upon the above findings of fact, I conclude that at the time of the acquisition the all wine market was concentrated and skewed, as were the table and dessert wine submarkets; and that the sparkling wine submarket was concentrated. Concentration ratios for the top two, four and eight firms in the market and submarkets in 1968 were:

	Top 2	*Top 4*	*Top 8*
all wine	41.6%	47.9%	57.4%
table wine	39.2	48.1	60.0

	Top 2	*Top 4*	*Top 8*
dessert wine	43.9	50.4	58.5
sparkling wine	24.0	41.9	62.7

In each of these markets, four-firm concentration exceeded the 40 percent threshold at which Professor Scherer deems industry interfirm coordination likely. In each of these markets, the eight-firm concentration substantially exceeded the 50 percent threshold at which Professors Kaysen and Turner characterize an industry as an oligopoly within which interfirm coordination and interdependence is likely.

Following the acquisition, the all wine market, as well as the table, dessert and sparkling wine submarkets remained concentrated. The two, four and eight firm concentration ratios in 1969 were:

	Top 2	*Top 4*	*Top 8*
all wine	44.7%	50.9%	60.3%
table wine	39.1	47.4	59.6
dessert wine	44.1	51.3	59.5
sparkling wine	38.9	54.9	71.9 **[112]**

The four and eight firm concentration ratios exceeded the Scherer and Kaysen and Turner thresholds discussed above. In addition, the four firm concentration ratios (except for table wine) exceeded the Kaysen and Turner thresholds for a tight oligopoly within which interfirm coordination and interdependence is deemed extremely likely.

The concentrated state of the wine industry is enhanced by its skewness. Skewness, as explained by economist Dr. Robert E. Smith (Tr. 5695), describes the disparity in size among the leading firms in an industry. As the preceding market share tables indicate, the all wine, table wine and dessert wine markets were skewed both in 1968 and in 1969, the year of the acquisition. The sparkling wine market appears to have become skewed in 1969. However, contrary to complaint counsel's assertion (CB, p. 20), I do not find that such skewness which occurred in that market in 1969 as a result of the merger is relevant to the issue of a possible or probable long-term increase in concentration in this submarket due to the merger. As previously noted (Finding 475 n. 21), in November 1969, the carbonation level of Lancers, which accounted for 99.7 percent of Heublein's 7.2 percent share of the sparkling wine market (derived from CX 373Z-10, Z-11), was stabilized at a level below that at which it could be classified as a sparkling wine. In succeeding years, Complaint counsel include Lancers as a table wine. Thus, the increase in United's sparkling wine market share achieved by inclusion of Lancers was of consequence only from the date of acquisition, February 21, 1969, until November 1969. This transitory impact upon skewness is of no significance in this case which is concerned with long term probabilities.

Skewness is marked, however, in the other markets, and is important as an indication that the power accompanying strong market shares may be enhanced by disparate size in relation to other competitors in the market. The more skewed a given market is, the greater the likelihood that firms will be able to coordinate their activities effectively. The skewness of market structure is an independent determinant of the ability of competitors to coordinate their activities (Tr. 5696-97). In *Warner-Lambert Co.*, 87 F.T.C. 812 (1976), the Commission considered the issue of skewness of the market:

> In addition to conventional concentration ratios, the degree of asymmetry in size among leading firms is another factor which economists consider in assessing the competitive structure of markets. A given level of concentration measured by aggregate market shares held by top firms may portend different market conditions depending upon whether firms within the grouping are [113]relatively equal or quite disparate in size, with equality of size evidencing a more favorable climate for competition (at 870).

In *American General Insurance Co.*, 89 F.T.C. 557 (1977), the Commission also looked at skewness in the market and, while finding that skewness was not significant there, nevertheless held that: "An asymmetrical oligopoly may aggravate whatever lessening of competition may result from a merger. . ." (at 638). The disparity in size between United, the second leading firm, and the third leading firm in each market except sparkling wine is clear when expressed as the third ranked firm's percentage of United's volume:

PERCENTAGE OF THIRD RANKING FIRM'S SHIPMENTS TO THOSE OF UNITED

	1968	*1969*
all wine	17%	16%
table wine	36%	33%
dessert wine	15%	16.5%

(Source: market share tables, Findings 498, 499, 500, *supra*)

At the time of the acquisition, the all wine market, and the table wine and dessert wine submarkets were concentrated and skewed. In *United States* v. *Philadelphia National Bank,* 374 U.S. 321 (1963), the court held that " . . . if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great" (at 365 n. 42). HUV has raised arguments that the Court in *Philadelphia National Bank* rejected. HUV argues that Heublein's pre-acquisition market shares were insufficient to materially change the competitive structure of the industry. While Heublein's shares may have been small (see below, p. 114), the court in *Philadelphia National Bank* rejected such logic: "It is no answer that, among the three presently largest firms . . ., there will be no increase in concentration. If their argument were valid, then once a market had become unduly concentrated, further concentration would be legally privileged" (*Ibid.*).

The slight decline in United's share of the table wine market in the year of the acquisition does not vitiate a finding of high concentration in that submarket, nor prohibit a finding that the acquisition was illegal as to that submarket. In *RSR Corp.*, 88 F.T.C. 800 (1977), a case in which the second place producer with 12.16 percent of **[114]** production acquired the fifth place producer with 7.02 percent, thereby creating a new number two firm with 19.18 percent of industry shipments, the Commission noted that:

> . . . even were the record to point . . . to a decline in concentration exclusive of this merger, such a consideration would not weigh heavily in the face of the high absolute level of concentration and the increase therein caused by this merger. Evidence of a trend toward concentration may be relevant to show a violation in a case such as *United States* v. *Von's Grocery Co.*, 384 U.S. 270 (1966) involving comparatively small market shares and comparatively low concentration. It is obviously not necessary in a case involving large shares and high concentration (at 888 n. 18).

In 1968, Heublein's rankings and market shares were:[24]

all wine	16th	.79%
table wine	30th	.23%
dessert wine	13th	.54% (CX 373E, N, Z; RX 15, 27)

HUV argue that these increments to United's market shares resulting

[24] Sparkling wine is not being considered in light of the temporary nature of the increment. See p. 112, *supra*.

from the merger were so small as to be *de minimis* (RPF, pp. 190, 256, 263). The contention that such small increases cannot be considered in support of a finding that the acquisition had the proscribed anticompetitive effect, is without merit.

In *United States* v. *Aluminum Co. of America*, 377 U.S. 271 (1964), the Court found that an addition of 1.3 percent to the leading market share of 27.8 percent was anticompetitive in a highly concentrated market (two-firm concentration of 50 percent, four firm concentration of 76 percent) but one in which small independents still participated. The Court noted that the objective of the 1950 Amendments to Section 7 " . . . was prevent accretions of power which 'are individually so minute as to make it difficult to use the Sherman Act test against them' " (at 280).

In *Stanley Works* v. *FTC*, 469 F.2d 498 (2nd Cir. 1972), *cert. denied*, 412 U.S. 928 (1973), the court found that a market with a four-firm concentration ratio of 41 to 51 percent was "sufficiently concentrated to invoke the proscriptive sanction of the Clayton Act" (at 504), and held that " . . . the rationale underlying at least two Supreme Court decisions indicates that [the foreclosure of] Stanley's [115]1 percent is not a *de minimis* share of the . . . market" (at 506). Significantly, in responding to the dissenting opinion which noted that Stanley's market share was .47 percent smaller than the smallest foreclosure which had been held illegal prior to *Stanley*, the majority held that:

> In view of this market concentration . . . we cannot assume . . . that a difference of less than one-half of one percent—the difference between Blatz's 1.47 percent and Stanley's 1 percent market shares—is of decisive significance for a question of such controlling importance as whether one percent market control is, or is not, *de minimis* (at 507).

Adopting the Second Circuit's reasoning, in view of Heublein's entrenchment of United's market position (pp. 172–75, *infra*), the concentrated and skewed structure of the wine industry and Heublein's position as an actual potential expander (pp. 175–85, *infra*), Heublein's market shares at the time of the merger were not so insignificant that they should not be considered along with these various other factors.

HUV, relying primarily upon *United States* v. *Black and Decker Mfg. Co.*, 430 F.Supp. 729 (D. Md., 1976), assert that it is improper to include in the same market wines *imported* and sold by Heublein and wines *manufactured* and sold by United. In that case, however, the court found no competitive overlap between the manufacturer and its retail seller. But, based on the facts of this case, considerable competitive overlap did exist between Heublein and United.

In *United States* v. *Continental Can Co.,* 378 U.S. 441 (1964), the Court held that "Where the area of effective competition cuts across industry lines, so must the relevant line of commerce . . . . " (at 457). Heublein and United compete at the distributor, supplier, and wholesale levels in distribution of their wine products, and both compete in promotion of their products at these levels and in advertising media to increase retail sales.

HUV have argued that Lancers Rose and Harveys Bristol Cream, the bulk of Heublein's gallonage, should not be included in its market share because they are imports and thus subject to supply volatility (in the case of Lancers) and the control of the actual owners (in the case of Harveys). To the contrary, the Lancers endeavor (jointly owned by Heublein) is a sophisticated, growing, and profitable business with no indication that supply problems are of any concern to Heublein. Neither is there any evidence of record that Allied Breweries, Ltd., owners of Harveys, participates in the marketing or distribution of **[116]**Harveys wines imported by Heublein for the United States market to the extent of usurping Heublein's control over such matters.[25]

HUV contend (RPF 240) that, as a general proposition, imports should be distinguished from domestic products in Section 7 cases, and rely on the following statement from W. Fugate, *Foreign Commerce and the Antitrust Laws,* 345, 351 (2nd ed. 1973):

> Imports are much more subject to being cut off, and they can be cut off merely by a decision of the foreign producer. Likewise, they can be cut off by tariffs and other governmental trade restraints.

HUV neglected, however, to include the immediately preceding sentence: "*Imports have been treated the same thus far,* although there is room for distinction" (emphasis added). The case law does not distinguish foreign from domestic products in computing market shares based on universe figures of total United States sales including imports. See, *e.g., United States* v. *Standard Oil Co. (New Jersey) and Potash Company of America,* 253 F.Supp. 196, 204 (D.N.J. 1966).

I also reject HUV's argument that the acquisition was procompeti-

[25] While the Harveys marketing plan is a joint effort of Heublein's brand manager, Harveys' representative and the advertising agency, the Heublein brand manager would make the final decision in the event of any disagreement (Tr. 4404).

tive. The contention is made that since Gallo has been firmly established as the leading producer in the wine industry since the mid-1960's (RRPF 13), " . . . the merger has aided—not hindered—compeition . . . " (RPF 250); and, that " . . . the 10.1 point increase in the eight-firm ratio between 1967 and 1972 was due to the increases of Gallo (9.5 points); Almaden (1.9 points); and Mogen David (1.5 points)" (RPF 251). While United's share did decline 4.2 points during this period, it remained the second leading firm far ahead of the third producer; its absolute volume increased impressively (from 38,226,600 gallons to 45,307,700 gallons); and in the six years since 1972, its market share has risen again in at least five of those years (Finding 516, *supra*).

HUV's contention that an otherwise unlawful acquisition is not anticompetitive if it results in the creation of a company better able to compete with a major competitor has been rejected as a matter of law. See, *e.g., Ford Motor Company* v. *United States,* 405 U.S. 562, 569-70 (1972); [117]*United States* v. *Bethlehem Steel Corp.,* 168 F.Supp. 576, 615-18 (S.D.N.Y. 1958); and, *United States* v. *Philadelphia National Bank,* 374 U.S. 321, 371 (1963).

At the time of the acquisition, the wine industry was a tight oligopoly and the market was skewed. While possessing a market share substantially smaller than that of the largest company, United had the second largest share which was several times larger than that of the company in third position. Heublein's acquisition of the second ranking producer immediately increased concentration by the extent of Heublein's share of the market. The acquisition also served to entrench United's dominant position and to remove Heublein as an actual potential expander (See pp. 172-85, *infra*). The effects of the merger, therefore, may be to substantially lessen competition.

VII. BARRIERS TO ENTRY OR EXPANSION IN THE WINE INDUSTRY

In order to further understand the overall impact of the acquisition upon competition in the relevant market and submarkets, we must proceed beyond the percentage increments added to United's market shares and the measurable percentages of additional competitive strength resulting from Heublein's elimination as an actual competitor of United. It is also necessary to examine what special competitive assets the Heublein organization brought to United, and whether United's second ranking position was entrenched by the Heublein acquisition in light of the characteristics of the wine industry.

Such analysis begins with an examination of whether there are high barriers to entry or expansion. Barriers to entry or expansion are conditions or arrangements which impede free entry into the relevant market on a level of sufficient magnitude to compete with industry leaders. Thus, the concept is better termed a "barrier to effective competition." *The Budd Co.,* 86 F.T.C. 569, 577 (1975).

Whether there are high barriers to entry is also relevant to the general question of whether the acquisition of a company may, for any other reason, have the effect of substantially lessening competition. For, if barriers are low any apparent anticompetitive effect could be dissipated in the long run by the entry of new competition. *Ekco Products Co.,* 65 F.T.C. 1163, 1207-08 (1964). Findings relating to barriers to entry or expansion in the wine industry on an effective competitive level follow.

A. Capital Requirements and Long Payout Period Barriers

518. The capital requirements to engage in wine production on a significant scale are great. Capital requirements for even a modest level of winery operation are substantial. Capital requirements to market wines in significant [118]volume, and establish brand recognition, are large. High capital requirements constitute a significant barrier to entry and expansion in the wine business (Tr. 5712-13, 5715, 5717).

519. Witnesses who addressed the subject of capital requirements noted the extremely high capital intensity of the wine business. The general manager of Souverain winery testified:

> It takes a lot of money to stay in the wine business. You can enter the wine business with one barrel and a tub to crush the grapes in, but if you want to go into a large national brand as we have chosen to do, it takes money to sustain your operation . . . It is definitely capital intensive . . . You don't enter in one year and make a profit the next year (Tr. 2139).

520. Dr. Richard Peterson, Winemaster and President of The Monterey Vineyard (Tr. 320), testified:

> I am sure everyone knows by now, the wineries' business is capital intensive in the extreme . . . (Tr. 359).

Dr. Peterson added that the winery business is "just like pouring money down a hole, you just keep putting money in before you can begin to sell wine to start with" (Tr. 359).

521. Patrick McDonald, a director of and consultant to Montcalm Vintners, Inc. (Tr. 5115), a failed new entrant testified:

> We elected to limit our capital involvement in the industry by not going into the

vineyard business or the grape business, but merely concentrating on the production of the wine and the marketing of the wine. Even limiting ourselves that way, we found out that for the type of operation that we wanted to become that it required what we considered to be an inordinate amount of capital (Tr. 5182).

522. Andrew Beckstoffer, the Heublein employee responsible for gathering and analyzing data with respect to the wine business, also judged the wine industry as capital intensive (Tr. 8979–80, 9026–28, 9074, 9085–86, 9092–93). [119]

523. Capital requirements to establish the plant and facilities for even a modest sized winery are substantial (Tr. 352–57, 674–75, 2107, 2119, 2142–44, 2245–50, 2154, 3452–53, 5136–38, 5181–82, 5184, 5188–89, 5218).

524. For example, the Souverain Winery, with capacity of approximately 2 1/2 million gallons, was built by the Pillsbury Co. in 1973 at a cost of $5,800,000 (RX 1192G; Tr. 2107, 2119, 2144).

525. Lee Chandler, the current general manager of Souverain considers Pillsbury's building costs of Souverain to have been "very low" relative to the average per gallon cost of building a winery (Tr. 2144). Mr. Chandler estimated that it would cost between $10 million and $11 million today to build the Souverain facility, not including the fountain and restaurant which are an integral part of the winery (Tr. 2142–43). He estimated that in 1973 or 1974, it cost between $3 and $4 per gallon of capacity to build a winery (Tr. 2144).

526. The relatively small size of the Souverain endeavor is apparent when we compare its 2 1/2 million gallon capacity with the 226 million gallon capacity of Gallo, the 95 million gallon capacity of United and the 57 million gallon capacity of Guild in 1976, and note that Guild was the fourth largest company in the all wine market in 1972 with but 3.8 percent (CX 373K, 458).

527. The cost of obtaining an adequate supply of grapes and bulk wine significantly contributes to the high capital requirements in the wine business, particularly for new entrants and expanding firms (Tr. 356, 3464, 3468–69, 5137, 5181–82, 5186–89, 5255, 8128–29, 8131; CX 413B).

528. In order to assure themselves an adequate supply of grapes, many vintners operate their own vineyards (Tr. 350, 352, 1008, 1953–54, 3202–03, 3453, 8972, 9005).

529. The costs of establishing a producing grape vineyard contribute to the high capital requirements in the wine production business by as much as $8,000 per acre (Tr. 360–62, 2237, 3453, 3466, 5181, 5184).

530. Since the production period of raw wine is seasonal, depending upon the seasonal maturation of grapes (CX 308U), wineries

must bear large bulk wine inventory costs from grape crush season to grape crush season (Tr. 2272; CX 240D, 247C).

531. The cost of maintaining inventories of bulk wine significantly contributes to the high capital requirements in the wine business, particularly for new entrants and expanding firms (Tr. 2140-41, 2235, 3464, 5181-82, 5184, 5186, 8131; CX 240D, 241D, 242C, 243C, 244D, 245D, 246D, 247C). [120]

532. Contributing to high capital requirements in the wine business for new entrants and expanding firms are the marketing costs of establishing brand recognition (Tr. 5184, 5188-89), as well as the costs of establishing and maintaining a winery sales force to solicit wholesale distributors and assist distributors' salesmen in obtaining and maintaining retail distribution of a winery's products (Tr. 630-31, 2122, 2125, 2174, 2222-23, 3324).

533. Also contributing to high capital requirements in the wine business is the extended payout period over which a winery must wait to begin to earn returns on its investment and recoup its full investment. This is a characteristic of the wine industry and constitutes a significant barrier to entry and expansion (Tr. 5712).

534. From the time of planting, it takes five to six years for a grape vineyard to produce a full crop (Tr. 361, 2238). In some grape growing areas, the length of time from planting to vineyard maturity may be as much as eight to nine years (Tr. 362).

535. The aging period required for wines, particularly red table wines, before they may be sold prolongs the period over which a winery must wait in order to earn income from its investment (Tr. 359, 1021-23, 2140-41, 5184, 5188-89). The time of grape crush to sale of the wine ranges from a minimum of six months to as long as ten years (Tr. 3133-34, 3161, 3223).

536. The length of time required to establish brand recognition also contributes to the long payout period during which a winery must wait to recoup its investments (Tr. 5713).

537. A substantial length of time is required before a new entrant in the wine industry becomes profitable. In the opinion of Dr. Peterson, Winemaster and President of The Monterey Vineyard in California, it takes six to ten years for a winery to become profitable from the initial time of building of the winery. If the new entrant plants its own vineyards, an additional four to eight years are expected to elapse before the winery becomes profitable (Tr. 363).

538. During the 3 1/2 to 4 1/2 years that the Souverain winery was owned by Pillsbury, Souverain did not make a profit (Tr. 2107, 2113). In 1976, Pillsbury sold Souverain at a loss (Tr. 2118-19). Since it was sold by Pillsbury, Souverain has operated at a loss and at less

than full capacity (Tr. 2141). The current general manager of the company expects it to be profitable within three or four years (Tr. 2144). [121]

539. California Growers Winery started its branded case goods business in 1971 (Tr. 1958-59). The President of California Growers testified on January 26, 1978: "I would say that during the last seven years that there has been virtually no contribution to profit on our proprietary case good business" (Tr. 1958-59).

540. Geyser Peak Winery in California was acquired by Joseph Schlitz Brewing Company in 1972 and began selling branded case goods in the fall of 1974 (Tr. 3452). In every year since 1974, Geyser Peak has sustained an operating loss (Tr. 3453-54; CX 389). Geyser Peak is not profitable today and is operating at less than full capacity (Tr. 3453, 3467). Geyser Peak's operating plan forecasts that it will be operating in the black within the next five years (Tr. 3467).

541. One notable example of substantial capital investment in the wine business is United's glass plant, valued at $18 million (Tr. 9221-22). The glass plant results in substantial cost savings to United (Tr. 9223).

B. The Distribution Barrier

1. Methods of Wine Distribution

542. Since the repeal of prohibition, 32 states and the District of Columbia have adopted licensing systems for distribution of alcoholic beverages. In general, these states have established three-tier systems of distribution. Ownership of each of the three levels of distribution—supply, wholesale and retail—must be separately maintained. Individual suppliers, wholesalers and retailers are licensed by the state to do business (CX 368 O). Generally, licensed suppliers may sell only to licensed wholesalers who, in turn, may sell only to other wholesalers and to retailers (CX 508A-B; state statutes cited under para. 2(c), p. 5, of Facts Submitted for Official Notice, dated May 2, 1978—noticed on record without objection; CX 368D, 511). These 32 states are referred to in the wine industry as "open" states (Tr. 4217).

543. The 18 remaining "monopoly" states, pursuant to the Twenty-first Amendment, exercise varying degrees of monopoly control over the wholesaling of alcoholic beverages (CX 368F). Eight states (Montana, Utah, Wyoming, Iowa, New Hampshire, Pennsylvania, West Virginia and Mississippi) monopolize the wholesaling of all wines and spirits (Tr. 9623-28). In 1969, these eight states accounted for 5.9 percent of total consumption of wines in the United

States, as measured by case shipments. In 1976, these eight states accounted for 6.3 percent of total wine consumption (RX 1231).

544. In four additional monopoly states (Idaho, Maine, Alabama and Michigan), the state monopolizes the wholesaling of spirits and wines over 16 percent alcohol by volume (Tr. 9623–28). [122]

545. The six remaining monopoly states (Oregon, Ohio, Washington, North Carolina, Vermont and Virginia) monopolize the wholesaling of spirits, but license others to wholesale wines (Tr. 9622–28, 9873–77).

546. The 18 monopoly states are often referred to as "control" states by wine industry members (Tr. 625, 4217).

547. It is more difficult to secure distribution in control states than in open states because control states' purchasing agents limit their purchases to those brands they select for sale at all outlets. In open states, while the seller may not be able to get full distribution, he still may be able to acquire some accounts (Tr. 4217).

548. As described by wine marketer and consultant, Stanford Wolf, the general methods of distribution for a California winery are as follows:

> A California winery can distribute directly to the consumer [in California]. Under our laws in California, he can distribute to wholesalers or combinations thereof. A winery distribution outside of California can be to wholesalers who are just wine wholesalers or to wholesalers which are beer and wine wholesalers, or to wholesalers that are spirits and wine wholesalers, or all three. There's distribution to the control state board in a limited number of states. These are the general methods of distribution (Tr. 7502).

549. A "primary" or "prime" distributor is a marketing and sales intermediary between the vintner and the wholesaler. A primary distributor usually handles a vintner's brand on a national or at least regional basis and acts on behalf of the brand owner in contacting and selling to wholesalers (Tr. 7503).

550. As a rule, the primary distributor purchases the products from the vintner and then resells to a wholesale distributor. The winery may then ship directly to the wholesale distributor or to primary distributor warehouses (Tr. 666).

551. Primary distributors frequently undertake marketing responsibilities, and have control over marketing and sales decisions (Tr. 2233, 2300, 2320, 2322).

552. A "broker" in the wine business handles the sale of a winery's products to the wholesaler without taking title and usually is paid on a commission basis. Brokers do not replace wholesale distributors in the distribution chain, [123]but serve as distribution intermediaries between the vintner and wholesaler (Tr. 7502).

553. Where permitted by state law, vintners sometimes organize their own direct wholesale operation. Such direct operations are generally unprofitable (Tr. 1033–34, 9718–21).

2. Importance of Effective Distributors

554. Obtaining good wholesale distribution is vital to the success of a wine company engaging in branded case goods sales (Tr. 1973, 2993, 3327).

555. Two factors were most frequently identified by witnesses to qualify a wholesale distributor as "good" or "effective". First, the wholesaler must have financial strength and be a good credit risk to the wine supplier. Second, the wholesaler must be capable of soliciting and servicing all the retail accounts within its market area (Tr. 644, 662–63, 1970, 1994, 2123–24, 2994, 4208–10, 4699, 4701, 4703, 6853).

556. Part of a wholesaler's ability to cover retail accounts adequately is determined by the size of its sales force. In addition, the sales force of a "good" or "effective" distributor must be trained to sell wine (Tr. 644, 1972, 2123, 4208–09). Aside from the ability of a wholesaler to be a "good" distributor, it tends to be "good" for a winery which is a significant supplier to it (Tr. 1972, 1994).

557. A significant mark of a "good" or "effective" distributor is the wholesaler's strength with the retail trade in securing shelf space for the products it distributes (Tr. 6853). One vintner explained how a good distributor helps get shelf facing. He is already selling the retailer one of the must items in his store. Each of the distillers has one or two or three must items. There may be 20 or 30 items without which no retail store could live (Tr. 655).

558. A weak distribution system impedes the ability of a new winery entrant to generate sufficient volume of sales to spread fixed operating costs. The larger the size of the new entrant, the more important it becomes to secure effective wholesale distributors (Tr. 2111, 2121, 2141, 2176, 5181–82, 5185).

559. Although not all large wine and spirits wholesale distributors may be said to be "effective" wine distributors (Tr. 3022), it is generally true that the large wine and spirits wholesalers tend to have the requisites to handle wine effectively for a significant new entrant or expanding firm (Tr. 641–42, 662–65, 1057–58, 1063, 1240–41, 2123–24). **[124]**

560. Strong selling spirits lines give wine and spirits wholesalers strength with the retail trade (Tr. 650–51, 662–65, 1085; CX 115B).

561. There are few wine only wholesalers (Tr. 663, 1081–82, 4210). It is very difficult to support a wholesale organization on the volume

generated by selling wine alone (Tr. 3311–12, 4210). With the exception of the Gallo and United direct wholesale operations, wine only wholesalers tend to be weak (Tr. 663–65, 5169, 5185, 5230).

562. Except in those states where the state reserves to itself the wholesaling of spirits, beer distributors which also distribute wine tend to be less effective wholesalers of wine than wine and spirits distributors (Tr. 661, 5147–48, 5153, 6669).

563. If a substantial volume of wine were sought to be wholesaled by a wholesaling facility whose major business is beer, the beer and wine would be incompatible products within that facility because of their different methods of sale and delivery (Tr. 661–62, 686, 3351, 3354, 3364, 3371, 3420, 3610, 6836).

564. It is not surprising, therefore, that wine suppliers generally prefer to distribute their wines through wholesalers who carry both wine and spirits (Tr. 626, 662–63, 1083–84, 1240–41).

565. Few wholesalers whose major business is distributing beer also distribute wine (Tr. 2999–3000, 3428; CX 218A thru Z–316).

566. The current president of the California Beer Wholesalers Association could name only one California beer wholesaler, other than his own company, which distributed only wine and beer (Tr. 6221, 6245, 6284–86).

567. Guild, Canandaigua, California Wine Association, Paul Masson and Christian Brothers are distributed primarily through wine and spirits wholesalers, except in those states where the wholesaling of spirits is undertaken by the state and wine passes through wine only or beer/wine wholesalers (Tr. 3000, 4210–12, 4689–90).

568. Asked to name United's wine wholesalers who were beer distributors, Mr. Powers, the Chairman of the Board of United, named only one beer distributor in the entire United States who was not either located in a monopoly state where independent spirits wholesaling is prohibited or was not also a distributor of spirits (Tr. 9638–39, 9873–77). **[125]**

569. United's wines are wholesaled in the top 20 metropolitan markets for the sale of wine (Tr. 9872). United, however, has neither a beer/wine only wholesale distributor nor a wine only distributor, with the exception of those areas where United has its own direct all-wine wholesale operation, in any of these markets (Tr. 9812–16). This clearly demonstrates the importance of being able to utilize combined wine and spirits wholesalers.

3. Important Areas of Distribution

570. From 1962 through 1976, California, New York, Illinois, New

Jersey, Pennsylvania, Michigan, Florida, Ohio, Texas and Massachusetts have consistently been the top ten states in terms of consumption of wine (CX 297G; RX 1231). These ten states collectively received 70.4 percent in 1962, 69.2 percent in 1968 and 65.6 percent in 1976 of all commercially produced wine entering distribution channels in the United States (CX 297G).

571. Wine consumption is concentrated in the major metropolitan population centers where regular users of wine are also concentrated (CX 379U, 386B; Tr. 7524, 8353-54, 9619).

572. For the introduction of new brands of wine, wine marketers tend to focus upon the major metropolitan markets where wine consumption generally is concentrated (Tr. 1965; CX 3520).

4. Limited and Declining Number of Effective Distributors

573. New entrants aspiring to significant size and independently owned wineries find it difficult to obtain effective wholesale distributors. The number of effective wine wholesalers is limited (Tr. 655, 681, 1057-58, 1063, 1969, 1984, 2111, 2121, 5154-55, 5185, 5188-89).

574. Montcalm Vintners, Inc., attempted to acquire other wine companies in order to get distribution by virtue of the other companies' associations with wholesalers (Tr. 5143, 5194-95).

575. For at least the past ten years, the departure from business of wine and spirits wholesale distributors and the mergers and consolidations of wholesalers have reduced the number of independently owned wine and spirits wholesalers (Tr. 643-46, 652, 680, 1058, 1064-65, 1093, 2996, 3525-27, 7182-85, 7228, 7236, 7289-90, 7306, 7568, 6813, 6827, 6831, 6875, 7370-71).

576. Overall, there are fewer wine and spirits wholesale distributors than there were ten years ago (Tr. 643, 6831), and fewer "good" or "effective" distributors (Tr. 1057-58, 2996). **[126]**

577. The number of large distributors in metropolitan markets, with populations over one million people, has also been declining (Tr. 1057-58, 4209-10).

578. On the average, there are four to six large wholesale distributorships for a given major metropolitan market (Tr. 641-42, 3019, 3021). For example, within the Los Angeles area, there are five major ownerships (totaling nine distribution branches) of wine and spirits distributors (Tr. 6946, 6951). In the New York metropolitan area, there are five major wine and spirits wholesalers, each having separate divisions (Tr. 7250; CX 395Z-12).

579. In Washington, D.C., where per capita consumption of wine is the highest in the nation, there are roughly a dozen wholesalers who handle wine (Tr. 7572; CX 379S).

580. Illustrative of the substantial difficulty which wineries, particularly new entrants aspiring to significant size, have in endeavoring to find effective distributors in major metropolitan markets is the experience of California Growers Winery. Mandia is California Growers' current wholesale distributor in New York City, but it is not a major distributor. Mandia covers less than 1 percent of the New York metropolitan area in its endeavors to sell California Growers' wines (Tr. 1984).

581. In both 1970 and 1976, New York was the second largest metropolitan area in the United States for case sales of wine, behind the Los Angeles-Long Beach metropolitan area (CX 379U, 386B).

582. Even California Wine Association ("CWA"), a reasonably well-established, independently owned wine supplier, has experienced significant difficulty in securing a New York City wholesale distributor for its wines. CWA has not been able to secure a meaningful distributor in New York since CWA's previous wholesaler in New York closed its doors in 1977. CWA did have a wholesale distributor, a small house called Testa, in metropolitan New York. Testa had no salesmen and buys about 500 cases from CWA every three or four months (Tr. 1008, 1059, 1105).

583. One central cause of the declining number of wine and spirits distributors is the low profitability of liquor wholesaling. Generally, the wholesale business operates on a very small net profit ranging from 1 percent to 1 1/2 percent to 2 percent before taxes (Tr. 3536).

584. The president of one large wholesaler, whose sales were about $78 million in 1977, testified that the cost of operations in the wine and spirits wholesale business has increased rapidly, more rapidly than profits (Tr. 7356, 7390). Mr. Hermann, President of McKesson Wine and Spirits Co., testified: "Liquor wholesaling trends are for a high volume, low margin industry" (Tr. 7233). McKesson consolidated [127]wholesaling facilities in response to pressures squeezing the industry's profit margin (Tr. 7289–90, 7306).

585. Demonstrating the decreasing number of substantial wholesalers is the decrease in membership of the Wine & Spirits Wholesalers of America, Inc. ("WSWA"), a trade association of major wine and spirits wholesalers in the United States (Tr. 3507–08, 3511, 3517–18).

586. There are no other trade associations for the wholesale liquor industry on a national level comparable to WSWA (Tr. 3512). The WSWA convention is the largest convention of the industry (Tr. 8670).

587. The General Counsel of WSWA believed that it had the vast

majority of substantial wholesalers operating in the United States (Tr. 3541); that there are relatively few substantial wholesalers who are not members of WSWA (Tr. 3511). By "substantial wholesalers" he meant "those people that have capital invested or substantial capital invested in it and are in a position to service suppliers adequately" (Tr. 3717-18).

588. Excluding monopoly states, WSWA had 435 members plus 281 branches of members in 1973, 428 members plus 276 branches of members in 1974, 427 members plus 257 branches of members in 1975, 399 members plus 229 branches of members in 1976 and 383 members plus 227 branches of members in 1977 (Tr. 3543-44).

589. In monopoly states, WSWA had 29 members and three branches in 1973. In 1977, there were 37 members and three branches of members of WSWA in the monopoly states of Maine, Michigan, Ohio, Oregon and Virginia (Tr. 3544).

5. Supplier Influence

590. As Dr. Richard Peterson, President and Winemaster of the Monterey Vineyard, testified:

[P]ower, the muscle, whatever it is called, leverage, I think that it is common in the wine industry. I don't like it, but I think it is there (Tr. 489).

591. Dr. Peterson explained wine supplier "leverage" to mean:

Well, someone has muscle or someone has leverage with someone else, I guess I will say A has muscle with B when B needs A to do something or to continue doing what he is doing. If it is a distributor, the distributor [128]might be carrying a wine line that he continues to want to carry, maybe it is growing or doing quite well. That distributor will bend over backwards to continue that wine line if possible (Tr. 378).

592. In the judgment of Fred Switzer, General Counsel of WSWA, a major liquor supplier theoretically could influence one of its wholesalers not to take on a particular line or product of competing suppliers if the major supplier had the "leverage to influence the wholesaler" (Tr. 3551-52).

593. In Mr. Switzer's view, "Heublein would have the normal leverage that would be associated with the importance of their brand in a wholesaler's house" (Tr. 3580; see also Tr. 3612, 3614, 3628-30). Mr. Switzer observed that "Heublein is considered an important factor in the market [by wholesalers]" (Tr. 3614).

594. Heublein's General Counsel, George Caspar, acknowledged the existence of spirits supplier leverage in a transmittal to the Federal Trade Commission during the formal investigation of the merger. Mr. Caspar stated:

A number of the questions has indicated a concern on the part of the Commission's staff as to the possibility of foreclosing distribution by the entry of liquor companies into the wine industry. This is obviously a legitimate concern . . . Certain distillers . . . can, and often do, dominate and control their distributors (CX 327Z-13 through Z-14).

595. Robert Ivie, President of Guild Wineries & Distillers, defined a "captive house" as a wholesaler in which a particular supplier is in a strong enough position to heavily influence the wholesaler's activities (Tr. 3001).

596. A supplier's influence over the wholesaler's activities could affect the ability of other companies to obtain distribution through that wholesaler. Guild has experienced problems in obtaining distribution with a captive house (Tr. 3001-02).

597. The importance of a major spirits supplier to a wholesaler and retailer has been described by the President of Wine World, a producer and marketer of wines:

Any time you have a successful liquor brand such as Smirnoff [Heublein's major brand] or [129]Canadian Club or Cutty Sark Scotch, any distributor would have to have some interest in that. If he was in the liquor business or had thoughts of going into the liquor business, it is just common, good business practice to check the interest in a brand such as that (Tr. 3336-37).

598. The major spirits suppliers have considerable power to influence the operations and decisions of wine and spirits wholesalers (Tr. 641, 1064-65). Whenever a distiller acquires a winery, it makes it more difficult for an independent to compete for distribution (Tr. 1057-60).

599. Joseph E. Seagram & Sons, Inc., Heublein, Inc., National Distillers & Chemical Corp., Schenley Industries, Inc., Fleischmann Distilling Corporation, Hiram-Walker-Gooderham & Worts, Ltd. and Brown-Forman Distillers Corporation are the distilled spirits suppliers most frequently identified in the record as major suppliers (Tr. 640-41, 656, 1065, 3361, 3532, 6543-44, 6773, 6947, 7210, 7312, 7359).

600. Each of these spirits suppliers owns and operates one or more domestic wine companies and/or one or more wine importing companies (CX 373K; Tr. 8692-93). For example, Joseph E. Seagram & Sons, Inc. owns and operates Paul Masson Vineyards, Inc.; and National Distillers & Chemical Corporation owns and operates Almaden Vineyards (CX 373K).

601. It is a common practice in the wine industry that a wine supplier obtaining a new product or group of products—whether by new product development, by acquisition, or by virtue of a primary distribution arrangement with a wine producer—endeavors to place the new product(s) in wholesale distribution houses with which the

supplier has an ongoing relationship (Tr. 627, 636-37, 646-47, 2137, 2232, 3310-11, 3360-61, 3379-82, 3405, 3438, 3837-38, 3866, 3925-26, 3985-86, 4288-89, 4689, 4693, 5165-66, 5194-95, 5237, 7226, 7298, 7312, 7359, 7531-32, 7582-87, 7952-53, 8483-84, 9644; CX 325, 218Z-9, 256Z-34, 533A-B).

602. When Heublein obtained the agency for importing and marketing Harveys ports and sherries in 1957, it placed the Harveys products in the wholesalers in which the Heublein spirits products were already being carried. This was in addition to retaining the distributors through which the Harveys wines were already being sold (Tr. 3985-86).

603. When Heublein purchased Vintage Wines, Inc. in 1965 and obtained the Lancers trademark, Heublein retained the existing distributors for Lancers wines and added additional **[130]**ones. The majority of the additional distributors were already carrying Heublein alcoholic beverage products (Tr. 4288-89).

604. When United introduced the Inglenook Navalle brand of wines, in most cases, the wholesale distributors used for the distribution of Inglenook were United's preexisting Italian Swiss Colony distributors (Tr. 7952-53).

605. United's Fiscal 1972 Profit Plan and Major Programs established a "sales plan" to "Place Annie Green Springs in Petri (a United brand) houses if product is rolled out nationally" (CX 256Z-34).

606. As specifically evidenced for the period July 1972 to January 1975, United's rule of thumb in test marketing and introducing new products was to place them with wholesale distributors which were already handling United's Italian Swiss Colony line. In order to expand the geographic distribution of Inglenook products, United generally went with the same wholesalers that were handling United's other wine lines (Tr. 3310-11).

607. Heublein chose 11 introductory markets for the distribution of Beaulieu brandy. In July 1970, in nine of those markets, the distributors targeted by Heublein were existing distributors of Heublein products. Heublein targeted an existing distributor of Beaulieu wine in one of the remaining two markets and in the other utilized a broker (CX 93M, 94B, 324, 325, 356Z-5, Z-37).

608. Effective January 1, 1977, Julius Wile Sons & Co., Inc., became the sole marketing agent for the wine products of Souverain Cellars (Tr. 2126). Julius Wile is a subsidiary of Standard Brands, Inc. (CX 299B) and markets imported liquers and wines (RX 518C; Tr. 2125). Julius Wile placed Souverain in wholesale houses that had handled other Julius Wile products for many years (Tr. 2137).

609. As Fred M. Switzer, Executive Vice President and General Counsel of the Wine & Spirits Wholesalers of America ("WSWA"), testified, generally the alcoholic beverage supplier "expects the wholesaler to assist him in connection with his whole family of lines" unless the supplier has split his lines between different distributors in the same market. "But if he has only one distributor in the area he naturally expects him to handle the entire line" (Tr. 3550).

610. One factor motivating liquor wholesalers to handle the full family of products of an alcoholic beverage supplier, including its wines, is the desire of the wholesaler to maintain or secure an exclusive relationship with the supplier for one or more products of the supplier. One Washington, D.C. [131]wholesaler who distributes United's products explained, "We don't want him dealing with anybody else" (Tr. 6412). In the District of Columbia area, liquor wholesalers generally handle product lines on an exclusive basis (Tr. 6402).

611. Wholesalers prefer to obtain long-term exclusive distribution rights, or primary marketing area rights, to a wine or spirits brand or line, in contrast to sharing primary distribution rights with another wholesaler (Tr. 6412, 6841–44, 7383–89). To the extent a wholesaler is successful in building sales of an exclusively distributed brand within his marketing area, that wholesaler alone enjoys the repeat wholesale sales of the brand (Tr. 3366–67, 6843, 7385).

612. Normally, a wine and spirits wholesaler has no control over whether or not he obtains a brand or line of wine or spirits on an exclusive basis (Tr. 6844).

613. Wholesalers of wines and spirits generally do not have written contracts with their suppliers (Tr. 3385, 6787, 7352, 7403). And when a liquor supplier does have a contract with a liquor wholesaler, it is universally true that the supplier writes the contract (Tr. 3533).

614. Although WSWA has recommended to wine and spirits suppliers that they write contracts which provide for termination of the right to distribute the supplier's brands only for good cause, generally those recommendations have not been adopted by suppliers (Tr. 3533–34, 3545–46, 3565).

615. Wholesalers of wine and spirits want to maintain good relations with their suppliers. To that end, they may purchase and carry a supplier's slow moving products and so lose money (Tr. 3551). When a wholesaler takes on an additional product which he deems to be a strong seller, he also takes on additional weaker selling items of the line in order to obtain the stronger selling product (Tr. 3393–94).

616. Heublein's own agency relationship with Harveys exempli-

fies the obligation imposed by a major supplier. The obligation was articulated by Heublein's Executive Vice President:

Q. Was it Heublein's desire to take on Harvey's Selections?
A. No, it was not. It was Harvey's desire to sell some imported wines in the United States.
Q. Then why did you take them on?
A. Because we were asked to and we did have the Harvey's Bristol Cream and sherries and ports, and [132]we felt it somewhat of an obligation, so we said, "Yes, we will take it on" (Tr. 4414).

617. Vintners consider the offering of a broad line of wine products to be an attractive selling point to wholesalers since the vintner can supply all the wholesalers' needs (Tr. 1100, 1980, 2024). When this is done, it makes it more difficult for other wine companies to compete for wholesale distribution (Tr. 1100).

618. When wholesalers carry full lines of their major or desired suppliers, this makes it all the more difficult for a new winery which is starting with a limited line to supplant a type of wine the wholesaler already carries.

619. A wholesaler is reluctant to take on an additional substantial line of wines which includes products of the same types and price points as lines of wines he is already carrying. However, a weak or small line of wines may not meet the same objection and unique individual items of wines may also readily find distribution (Tr. 507, 640-41, 1969, 1973, 2994, 3366, 3402, 3406, 4206, 5159-60, 6799, 6960, 7588).

620. Alcoholic beverage supplier influence with a wholesaler is a function of the number and kinds of product offerings of the supplier and the dollar volume of business to be produced by the supplier's products. The larger the number and kinds of products of the supplier and the dollar volume of business represented by the supplier's products, the greater the influence of the supplier with a wholesaler (Tr. 1042, 1064-65, 1068-69, 1089, 1100, 4799-4801, 5004; CX 395Z-11 thru Z-13).

621. The power of an alcoholic beverage supplier to terminate its wholesalers without cause is a source of influence of the supplier over the wholesaler. Mr. Switzer, General Counsel of WSWA, explained that, although major liquor suppliers seldom terminate their wholesalers, "the power to terminate arbitrarily without cause gives the supplier an influence, a leverage over the daily day-to-day operations of the wholesaler in the way he runs his business and it deprives him of a certain independence" (Tr. 3547); Mr. Switzer also stated, "Where a supplier whose brands represent a substantial portion of the wholesaler or distributor's business terminates the

franchise, it is a serious business setback to the wholesaler, depending upon . . . " the circumstances, " . . . but in the majority of the cases it is a very serious setback" (Tr. 646, 3536).

622. Prompted by its inability to get wine and spirits suppliers to add provisions to their contracts with wholesalers which provide for good cause termination only, WSWA [133]has recommended the adoption of state franchise security laws to that effect (CX 554, 555A-C; Tr. 3565, 6838, 7400-01).

623. WSWA is interested in state franchise security laws to protect wine and spirits wholesalers not only against unjust terminations but also against the possibility that the supplier exercise a threat of termination implicitly or explicitly to influence daily operations of the wholesaler to his detriment (Tr. 3561).

624. Franchise protection laws, including the subject of "leverage" of suppliers over wholesalers in the sale of spirits has been on the agenda and has been discussed at WSWA conventions.

625. Major spirits lines frequently are a substantial source of revenue to large wine and spirits wholesalers (Tr. 3352, 3362, 6551-52, 6612, 6658-59, 6812, 6855, 6947-48, 7356-58). They may well be essential to the very existence of the wholesaler (Tr. 646-47, 1064, 1070-71, 1082-83).

626. Major spirits suppliers frequently have primary or exclusive distribution arrangements for a product line or lines with distributors in a metropolitan market (Tr. 640-42, 656, 4689, 4693, 4695, 4697, 4708-09, 6402, 7357, 7388-90). A spirits supplier may give an exclusive on one product or group of products to one wholesaler and an exclusive on other products to another wholesaler for a given territory (CX 218Z-12 thru Z-33).

627. The products of the major spirits suppliers tend to be distributed by the principal wine and spirits wholesalers in a given metropolitan market (Tr. 640-42).

628. The commitment of a wholesaler to handle the newly acquired wine products of an established supplier may itself have an exclusionary effect upon competing wine suppliers (Tr. 1068-69).

629. To the extent that offering a wholesaler a broad line of spirits and wines influences the distributor to accept the wine line, suppliers of more limited wine product offerings are disadvantaged in obtaining and retaining effective wholesale distribution (CX 395Z-11, Z-12; Tr. 1064-65).

630. Vintner Weibel testified that when he sought new distributors in 1968, "I would automatically have crossed off all Seagrams distributors because Seagrams is automatically Paul Masson. I was

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barred from them. You have National Distillers with Almaden in a similar situation" (Tr. 639-40).

631. Bruno Solari, President of United prior to its acquisition by Heublein (Tr. 4686), was concerned that the entry of liquor suppliers into the wine business would cause [134]United to have to rely upon less effective distributors (Tr. 4686, 4696-97, 4699-4701, 4703; CX 295Z-11 thru Z-13).

632. Mr. Solari's explanation of why it was necessary for United to set up a direct wholesale operation in Southern California, exemplifies supplier influence:

> I had one [wholesaler] in Southern California, Bohemian Distributing Company, but they tied up very closely with Seagrams. When that happened, we had to step out and start our own thing in Southern California (Tr. 4708-09).

633. Stuart Watson, Chairman of the Board of Heublein, related Mr. Solari's concerns of the effect of National Distillers' Almaden acquisition and his expectation of the beneficial effects of the merger of Heublein and United:

> He [Solari] was concerned that now that National Distillers owned Almaden that the future of United Vintners and those distributorships would be in jeopardy and that it was important in looking ahead for United Vintners to affiliate itself with a company like Heublein who had access to these distributors because it was a principal alcoholic beverage company distributed through the same channels (Tr. 4967).

634. Mr. Watson also testified:

> Many of the Italian Swiss Colony distributors across the country were National [Distillers] distributors because of this heritage and so there was concern on the part of the management of United Vintners from a marketing standpoint about the relationship of the distributors. There was a duplication, in other words (Tr. 4962).

635. Indeed, just five days after the merger, Heublein's Senior Vice President for the Smirnoff Beverage and Import Company reported to Mr. Watson as follows:

> Knowles [Beaulieu's Vice President] also told me that Pete Jurgens of Almaden Vineyards [owned by National Distillers] is very much concerned over the fact that U.V. is in so [135]many National Distiller's wholesalers. Almaden's West Coast sales manager has asked the salesmen to list specific instances where the promotion and sale of Inglenook may be impeding the progress of Almaden (CX 208B).

636. Fred Weibel, President of Weibel Champagne Vineyards since the 1950's, explained supplier influence:

> Q. What has been your experience in remaining in a wholesale liquor house where in that house there is present a liquor company which also owns a wine company?
> A. You are there by the grace of the liquor company until they blow the whistle on you (Tr. 648).

637. Wine and spirits wholesalers desire to maintain good relations with their major suppliers (Tr. 3557) and decline to carry wine or brandy products of certain vintners for fear of jeopardizing their relationships with their major suppliers (Tr. 640–41, 1070–71, 3557).

638. Wholesalers have declined to purchase The Monterey Vineyard's wines due to leverage exercised by wine suppliers of the wholesalers. In one instance, it appears that Paul Masson exercised leverage and in another either United's or Almaden's influence precluded the purchase of Monterey Vineyard wines (Tr. 381–82, 393–94).

639. A limited number of wine items of a new wine supplier may achieve distribution. However, a broad line of wine items of a wine supplier can pose a threat to other wine suppliers at the wholesale distribution level and may encounter major supplier influence (Tr. 385, 698).

640. Dr. Peterson, when seeking wholesale distribution for the wines of The Monterey Vineyard, a new entrant, found it very difficult to get distribution in wholesale houses whose major suppliers were Heublein, Seagram, Schenley, National Distillers or Hiram Walker. However, after Monterey Vineyard's failure and reorganization as a smaller producer, Dr. Peterson found it easier to get wholesale distribution (Tr. 354, 384–85).

641. Christopher Carriuolo, then Senior Vice President of Heublein's Smirnoff Beverage and Import Company (CX 357Z–5), when discussing the possibility of a primary distribution arrangement between Heublein and Beaulieu Vineyards, reported to Mr. Watson in February 1969 that: [136]

> [He] . . . pointed out [to the national sales manager of Beaulieu] that such an alliance would be an advantage to BV in guaranteeing good distribution, merchandising coverage, development of wine lists, technical know-how, distribution and warehousing facilities, etc." (CX 208B).

This representation had been made because of Beaulieu's inability to expand beyond the few markets the product was then being sold in (Tr. 8787).

642. In documents prepared by Heublein and presented to the Allied Board of Directors as well as at Allied member meetings, Heublein represented that one of the advantages to accrue to United from the merger would be "marketing strength through wider distribution" (CX 341, 342). This meant that, having access to Heublein's distributors, United would be given greater marketing strength (Tr. 2467, 2487).

643. Heublein represented that since Heublein's and United's products were compatible, United's wine distribution could be enhanced by Heublein's distributor organization. Smirnoff vodka was cited as a product which could be used to secure better distribution for United's wines; and it was stated that by having Lancers and Smirnoff together with United's wines, distribution for both companies could be increased (see Finding 258, *supra*).

644. Heublein's influence at the wholesale level is recognized by wine suppliers (Tr. 640–41, 650–51, 3336–37, 4226). As the President of Weibel Champagne Vineyards testified:

Q. Now, do you have an opinion as to Heublein's potential to exercise influence as to exclude your company from wholesale distributors?

* * * * * * *

A. They certainly have the power if they were to elect to exercise it.
Q. Why do you say that?
A. Heublein is extremely important to that distributor. Obviously he is making a lot of money off the Heublein line (Tr. 650–51). [137]

645. A Heublein internal management communication reveals Heublein's awareness of the leverage it had at both the wholesale and retail levels. George McCarthy, Brand Manager of Lancers, wrote to Walter Cohan, Vice President of Marketing of Heublein:

The opportunity for Vinya in many ways relys [*sic*] on the continued growth of Lancers. We are able to insist on Vinya distribution and display mainly because of the Lancers leverage we have in many distributors. At the retail store level, the Lancers leverage also allows us Vinya distribution and display. Any serious softening of this leverage can result in a loss of Vinya potential as well as Lancers.

Lancers as a high volume, high profit item, also allows us distributor and promotion leverage for new product introductions. Since Lancers is in many distributing houses that are not Smirnoff houses the importance of this brand gives us additional alternatives (to main line distributors) for distributing new products. Since Lancers as a wine product is not under the same restrictions as liquor, it also gives us promotional opportunities for new products. Obviously this leverage is only effective if Lancers continues to be a high volume growth item with strong consumer demand (CX 115B; see also CX 114 for identification of personnel).

This document details the leverage enjoyed by reason of Lancers in addition to that in houses that carry Smirnoff, where leverage is assumed.

646. Heublein's Vinya Marketing Plan for fiscal 1972/73 stated:

[W]e will insist on all Lancers distributors stocking and distributing this product. As a general rule, we have already notified sales personnel that all Lancers distributors should carry a minimum of 10% of their Lancers inventory in Vinya (CX 352P). [138]

647. In 1976, of the top 25 United States metropolitan areas for

consumption of wine, measured by case sales, 19 were also among the top 25 metropolitan areas for the consumption of vodka, measured by case sales (CX 313C, 379U).

648. In 1976, of the top 50 United States metropolitan areas for consumption of wine, measured by case sales, 41 were also among the top 50 metropolitan areas for the consumption of vodka, measured by case sales (CX 313C, 379U).

649. In 1976, of the top ten state markets for wine consumption, measured by case sales, eight were among the top ten state markets for vodka consumption, measured by case sales (CX 379S, 383E).

650. In 1976, of the top ten state markets for wine consumption, measured by case sales, seven were among the top ten state markets for tequila consumption, measured by case sales (CX 379S, 383H).

At the time of the merger, Heublein ranked first in the United States in the sale of vodka (Finding 16, *supra*). Its Smirnoff brand was not only the world's largest selling vodka, but was the second best selling brand of liquor internationally. It was the third best selling distilled spirits brand in the United States and was gaining on second place (Findings 29, 30, *supra*). Lancers was the best selling imported wine in the United States (Finding 38, *supra*). Heublein's tequilas accounted for more than 50 percent of the United States tequila market (Finding 39, *supra*). In addition, Harveys Bristol Cream was a "call item" (Finding 35, *supra*).

651. Considering Heublein's strength in the very markets where the sale of wine is concentrated, Heublein's potential leverage and influence on wholesalers to carry United's products is all the greater.

652. Due to possible repercussions with respect to this administrative proceeding, a Heublein executive, Christopher Carriuolo, who was then the Group Vice President of the Beverages Group of Heublein which included supervision of United (CX 357Z-5; Tr. 4316), instructed Mr. Richard Maher, Jr., United's Vice President of Sales and Marketing, not to seek to combine Heublein distributorships with United distributorships. Mr. Maher testified as follows:

Q. Now, sir, for the period of time that you were employed by United Vintners, were you under instructions from any Heublein employees not to seek to combine the wholesaling efforts of United Vintners with the wholesaling of Heublein products? [139]

* * * * * * *

A. Yes.

By Mr. Masson:

Q. What were those instructions?

A. The general discussion was that we *should not go ahead and seek to combine*

Heublein distributorships with United Vintners distributorships. However, there was no limitation upon individual cases.

Q. Who gave you those instructions?
A. I believe it took place in a conversation with Mr. Carriuolo and Mr. Oster. I believe he was there.
Q. And who is Mr. Carriuolo?
A. At that time, he was group vice-president of the spirits and wine division, whatever the exact title was.
Q. Were any reasons articulated to you by Mr. Carriuolo why you should not seek to combine the wholesaling efforts of United Vintners with Heublein?
A. Complications relative to the FTC case.
Q. This FTC case?
A. Yes. (Emphasis added; Tr. 3317-19)

This testimony evidences Heublein's understanding of the distribution advantages afforded by the merger and its intention to utilize those advantages. It also refutes the evidence upon which HUV rely (RR 252), which purports to demonstrate that no such advantages have accrued to United. **[140]**

Conclusion

653. The wholesale distribution system for wines constitutes a significant barrier to entry and expansion (Tr. 5708-09).

C. Retail Shelf Space Barrier

654. Obtaining shelf space in retail stores is critical to successful distribution of wine (Tr. 3015, 6256). The important aspect of shelf space is shelf facing. Shelf facing is the amount of space on a shelf required to display one wine bottle with its label showing (Tr. 654).

655. Fred Weibel, President of Weibel Champagne Vineyards testified:

> The total battle in distribution is for shelf facings. You cannot sell to the consumer if you don't have it exposed on a shelf where the consumer can see and buy it (Tr. 654).

656. While the overall amount of shelf space allocated to wines at the retail level has increased as consumer interest in wine has grown (Tr. 673, 2008-09, 7474), gaining access to the expanded wine shelf space remains very difficult (Tr. 654, 5710-11, 10,484). Witnesses described the efforts to gain shelf space as a "battle" (Tr. 654), a "bitter fight" (Tr. 6257) and competition for shelf space as "extremely intense" (Tr. 6849). The 1976 edition of *Impact,* a wine industry trade publication, summarized the situation: "[T]he battle for inches on the retailers' shelf has never been fiercer" (CX 367Z-3).

657. Mr. Setrakian, President of California Growers Winery, Inc., testified:

One of the basic keys to the success of a proprietary case goods operation is the availability of shelf space, which is becoming a commodity in great demand because of the limitation of it. Once you gain it, you do everything you can to retain it. Once you lose it, it is very difficult to get back (Tr. 1989).

658. One indication of the constricted nature and importance of wine shelf space is the necessity of retailers to discontinue a wine item if another wine item or line is added to the shelf (Tr. 2033–34, 2066–67, 2069, 6853, 7938). And once a wine item has lost its shelf space to another brand, it is difficult to get space back (Tr. 1989, 7934–35). [141]

659. Although floor stacks have been used to expand the space available for retailing of wines, floor stacks for a given brand or item are limited, temporary and difficult to obtain. It is shelf space that really counts (Tr. 1085, 1990, 2031–33, 2062–63, 6257, 7242).

660. The greater the number of wine items in a brand line for which a winery can obtain shelf space, the greater the potential for development of brand recognition through shelf space exposure (Tr. 1084–85, 8608). Correspondingly, the greater the number of wine items of a brand or brands for which a winery can obtain shelf space, the more difficult it becomes for items of competing brands to obtain shelf space (Tr. 1989).

661. Eye level shelf position in a retail store is considered the most desirable (Tr. 2062).

662. Retailers decide on the shelf space and shelf facing to allocate to items of a wine brand based upon their expected movement off the retail shelf (Tr. 1085, 2061, 2068, 3011).

663. A supermarket chain's wine buyer testified that he generally does not purchase wine items unless they have already established a record of sales and that the most important factor in determining which wine items or brands to carry is case movement or turnover. The record of case movement off the retail shelf also determines whether a wine item will be dropped or retained (Tr. 2066–68, 2072).

664. The relationship between a wine brand's wholesaler and prospective retailers is a significant factor controlling the likelihood of a brand's items being placed on retail shelves (Tr. 626, 662–65, 1085, 4699, 4701, 4703, 5169, 5230; and see Finding 557, *supra*).

665. In recounting the advantages of the proposed Heublein/United merger to members of Allied, Heublein representatives represented that, with a major supplier like Heublein, the likelihood of getting greater shelf space would be increased if United's wines were distributed along with Heublein's products (Tr. 2695).

Utilization of Secondary Wine Lines As a Marketing and Distribution Tool

666. A "secondary line" of wine is generally a case goods line of a vintner which is priced lower than its more widely known or primary case goods line (Tr. 1115, 1984).

667. A secondary line of wine can be used to block out wine brands of competing vintners at the wholesale and retail levels (Tr. 1116, 1124, 1989, 2033–34). [142]

668. A secondary line of wine may be utilized to erode a competitor's relationship with its wholesale customers by offering a cheaper price to get a foot in the door with the distributor (Tr. 2033, 3244, 3246–47, 3257, 3284).

669. A secondary line of wine may be utilized defensively by a wine marketer to retain shelf space in retail outlets against other wine brands, as well as offensively to undermine competitors' wine sales and thus threaten the continued position of other branded wine items on the retail shelf (Tr. 1989, 2011–12, 2031–34).

670. In marketing Lancers, Heublein has used a secondary line of wine as a blocking brand. As stated in Heublein's Faisca Rose Wine Marketing Plan for fiscal 1972/73:

> At various corporate junctures, Quinta, Vinya and Faisca were conceived as "blocking" brands on the one hand, or as candidates which might generate control of segments of the Portuguese Rose business at different price levels (CX 129B).

671. Heublein's Vinya Marketing Plan for fiscal 1972/73 included, as part of its "Brand Philosophy":

> Vinya will be repackaged and repriced, and will be used as a brand to stave off the increasing low priced competition from other imported rose wines that are making inroads in various parts of the country (CX 352G).

The Plan called for lowering the FOB price (CX 352M, U) and forecast negative gross profits for the brand (CX 352U, V). The plan was "to use Vinya to fight the lowest priced roses . . . " (CX 352W).

672. Petri and Parma, also known as Petri's Parma (Tr. 1093), are two secondary wine brands of United (Tr. 1116–17, 1985).

673. From March 1977 to at least December 1977, United offered Petri or Parma table wines at FOB prices below cost to wholesalers in Florida, Virginia, New York, Massachusetts, Rhode Island, Missouri and Wisconsin (RX 1147A, F; CX 354; Tr. 1090–92, 1187–91, 3241–44, 3248, 3284, 4428–30).

674. The record contains illustrations of four winery competitors of United that lost wine sales as a result of their inability to meet the Parma or Petri FOB table wine prices on a profitable basis during

the period in 1977 that Parma and Petri were being sold below cost (Tr. 1092–93, 1986–87, 3246–47, 4231). [143]

D. The Advertising and Brand Recognition Barrier

1. Brand Recognition

675. From the mid-1960's to the present, as consumption of wine has increased, the brand marketing of bottled wines has received increased emphasis by wine suppliers in the United States (Tr. 7796, 9839; CX 360N).

676. Consumers of wine are brand conscious, particularly frequent users who are brand followers and tend to be brand loyal (Tr. 2977, 7525, 9928).

677. A 1972 *Time* magazine study of wine buying in six major metropolitan markets found that the most important consideration for a purchaser of wine is brand reputation. The study noted: "An advertised brand with a quality image has its greatest sales potential in this primary market" (RX 479Y).

678. The 1977 edition of *Impact,* a wine industry trade publication, described 1976 as a year in which "established brand franchises showed their importance" and a year in which "establishment of new brands was extremely difficult" (CX 366Z–10). *Impact* further noted that "most large bulk-oriented wine producers without established brands" had a poor year in 1976 (CX 366Z–5).

679. Vintners prefer to engage in the proprietary (*i.e.,* branded) case goods business in contrast to private label (Tr. 1016, 1950, 5170, 7796, 7799). Bulk wines are not profitable for wine producers (Tr. 7799, 9527).

680. The goal of brand marketing is product differentiation (Tr. 8556–57; CX 125E, 335).

681. Establishing and maintaining a favorable brand image of a line of wines is vital in order (a) to create and maintain consumer awareness and demand and (b) to attract and retain wholesalers and retailers (CX 97U, Z–6, 114F, 116B, J, 125F, H, Q, 188K, 192A–B, D, F–H, 231F–G, Z–25, Z–44, Z–45, Z–47, Z–51, Z–53, Z–55, 326, 367W, 393C, L; RX 251D, B, G, 400A–D, 424A–C, 461A–C, 479Y, 492, 933M; Commission Physical Exhibits Y thru Z–2; Tr. 465, 511, 657, 767, 1871, 1983, 2095, 3038, 3367, 4026, 4883, 5239, 6364–65, 7490, 8311–12, 8608, 8555–56, 8743–44, 9839).

682. Wholesale distributors of wine are reluctant to take on wine lines which have not achieved some brand recognition. They do not have time to do pioneering to get new products accepted (Tr. 3368–69).

683. Brand recognition makes it easier to get shelf space and shelf facings (Tr. 657, 1086). One long-time California vintner (Tr. 618-19) testified, "The better known your brand is the easier it is to get a shelf facing. If [144]it is a name brand, retailers know it is going to move and that is the proof of the pudding as far as the retailer is concerned" (Tr. 657).

684. Following the acquisition of United by Heublein, efforts were made to emphasize the promotion and marketing of United's products as brands rather than as commodities (Tr. 4464, 7778, 7796, 7799).

685. Strong brand recognition in the wine business takes an exceptionally long time to establish. Robert Setrakian, President of California Growers Winery, a new entrant in the proprietary or branded wine case goods business, testified that he expected his branded label, which had been introduced in 1973 or 1974, to "take a minimum of another fifteen years" to establish with "long-term continuity" (Tr. 1948, 1983, 1999, 2029).

Mr. Setrakian added:

> If one were to check into the marketplace, you would find out that the well-established brands, whether it be Gallo or Christian Brothers or any of them, have been in the marketplace for well over 35 years (Tr. 2029).

686. A brand name which is identified with a long tradition of winemaking is a substantial asset. Brand association with a tradition of winemaking is a fact which is emphasized in wine marketing to wholesalers, retailers and consumers. This helps in developing consumer acceptance (RX 378A, 384A, 422, 457, 486, 494A).

687. A "wine item" generally refers to any size or any variety of wine product. It encompasses the same products sold in different sizes and different varieties sold in the same size (Tr. 2024, 7895-96).

688. A "line extension" is a new product item sold under an existing brand name, *e.g.*, Lancers White wine [Vinho Branco] (Tr. 3759).

689. Once brand recognition of a line of wines is achieved, wine producers seek to capitalize on the brand recognition by line extensions under the brand name (Tr. 3759, 7834-35, 8557; CX 361P, 366Z-5, Z-7, 367Z, Z-2).

690. Among the long-term objectives of the 1972/73 Lancers Marketing Plan was to "[t]ake advantage of line and size extensions to maintain and increase momentum (Increased share)" (CX 125G). [145]

691. A Heublein February 1970 intracompany memorandum reported: "Long range plans call for line extensions of White and

Red Lancers . . . The stronger base we are able to build in the next couple of years on Lancers Vin Rose, the easier (and cheaper) it will be to introduce line extensions without corresponding increases in advertising" (CX 115A).

2. Utilization of Advertising To Create and Maintain Brand Recognition

692. Advertising is recognized by wine marketers, including Heublein, as a very important factor in creating and maintaining wine brand recognition and in increasing wine brand sales (Tr. 1983, 3038, 3367–68, 3690, 3699–3700, 3715, 3756, 3763–64, 3804, 8608; CX 49M, 51H, 52H, 97Z–12 thru Z–16, 98B, 99K, 102C, F, 103K–L, 116K, W, 125F–H, Q, 129L, N–O, U, 231E, Z–20, Z–22, Z–23, Z–25, Z–33, Z–42 thru Z–49, Z–54, Z–60 thru Z–63, 256Z–14, 352C, I, Z–1, 353B, 360M, 585D, I, K, P; RX 251D, F).

693. Image advertising is widely utilized in the marketing of wines (CX 466; RX 348A–B, 373, 406, 425, 457A–B, 462A, 464, 468, 566). Advertising can be a central factor used in the creation or enhancement of a wine brand's image (CX 97K, Z–6, 98B, 99B, K, M, 116K, 125E, F, Q, 231F–G, Z–25, Z–44, Z–45, Z–48 thru Z–50, Z–53 thru Z–56, 256Z–59; Tr. 8743–44).

694. The Italian Swiss Colony Marketing Plan for fiscal 1970/71 cited as a marketing strategy for its table wines: "Increase consumer awareness and quality image of ISC versus Gallo, especially for products where no discernible difference exists, through 'line' advertising" (CX 231Z–25).

695. Heublein's "Harveys Marketing Plan Summary," dated April 23, 1970, notes that it will rely primarily on advertising and merchandising to position "Harveys Bristol Cream away from the sherry or cream sherry market in terms of image," adding however that "we still must consider this market in terms of potential and competition" (CX 99K, M).

696. Notable examples of substantial advertising expenditures to create brand recognition for a wine product are the Lancers and Blue Nun brands (Tr. 3368; CX 125Z–7, 128, 366Z–13, 379D).

697. Advertising has been an important factor in creating and maintaining a high profit margin for the Lancers and Harveys products marketed by Heublein. Both products, backed by substantial advertising, have achieved product differentiation and premium prices in part through the creation and maintenance of recognized brand images (CX 97K, 99A, J, K, M, 114E–G, 116B, J, L–M, 125E–G, 218Z–289, Z–290, 441B; Tr. 3690, 3699, 8743–44; RX 251C, D, G). **[146]**

698. Heublein's 1972/1973 Marketing Plan for Lancers called for

continued "heavy spending" on Lancers in order to "reinforce our image and story to the consumer" (CX 125F). Shorter length commercials were preferred because of already high Lancers Rose consumer awareness but continued "need to reinforce our image" (CX 125Q).

699. Heublein's Vinya Marketing Plan for 1972/73 stated: "In order to build Vinya into a volume brand, it is essential that significant advertising dollars are available to build the necessary consumer awareness and demand in our major markets, and to insure distributor and trade support" (CX 352I).

700. Wine suppliers whose wines already have established brand recognition enjoy an absolute cost advantage in advertising over firms without established wine brand names (Tr. 5718–19, 5738–39).

701. Richard Oster, President of United from September 1970 until September 1973 (Tr. 7778), judged that, for the long-term good of United's wine business, the company could more profitably spend its money in advertising, which has a cumulative effect, than in price promotions (Tr. 7859, 7863–64, 7926–27). Mr. Powers, Chairman of the Board of United, also believes wine advertising benefits extend into the future (Tr. 9902).

702. Advertising is also required to maintain substantial sales of already established brands (Tr. 7944, 9322, 9608; CX 111A, 114F).

703. The necessity to advertise a branded wine increases as competing brands of wine are advertised (Tr. 8342, 8354–56, 9608; CX 125F, Z–17).

704. The fiscal 1972/73 Lancers Marketing Plan strategy was to "continue to spend at a high level behind advertising and promotion" in order to "dominate the 'noise level' among wine advertisers" (CX 125F).

705. Since other wineries provide advertising support to their brands, it is also necessary for United to cultivate retailers through commitments of advertising support for United's brands in order to help move the product out of the store. Although an attractive promotion may encourage a retailer to carry a wine brand, it is still necessary to advertise (Tr. 8355–56).

706. Wholesalers' salesmen have priorities in devoting time to the wine brands they represent. A salesman generally gives preference to the brands carried exclusively by the wholesaler. Next, he is motivated to sell the wines that are most attractive to the retailer by virtue of fast movement off the retail shelf (Tr. 3324–25, 3366–67). [147]

707. Brand advertising is an important factor in creating movement of wine off the retail shelf. Consumers are influenced to

purchase wine brands by brand advertising (Tr. 654, 656, 660, 767, 772, 1088, 2232, 2853, 2859, 3011, 3367, 8356, 9838).

708. A commitment by a wine supplier of advertising support for a brand is an important factor in getting wholesale distributors and retailers to carry the brand (Tr. 2994, 3010–11, 3366–68, 4206–07, 6849; CX 97Z–27, 120S–T, 125F). Advertising in trade journals may also influence purchases (Tr. 656).

709. In states with pricing restraints, such as affirmation laws, price posting requirements or minimum markup requirements, large wine companies with resources to advertise can be much more effective than where there is an unrestrained market (Tr. 1055–56).

710. In states which control the sales price of wine, advertising is more effective in generating wine sales. If pricing is one of a supplier's tools of selling and he does not have advertising money to spend, the inability to use pricing as a selling tool makes competitors' advertising all the more effective. For example, Ohio fixes the minimum price, called a "floor", at which a winery can sell to the wholesaler, the minimum margin at which the wholesaler must sell to the retailer, and the minimum margin or markup of the retailer to the consumer. A vintner that tries to break into such a market without advertising money to spend is deprived of price as a selling tool. If competitors advertise their wine brands in a state such as Ohio, the winery without advertising funds cannot lower its price to save its sales volume against competitive inroads induced by the advertising (Tr. 1047–48).

711. In states with affirmation laws, the vintner is compelled to sell to wholesalers at the lowest price at which the wine product is sold anywhere in the United States. Therefore, advertising is more effective even in non-affirmation states in generating sales and taking business away from non-advertisers of wines who cannot drop price any lower and remain profitable (Tr. 1053–56).

712. United Vintners has utilized "line advertising" to promote all the products of different wine types under the same brand name. The FY 70/71 Italian Swiss Colony Marketing Plan states the "rationale" for line advertising:

> Line advertising provides an umbrella for products under the ISC Brand which have no discernible difference from similar Gallo items. The objective is [148]to plant an image of modernity and quality in the consumer's mind . . . (CX 231Z–45).

713. Heublein's Lancers Marketing Plan for fiscal 1972/73 also recognized the advantages of line advertising when enunciating the long term strategies of the Lancers brand:

Take advantage of line concept in advertising, merchandising and sales promotion. (Some cannibalization, but great economies and more realistic.) (CX 125G)

3. Merchandising and Packaging

714. "Merchandising" materials in the wine business generally refer to retail point-of-sale or retail display materials used to attract consumers' attention to a branded product (Tr. 632–33, 2063, 7858, 8765).

715. Such merchandising is utilized in wine brand marketing as a tool to establish and maintain wine brand recognition (CX 99C, K, T, 111B, 115B, 116E, 125Z–6, Z–26, Z–27, 129L, V, 236F, 352P, Z–2, 256Y, Z–14, Z–15, 569C–J; RX 251E, M–N).

716. It is a form of advertising, although distinct from media advertising (Tr. 2284, 6213, 6650; RX 438).

717. The quality and quantity of retail display materials available from a vintner is a factor which wholesale distributors weigh in deciding whether or not to take on a wine or wine line and how strongly to support the vintner's wine products viz-a-viz other wine products in the wholesale house. Display materials also motivate retailers to buy a vintner's brand(s) (Tr. 3324–25, 7508–09, 8305).

718. Packaging (including bottle size and design) and labeling changes are another form of nonprice competition used in wine brand marketing (CX 97Z–27, Z–28, 99C, T, 111B, 125Z–35, 129W, 231F, Z–25, 242D, 256Z–17, Z–26, Z–34, 352W, 569C–J).

719. Packaging and labeling are very important in the sale of wine (Tr. 3325, 3789, 4207, 6201, 6799, 7490, 7509, 9617; CX 231F–G, 352G, 360P, 393C–D).

720. Packages go out of style and more contemporary designs are fashioned to make wine products attractive (Tr. 3789, 7484–85, 7490). Different bottle sizes are used to achieve variable retail pricing per ounce of wine (CX 256Z–61). [**149**]

721. Label designs are used in wine brand marketing to differentiate products (Tr. 7614–15).

722. Most major competitors, including United and Heublein, Gallo, Almaden, Christian Brothers and Paul Masson, restyle their packaging (Tr. 3789; CX 231F, 352G, 367Z–2).

723. Brand advertising, including merchandising, works together with packaging in wine brand marketing to establish and maintain brand recognition at the retailer and consumer levels (CX 97Z–27, Z–28, 115A–B, 116B–C, 129U–W, 231F–G, Z–46, Z–48, Z–50, Z–54 thru Z–56, 360P, 393C–D).

4. The Necessity of High Advertising Expenditures Constitutes a Barrier to Entry

724. As testified to by United's recent Vice President of Marketing, a firm wishing to enter or expand in the wine industry so as to take a share of the market away from United or Gallo would have to engage in advertising (Tr. 8441, 8616–17).

725. Among the factors contributing to the failure of Montcalm Vintners, Inc., a new winery entrant, was inadequate advertising support of the company's brands (Tr. 5154–55, 5175–76, 5185).

726. Korbel Winery, a well-established sparkling wine producer tried to expand into the production and sale of table wines, but failed due to inadequate advertising support for its table wine line (Tr. 2208, 2230–33, 2271).

727. Advertising support for national introduction of a new wine product is costly (Tr. 2146–48, 2223, 2232–33, 3705–08, 3710–11, 5154–55, 7963, 8023–24; CX 201A, 585Z-2, Z-34).

728. Generally, in order to establish a new wine brand, it is necessary to spend more on advertising than for an established brand to the point that a firm entering the market must spend twice the advertising dollars of its competitor to take a share of the market away from that competitor (Tr. 8432–33; CX 115B).

729. The enormity of that undertaking in connection with competing for a portion of United's market share is reflected by the public statement made a little over a year after the merger, in May 1970, by Stuart Watson, Chairman of the Board and Chief Executive Officer of Heublein:

> I think our [advertising] effort in national magazines such as Life, Time and Newsweek, on TV and in newspapers probably rates as the most intensive and extensive campaign of wine promo- [150]tion ever undertaken by a single company in this country (Tr. 5015–16).

730. A new firm spending the same dollar amount as industry leaders for advertising must spread its costs over a smaller volume of sales. A company attempting to enter or expand in the wine industry, therefore, suffers an absolute cost disadvantage in advertising in comparison to industry leaders (Tr. 5719–20).

731. A new line would have to be supported by "front load" or "investment spending". This means advertising expenditures at such a high level in support of a wine product over an initial period of time that the margin on the product sold would not recover current advertising expenditures. The product would have negative earnings on the assumption the investment would be recovered on later sales (Tr. 3705–08, 3710–12; CX 129U).

732. There is no certainty that advertising investment spending for a wine product will ever be recovered. Advertising investment spending is a risky proposition (Tr. 3712; CX 585Z-42).

733. In Heublein's Faisca Rose Wine Marketing Plan for Fiscal 1972/73,[26] it was estimated that the introductory media advertising campaign for national rollout of Faisca would be $1 million and that the cost of the media advertising campaign to sustain Faisca would be approximately $925,000 per [151]year. It was estimated that an additional $350,000 in merchandising expenses would be required for the introductory national rollout (CX 129E-G, L). For the first two years of rollout Heublein estimated that "front load" spending on Faisca, and other factors, would result in product line earnings loss for Faisca of $322,500 (CX 129P, U).

734. Lancers' advertising to sales ratios were 2.7 percent in Heublein's fiscal 1966, 10.9 percent in fiscal 1967, 11.6 percent in fiscal 1968 and 8.0 percent in fiscal 1969 (CX 135G).

735. Between Heublein's 1966 and 1972 fiscal years, Lancers' annual advertising expenditures rose from $75,000 to $2,160,000 (CX 125Z-16), and the brand earned direct profit of $4,276,000 on net sales of $11,853,000 in 1972 (CX 125Z-7). This represents an advertising to sales ratio of over 18 percent. For fiscal 1970/71, Heublein projected spending $4.44 per case of Lancers on media advertising (CX 116I).

736. Harveys' advertising to sales ratios were 17.9 percent in Heublein's fiscal 1966, 15.1 percent in fiscal 1967, and 15.6 percent in fiscal 1968 (CX 135G).

737. The following charts depict advertising to sales dollar ratios for a number of Heublein and United products. The charts provide such ratios in a number of ways, including and excluding excise taxes, and reflecting in some instances marketing expenditures which include advertising, merchandising and packaging. Promotional expenses are also treated in varying manners to take into account HUV's contentions that promotional expenses are really price post-offs. HUV object to the exclusion of excise taxes from sales contending that the total price includes the excise tax. I disagree. Taxes are imposed upon sales or withdrawals but do not reflect the

[26] HUV have objected to the reliance upon projected or planned advertising figures which, they claim, do not necessarily evidence actual advertising expenditures. However, marketing plans and budgets are very carefully prepared documents produced and maintained in the regular course of business and approved at the highest levels. Corporate expenditures, including advertising expenses, are matters concerning which detailed and exact business records are maintained. To the extent HUV may have wished to overcome reliable documents reflecting advertising expenses introduced by complaint counsel, it was incumbent upon HUV to have produced and authenticated more reliable documents. This they have not done. Self serving letters submitted to complaint counsel (*e.g.*, CX 330A-B) do not overcome such reliable documents.

The same ruling applies to data supplied to the Commission by HUV during the course of the investigation of this case to the extent that HUV now assert the submittals are incorrect.

return to the seller. The appropriate sales figure is one which excludes excise taxes. [152]

SEE *IN CAMERA* ADDENDUM [153]

SEE *IN CAMERA* ADDENDUM [154]

ADVERTISING:SALES RATIOS
UNITED VINTNERS
(FY 72 (budgeted) (CX 256Y))

PRODUCT	MEDIA AD: SALES RATIO 36/	MEDIA AD: SALES RATIO 37/	AD:SALES RATIO (NON-PRICE MARKETING) 38/
ISC (excluding Bali Hai)	5.8%	6.0%	7.0%
Bali Hai	9.5%	9.8%	11.3%
Inglenook	8.7%	10.0%	13.2%
New Products	22.8%	26.2%	30.9%

36/ Excluding excise tax.

37/ Excluding excise tax and sales promotions from sales.

38/ Combining budgeted non-price marketing expenditures for advertising and merchandising, excluding excise tax and sales promotion.

[155]SEE *IN CAMERA* ADDENDUM [156]

SEE *IN CAMERA* ADDENDUM [157]

The advertising:sales ratios reproduced above are particularly significant in that they show that Heublein engaged in much higher advertising in proportion to sales[44] than United and that the ratios for new products is twice as much, and more, as those for established products.[45]

738. The fact that a fixed amount of advertising is being used for a product which has an increasing number of cases being sold does not dilute the impact of the advertising to the consumer (Tr. 3763-64). Therefore, the absolute amount of dollars spent by a wine

[44] Heublein's advertising:sales ratios for wines are comparable to the 15.7 percent considered high in *General Foods Corp.*, 69 F.T.C. 380, 434 (1966), *aff'd*, 386 F.2d 936 (3d Cir. 1967).

[45] In addition to the data for "New Products", the ratios given for Lancers Red and Jacare reflect new product expenditures.

marketer for a brand is significant, independent of the advertising to sales ratio in evaluating advertising as a barrier to competition (Tr. 5724).

739. Major competitors in the wine industry, including Heublein, United, Gallo, Paul Masson, Almaden, Taylor, Christian Brothers and Mogen David, all advertise their brands nationally (Tr. 4887, 4889–90, 7620–21, 9830; CX 216A, 379C, D, 444–45, 579C–D).

740. Major media advertising such as network and spot television and radio, as well as print media, are used by a substantial number of wine marketers, including Heublein and United (CX 97Z–12, Z–32, Z–35, 98J, 99K, 100C, 102C, F, 111B, 115A, 118A, 119C, G, 120C, F, 125F, I, L, T, 201A, 216A, 231Z–60 thru Z–62, 239D, 240E, 241E, 242E, 243E, 300C thru M, 367Z–17, 379C thru U, 444–45, 472A–B).

741. In 1970, $30.6 million was spent in wine media advertising. By 1976, the figure had more than doubled to $63.7 million (CX 300B, 379B; Tr. 3726–33).

742. In 1976, each of the leading firms in the wine market,[46] with the exception of Guild, spent in excess of $1 million in advertising. Heublein topped the list with $16,982,977 (including HMS Frost) and Gallo followed with $13,411,227. National Distillers spent $2,101,595. Mogen David and Franzia combined for $1,269,184. Seagram spent $2,846,242 and Taylor (Coca-Cola of Atlanta) spent $1,933,816. Guild spent $686,530 (CX 379K–L). [158]

743. In 1976, estimated total expenditures for media advertising in magazine, broadcasting (television and radio) and outdoor by wine marketers was $62,017,251. Heublein's estimated wine advertising expenditures of $16,982,977 (including expenditures for HMS Frost) in that year accounted for 27.4 percent of total wine advertising in these media (CX 379L).

744. Eight companies (Gallo, Heublein, National Distillers, Guild, Mogen David, Taylor, Franzia and Seagram), which were the wine industry leaders in 1972 (CX 373K), accounted for 73.1 percent in 1970 and 66.0 percent in 1971 of total wine advertising expenditures in magazines, radio, television and outdoor media (CX 300B, K–M). In 1976, the same eight companies (Taylor having been acquired by Coca-Cola of Atlanta) accounted for 58.4 percent of all wine advertising expenditures in magazines, radio, television and outdoor media (CX 379K–L; Tr. 3726–33).

745. In 1970, estimated percentages of total United States wine advertising expenditures (excluding newspapers), by type of media utilized, were as follows: magazine, 24.4 percent; outdoor, .6 percent;

[46] These are the eight leading firms as of 1972.

spot television, 41.4 percent; network television, 20.6 percent; spot radio, 12.8 percent; and network radio, .2 percent (CX 300B; Tr. 3726–33).

746. In 1976, estimated percentages of the total United States wine advertising expenditures, by type of media utilized, were as follows: magazine, 12.6 percent; newspaper, 2.7 percent; outdoor, 1.0 percent; spot television, 41.1 percent; network television, 27.0 percent; spot radio, 12.3 percent; and network radio, 3.3 percent (CX 379B; see also Tr. 3726–33).

Conclusions

747. Advertising and other forms of non-price competition such as merchandising, packaging and label design significantly contribute to establishing and maintaining brand recognition in the wine industry.

748. Wine companies with established brands doing a substantial volume of business may enjoy absolute cost advantages in advertising their wine brands.

749. An entering or expanding firm in the wine industry has an absolute cost disadvantage with respect to advertising by virtue of the brand recognition of established competitors, large and small, achieved in part through the accumulated effect of advertising and other non-price marketing tools.

750. If the new entrant or firm desiring to expand its wine market share wants to compete on a par in terms of advertising with a firm with the established brands, it has to spend more than the established brand due to the accumulated recognition of the established firm's brand(s). [159]

751. Heublein, as one of the leading marketing and advertising firms in the United States, adds the capability of significantly increasing advertising and other merchandising expenditures in support of United's already well-established brands. This would accentuate the barrier to entry and expansion associated with the accumulated brand recognition of United's products. By May 1970, Heublein had already taken giant steps to accomplish this (Finding 729, *supra*).

E. State Laws and Regulations

752. State laws and regulations regarding wine are voluminous and complex and vary widely from state to state (*e.g.*, CX 289; Facts Submitted for Official Notice, dated May 2, 1978 and subsequently noticed without objection; Tr. 3028, 7181).

753. An August 1972 publication of The Wine Institute, the most important industry trade association, states:

Distribution methods within the states vary radically.

* * * * * * *

So complex, in fact, are wine-selling restrictions among the states that it is difficult for vintners to establish national distribution. Many concentrate on selected markets, for which they have specifically designed their business operations. Interstate trade barriers and non-uniform wine laws and regulations gradually are being corrected, but progress has been slow (CX 308Z-1).

754. Mr. Serlis, former President of The Wine Institute, described the regulation of the wine industry across the country as a "hodgepodge" that makes it extremely difficult to do business (Tr. 576).

755. One of the reasons the McKesson wholesale operation is decentralized is the complexity of state regulations (Tr. 7181, 7271).

756. Even Heublein found it easier simply to avoid "the maze of laws" concerning entry in Kansas by not seeking to introduce its Faisca Rose wine in that state (CX 129D).[47] **[160]**

757. An Italian Swiss Colony advertisement represents that not all wine varieties are sold in every state, due in part to various state regulations (CX 333E).

758. Heublein represented to the Federal Trade Commission that it was important even for a winery the size of United to obtain a partner having "management and marketing expertise" and "knowledge of the highly complicated, comprehensively regulated alcoholic beverage business" (CX 327Z-5).

759. State laws that limit the alcoholic content of wine make it more difficult for a winery to operate because the laws vary from state to state. Florida, for example, has a tax penalty for wine with more than 17 percent alcohol (Tr. 1049-50).

760. Affirmation laws make it harder to enter a market and favor the dominant brands (Tr. 1053-55; Findings 709, 711, *supra*).

761. Many states have laws governing the resale price of wine. In Ohio, for example, the state fixes the minimum price at which a winery sells to a wholesaler, the margin at which the wholesaler can sell and the margin at which the retailer can sell (Tr. 1046-47).

762. In a fair trade price posting state, a vintner loses freedom of pricing and discounting (Tr. 1046).

763. In some states, the vintner posts the retail price. In other states, the distributor posts the retail price. The posted retail price for a winery will vary from state to state (Tr. 3272-75).

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[47] Kansas' ranking as "a very poor wine consuming state" was an additional factor in not seeking to sell in that state (CX 129D).

764. Some states permit only periodic price changes. Massachusetts has such a law (Tr. 7844, 7973).

765. It is more difficult to get distribution in control states than in open states (Finding 547, *supra*). It is necessary to make a separate application for each product a wine company wishes to have listed in a control state (Tr. 4217, 4263).

766. Some states require submission of labels for approval. Some require the submission of the wines themselves for analysis and approval (Tr. 1050).

767. To obtain a listing in Pennsylvania, each wine, type and size must be approved by the state. The application for a listing is made for a flavor type and a particular size and each application is reviewed separately (Tr. 9937).

768. Federal and state taxes vary with the alcoholic content of the wine. Federal taxes differ from state taxes. Taxes on wine differ from taxes on spirits. Taxes on wine vary from state to state (Tr. 7291-92). **[161]**

769. Wine and spirits prices vary from state to state depending on the various state tax laws and whether the markup structure is fixed by state regulation (Tr. 7254). Wine prices in a state also vary over time as state taxes and other variables change (Tr. 7259).

F. New Entrants in the United States Wine Industry Have Been Small Local Producers

770. Mr. Louis Gomberg, a paid consultant and witness for Heublein, prepared an exhibit (RX 1176A-H) showing "De Novo Winery Entrants" for the period 1960-76. Of 255 entrants listed during the 1960-1976 period, 221 were characterized by Mr. Gomberg as "very small, total capacity to 100,000 gallons." Mr. Gomberg further identified 29 of the new entrants as "small, total capacity 100,001 to 1,000,000 gallons." Four other new entrants were described by Mr. Gomberg as "medium, total capacity 1,000,001 to 5,000,000 gallons." Of all the entrants, one was identified as "large, total capacity over 5,000,000 gallons" (RX 1176A-H).

771. The exhibit prepared by Mr. Gomberg, however, does not accurately reflect the size and nature of new entry into the wine industry. The capacities listed do not reveal production or production capacity; they refer only to storage capacities and count an empty tank as much as a filled container. Thus a new entrant may take over an existing facility, but the storage capacity of the acquired winery does not reflect the production goals or achievements of the new entrant (Tr. 1741, 1753-54, 1757-58). Further, a winery given a permit to produce wine might actually produce none. This condition

could continue for two years before the winery's basic permit would be subject to cancellation under provisions of the Federal Alcohol Administration Act.[48] Nevertheless, the winery would be carried on RX 1176A-H as a new entrant (Tr. 1791-92, 1912-13).

772. The witness relied very heavily upon the Wines and Vines Directory, a wine industry publication, in preparing the exhibit. That directory listed capacities for most wineries. While the great preponderance of the wineries in the "very small" category had capacities substantially below 100,000 gallons, with most apparently below 10,000 gallons, Mr. Gomberg nevertheless set up the category with a 100,000 gallon cut-off (Tr. 1751, 1886-88, 1893-1904). The witness conceded that a sample check of the "very small" new entrants showed that the vast preponderance were insignificant in terms of size (Tr. 1903-04). After an attempt to avoid answering the question, the witness also conceded that some of the "very small" entrants, less than 50 percent, were retirement, hobby or part-time wineries (Tr. 1904-12). **[162]**

773. The one "large" new entrant identified by the witness was California Mission Wines, Inc. (RX 1176E). This company, however, is a bulk wine producer with no brands and no bottling capacity (CX 459E).

774. The four "medium" wineries were The Monterey Vineyard, Noble Vineyards, Papagni Wine Co. and Bronco Wine Co. (RX 1176D-F). The Monterey Vineyard failed and was sold to Coca-Cola of Atlanta on November 3, 1977 (Tr. 363-65). Noble Vineyards is a bulk wine producer only (CX 459E). While listed as having entered in 1972 (RX 1176D), as of January 1978, the witness could not say that company had actually marketed any wine (Tr. 1782-83).

775. The storage capacity of Papagni Wine Co. is 3,000,000 gallons (CX 459B). Bronco Wine Co.'s storage capacity is 1,000,000 gallons (CX 459B). There is no record data as to the production or profitability of Bronco Wine Co. or Papagni Wine Co.

776. During the period 1968 through 1976, there have been 105 *de novo* California "entrants" into the wine industry, which account for 3.4 percent of total California wine industry capacity in 1976 (CX 459A-E).

777. Between December 31, 1960 and December 31, 1976, total non-California winery storage capacity, including capacity both of bottled and bulk wine companies, grew by 38,168,000 gallons (RX

[48] For example, the witness conceded that he did not know whether A. Fillippi Winery, listed as a "small" entrant in 1975 (RX 1176F) had produced any wine "in the two years since they were authorized to produce" (Tr. 1781).

660). In the same time period, comparable California winery capacity grew by 417,107,000 gallons (RX 659).

778. California companies thus accounted for 91.6 percent of the total growth in domestic wine storage capacity of bulk and bottled wine companies during the period December 31, 1960 through December 31, 1976. California wine companies accounted for 93 percent of the growth during the period December 31, 1968 through December 31, 1976 (RX 659-60).

779. The ten largest California wineries plus three major bulk producers accounted for 78.4 percent of the total increase in California winery storage capacity between December 31, 1968 through December 31, 1976 (CX 458A-B).

780. Two ambitious attempts to enter the production and marketing of bottled and branded wine on a significant scale since 1970 are California Growers Winery and Bear Mountain Winery. Both of these entrants were successors to bulk wine operations and have continued to sell bulk wine while attempting to develop a case goods operations (CX 409, 458A; Tr. 1948-49, 1956-58, 1965, 1980, 1998-99, 2014, 9767-68).

781. California Growers Winery has never earned a profit from its branded case goods sales in the seven years during which it has endeavored to establish itself (Tr. 1958-59). **[163]**

782. Bear Mountain Winery began producing bottled wines under its own labels in 1973 or 1974 (Tr. 9767). It had sustained losses in excess of $31,000,000 as of January 1978 (Tr. 1996, 7634, 9505-06). Its tax-paid withdrawals of wine have declined over the period 1975 through 1977 (Tr. 9505). Within the last year, Bear Mountain has been sold to the Jean Labatt Company of Canada (Tr. 9504).

783. The record, therefore, shows that, while there have been a number of small *de novo* entrants into the wine industry, there have been no successful, significant *de novo* entrants.

G. There Are Substantial Barriers to Entry in the Wine Market—Discussion and Conclusions

A barrier to entry is an arrangement or condition in an industry that impedes free entry. A barrier to entry may also be referred to as a "barrier to effective competition." *The Budd Co.,* 86 F.T.C. 569, 577 (1975). The concept encompasses a barrier to expansion (Tr. 5701-03). It is not necessary that there be many or a particular number of barriers. Cases in which barriers play a role may involve only one or two barriers. See, *e.g., General Foods Corp.* v. *FTC,* 386 F.2d 936 (3d Cir. 1967). The issue to be resolved is whether there is in fact a barrier to entry. Such a barrier may exist because of a single situation or because of a combination of circumstances. Here, the record shows a number of substantial barriers to entry.

Entry or expansion, for purposes of Section 7 analysis, refers to an "effective competitor" making "substantial sales" in a relevant (here national) market. See, *Warner-Lambert Co.,* 87 F.T.C. 812, 880–81 (1976). See also, *Missouri Portland Cement Co.* v. *Cargill Inc.,* 498 F.2d 851, 857 (2nd Cir.), *cert. denied,* 419 U.S. 833 (1974) (court's analysis assumes entry the size of the acquired company); *United States* v. *Falstaff Brewing Corp., on remand,* 383 F. Supp. 1020, 1021 (D.R.I., 1974) (court's analysis assumes entry at "an acceptable level of sales"); *United States* v. *Phillips Petroleum Co.,* 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd,* 418 U.S. 906 (1974) (court's analysis assumes a major market entry).

As most recently evaluated by the Commission, the question is whether there is a barrier to that level of entry which approaches that of the industry leaders or which is sufficient to challenge the dominance of industry leaders. *Freuhauf Corporation, Inc.,* 91 F.T.C. 132, 232 (1978).

While it has been possible for a number of entrants to produce and sell wine in small quantities, such endeavors have no significance in terms of competition in the relevant markets. [164]

1. The Long Payout Period Characteristic of Investment in the Wine Industry Constitutes a Significant Barrier

The long period of time during which a firm must pay money out before receiving a return is a significant barrier to entry in the wine industry. Three aspects of the industry contribute to this long payout period. First, new vineyards do not produce grapes at capacity for five to six years after planting. Second, because of the nature of the production process, wine is not placed into distribution channels until at least six months to as long as ten years after the grapes are first picked. Third, it takes a great deal of time to create consumer demand for a brand of wine. The expenditures necessary to create brand recognition must be made up front and there is no way to predict when to expect a return. A return on investment will not begin until there is an established demand for the product.

Long lead times significantly reduce the likelihood that entry into a particular industry will be economically feasible. *FTC* v. *Atlantic-Richfield Co.,* 549 F.2d 289 (4th Cir. 1977). The delay involved in establishing a business to the extent necessary to receive a return is, therefore, one of the obvious factors that potential entrants consider. See *Missouri Portland Cement Co.* v. *Cargill Inc.,* 498 F.2d at 864; *United States* v. *Black & Decker Mfg. Co.,* 430 F. Supp. 729, 762 n. 64

(D. Md. 1976). In *Fruehauf Corporation, Inc.,* 91 F.T.C. at 225 n. 16, the Commission found that a time component of four years for entry was "obviously a barrier." *Accord, RSR Corp.,* 88 F.T.C. 800, 888 (1976) (three years).

This record shows that a varying but substantial number of years is required from the time a company first seeks to establish a source of grapes until its wine is ready to enter distribution channels. In addition, substantial time is required to create consumer preference for a brand. Clearly, the overall length of the payout period for entry into the wine industry compounded by the addition of time it would take to become profitable constitutes a high barrier to entry.

2. Capital Requirements Constitute a Significant Barrier

The amount of capital that must be invested to develop new production capacity in the wine industry is sufficiently high to impede significant new entry or expansion. If a winery chooses to establish its own vineyards, as many have in order to assure themselves an adequate supply, it may cost $8,000 per acre, exclusive of the price of the land itself, to bring the vineyard to full bearing capacity. Beaulieu, for example, number 28 in the table wine market in 1968 with a .25 percent market share (CX 373Z, unranked in other markets), expected to be able to increase its capacity by 75,000 cases in that year because of 150 additional acres it had put under cultivation several years before (CX 207A). [165]

The record shows an example of where the capital outlay for production facilities alone has been $5,800,000 for 2 1/2 million gallons of capacity, a gallonage substantially below the eighth ranked firm in the all wine industry in 1972 which, with a market share of 2.3 percent had 75,953,000 gallons of wine entering distribution channels (Findings 524–26, *supra*).

An additional investment burden is the necessity of maintaining expensive wine inventories. Certain parts of the plant and equipment necessary to produce wine are used for a relatively short period of time each year. This seasonal aspect of the industry means that at least a year's supply of inventory must be maintained.

The absolute amount of capital required for entry or expansion in an industry is significant to the extent that it is "so large that relatively few individuals or groups could secure it." It is also "a rough measure of the *risk* faced by a new entrant" so that even if a company could afford it, it would be reluctant to take the risk. *Fruehauf Corporation, Inc.,* 91 F.T.C. at 224 n. 14. And see, *Jim Walter Corp.,* 90 F.T.C. 671, 761, 762 (1977) ($9 to $12 million considered "not insignificant" or "moderate"); *RSR Corp.*, 88 F.T.C. 800, 888 (1976) ($10 million considered "significant").

The absolute amount of investment necessary to develop new capacity in the wine industry constitutes a significant barrier to entry. The investment figures in this record referred to above would have to be multiplied several times for entry on a scale sufficient to challenge the market leaders.

3. Limitations on Distribution Constitute a Highly Significant Barrier

One of the requisites for successful entry is an adequate distribution system. See, *e.g., United States* v. *Falstaff Brewing Corp., on remand,* 383 F. Supp. at 1024. *United States* v. *Phillips Petroleum Co.,* 367 F. Supp. at 1246. In *United States* v. *General Dynamics Corp.,* 415 U.S. 486, 501 (1974), the Court observed that "in most markets distribution systems" are a "significant" factor in assessing a firm's competitive strength. A commercial winery seeking to grow to any appreciable size faces a very steep barrier in trying to arrange effective distribution for its products.

In most states, wineries are required by law to distribute their products through wholesalers. Wineries generally prefer to distribute their products through combined wine and spirits wholesalers because they are usually the more effective wholesalers in a given market. The fact that established wine companies distribute through major wine and spirits wholesalers demonstrates that this is the more [**166**]effective method of distribution. The major metropolitan markets, in which most wine is sold, generally have only a limited number of effective wine and spirits wholesalers for a winery aspiring to significant size. The number of such wholesalers has been decreasing.

The problem, however, goes beyond the limited and declining number of effective wholesalers for wine in major wine consumption areas. Whether or not they choose to exercise it, major suppliers, particularly spirits suppliers, have an undue influence over their wholesale houses so that competing products may not be taken on. This is because of the importance to the wholesalers of the major products they are handling and the fear of doing anything that might impair ongoing relationships with their major suppliers.

Effective wholesalers are reluctant to take on new lines of wines of any significance in terms of volume from anyone other than a present major supplier. A strong favoritism is inherent in the wholesaler's relationship with the major supplier. Indeed, as in *United States* v. *Wilson Sporting Goods Co.,* 288 F. Supp. 543, 555

(N.D. Ill. 1968), the incentive to treat a major supplier's products favorably "may even initiate with the dealer." Heublein and United are prime examples of major suppliers that are in an advantageous position to place new products or line extensions with their existing wholesalers to the point of filling all the wholesalers' needs and, correspondingly, to deter their wholesalers from taking on competing products. In addition to a relationship which favors present major suppliers to the detriment of new entrants, the record evidences instances where major suppliers have exercised leverage to that end.

The process of building a distribution network sufficient to gain an appreciable share of the market would be an obstacle to a new entrant or a small firm in any national consumer goods industry. In the wine industry, however, it is especially difficult to the point of constituting a significant barrier because of the limited availability of effective distributors and because of the ability of large, established firms to influence their existing wholesalers to extend distribution of their own new products to the exclusion of aspiring competitors.

Apart from the barriers to securing adequate distribution through wholesalers, it is also difficult for a new entrant to secure any distribution in a control state.

4. The Difficulty in Obtaining Retail Shelf Space Constitutes a Barrier to Entry

Obtaining shelf space, or shelf facings, in retail stores is critical to successful distribution of wine. However, it is difficult to obtain such space. A limited amount of shelf **[167]**space is available for wine at any given time, and it is usually necessary to displace a wine item currently on the shelf in order to expand the number of facings for another item or to obtain a facing for a new item. Large, established firms may be able to obtain more favorable and greater amounts of shelf space. Heublein, for example, represented to Allied that it was capable of obtaining greater shelf space for United's products.

High costs are incurred in obtaining shelf space. Retailers prefer to take on products only if they have established brand recognition or established sales. Brand recognition is costly to acquire. Other means of obtaining shelf space, such as promotional pricing or use of a great deal of salespower, are also very costly. See *The Procter & Gamble Co.,* 63 F.T.C. 1465, 1566–67 (1963).

Difficulty in obtaining adequate displays or shelf space, therefore, constitutes another barrier to entry or expansion in the wine industry. See *General Foods Corp.* v. *FTC,* 386 F.2d 936, 945 (3rd Cir. 1967).

5. The Difficulty in Creating Consumer Demand for a Wine Brand Sufficient To Gain an Appreciable Share of the Market Constitutes a Substantial Barrier to Entry or Expansion

One of the requisites for successful entry into the wine business is the ability of the entrant to ensure sales by creating a preference among consumers for its particular wine products. Impressing the consuming public that products are different is important in marketing wine because wines are relatively low-priced products whose distinguishing physical features, aside from color, are not readily discernible by consumers. See *General Foods Corp.* v. *FTC,* 386 F.2d at 338; *Black and Decker,* 430 F. Supp. at 775; *Fruehauf Corporation, Inc.,* 91 F.T.C. at 227. Furthermore, some sort of pre-sale or differentiation of products is important in the sale of wine because it is often sold through self-service outlets. See discussion in *United States* v. *Lever Brothers Co.,* 216 F. Supp. 887, 893 (S.D.N.Y. 1963). *Accord, General Foods, supra.* Because of the array of wines available for the consumer's selection, the creation of the impression of product differentiation is probably more important in the marketing of wines than for most consumer goods.

Product differentiation is achieved in the wine industry primarily through brand recognition based on favorable images of quality. Successful achievement of brand recognition is a very significant factor and an indicator of competitive strength. See *General Dynamics Corp.,* 415 U.S. at 501. The [168]record shows that it is essential to establish and maintain brand recognition by projecting a favorable brand image. Brand name recognition can "prove a decisive advantage" insofar as it is likely to be transferable to new products in the same market. *Black and Decker,* 430 F. Supp. at 764–65. The record exemplifies how wine companies with established brands trade on their name through "line extensions".

Brand marketing has become increasingly important in the wine business, and all wineries attempt to associate the image of their brands with quality. The record shows that advertising is very effective in stimulating and maintaining a preference among consumers for a particular brand of wine. Some notable examples of the successful use of advertising in the wine business are Italian Swiss Colony, Harveys and Lancers. Advertising also has been used effectively as a means to create brand recognition and preference sufficient to enable marketing high margin wine products such as Lancers and Harveys.

Consumer preference for certain brands in the wine industry may also stem from a "long history of industry dominance." *General Foods,* 386 F.2d 936 at 945. United and Gallo enjoy this advantage. Brand recognition may also be generated through the use of other non-price forms of promotion such as merchandising, packaging and labeling.

"[C]ommon sense" indicates that advertising has a significant impact in markets of a consumer oriented nature. *Black and Decker,* 430 F. Supp. at 752. The principal way to gain an appreciable share of the market within a reasonable period of time is through the use of "mass advertising and market promotion." See *General Foods,* 386 F.2d at 938. The record in this case shows that advertising is a major competitive weapon in the wine industry. New firms and small firms that seek to grow must somehow find a way to overcome the existing "noise level" of advertising to capture the attention of consumers for their brands.

New firms and small firms attempting to gain an appreciable share of the market operate at a disadvantage with respect to advertising since firms with larger established brands enjoy absolute cost advantages. As a general rule, "distinct advantages" in advertising and brand loyalty "stem from nationwide marketing." *United States* v. *Phillips Petroleum Co.,* 367 F. Supp. at 1245.

One absolute cost advantage stems from the cumulative effect of advertising. The effect of a given advertising expenditure by an established firm is greater than the effect generated by the expenditure of the same amount by a firm with a less established brand. A new entrant or expander would have to spend more on advertising to compete on a par [169]with the firm having the established brand. Gallo and United, with their firmly established brands, enjoy great advantages in this respect. They also have an advantage because of their large market shares. A firm attempting to enter or expand on a smaller scale than existing companies by spending an equal or greater amount on advertising will have a higher per unit cost because the total cost is applicable to a smaller number of units sold. It will be necessary, therefore, to make heavy advertising expenditures in order to achieve appreciable market penetration.

Consumer preference for certain brands has been "generated through extensive advertising and a long history of industry dominance." *General Foods,* 386 F.2d at 945. See *Procter & Gamble,* 63 F.T.C. at 1533; *Black and Decker,* 430 F. Supp. at 764. Wine is als(a business in which brand name recognition and advertisin(capability have a definite impact on a firm's likelihood of succes(

The use of advertising to create brand recognition (here in the wine industry) operates "as a formidable barrier to new market entrants who, in order to gain a significant foothold in the market, would have to withstand the powerful competitive weapons" presently employed by others which would "confront them upon their first entry." *General Foods Corporation,* 69 F.T.C. 380, 424 (1966). *Accord, Procter & Gamble,* 386 U.S. 568, 579 (1967) (recognition of advertising by others as a "major competitive weapon" confronting new entrant).

A product differentiation barrier exists when an entrant or expander must take affirmative steps to differentiate its product, whether through brand recognition or otherwise, in order to lure buyer loyalties away from similar products of an established seller or to capture the loyalties of new consumers. The Commission has observed that "[w]hether national advertising and distribution programs are viewed simply as a condition of entry . . . or as a means of creating substantial product differentiation, or a combination of the two . . . it is clear that these barriers" can be substantial. *Sterling Drug,* 80 F.T.C. 477, 597 n. 23 (1972).

The Commission has long recognized the product differentiation barrier. As explained in *The Procter & Gamble Co.,* 63 F.T.C. 1465, 1553 (1963):

> The term refers to consumer preferences as between very similar, close-substitute products or brands. Such preferences need not, and frequently do not, rest on real or substantial differences in terms of quality or usefulness. By reason of distinctive packaging, the firm's long history, mass advertising and sales promotions, or other factors, a firm may succeed in establishing such a definite [170]preference for its brand that the consumer will pay a premium to obtain it, although it is functionally identical to competing brands. Such brand allegiance, which the prospective entrant, marketing a new brand, will not, of course, command, may be the cumulative result of the expenditure of many millions of dollars over a period of many years to promote the brand, and may, in consequence, be very difficult to counteract even if the entrant makes a very substantial initial investment to promote his own brand. As a result, in an industry in which product differentiation is an important factor, not only may the new entrant find it especially difficult to pry customers loose from the established firms, but the higher price obtainable for a brand that has been successfully differentiated in the public mind from competing brands may impart a flexibility in pricing, akin to that imparted by cost advantages, which the newcomer may not be able to achieve for many years.

The record shows that the product differentiation barrier exists in the wine industry to such an extent that it constitutes a very substantial impediment to entry and expansion.

6. The Proliferation of Laws and Regulations Subsequent to Passage of the Twenty-First Amendment Constitutes an Additional Impediment to Competition in the Wine Industry

The Twenty-first Amendment, in addition to repealing Prohibition, also granted to the several states and territories the authority to regulate the sale and distribution of alcoholic beverages within their borders. The result has been a proliferation of varying laws and regulations among the states regarding such matters as wholesaling, label approval, price posting, markups, minimum prices, taxes and advertising.

It would appear that a company large enough to attempt a significant national entry or expansion in the wine industry would be able to hire the expertise necessary to cope with the various state statutes and regulations. Therefore, I do not consider this problem in itself to constitute a barrier to entry. Nevertheless, it is a situation which, when considered along with the various impediments and barriers discussed above, constitutes a real impediment to entry or expansion in the wine industry. [171]

7. New Entry Does Not Belie the Existence of Barriers to Entry

Many small new wineries have entered the industry (RX 1176). As interest in wine has increased in this country, many people have decided to try to make wine for themselves. In large part, these endeavors, which are required by law to operate as bonded wineries, are very small and may be characterized as "garage" or "one-man" operations (Tr. 7305; CX 192A). In terms of storage capacity, the new wineries account for a small percentage of industry growth and an even smaller percentage of total industry capacity (CX 459C–D).

The sheer number of new entrants means nothing when their total share of the market remains slight compared to the market leaders. *United States* v. *Black & Decker Manufacturing Co.*, 430 F. Supp. 729, 751 (D. Md. 1976); *Jim Walter Corp.*, 90 F.T.C. 671, 762 (1977). As in *Procter & Gamble*, 386 U.S. at 578, where the existence of some 200 fringe firms did not belie the fact that Clorox enjoyed a dominant position nationally, the existence of numerous, tiny new wineries does not belie the dominance of United and Gallo. This is true regardless of the age of such operations. In the wine industry, it is the leading firms that have captured by far the greatest share of growth (CX 458).

Nor do the number of new entrants belie the substantial barriers to entry or expansion characteristic of the relevant markets in this case. See *Black & Decker*, 430 F. Supp. at 751 and cases cited therein

Barriers to significant entry or expansion exist wholly apart from what is required to start a household bonded winery.

Given an expanding market, such as wine, an increase in the number of competitors or even a rise of the sales of smaller firms at a faster rate is neither surprising nor inconsistent with an overall lessening of competition. *Jim Walter,* 90 F.T.C. at 762–63; *American General,* 89 F.T.C. 557, 636 (1972). New entrants may simply be prospering under the umbrella of weakened competition resulting from high levels of concentration in the market or responding in small part to rapidly increasing demand, without posing an immediate or certain threat to the leaders. *Ibid.*[49] In the wine industry we have the additional fact that many of the so-called "new entrants" are not even commercial operations but rather have been established as vocational pursuits.

More large-scale entry is expected to occur when demand is growing rapidly. Scherer, *Industrial Market Structure and Economic Performance* (1970) 229–30. Even to maintain its market position in a period of industry expansion, [172]a firm would have to grow. The leading firms would have to grow that much more to increase the concentration ratios. And that is what occurred in the all wine, dessert and sparkling wine markets from 1968–1972. As in *American General,* 89 F.T.C. at 640, the substantial increases in the four- and eight-firm concentration ratios from 1968 to 1972 show that the industry leaders "have made their gains primarily at the expense of the smaller members of the industry." The post-1972 data for the wine industry indicates that this has continued to be true, despite the rising demand.

Aside from the very small wineries of insignificant individual or aggregate volume, a few new entrants are plainly serious endeavors intent on establishing themselves with a place in the market on a noticeable, even if relatively small scale. Even these entrants, however, have had no effect on the concentrated state of the markets. Their record of success has been less than impressive. By expanding too quickly, some have sustained serious losses. See *American General,* 89 F.T.C. 557 at 637. To the extent that they still project success in the future, such projections, particularly in view of the difficulties others have experienced, should be greeted with some skepticism. *American General,* 89 F.T.C. at 637. Even if they meet their own projections, these firms would still be small in comparison to Gallo, United and other high ranking firms, and could easily take

[49] This is true even where, as here, the market share of a leading firm has dropped slightly. *Jim Walter,* 90 F.T.C. at 763.

their sales from the overall growth of the market without eroding the position of the market leaders.

VIII. ENTRENCHMENT OF UNITED'S DOMINANT POSITION

Entrenchment, as an antitrust violation, occurs when the acquiring firm affords additional competitive advantages to a dominant firm in a concentrated market. *Sterling Drug, Inc.*, 80 F.T.C. 477, 604 (1971). There, the Commission considered such factors as contributions to the acquired firm's production, distribution and marketing capabilities and resources *ibid.*; and, at 604 n. 29, the threat to change the structure of the industry and the effect of dissuading smaller firms from competing aggressively. The structure of the industry referred to by the Commission was that resulting from the raising of entry barriers, as recited in *FTC* v. *Procter & Gamble Co.*, 386 U.S. 568, 578 (1967).

In *Procter & Gamble, supra,* at 575, the Court discussed the heightening of such entry barriers as advertising costs, retail distribution and fear of retaliation by the industry leader. *Black and Decker,* 430 F. Supp. at 774 discussed ". . . the degree of synergy between the acquired and acquiring firms' marketing and manufacturing systems, between their technologies, and between their brand name recognition." *General Foods,* 386 F.2d at 945 noted the advantages in retail display and marketing which the acquiring company, "an even more formidable opponent," would enjoy. These elements are clearly present in this merger. [173]

It is not necessary that the acquired company's market share be increased. The maintenance or entrenchment of a large market share in a concentrated market is sufficient to constitute a violation.

United's market shares and market positions at the time of the merger were sufficiently large and significant in the all wine, table wine and dessert wine markets that it could be anticompetitively entrenched. In all wine, it had 17.9 percent of the market and its second place share was over six times that of The Taylor Wine Company which was in third position (Finding 498, *supra*). The entrenchment of such a share and such a market position clearly would be anticompetitive.

In table wine, United had 14.6 percent of the market and its second place share was 2.7 times that of Mogen David which, was in third position (Finding 499, *supra*). The entrenchment of such a share and such a position clearly would be anticompetitive.

In dessert wine, United had 21 percent of the market and its second place share was over six times that of The Taylor Wine

Company which was in third position (Finding 500, *supra*). The entrenchment of such a share and such a position clearly would be anticompetitive.

In sparkling wine, United was in third place with 10.7 percent of the market. As complaint counsel concede (CPF 1131), the entrenchment of such a share would not be anticompetitive in view of Taylor's 12.1 percent and Gallo's 11.3 percent market shares. Also, discounting Heublein (See discussion p. 112, and Finding 501, *supra*), the next two largest firms had 6.3 percent and 6 percent of the market, respectively. Thus, United was not in such a dominant position vis-a-vis the next smaller firms as it was in all wine, table wine and dessert wine.

The record establishes that the acquisition has served to entrench United's dominant market position in all wine, table wine and dessert wine.

The first barrier to entry discussed above was that of large capital requirements. Heublein, one of America's largest and most profitable corporations at the time of the merger, has financed United's operations with outstanding loans or lines of credit ranging at all times from $50 MM to $96 MM (Tr. 2515). This financing has been at rates lower than United could have secured elsewhere (Tr. 8121–25, 9473–76). Further, Heublein, which itself expends large sums for expansions in capacity (Findings 56–60, *supra*), announced almost immediately after the merger plans for a new United production facility for sparkling wine (Finding 61, *supra*). Also right after the merger, Heublein helped finance the $18 million dollar glass plant which has resulted in savings for United in the cost of glass and has operated at a profit. Heublein's participation in financing was to arrange [174]for $11 MM in bank loans by guaranteeing payments. It also was to contribute any additional operating capital that might be needed beyond that originally put up by United and Indian Head, the joint venturers (Findings 62–63, *supra*).

The merger has also entrenched United's ability to achieve distribution and, correspondingly, has increased that significant barrier to entry and expansion for others (Findings 590–652, *supra*). As one wine marketer testified:

> Every time there is an acquisition by a distiller of a winery or of a brand of wine, it makes it that much more difficult for a company like ours, an independent company to compete . . . (Tr. 1057).

At the time of the acquisition, Heublein had a large, well-established, nationwide distribution network for both wine and spirits. In most instances, its wines and spirits were distributed by the same distributors (CX 93; Tr. 2464). As found above, Finding 258, *supra*, Heublein, as one of the inducements for Allied members to vote in favor of the merger, stressed the distribution advantages that would accrue to United by reason of Heublein's existing wide range of distribution of both spirits and wines. And the opportunity to take advantage of Heublein's distribution channels and selling muscle was one of the benefits of the then proposed merger recognized by Mr. Bruno Solari, President of United (Tr. 4967–68).

Heublein's past exercise of leverage with wholesalers to expand the distribution of Heublein products (Findings 645, 646, *supra*) shows both its capability and the likelihood of capitalizing on its importance to wine and spirits wholesalers to the distributional advantage of United and so increasing barriers to others.

The record otherwise demonstrates Heublein's intention to utilize the distribution advantages of the merger (See, *e.g.*, Finding 652, *supra*). While Heublein may have refrained to an extent, because of this suit, from generally exercising these advantages, Heublein currently has one common sales group handling national accounts such as airlines, chain hotels and chain restaurants for both its spirits products and United's products (Finding 135, *supra*).

Heublein's ability to maintain and protect United's shelf position through advertising (and other non-price marketing tools) and through use of secondary lines of wines may result in a raised barrier at the retail shelf level (Findings 670–74, *supra*). And the likelihood of United securing greater shelf space was one of the advantages of the proposed merger recounted to Allied's members by the spokesmen for Heublein (Finding 665, *supra*). [175]

Clearly, the merger will significantly increase the advertising and brand recognition or product differentiation barrier. The acquisition of United by Heublein, one of the leading marketers and advertisers in the nation, provides the capability of significantly increasing advertising and merchandising efforts in support of United's already well-established brands. And by May 1970, United's wines were supported by what was then probably the most intensive and extensive advertising campaign of wine promotion ever undertaken by a single company in this country (Finding 729, *supra*).

Heublein is a very strong marketer and merchandiser (Findings 118–148, *supra*). In 1965, it asserted that it had a "reputation in the industry as perhaps the most astute and successful merchandisers of alcoholic beverages" (CX 178A).

Its outstanding, indeed spectacular, successes with Smirnoff Vodka (Findings 27–32, 47, 49), Harveys Bristol Cream (Findings 34–35, 45, 133), Lancers (Findings 37, 38, 46, 49, 133), Heublein Cocktails

(Finding 33), Arrow Cordials and Brandies (Findings 36, 46, 49) and Jose Cuervo and Matador Tequila (Findings 39, 49) demonstrate its capabilities. The superimposition of these capabilities upon United can only serve to entrench United's dominant position.

Conclusion

I find that Heublein's acquisition of United entrenched United's dominant position and strengthened barriers to significant entry or expansion in the all wine market and in the table and dessert wine submarkets.

IX. POTENTIAL EXPANSION

A. Heublein Was an Actual Potential Expander into the Domestic Segment of the United States Wine Industry

784. As of the time of its acquisition of United, Heublein was an actual potential expander in the United States wine industry by entry into the domestic segment of the industry; and, but for the acquisition of United, would have entered by alternative, more procompetitive means. The record shows, by both objective and subjective evidence, that Heublein definitely intended to expand its position in the market by entering the domestic segment, had explored various means of so doing, and was capable of expansion *de novo* or by toehold acquisition.

785. Heublein had not only the capability, but also the incentive to expand its position in the wine industry by entering the domestic segment. Heublein was an aggressive growth company (Tr. 4438). The wine industry was experiencing a period of rapid growth and appeared attractive (Tr. 4456–57, 5117). Heublein had a high return on capital, was seeking [176]additional high return opportunities and the wine industry offered such an opportunity (Tr. 5117). Heublein could put to use in related fields the marketing and advertising skills which it possessed (RX 1215; Tr. 4439). Heublein could put to use its familiarity and capability with respect to supermarket and alcoholic beverage channels of distribution (Tr. 4945–46).

1. Heublein Was a Small but Important and Growing Force in the United States Wine Industry

786. At the time of the acquisition, Heublein's market share in the all wine, dessert wine and table wine markets was relatively small. Nevertheless, because of the concentrated state of the market,

it ranked sixteenth, thirteenth and thirtieth in those markets, respectively. Until Heublein, by its own choice after the merger, repositioned Lancers from a sparkling wine, it ranked fourth in the sparkling wine submarket.

787. Heublein had been in the wine business only since 1957, but since that time it had experienced a very rapid growth. From 1963 to 1968, sales of its two leading wines had increased—84 percent for Harveys Bristol Cream Sherry and 294 percent for Lancers. In the fiscal year in which the acquisition occurred, sales of both products increased again (Findings 45, 49, *supra*).

788. As the market share tables for 1967 and 1968 show, Heublein's wine business was growing fast enough to improve its market position and, in the all wine and table wine markets, to move up in rank:

	1967	*1968*
Heublein	*Market Share (Rank)*	*Market Share (Rank)*
All wine	.63% (17)	.79% (16)
Dessert wine	.45% (13)	.54% (13)
Table wine	.20% (31)	.23% (30)
Sparkling wine	6.0 % (4)	7.2 % (4) (CX 373)

789. Heublein prided itself as a growth company and actively pursued a growth and diversification policy. Included in this was an active determination to expand its position in the fast growing wine industry, particularly the domestic segment. The only realistic assessment of Heublein's market position but for the merger is that it would have continued to grow at an impressive rate.

790. In 1967, Heublein reported that the wine portion of its business had grown rapidly and accounted for an important share of total sales and earnings. In acknowledgement of this growth, Heublein expanded the sales force covering its wine market and gave its top brands special attention (CX 48K). [177]

791. In 1968, Heublein's Annual Report reflected awareness of the substantially increasing consumption of wines and increased consumer interest in wines (CX 49K). It reported that the trend toward flavorful, light alcoholic drinks was a factor contributing to the growth of wine sales (CX 49M).

792. In October 1968, Heublein told its stockholders that its "success with imported wines has accentuated our interest in domestic wines" (CX 34G). It showed its further awareness of the

opportunities in wine by saying, "We believe that California wines are about to enter an era of rapid growth" (CX 34G).[50]

793. Heublein had expertise in the wine business (CX 37B), having achieved its initial market share in wine with only two major single-item products (CX 320, 373D, N, Y, Z-9).

2. Heublein Was a Major Industrial Corporation, a Leading Marketer of Alcoholic Beverages

794. At the time of the acquisition, Heublein was the largest wine importer in the United States and in the year following the acquisition was the fifth largest domestic producer of alcoholic beverages (Finding 15, *supra*). In the year of the acquisition, Heublein distributed 22 brands of spirits, ten of which it produced (Finding 22, *supra*). In the year of the acquisition, Heublein distributed 24 primary brands of wine (excluding United and Beaulieu) and others in limited quantities (Findings 23, 24, *supra*). In addition, Heublein produced three brands of beer and malt liquor (Finding 25, *supra*) as well as specialty foods (Finding 26, *supra*). Heublein's legendary success with Smirnoff Vodka, Lancers Rose and Harveys Bristol Cream Sherry has been discussed above (Findings 27-32, 34-35, 37-38), as has its success with canned cocktails, tequila, rum, and the Arrow line of cordials and brandies (Findings 33, 39, 71).

795. One of the reasons for Heublein's great success and growth over the years was its strength in marketing. Aggressive, effective marketing was a major point of pride with Heublein. Heublein originated prepared cocktails and with its Smirnoff vodka it pioneered the rapid growth of the vodka market, leading it from virtually nothing to become one of the major distilled spirits categories. Even when Heublein was not setting the trends, it was keeping pace with them. For example, as interest in travel increased, Heublein took the [178]lead in marketing distilled spirits to the airlines and to other travel accounts (Finding 127, *supra*).

796. Heublein was a leading producer and importer of the distilled liquors commonly known as "white" goods, notably vodka, gin, rum and tequila. Indeed, in 1968, Heublein considered itself to be "in a unique position with representative brands in all eight of the fastest growing categories of distilled spirits" (CX 49K). Heublein was capitalizing on the trend toward the light taste in alcoholic beverages with its spirits products and its wines.

797. Heublein regularly introduced and promoted new products,

[50] While these statements were made after entry into the merger agreement, they reflect the prior existence of an overall interest in domestic wines not limited to the particular merger.

and it emphasized the full range of marketing activities including merchandising and packaging. It was a major advertiser and used its advertising effectively to promote sales.

798. Heublein had a well-established and strong distribution network. At the time of the acquisition, it was the fifth largest distilled spirits supplier in the country. Today it is number two. Several of its products, including its Lancers and Harveys Bristol Cream wines, were "call" or "demand" items in retail accounts. As a result of this, in addition to its size, Heublein's strength in terms of wine and spirits distribution gave it a very real advantage and incentive in expanding its market position further. In addition, Heublein had demonstrated knowledge and capability with respect to distribution through supermarkets, where a growing percentage of wine sales were occurring.

799. Heublein sells to distributors, state agencies, transportation and military accounts (CX 4, 16, 56Z–7).

800. Heublein is in a dominant position vis-a-vis its distributors and is able to secure distribution advantages (pp. 218–240).

801. There were approximately 400 Heublein spirits distributors in 1972 (Tr. 8797).

802. Heublein was interested in acquiring products that could be sold through its spirits distribution channels (Tr. 3929).

803. When Heublein obtained the rights to sell Harveys, it increased Harveys distribution by placing it with Heublein wholesalers (Tr. 3985–86).

804. Prior to the acquisition of Vintage Wines, Inc., Heublein's imported wines were marketed through the Smirnoff Beverage and Import Co. (Tr. 8651). When Heublein acquired Lancers, it was placed in the Heublein spirits division (Tr. 8658). [179]

805. Heublein believed that Lancers wine "lends itself to our type of distribution" (CX 46G).

806. Lancers and Harveys wines were sold in part through distributors that handled Heublein spirits products (Tr. 3924).

807. The Heublein spirits sales force handles Beaulieu Vineyard Wines (Tr. 9841).

808. Heublein believed that United's wine products were compatible with its own. Heublein told Allied's members this compatibility could be beneficial in the distribution of United's products, because Heublein could place United products with its distributors, and mentioned Smirnoff as a primary example of one of its compatible products (Tr. 2464–68).

809. Heublein representatives stated that by having domestic wine to go along with Smirnoff, Lancers and other Heublein

products, United's distribution system would be greatly enhanced by using Heublein's warehouses and distributors and, similarly, Heublein would be able to use United warehouses and distributors. This would result in greater overall distribution (Tr. 2691).

810. Mr. Carriuolo, Heublein's Executive Vice President, believed that an alliance with Heublein would give a small winery an advantage in terms of distribution as well as in other ways (CX 208B).

3. Heublein's Efforts To Implement Its Corporate Growth and Diversification Policy Pointed toward Expansion in Wine

811. Heublein was a "growth" company with strong financial resources as measured by its excellent price earnings multiple for its shares, by its ability to generate internal funds from profits, and by its access to external funds at favorable rates. Heublein's growth was achieved by acquisition of established businesses, new products and lines, expansions in capacity, and by marketing new brands (by acquisition and distribution agreements) of products already being marketed by Heublein. In deciding upon candidates for acquisition, Heublein looked for products compatible with its marketing skills and channels of distribution (*e.g.,* supermarkets or spirits distribution channels), and which would expand the kinds of businesses it was already in (Finding 91, *supra*).

812. In the early 1960's, one Ray Weiser, who identified himself as representing Heublein's importing company, told Louis Gomberg, a wine property broker, that Heublein was [180]interested in the Alta Vineyards Company[51] (Tr. 1415). At the time Schenley sold Alta Vineyards in 1963, it was substantial in size and had an established distribution network (Tr. 2971-73).

813. In January 1965, Ed Kelley, Vice President of Heublein, advised a merger consulting firm that Heublein would not be interested in acquiring a wine distributor unless it owned all or a substantial portion of its brands and the brands were other than "price" items, in which case it might be interested and would appreciate further information (CX 173-74).

814. In 1965, John Martin, Heublein's Chairman, wrote to a financial representative to express Heublein's interest in acquiring

[51] HUV would dispute this finding on the ground that "There is absolutely no proof that Mr. Weiser was even employed by Heublein, or what position, if any, he held with any company" (RRPF 337). However, there is no reason to reject the particulars of the contact between Mr. Weiser and Mr. Gomberg as related by Mr. Gomberg, and Mr. Gomberg could not reasonably have been expected to verify the fact and nature of Mr. Weiser's employment by Heublein. Heublein was in a position to present any evidence to refute the related fact that Mr. Weiser was employed by Heublein. Heublein having failed to offer any such evidence, I have accepted the testimony of Mr. Gomberg.

the Taylor Wine Company. Mr. Martin indicated that he had already had an exploratory talk on the subject with Taylor people and, although Taylor was not presently interested, he wanted a follow-up on the matter (CX 165). Various reports on Taylor to Heublein followed (CX 166-69), although nothing ever came of the matter.

815. Mr. Kelley, Heublein's Vice President, said that the Taylor Wine Company was one of the alternative acquisition candidates for Heublein and that they studied it as thoroughly as one could without having inside information (Tr. 4542).

816. Heublein, as early as mid-1965, had contacts with representatives of Almaden and advised them of Heublein's interest in acquiring that company (CX 139–42).

817. In January 1967, after having been advised that Almaden was willing to sell, Heublein prepared an outline of a proposal to purchase and made an offer of purchase. The offer was approximately $12 million (Tr. 917; CX 144–47).

818. On or about August 17, 1967, the Charles Krug Winery was suggested to Heublein as an acquisition possibility. The information was immediately passed on to Mr. Edward Kelley, Heublein's Executive Vice President, who was then responsible for long-range planning (CX 148; Tr. 4425–26). As of October 2, 1967, the matter was still under consideration (CX 152). [181]

819. In December 1967, Ed Kelley, Heublein's Executive Vice President, informed a broker for the Mogen David Wine Company that he would "think about" that winery but that Heublein was then "considering other wine possibilities" (CX 197). Mr. Watson, Heublein's Chief Executive Officer, suggested that Mr. Martin, the Chairman, should make any initial contact because of his "direct access to Mogen-David" (CX 198). After reviewing the matter, Heublein decided not to pursue the acquisition of Mogen David (CX 203).

820. In March 1968, Chris Carriuolo, Heublein's Senior Vice President, reported to Heublein's Executive Vice President that he had had a discussion with Lee Knowles, Vice President of Beaulieu Vineyards (CX 207). Mr. Carriuolo stated that "because of our [Heublein's] interest in the U.S. wine business," Heublein should consider several kinds of agreements with Beaulieu in order to get closer to the company with the view of eventually taking it over (CX 207B). He expressed his understanding that Heublein's Mr. Martin and Mr. Hart had approached Beaulieu about the possibility of buying it a few years before (CX 207A). Nearly a year later, Mr. Carriuolo reported his further efforts to develop ties with Beaulieu

(CX 208B), and, on June 5, 1969, the company was acquired by Heublein (Finding 78, *supra*).

821. In the Spring of 1968, Heublein executives had focused on wine as an area of expansion opportunity (Finding 92). Previously, Heublein had explored the possibilities of foreign production of wine (Tr. 346, 4732); and, as far back as 1966, Heublein's long-range planning group had identified wine as a product suitable for diversification. In March 1968, Heublein's Executive Vice President referred to ". . . our interest in the U.S. wine business" (CX 207B). At that time, Heublein was not interested in "small vintage wine types" of wine companies (Tr. 4950), but was interested primarily in a California winery (Tr. 4955).

822. In the early summer and fall of 1968, Heublein considered the acquisition of the San Martin Winery (CX 185–90). Heublein's Mr. Beckstoffer visited San Martin, collected information about the winery, discussed the various arrangements that could be made and reported back to Heublein's Executive Vice President (CX 187). Heublein obtained a detailed report on various aspects of San Martin from wine industry consultant Louis Gomberg (CX 188).

823. At Heublein's request (CX 191A), wine industry consultant Louis Gomberg, in the fall of 1968, submitted reports to it regarding several domestic wineries that might be acquisition candidates (CX 191). [182]

824. Also at Heublein's request, Mr. Gomberg reviewed a number of wineries that Heublein might use "in bridging the price gap between the top of the Italian Swiss Colony line and the bottom of the Inglenook line" (CX 192A). In reviewing the field of candidates, Mr. Gomberg reported on the prospects of acquiring each winery (CX 192E, F) and, if the winery were small, on expanding it (CX 192G).

825. During the period of discussions with United, Heublein did not reject, but merely postponed merger talks with Guild, a small winery, pending completion of "a study of the alternatives of how to enter the wine industry" and of its negotiations with United (Tr. 4512–13).

826. When Mr. Ed Kelley, Executive Vice President of Heublein was placed in charge of planning in March 1968, one of Heublein's corporate objectives was to enter the wine industry within one to three years. And this goal was assigned to Mr. Kelley (Tr. 9279–86).

827. Subsequent to the acquisition, Heublein reported to its stockholders in the 1969 Annual Report that "The addition of the

domestic wine business to an already flourishing imported wine business was one of our three corporate goals"[52] (CX 50E).

828. I conclude that Heublein had the intent and capability to expand into the domestic wine industry at the time of its acquisition of United;[53] and, but for the acquisition would have entered by other means in the near future. In light of Heublein's proven capabilities and successes, particularly in the imported segment of the wine industry, it may also be anticipated that its expansion into the domestic segment of the wine industry would have had a significant competitive impact. [183]

B. The Merger Violated Section 7 of the Clayton Act under the Actual Potential Entrant (Expander) Doctrine

Heublein's acquisition of United, a dominant firm in the concentrated United States wine industry, had the anticompetitive effect of eliminating Heublein as an actual potential competitor. Section 7 of the Clayton Act "looks not merely to the actual present effect of a merger but instead to its effect upon future competition." *United States* v. *Von's Grocery Co.,* 384 U.S. 270, 277 (1966). A merger's effect upon future (potential) competition may be either the edge effect (the "waiting-in-the-wings" or "on the fringe" perceived potential competitor effect), or the entry (actual potential entrant) effect.

The court in *United States* v. *Phillips Petroleum Company,* 367 F.Supp. 1226 (C.D. Cal. 1973), *aff'd,* 418 U.S. 906 (1974), discussed the theoretical foundations of the actual potential entrant doctrine as follows:

> The crux of the entry effect is that if the company which enters the market by acquisition had entered unilaterally,[4] it could have supplied an additional competitive force without eliminating one already present in the market. An acquisition of a company in the market by a company which is likely to enter on its own thus has an anticompetitive effect on the market.

[4] . . . the terms 'unilateral entry', 'independent entry', or '*de novo* entry', . . . denote entry into a market through the entering firm's own efforts without a purchase or acquisition of stock or assets of a firm already in the market other than of a *de minimis* nature (at 1232).

[52] The other two objectives "were record growth in sales and earnings-per-share and the successful introduction of profitable new products" (CX 50E).

[53] As developed above, the barriers and impediments to entering the wine market would not have been substantial barriers to Heublein. Heublein had, or had ready access to, the necessary capital; its compatible distribution system was already in operation and it had the influence with wholesalers to secure additional wine distribution as required; it was in position to obtain the necessary retail shelf space; it was a national leader in advertising and promoting products to develop brand recognition and preference; and it was fully acquainted and capable of coping with the multitude of varying state laws and regulations.

In *United States* v. *Black and Decker Mfg. Co.*, 430 F. Supp. 729 (D. Md. 1976), the court reviewed the case development of the actual potential entrant doctrine,[54] and summarized the analytical prerequisites enunciated therein as follows: [184]

In a nutshell, review of prior potential competition cases suggests that the competitiveness of the market first be determined; the feasibility of alternative means of entry to a leading firm acquisition must then be explored with reference to the incentive and capability of the acquiring company; and finally, the ability of those alternative means of entry, if any, to deconcentrate or provide significant procompetitive effects must be examined (at 748).

Applying those criteria to the facts of this case, it is clear that Heublein was an actual potential competitor whose elimination had an anticompetitive effect. First, as discussed above, at the time of the acquisition concentration ratios in the relevant market (all wines) and in the three submarkets was high. Furthermore, market shares in the all wine market and in the table and dessert wine submarkets were skewed by the high shares of only two dominant firms, one of which was United.

Second, Heublein had feasible alternative means of entry in terms of its incentive and capability. As noted above, Heublein intended to expand in the domestic wine industry because such products would allow it to efficiently utilize its marketing experience and ability and its distribution channels for imported wines and domestic and imported spirits. Heublein's incentive and ability to expand in the wine industry distinguish this case from such conglomerate mergers as *Missouri Portland Cement Co.* v. *Cargill, Inc.*, 498 F.2d 851 (2nd Cir.), *cert. denied*, 419 U.S. 883 (1974); and *Federal Trade Commission* v. *Atlantic Richfield Company*, 549 F.2d 829 (4th Cir. 1977). In the latter, the Commission challenged the acquisition by Arco (a producer of petroleum, natural gas, and uranium) of Anaconda Co. (a miner and producer of copper and aluminum). There, in an action brought by the Commission for preliminary injunction to prevent consummation of the merger during pendancy of administrative antitrust proceedings, the court found that the Commission had failed to show substantial likelihood of success in demonstrating the anticompetitive effect of the merger:

. . . the conglomerate merger in the instant case involves no product or market extension; it is a merger purely for purposes of diversification. Arco is not poised on the fringe of the copper markets; it has no technological skills readily transferrable to

[54] *United States* v. *Marine Bancorporation*, 418 U.S. 602 (1974); *Federal Trade Commission* v. *Procter & Gamble Co.*, 386 U.S. 568 (1967); *United States* v. *Falstaff Brewing Corp.*, 410 U.S. 526 (1973); and, *United States* v. *Phillips Petroleum Company, supra.*

the copper markets; it has no channels of distribution which may be utilized to distribute copper (at 295). [185]

Heublein's acquisition of United was a product extension merger into the domestic wine business for which it had readily available the technological marketing skills and distribution channels such as were noted in *Federal Trade Commission* v. *Procter & Gamble*, 386 U.S. 568, 580 (1967), and *Federal Trade Commission* v. *General Foods*, 386 F.2d 936, 945 (3rd Cir. 1967).

Heublein's intent to expand in the United States wine market was formulated and accomplished within a definite time frame: one to three years from the time its executives were assigned the goal of expansion in this industry (Finding 826, *supra*). The facts of this case thus meet the " . . . reasonable temporal estimate related to the near future," requirement announced in *BOC International Ltd.* v. *Federal Trade Commission*, 557 F.2d 24, 29 (2nd Cir. 1977).

Heublein had the financial capability for either *de novo* or toehold entry. It had for several years been exploring the possibilities of acquiring specific small wineries and had made efforts toward that end (Findings 812–25, *supra*). Indeed, it had acquired Beaulieu in a move that culminated efforts that preceded, and were totally unrelated to, the acquisition of United (Findings 78, 820, *supra*). Heublein could have made such an acquisition or acquisitions and expanded production in the manner pursued by Almaden and indeed as it did with Inglenook in developing their "Mountain" and "Navalle" lines, respectively, or in the manner of its extension of the Lancers line from rose into Vinho Branco white wine and Rubeo red wine (Findings 65, 106–10, 203, 204, 315, 688, 690, 691, 713, *supra*). At the time of the acquisition, Heublein was financially strong, capable of financing its investments in new products through internally-generated profits, by borrowing from external sources at favorable rates or by purchase with shares of Heublein stock, which was the method used to purchase United. It was also able to provide financial support to its acquisitions and new endeavors, *e.g.*, the $96 million credit extended to United after the acquisition (p. 173, *supra*). Heublein's expansion in the United States wine industry was financially feasible.

Heublein's expansion in the United States wine industry *de novo* or by toehold acquisition and subsequent expansion in the manner of Almaden and Inglenook would have had procompetitive consequences. A major advertiser and strong marketer would have been introduced into the market to challenge the dominance of Gallo and United.

I therefore conclude that Heublein was an actual potential expander in the United States wine industry in 1968 with the incentive and capability of expansion within one to three years, and on a sufficiently large scale to challenge the dominance of Gallo and United. [186]

X. CONCLUSION: THE PROBABLE EFFECT OF HEUBLEIN'S ACQUISITION OF UNITED VINTNERS MAY BE TO SUBSTANTIALLY LESSEN COMPETITION IN THE UNITED STATES WINE INDUSTRY

Prior to the merger, Heublein's shares of the relevant markets were:

all wine .79 percent (16th in rank)
table wine .23 percent (30th in rank)
dessert wine .54 percent (13th in rank)[55]

These percentages are superficially small, although not appreciably smaller than the 1.3 percent and 1 percent held to be anticompetitive increments to a dominant firm's share in a concentrated market in *United States* v. *Aluminum Company of America*, 377 U.S. 271 (1964) and *Stanley Works* v. *FTC*, 469 F.2d 498 (2nd Cir. 1972), *cert. denied*, 412 U.S. 928 (1973), respectively.

In *United States* v. *General Dynamics Corp.*, 415 U.S. 486 (1974), the Court discussed the role of market share data in antitrust analysis:

> In most situations, of course, the unstated assumption is that a company that has maintained a certain share of a market in the recent past will be in a position to do so in the immediate future. Thus, companies that have controlled sufficiently large shares of a concentrated market are barred from merger by Sec. 7, not because of their past acts, but because their past performances imply an ability to continue to dominate with at least equal vigor. In markets involving groceries or beer, as in *Von's Grocery, supra*, and *Pabst, supra*, statistics involving annual sales naturally indicate the power of each company to compete in the future. Evidence of the amount of annual sales is relevant as a prediction of future competitive strength, since in most markets distribution systems and brand recognition are such significant factors that one may reasonably suppose that a company which has attracted a given number of sales will retain that competitive strength (at 501). [187]

The most basic premise of the antitrust laws, that increasing concentration leads to anticompetitive interfirm coordination, requires that any significant increment in the share of a dominant firm in a concentrated industry be prevented. The Court held in *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963)

[55] Heublein's share of the sparkling wine submarket is not being considered here for the reason stated at p. 112, *supra*.

that " . . . if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great" (at 365 n. 42). And in *United States* v. *Aluminum Co. of America*, 377 U.S. 271 (1964), the Court noted that the objective of the 1950 amendments to Section 7 of the Clayton Act "was to prevent accretions of power which 'are individually so minute as to make it difficult to use the Sherman Act test against them' " (at 280).

Therefore, the evaluation of whether Heublein's small shares of the all wine market and of the table and dessert wine submarkets were *de minimis* as of the time of the merger must be made in light of the recognition in *Philadelphia National Bank* and *Aluminum Co. of America* that "slight" or "minute" accretions in concentration or power must be considered under Section 7. Further, as of the time of the merger, Heublein's shares of the markets were growing. Its percentage shares, therefore, understate the probability of the potential future increment. In addition, Heublein's distribution rights to Harveys and Lancers, items of great prestige and consumer demand, were more significant than their small shares of the industry would indicate.

Under the circumstances recited above, the potential market share increment to United's already dominant position is found not to be *de minimis* and the acquisition violates Section 7.

As previously found, Heublein has also violated Section 7 by reason of its entrenchment of United's dominant position (pp. 172–75, *supra*), as well as by elimination of Heublein as an actual potential competitor (pp. 183–85, *supra*).

Therefore, Heublein has violated Section 7 under the three separate principles enunciated above. Under a broader view, Heublein has violated Section 7 because of the totality of these three anticompetitive effects (the increased concentration, the entrenchment of United, and the loss of Heublein as a significant actual potential competitor). The anticompetitive effect of all three elements considered together is, of course, greater than that of any one evaluated separately.

Heublein and United have asserted as an affirmative defense that "But for Heublein's acquisition of a controlling interest in United, United's predecessor cooperative associa[188]tion was destined to remain an ineffective competitor." In their post hearing submittal, HUV argue that at the time of the merger, United was clearly in a weakened financial and competitive position and did not have the ability to maintain into the 1970's the position it had enjoyed in the early to mid-1960's (RPF 102).

To the contrary, the record shows that United was the second largest company in the relevant markets (except for sparkling wine where it ranked third) at the time of the merger with market shares significantly larger than the third largest company. It also shows United's ability to maintain its position in the table wine market as consumer demand shifted from dessert to table wines. When a new opportunity arose in the wine industry, refreshment wines, United had the ability to secure almost 40 percent of that market, outselling the number three competitor many times over.

The findings descriptive of United prior to the merger (150-86, 190, 209-18, 222-41) depict a successful and aggressive company with multiple plants producing all types of wines and selling its products through 370 distributors and its own distribution system, in all 50 states and the District of Columbia.

It had acquired the Italian Swiss Colony line, among others, from Petri in 1957 for $24 million and had repaid that purchase price a year and a half ahead of schedule. United had also acquired the prestigious Inglenook Winery in 1964.

United was a leading advertiser in the wine industry and its president and chief executive officer was considered one of the most astute merchandisers in the wine business. United was consistently profitable, a financially strong company.

As of the time of the merger, United was planning a new table wine brand and had taken steps toward constructing a $10 million glass plant. United had been able to borrow money at reasonable interest rates as required.

Allied's membership increased from 230 grape growers in 1951 to over 1,600 in 1968, and members were anxious to participate in the cooperative venture. There was a waiting list of 100,000 tons of grapes the growers wanted to deliver through Allied.

HUV's discussion (RPF 53-102) of United's and Allied's operations is claimed to demonstrate a defense within the holding of *United States* v. *General Dynamics,* 415 U.S. 486 (1974). There, the Court found that statistics showing the acquired company's market share did not reflect its ability to compete because the company lacked uncommitted reserves [189]of coal and could not acquire any with which compete for future business. In this case, to the contrary, United (through Allied) was able to secure the raw material it required. There was no basic impediment to the continuation of United's vigorous competitive position.

The facts relied upon by HUV, interpreted in their very worst light, reflect business and organizational problems soluble in the normal course of operations. HUV's assertions that these present problems which presage a diminution of United's competitive position are too conjectural for adjudicative determination. The record does not indicate that United could not have resolved its alleged difficulties. HUV's assertions are insufficient to comprise a "failing company" defense.[56]

XI. REMEDY

A. Divestiture of United Vintners

> The principal purpose of relief in a Section 7 case is to restore competition to the state in which it existed prior to, and would have continued to exist but for, the illegal merger. . . . Ordinarily, a presumption should favor total divestiture of the acquired assets as the best means of accomplishing this result, *United States* v. *Continental Can Company, Inc.*, 1964 ¶ 71,264 at p. 80,183 (S.D.N.Y. 1964) . . . ., *RSR Corp.*, 88 F.T.C. 800, 893 (1976).

Divestiture in this case is both necessary and appropriate to remedy the anticompetitive effects of the acquisition. The Heublein share of the market will be removed from United. United will be restored to its former competitive position, a positive benefit for the market since United will no longer be bolstered by the entrenching effects of Heublein's resources. And Heublein will be repositioned as an actual potential competitor.

HUV have argued that, in the event of an order of divestiture, it should not be required to divest Jacare, Esprit and T.J. Swann, trade names owned by Heublein and which came into existence after the acquisition (RR 352). The inclusion of after acquired proprietary rights to T.J. Swann and Esprit in the order of divestiture is necessary and appropriate to maintain United's competitive integrity. At the time of the merger, United already had a strong share of the refreshment wine market while Heublein marketed no such wines (Finding 513, *supra*). **[190]**

T.J. Swann, thereafter, was produced and distributed by United as a continuation of its endeavors in the refreshment wine market. It is a high volume, profitable brand (Finding 195, *supra*) and it must be divested with United. Esprit is another refreshment wine developed by United (Tr. 9544-45), and thus should not be excluded from the divestiture. Jacare originally was the name of a Lancers type carbonated wine developed by Heublein in the facility partially owned by Heublein in Portugal. The wine was test marketed in the United States but was a failure and was discontinued before United was acquired by Heublein. The Jacare wine being sold by United

[56] As previously found (Finding 262, *supra*), United was not sold because of an inability to continue in business on its own, but rather in response to what appeared to be an advantageous offer which was initiated by Heublein.

today is a California wine developed and produced by United. It is a table wine and has no resemblance to the product previously sold by Heublein under the Jacare label (Tr. 321–27, 4438, 4486, 9977–78). Jacare, therefore, is not being excluded from divestiture.

Divestiture of T.J. Swann, Esprit and Jacare is being ordered because these products are an integral part of the United product line. Divestiture does not depend upon Heublein's choice as to which company holds title to the trade names under which United does business.

Complaint counsel would have Heublein prohibited, for ten years, from acquiring, without Commission approval, any interest in any concern engaged in the production, importation, distribution and/or sale of wine. Such a sweeping prohibition would be inconsistent with the actual potential entrant basis of this case. One of the reasons Heublein's acquisition of United violated Section 7 is because it removed Heublein as an actual potential entrant. The order of divestiture is procompetitive, in part, because it repositions Heublein as an actual potential competitor, allowing potential entry by toehold acquisition. The provision requested by complaint counsel would preclude this procompetitive element of the order. In addition, as proposed, the provision would prohibit vertical integration to facilitate distribution. This case involves a horizontal acquisition with product extension and entrenchment aspects. There is no basis for prohibiting vertical integration.

In *Budd Company,* 86 F.T.C. 518, 582 (1975), the Commission announced a general presumption that a firm holding 10 percent or less of a target market would be considered a "toehold" firm. Consistent with that principle, the prohibition against further acquisitions is being limited to situations where the acquisition or acquisitions would increase Heublein's total share of the relevant market or submarkets to over 10 percent. Such a provision would permit toehold acquisitions in the markets as they exist today and would allow for considerable market change before a toehold acquisition might be prohibited. Heublein may seek Commission [191]approval of an acquisition which would be inconsistent with the 10 percent limitation or, upon a showing of changed conditions of fact or as a matter of public interest, may seek such modification as may be appropriate under Section 3.72(b) of the Rules of Practice.

B. Dismissal of the Complaint Against Allied Grape Growers, United Vintners, Inc., and Heublein Allied Vintners, Inc.

Under the terms of the acquisition, United was converted from an agricultural cooperative association into a corporation which then became a wholly-owned subsidiary of Heublein Allied Vintners. Heublein Allied Vintners was owned by Heublein (82 percent) and Allied (18 percent). On September 13, 1978, Allied moved for its dismissal from the proceeding upon a showing that it had sold its 18 percent interest in Heublein Allied Vintners to Heublein which then owned 100 percent of Heublein Allied Vintners and, through it, 100 percent of United. Allied also abandoned all claims formerly made in this case including the right of first refusal in the event Heublein should be required to divest itself of its interest in United. On November 9, 1978, Heublein Allied Vintners merged into Heublein and ceased to exist. Heublein thus now owns directly 100 percent of United (pp. 7–9, *supra*).

Relying upon the foregoing, Heublein United Vintners and United, on December 13, 1978, also moved for dismissal of the complaint against them. I deferred ruling on all three motions for dismissal until the initial decision. In their post-trial memorandum (CB 3), complaint counsel state that they do not oppose any of the three motions.

In consideration of the order being issued against Heublein which affords all of the relief required in this case, any order issued against Allied Grape Growers, United Vintners, Inc. or Heublein Allied Vintners, Inc. would be superfluous. Therefore, I am dismissing the complaint as to these three respondents.

ORDER

I

It is ordered, That the complaint against Allied Grape Growers, Heublein Allied Vintners, Inc., and United Vintners, Inc. be, and it hereby is, dismissed.

II

It is further ordered, That, subject to the prior approval of the Federal Trade Commission, respondent Heublein, Inc. (hereinafter "Heublein"), a corporation, its successors and assigns, and its officers, directors, agents, representatives, [192]employees, subsidiaries and affiliates, shall, within one year from the effective date of this Order, divest all of the stock of United Vintners, Inc. and all assets, rights, property and privileges, tangible and intangible, including all plants, equipment, machinery, raw material reserves, inventory, customer lists, trade names, trademarks, good will and other property, including all additions and improvements thereto, of whatever description acquired by Heublein as a result of its acquisition of any interest in Heublein Allied Vintners, Inc. and, thereby of its wholly-owned subsidiary United Vintners, Inc. (hereinafter "United"), formerly a wholly-owned subsidiary of Allied Grape Growers (hereinafter "Allied"), or acquired by Heublein as a result of the sale to Heublein by Allied of Allied's interest in Heublein Allied Vintners, Inc. or the subsequent merger of Heublein Allied Vintners, Inc. into Heublein, and all trade names under which wine is produced and marketed by United, including but not limited to Jacare, Esprit and T.J. Swann.

III

It is further ordered, That for a period of ten (10) years from the date of approval of the divestiture required by this Order, Heublein shall not acquire, directly or through any corporation, subsidiary, division or other device, without the prior approval of the Federal Trade Commission, the whole or any part of the stock, share capital, assets or any other interest of or in any concern engaged in the production, importation, distribution and/or sale of wine, where Heublein's and said concern's combined share of the United States all wine, table wine, dessert wine or sparkling wine market or submarket would exceed 10 percent; nor shall Heublein enter into any arrangement with any concern by which Heublein obtains the market share in whole or in part, of any concern involved in the production, importation, distribution and/or sale of wine whereby Heublein would possess a total share in excess of 10 percent of the United States all wine, table wine, dessert wine or sparkling wine market or submarket.

IV

It is further ordered, That pending divestiture, Heublein shall not make or permit any deterioration in the value of any of the plants, machinery, parts, equipment, or other property or assets to be divested that may impair their present capacity or market value unless such capacity or value is restored prior to divestiture, nor shall Heublein take any steps to impair United's economic and financial position. **[193]**

V

It is further ordered, That within twenty (20) days of the effective date of this Order, United shall be maintained and operated as a separate corporation with separate books and accounts, separate management, separate assets and separate personnel.

VI

It is further ordered, That no substantial property or other assets of United or its subsidiaries shall be sold, leased, otherwise disposed of, encumbered, other than in the normal course of business, without the written consent of the Federal Trade Commission, and Heublein shall not commingle any assets owned or controlled by United with any assets owned or controlled by Heublein.

VII

It is further ordered, That, in complying with the requirements of Paragraph II, none of the property or business of United shall be divested to anyone who is an officer, director, or in any other way controlled or influenced by Heublein, or to anyone who owns or controls, directly or indirectly, more than 1 percent of the outstanding capital stock of Heublein or to anyone who is not approved in advance by the Federal Trade Commission.

VIII

It is further ordered, That Heublein shall, within thirty (30) days from the effective date of this Order and every sixty (60) days thereafter until Heublein has fully complied with the provisions of this Order, submit, in writing, to the Federal Trade Commission a report setting forth in detail the manner and form in which Heublein intends to comply, is complying, or has complied with this Order. All compliance reports shall include, among other things that are from time to time required, (a) the steps taken by Heublein to accomplish the required divestiture, and (b) copies of all documents, reports, memoranda, communications and correspondence concerning or relating to the divestiture. Heublein shall on the first anniversary of the effective date of this Order, and upon each anniversary date thereafter until the expiration of the prohibitions set forth in Paragraph III, submit a report, in writing, listing all of its acquisitions of or mergers with other concerns engaged in the United States wine industry, the date of each such acquisition or merger, the products involved and such additional information as may from time to time be required by the Federal Trade Commission or its staff. **[194]**

IX

It is further ordered, That respondent Heublein notify the Commission at least thirty (30) days prior to any proposed change in the corporate respondent such as dissolution, assignment or sale resulting in the emergence of a successor corporation, the creation or dissolution of subsidiaries or any change in the corporation that may affect compliance obligations arising out of this Order.

Opinion of the Commission

By Pitofsky, *Commissioner:*

The question here is whether the acquisition by Heublein, Inc. ("Heublein") of a controlling interest in United Vintners, Inc. ("United") violated Section 7 of the Clayton Act[1] and Section 5 of the Federal Trade Commission Act.[2] The amended complaint, issued in November 1972*, charged that the effect of the acquisition "may be substantially to lessen competition or to tend to create a monopoly in the production, distribution and/or sale of wine" in the United States. [2]

The amended complaint challenged the acquisition on a horizontal and several conglomerate theories, alleging that it: (i) eliminated actual existing competition between Heublein and United; (ii) eliminated the likely entry of Heublein into the wine market by the acquisition of a firm with a smaller market share than United; and (iii) would unduly entrench United's position as a market leader. The administrative law judge ("ALJ") found a violation based upon each of these three theories and ordered divestiture. We disagree, and, finding no violation of the antitrust laws, order the dismissal of the amended complaint.

As to the theories of horizontal anticompetitive effects, we find the small lessening of actual competition resulting from the merger was insufficient to establish a violation of Section 7. Similarly, with respect to the conglomerate theories, we find that the evidence in the record simply falls short of establishing a violation.

I. The Merging Parties and the Industry

Heublein is primarily a manufacturer, importer and marketer of alcoholic beverages. In 1968, the year prior to the acquisition,

[1] 15 U.S.C. 18.

[2] 15 U.S.C. 45.

* Amended Complaint issued November 16, 1976.

Heublein ranked as the fifth largest domestic producer of such beverages, I.D.F. 15,[3] earning a net income of $14,567,000 on net sales of $383,972,000. I.D.F. 17.[4] Distilled spirits and beer were Heublein's principal product lines; distilled spirits (mainly Smirnoff vodka) providing 52% and beer 39% of its 1968 sales. I.D.F. 16. Wine, a less significant product line, provided $14,371,000 of the 1968 sales. CX 135 B. At that time Heublein, principally an importer, sold approximately 1,685,400 gallons of wine making it the sixteenth largest seller of wines in the United States. CX 373 D, E. [3]

Prior to the acquisition, United produced and marketed numerous lines of wine—its best known brands being Italian Swiss Colony, Petri and Inglenook. In 1968 United sold approximately 38,226,000 gallons of wine, making it the second largest seller of wines in the United States. I.D.F. 498; CX 373. Its income in that year totaled $3,301,356 on net sales of $96,009,189. I.D.F. 165, 166.

Heublein acquired United at a time of rapid growth in the wine industry. Americans consumed an estimated 158.1 million gallons of wine in 1960; by 1968 that figure had risen to 205.1 million. I.D.F. 1. They spent an estimated $751 million on wine in 1960; by 1968 that figure had risen to $1,053 million. I.D.F. 2. This rapid growth continued into the following decade. American wine consumption had increased to 390.4 million gallons by 1977, and expenditures to $3 billion. I.D.F. 1, 2. Although this growth in consumption encouraged new entry in the market, I.D.F. 770, 776, the market has remained moderately concentrated. In 1968, the top four firms accounted for 47.9% of wine shipments, with the top two firms—Gallo and United—controlling 41.9%. I.D. 11.

II. THE RELEVANT MARKET

The Administrative Law Judge found, in accord with the stipulation of the parties, that the United States is the relevant geographic market for assessing the legality of the merger. He also found that one relevant product market is the "all wine" market, a market composed of the four basic types of wine: (1) sparkling, or efferves-

[3] The following abbreviations are used herein:

I.D.F.	- Initial Decision Finding of Fact No.
I.D.	- Initial Decision Page No.
Tr.	- Transcript of Testimony Page No.
CX	- Complaint Counsel's Exhibit No.
RX	- Respondent's Exhibit No.
RR	- Respondent's Reply to Complaint Counsel's Proposed Findings of Fact
CAB	- Complaint Counsel's Appeal Brief Page No.
RRAB	- Respondent's Reply Appeal Brief Page No.

[4] Heublein acquired 82% of the stock of United in September 1968 for about $33 million. I.D.F. 263. In August 1978, Heublein acquired the remainder.

cent wines; (2) still wines containing up to 14% alcohol, commonly called table wines; (3) still wines containing over 14% alcohol, commonly called dessert wines; and (4) refreshment wines, produced from inexpensive fruit concentrate rather than grapes.[5] As we acknowledged in *Coca Cola Bottling Co. of New York, Inc.,* [4]93 F.T.C. 110 (1979), the competitive offerings of the wine industry do "not consist of altogether homogeneous products." 93 F.T.C. at 204. But, as we stated there, those diverse products nevertheless may "appropriately be designated as a market" for antitrust analysis. 93 F.T.C. at 205. There is some significant competitive confrontation among even the most disparate wines, and there is also some supply-side interchangeability of productive facilities. Since no reason has been offered to abandon that conclusion here,[6] and since this record amply supports it, we hold that the all wine market is also appropriate in this case.

The ALJ also found that sparkling wines, table wines, and dessert wines each constituted a relevant submarket, but we do not find it necessary to reach these issues. Since the relevant concentration ratios and market shares for the acquiring and acquired companies do not substantially differ between the all wine market and these proposed submarkets, a determination of the validity of the submarkets would not affect the ultimate disposition of the case. *See Brown Shoe Co.* v. *United States,* 370 U.S. 294, 327 (1962).

III. HORIZONTAL ASPECTS OF THE MERGER

This case involves an acquisition by Heublein, a major marketer of alcoholic beverages with a very small presence in the wine market, of the second largest domestic wine company. In light of Heublein's extremely small percentage share of the market and the failure of complaint counsel to demonstrate that this percentage understates Heublein's true market significance, we cannot affirm the ALJ's finding of a violation in the horizontal line. United ranked second in the all wine market in 1968 with a share of 17.9%, and Heublein ranked sixteenth with a share of .79%. The 1968 market shares of

[5] The somewhat arbitrary categories of sparkling, table and dessert wines are used by state governments to tax wine distribution and by the industry itself to monitor production. I.D.F. 276, 331, 428, 430. The term refreshment wines is simply descriptive. Although refreshment wines are not made from grapes, as are other table wines, and contain less alcohol than other table wines (7-8% as compared to 10-14%), they are still included in the wine category for tax and statistical purposes. I.D.F. 438, 439.

[6] Although respondent apparently contested this market definition before the ALJ, insisting that there were separate markets for standard and premium quality wines, *see, e.g.,* I.D.F. 282; RR ¶ 90, this position has not been asserted here. RRAP 1.

United and Heublein in the table wine market were 15.6% and .23% and in the dessert wine market 21.0% and .54%.[7] CX 373 Although their 1968 market shares in the sparkling wine market were significantly higher, 10.7% and 7.2%, Heublein in late 1969 lowered the carbonation level of Lancers, the wine that accounted for [5] 99.7% of its sparkling wine sales, bringing it into the category of table wine, and leaving Heublein with a negligible share of the sparkling wine market. I.D. 112.[8]

At the time of the acquisition, the wine market was not highly concentrated nor was there any significant trend toward concentration. The four-firm ratio was 47.9%—falling near the lower end of any reasonable definition of "concentration."[9] The import of that four-firm ratio is amplified by the distribution of 41.9% of the market among the top two firms. Recent research has suggested that high two-firm shares may be more relevant than four-firm shares [6] in predicting interdependent anticompetitive behavior.[10] Disregarding, for the moment, other indicators of market behavior, we are willing to assume that the all wine market was sufficiently concentrated to warrant careful scrutiny of further increases but not so highly concentrated that an extremely stingent anti-merger policy is required. In light of the market share and concentration data presented here, Complaint Counsel cannot argue successfully that a prima facie violation has been shown. *See United States* v. *Philadelphia National Bank,* 374 U.S. 321 (1963).

Although market share percentages are "not conclusive indicators

[7] Since we do not find it necessary to reach the issues raised by the ALJ's definition of submarkets, we have relied upon submarket shares computed by complaint counsel.

[8] Complaint Counsel, in their appeal, challenge the ALJ's treatment of this change in carbonation level. The ALJ concluded that Heublein's premerger share of the sparkling wine market should be ignored because of the subsequent alteration of Lancers. But he did not then consider the Lancers sales in his evaluation of Heublein's share of the tablewine market. Doing so would have increased Heublein's share of the table wine market—apart from the wines of United—to .90% in 1970, the first full year after the change in carbonation. CX 373. United's table wines accounted for 14.8% in that year. CX 373. If the sales of Lancers in 1968, prior to the change, were added to Heublein's other table wine sales, it would yield a share of 1.2%. CX 373. While we agree with Complaint Counsel's criticism of the ALJ's calculations, that criticism does not alter our conclusion that this merger was not likely to substantially lessen competition in either the all wine market or any of the proposed submarkets.

[9] In *The Stanley Works,* 78 F.T.C. 1023, 1065 (1971), *aff'd,* 469 F.2d 498, 504-05, (2d Cir. 1972), *cert. denied,* 412 U.S. 928 (1973), the Commission found and the Court of Appeals agreed that four-firm concentration in this range described a concentrated market. *See also* Department of Justice Merger Guidelines, ¶¶5 and 6 (1968), 1 Trade Reg. Rep. ¶4510 at 6884 (1971) defining a market with four-firm concentration above 75% as "highly concentrated"); F. Scherer, *Industrial Market Structure and Economic Performance* 280 (2d ed. 1979) (suggests critical four-firm concentration level is between 45 and 59 percent); II P. Areeda & D. Turner, *Antitrust Law* ¶404 at 278 (1978) ("reason to believe that substantial effects generally disappear once four-firm concentration ratios fall below 50 to 55%"); J. Bain, *Industrial Organization* 131 (2d ed. 1968) (four firms controlling 50-65% reflects "high-moderate" concentration)

[10] *See* Kwoka, The Effect of Market Share Distribution on Industry Performance, 61 Review of Economics and Statistics 101 (1979).

Although this concern with two firm concentration has emerged only recently, the Commission has previously recognized that any skewing of the distribution of market share towards the leading firms may aggravate whatever lessening of competition that may result from a merger. *Warner-Lambert Co.,* 87 F.T.C. 812 (1976); Sullivan, *Handbook of the Law of Antitrust* 621 (1977).

of anticompetitive effects," *United States* v. *General Dynamics Corp.*, 415 U.S. 486, 498 (1974), we note that no decision has ever found a horizontal violation based upon so small a percentage increase in concentration. Violations have been found in two cases where there were percentage increases of approximately 1%: 1.3% in *United States* v. *Aluminum Co. of America*, 377 U.S. 271 (1964), and 1.0% in *Stanley Works* v. *FTC*, 469 F.2d 498 (2d Cir. 1972), *cert. denied*, 412 U.S. 928 (1973). But those cases differ significantly from that before us now.

First, in each case, the larger party to the merger controlled more of the market than did United; Alcoa accounted for 27.8%, and Amerock, the firm acquired by Stanley, 22–24%. Alcoa and Amerock were the largest firms in their respective markets, while United, by contrast, was second behind Gallo.

Second, the acquisitions reviewed in *Alcoa* and *Stanley Works* threatened more imminent anticompetitive effects. In *Alcoa* the market was already far more concentrated than the market here; the top two firms controlled 50% of the market, the top four 76%, and the top nine 95.7%. The Supreme Court also noted a trend toward vertical integration and elimination of small independent competitors resulting from recent mergers. 377 U.S. at 279 n.6. No comparable pre-acquisition trend exists in this case. Four-firm concentration in *Stanley Works* was approximately 50%, comparable to that of [7]the wine market but the Court of Appeals concluded that evidence of Stanley's strategy and pricing policies in other markets increased the likelihood of anticompetitive effects resulting from the small addition to concentration in the market at issue. Evidence before the Commission showed that Stanley had always sought to minimize price competition, acting as a "price leader" for every hardware product line in which its market strength permitted it to do so, and that pursuance of that policy was likely in the relevant market after the acquisition. *The Stanley Works*, 78 F.T.C. 1023, 1067-1074 (1971). According to the Second Circuit, the acquisition threatened to turn "a concentrated market manifesting limited signs of price competition into a rigid, lifeless market tending toward even greater concentration and economic enervation." 469 F.2d at 505. The record in this case contains no such evidence of past business activity by Heublein that adds an additional anticompetitive threat to an otherwise small increase in concentration in a moderately concentrated market.

A comparison with *United States* v. *Crowell, Collier and Macmillan, Inc.*, 361 F. Supp. 983 (S.D.N.Y. 1973) highlights the disparity between Heublein's acquisition of United and the mergers in *Alcoa* and *Stanley*. The acquisition by Crowell Collier closely paralleled Heublein's. Crowell Collier, with .6% of the relevant market, acquired the leading firm in that market. The District Court refused to find a horizontal violation, even though the four firm concentration was 69.6%, and the market share of the acquired firm was 41.9%—statistics significantly higher than those in the Heublein acquisition.[11] The court emphasized that the particular conditions present in the market undermined even the superficial appearance of a horizontal lessening of competition. Among these conditions were a lack of a trend towards concentration, the absence of a likelihood of future defensive mergers, a lack of vertical integration among the competing firms, and the inability of any of the firms in the market to affect competition through control of price, due to the prevalent industry practice of sales through competitive bidding. [8]

It can also be questioned whether the market share statistics of 17.9% and .79% depict, as accurately as did the figures in *Alcoa* or *Stanley Works,* the possible reduction of competition resulting from this acquisition. The wine industry, as we observed in *Coca Cola Bottling Co.,* is comprised of disparate products. 93 F.T.C. at 204. And although variations in price, quality or sweetness do not justify the rejection of a relevant market comprised of all wines, those variations must be considered when evaluating the possible competitive effects of a merger between two wine producers. In both *Alcoa* and *Stanley Works* little disparity existed between the products of the merged firms[12] and hence the market share figures of 1.3% and 1% accurately measured the competitive confrontation between the firms that might be diminished by the merger. Heublein and United, however, sell markedly different products, and thus Heublein's market share of .79% may well overstate the actual competition between them.[13]

In 1968 United produced and marketed a wide range of wines, primarily under the Italian Swiss Colony, Petri and Inglenook brands. I.D.F. 160, 190. Heublein had three principal wine products:

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[11] The Heublein-United percentages arguably fall outside even that "gray area at the edge of potential illegality" *The Pillsbury Co.*, 93 F.T.C. 966, 1039 (1979) under the Department of Justice guidelines for horizontal mergers. In a market with a four firm concentration under 75%, the guidelines suggest that an acquisition by a firm with 15-20% of the market is suspect when the acquired firm has at least 2-3%. Department of Justice, Merger Guidelines, ¶ 6 (1968), 1 Trade Reg. Rep. ¶ 4510 at 6884 (1971).

[12] In *Alcoa* the relevant market was defined as bare and insulated aluminum conductor, a product "designed almost exclusively for use by electric utilities in carrying electric power from generating plants to consumers." 377 U.S. at 273. The Court described no significant product variations among producers. In *Stanley Works*, the relevant market was stipulated by the parties as all residential and institutional cabinet hardware. 469 at 500. Although Judge Mansfield's dissent argued that an analysis of product variations reduced Stanley's 1% market share to an actual competitive overlap of .35%, the majority rejected the argument. 469 F.2d at 506.

[13] *See SKF Industries, Inc.*,[1976-79] Trade Reg. Rep. (CCH) (FTC Complaints and Orders) ¶21,595 (1979) [94 F.T.C. 6]; *Kaiser Aluminum & Chemical Corp.*, 93 F.T.C. 764 (1979); *United States* v. *Federal Company*, 403 F. Supp. 161 (W.D. Tenn. 1975).

vermouth, produced by Heublein in the United States, I.D.F. 11; Lancers, a carbonated rose produced by Rose Marie da Fonseca Sucrs. in Portugal, and solely distributed by Heublein in the United States; and Harveys Bristol Cream, a cream sherry produced by John Harvey & Sons, Ltd. in England, and also solely distributed by Heublein in the United States. [9]

Both Harveys Bristol Cream and Lancers stood high on the scale of prices in the wine industry. United's Inglenook line also commanded premium prices, but the vast majority of United's wines sold at the lower end of that scale.[14] Wine prices offer a rough guide to consumers' estimates of quality, and thus crudely delineate the areas of most intense competition for any wine along the broad spectrum of price and quality in the wine market. Most wine producers, as we noted in *Coca Cola Bottling Co.*, view "the bulk of their competition as coming from similar type wines within a narrow price range." 93 F.T.C. at 203–4. The record in this case, confirming that conclusion, reveals that the most intense competition for Heublein's premium priced Lancers and Harveys brands did not come from United's low price wines. To be sure, Harveys Bristol Cream and United's less expensive ports and sherries do compete: all are dessert wines, offering similar tastes and uses. *See* CX 63, 65, 97k; Tr. 2863–66, 2876. But the record reveals quite clearly that Harveys had achieved a unique position in the market. Heublein promoted it—and consumers apparently accepted it—as a prestigious wine especially suited for gifts and special occasions, *see* I.D.F. 34; Tr. 2082, 3801–02, 8737; CX 97 Z–17, 98B, 99G, J, K, and other wine producers considered that less expensive dessert wines provided no substantial competition. *See* Tr. 1868, 4245–46, 7218, 7316, 7512–16, 8744. Lancers occupied a somewhat similar position. Though it competed to some extent with all table and sparkling wines, Heublein had also marketed it, with apparent success, as a prestigious wine, *see* Tr. 8704; CX 107, 116B, C, Q, 120A, 125E, Z–25, Z–42, and Heublein, and other wine producers, believed that most lower priced wines offered little significant competition. *See* Tr. 465–6, 522–23, 2081–82, 7316–17; CX 129B, 352D.

The competitive distance between Heublein and United is less striking than that between Mogen David and Franzia described in *Coca Cola Bottling Co.*, 93 F.T.C. at 199. Nonetheless, our conclusions in that decision are still relevant here. To the extent that the wines of Heublein and United compete in separate segments of the broad

[14] Heublein's Harveys Bristol Cream sold for approximately $6.75 per fifth in 1968, CX 97M, and Lancers, $3.75. Tr. 8702–03. By comparison Italian Swiss Colony's burgundy, chablis and rose sold for approximately $.85 per fifth in 1968. RX 1255. Although Inglenook's brand Inglenook Estates sold its cabernet, pinot noir and chardonnay for approximately $3.50–$3.95, RX 1255, all of Inglenook's brands accounted for only .6% of all United's 1968 sales, and .1% of the all wine market. CX 227, 373.

all wine market, there is less "likelihood that this merger will increase opportunities for interdependent behavior on the selling side." 93 F.T.C. at 207. These observations are [10]not dispositive here, as they were in *Coca Cola Bottling Co.,* but they do indicate that Heublein's very low market share of .79% nevertheless may overstate the competitive overlap with United.[15]

Moreover, complaint counsel failed to prove that Heublein had special competitive potential such that its small market share understated its possible future competitive significance. In *Alcoa* the Supreme Court explained that Rome Cable's 1.3% market share did not fully reflect its competitive potential. Rome had competed aggressively, pioneered in research and sales, and developed special aptitudes and skills in the relevant product line. Complaint counsel did not establish that Heublein had comparable competitive significance in the wine market. It is true that Heublein was highly successful in product marketing. But it would distort *Alcoa's* definition of the special small competitor to make advertising or marketing, except in special circumstances not present here, a distinguishing characteristic. Heublein was not an innovative competitor. Its initial success came from sales of its principal product, Smirnoff vodka.[16] Most of its product diversification had resulted from acquisitions and distribution agreements, not research and development.[17] In the wine industry itself, Heublein had little significant aptitude, skill, or research potential at the time of the merger; its principal products, Lancers and Harveys, were imported from [11]foreign manufacturers.[18] Nor was Heublein an aggressive price competitor. Whatever competitive potential Heublein did possess was in no way unique; numerous other firms with a small

[15] We are careful, however, not to place too much reliance on the positioning of merged firms' products within a single market, or else the notion of a "market" could be eroded. We note the limited head-on competition between United and Heublein at the time of the merger only to assist us in assessing complaint counsel's contention that Heublein's .79% market share in reality understated the competitive significance of Heublein.

[16] In 1961, vodka sales accounted for approximately 75% of Heublein's gross sales. Tr. 3986–87. From 1963 to 1968, its sales of Smirnoff increased 43%. I.D.F. 47.

[17] Although Heublein had developed some successful premixed cocktails, based on work beginning at the turn of the century, *see* I.D.F. 51–53, its recent entry into new product lines had been accomplished by merger and agency agreements. Its list of acquisitions included: Arrow Liquers Corporation in 1965, a distributor of scotch, whiskeys, and brandies, I.D.F. 64; Vintage Wines in 1965, a distributor of foreign wines and spirits, I.D.F. 65; Theo Hamm Brewing Co. in 1965, I.D.F. 66; Don Q Imports in 1968, a rum distributor, I.D.F. 71; and Beaulieau Vinyards in 1969, I.D.F. 78.

The list of distribution agreements included: a 1966 agreement granting exclusive U.S. distribution rights for Bertani Italian Wines, I.D.F. 67; a 1966 agreement granting exclusive U.S. distribution rights for José Cuervo tequila, I.D.F. 69; a 1967 agreement granting exclusive U.S. distribution rights for Chateau St. George wines of France, I.D.F. 70; a 1968 agreement granting exclusive U.S. distribution rights for Black Velvet Canadian Whiskey, I.D.F. 75; and a 1968 agreement granting exclusive U.S. distribution rights for Kiku-Masamune Sake, Japan's leading sake. I.D.F. 76.

[18] *See* discussion p. 8, *supra.*

share of the market could be considered equally important future competitive factors.[19]

Finally, we note that the evidence of market concentration trends does not significantly increase the likelihood of adverse competitive effects from this acquisition by a firm with a market share of less than 1%. A trend toward concentration did emerge after the acquisition. The market share of the top four firms increased from 47.9% in 1968 to 56.7% in 1971. I.D.F. 447. But that figure has fallen thereafter. The unavailability of some import data for the years after 1972 makes impossible any precise calculation of the decrease. I.D.F. 489. We will assume, for the sake of argument, the accuracy of the smaller estimate of that decline proposed by Complaint Counsel, placing four firm concentration at 54.2% in 1976. CAB 16. This data does not describe a particularly strong trend toward concentration, *see, e.g., United States* v. *Philadelphia National Bank,* 374 U.S. 321 (1963) (increase of market share of top seven firms from 61% to 90%), and, in light of the decline in recent years, it is insufficient to elevate to the level of a violation the increase in concentration resulting from this merger.[20] [12]

We conclude, after consideration of these conventional elements of horizontal merger theory, that the increase in concentration resulting from this merger is not likely to produce significant anticompetitive effects, and thus does not constitute a traditional horizontal violation of Section 7. It has been urged, however, that Heublein's .79% market share understated its competitive significance because Heublein's active consideration of other acquisitions at the time it acquired United makes it a unique potential deconcentrator of the market, and also because Heublein's strength as a liquor distributor, the popularity of its products, its access to financing, and its large advertising expenditures, adds more to United than Heublein's market share indicates. Consideration of "conglomerate" aspects—here, the possibility of Heublein's expansion by toe-hold acquisitions, and the possibility of some entrenchment of United's market position—can be useful in the analysis of horizontal mergers involving small market shares. *See Stanley Works* v. *FTC,* 469 F.2d 498 (2d Cir. 1972); *United States* v. *Wilson Sporting Goods Co.,* 288 F. Supp. 543 (N.D. Ill. 1968). But the possibility of entrenchment or a lessening of potential competition cannot be deemed significant—

[19] *See* discussion pp. 21–23, *infra.*

[20] *Cf.* Department of Justice Merger Guidelines, ¶ 7 (1968) 1 Trade Reg. Rep. (CCH) ¶ 4510 at 6884 (1971) (suggesting that acquisition of firm with 2% of market will be challenged if eight-firm concentration has increased by 7% in 5–10 year period); Sullivan, *supra* note 10, at 622 ("If, all things considered, the merger does not alone or with other factors pose a threat of excessive concentration, the mere fact that in the recent past concentration increased due to internal growth ought not to be enough to invalidate the merger.")

whether under consideration as an independent basis of violation, or as an aggravating factor in a horizontal violation—without some consideration of the settled qualifications on conglomerate merger enforcement developed by the Supreme Court. Those qualifications, after all, are not arbitrary but are tools to evaluate whether the likelihood of anticompetitive effect is significant. Since the ALJ found that this merger violated Section 7 under both entrenchment and actual potential competition theories, we will evaluate those claims on their own, before considering their significance when coupled with a horizontal theory.[21]

IV. THE ACTUAL POTENTIAL COMPETITION ASPECTS

A potential entrant's acquisition of a leading firm in a concentrated market may violate Section 7 if it is likely that the potential entrant, but for the acquisition, would have entered the market independently or by the acquisition of a smaller competitor in that market. Any such merger may lessen competition by eliminating the substantial increased [13]deconcentration or other procompetitive benefits likely to result from the presence of a new, or a newly reinvigorated competitor in the market.[22]

A potential *expander,* with only a minimal share of a concentrated market, may also violate Section 7 by acquiring a leading firm in that market if it is likely that the potential expander would otherwise have attempted to increase its market share by building new capacity or acquiring a smaller competitor. The merger lessens competition much as if the potential expander were a potential entrant not yet in the market.[23] The ALJ found that Heublein's

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[21] *See* discussion pp. 23 & 26, *infra.*

[22] The Supreme Court has expressly reserved approval of the actual potential competition doctrine. *See United States* v. *Marine Bancorporation,* 418 U.S. 602, 625 (1974); *United States* v. *Falstaff Brewing Corp.,* 410 U.S. 526, 537 (1973). But as we noted in *Brunswick Corp.*,[1979] 3 Trade Reg. Rep. (CCH) (FTC Complaints and Orders) ¶ 21,623, "the Commission, together with numerous federal courts, has endorsed the doctrine and we are confident that it eventually will receive the Supreme Court's approval." [1979] 3 Trade Reg. Rep. (CCH) (FTC Complaints and Orders) ¶ 21,623 at 21,782, [94 F.T.C. 1174 at 1267].

[23] As the Commission observed in *The Bendix Corp.,* 77 F.T.C. 731 (1970) *reversed and remanded on other grounds,* 450 F.2d 534 (6th Cir. 1971), in holding that Section 7 is violated by the elimination of potential entry by toehold acquisition as well as by internal expansion, the "form of entry" eliminated was not determinative; "what was determinative . . . [was] the actual elimination of the additional decision-making, the added capacity, and the other market stimuli which would have resulted had entry taken a procompetitive form." 77 F.T.C. at 817. If the potential expander would have built new capacity or acquired a smaller competitor, the acquisition of a market leader arguably adversely affects competition in much the same manner. While Bendix is often cited as a potential competition decision, it is less commonly noted that Bendix already had a small .35% share of the automotive filter market before its acquisition of Fram Corporation. 77 F.T.C. at 809.

acquisition of United lessened potential competition by eliminating the possibility of any such pro-competitive expansion.[24] [14]

Under the analysis outlined by the Supreme Court in *United States* v. *Marine Bancorporation*, 418 U.S. 602 (1974), and elaborated in subsequent decisions in the Courts of Appeals, approval of the ALJ's conclusion requires findings that (i) the all wine market was substantially concentrated, (ii) Heublein had the capacity, interest and economic incentive to expand, (iii) its expansion offered a substantial likelihood of producing deconcentration or other significant pro-competitive effects,[25] and (iv) that Heublein was one of the few most likely entrants or expanders and that its elimination as a result of the merger would be reasonably probable to substantially lessen competition. While close questions arise on several counts, we conclude that the record would adequately support the first three of these findings. But the record also plainly shows that Heublein was but one among an unusually large number of potential entrants and expanders. Under those circumstances, as we will discuss more fully below, we do not believe that the elimination of Heublein's potential for deconcentration would be likely to *substantially* lessen competition. Before reaching this issue, however, we will first review the evidence bearing upon the concentration of the market, the likelihood of Heublein's expanding by alternative means, and the probable effects of such expansion.

A. Likelihood of Entry and Prospects for Deconcentration

The preservation of potential competition is only important when the relevant market is concentrated.[26] Concentration ratios may be used to establish a prima facie case that the relevant market is sufficiently non-competitive to warrant the application of the actual potential entrant doctrine and the burden then falls upon the party defending the merger to show that those ratios "did not accurately depict the economic characteristics" of the market.[27] The all wine market's four firm ratio of 47.9% arguably falls at the edge of a reasonable definition of those markets where the loss through

[24] Complaint Counsel have not argued, and the ALJ did not find, that the possibility of Heublein's expansion exerted any disciplining effect upon the pricing decisions of competitors in the all wine market. Thus this case does not involve the perceived potential entry doctrine. *See, e.g., United States* v. *Falstaff Brewing Corp.*, 410 U.S. 526 (1973); Sullivan, *supra* note 10, at 633-638.

[25] *Brunswick Corp.*[1979] 3 Trade Reg. Rep. (CCH) (FTC Complaints and Orders) ¶ 21,623 [94 F.T.C. 1174]. There is some authority, as well, that Heublein's expansion must be shown to have been likely to occur in the reasonably near future. *See BOC International. Ltd.* v. *F.T.C.*, 557 F.2d 24, 29 (2d Cir. 1977). *See also United States* v. *Siemens Corp.*,[1980] 5 Trade Reg. Rep. (CCH) ¶ 63,287 (2d Cir. 1980).

[26] *United States* v. *Marine Bancorporation*, 418 U.S. 602, 631 (1974). *See* Turner, Conglomerate Mergers & Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1382 (1965).

[27] *United States* v. *Marine Bancorporation*, 418 U.S. 602, 631 (1974).

merger of a potential entrant may [15]substantially lessen future competition.[28] In light of the high two firm ratio of 41.9%, we find that the actual potential entrant doctrine applies here. Respondent has offered no convincing evidence to the contrary.

We believe the record also supports the finding that it was reasonably probable that Heublein would have acquired a smaller competitor in the all wine market if the acquisition of United had not been possible.[29] In the years prior to the purchase of United, Heublein, primarily a marketer of vodka, had used acquisitions to enter the scotch, whiskey, brandy, beer and rum markets.[30] Strong economic incentives [16]encouraged the continuation of this pattern of growth into the wine market. That market was the only remaining major alcoholic beverage product market where Heublein did not fully participate.[31] The market's recent rapid growth, I.D.F. 1, 2, promised a profitable future, a promise made all the more tangible by the success Heublein had found possible with the two major wines it already sold.[32] Heublein's history of diversification into various alcoholic beverage markets suggests that wine was "a natural avenue of diversification"[33] for a company with Heublein's products and experience. Wine was distributed through the same channels as Heublein's other products, advertised and marketed in

[28] In *United States* v. *Marine Bancorporation*, 418 U.S. 602 (1974), three firm concentration was 92%, considerably higher than here. The Commission and lower federal courts have found lower concentration ratios sufficient to apply the potential competition doctrine, *see, e.g., The Bendix Corp.*, 77 F.T.C. 731 (1970), *reversed and remanded on other grounds*, 450 F.2d 534 (6th Cir. 1971) (4 firm concentration at 80.8%); *United States* v. *Black & Decker Mfg. Co.*, 430 F. Supp. 729 (D. Md. 1976) (4 firm concentration at 77.5%); *United States* v. *Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968) (4 firm concentration at 63%), and most decisions appear to have assumed that the lower boundary is near 50%. *See, e.g., United States* v. *Hughes Tool Co.*, 415 F. Supp. 637 (C.D. Cal. 1976) (4 firm concentration at 34% not sufficient); *United States* v. *Phillips Petroleum Co.*, 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd*, 418 U.S. 906 (1974) (4 firm concentration at 58% is sufficient); *United States* v. *Falstaff Brewing Corp.*, 383 F. Supp. 1020 (D.R.I. 1974) (on remand from Supreme Court, 4 firm concentration at 50% not sufficient). *See generally* Fox, Toehold Acquisitions, Potential Toehold Acquisitions, and Section 7 of the Clayton Act, 42 Antitrust L.J. 573 (1973) (60% is presumptively sufficient); V P. Areeda & D. Turner, *Antitrust Law* ¶ 1119 at 80 (1980) (55% is "ambiguous," must consider "other structural characteristics").

The market concentration here also falls just beyond the borders of the Department of Justice Merger Guidelines. *See* Department of Justice, Merger Guidelines, ¶ 18 (1968), 1 Trade Reg. Rep. ¶ 4510 at 6888 (1971).

[29] Although the ALJ also found that it was likely that Heublein would expand its share of the market through *de novo* construction if the acquisition of United were not possible, we find no evidence in the record to support this conclusion.

[30] *See* note 17, *supra*.

[31] *Cf. Brunswick Corporation*,[1979] 3 Trade Reg. Rep. (CCH) (FTC Complaints and Orders) ¶ 21,623 [94 F.T.C. 1174] (Yamaha's entry into U.S. outboard motor market found to be likely in part because it "was practically the only significant part of the world in which Yamaha was not selling substantial numbers of outboards at all").

[32] From 1963 until 1968, sales of Lancers had increased 294%, and Harveys Bristol Cream, 84%. I.D.F. 787.

[33] *FTC* v. *Procter & Gamble Co.*, 386 U.S. 568, 580 (1967). *Cf. The Bendix Corp.*, 77 F.T.C. 731, 815 (1970), *reversed and remanded on other grounds*, 450 F.2d 534 (6th Cir. 1971). ("the whole logic of Bendix's corporate development. . . and the unambiguous direction of its business growth, all pointed to expansion" into the relevant market).

the same manner, and called for management expertise not unlike Heublein's experience with similar products.[34]

There is also evidence that Heublein, recognizing these economic incentives, had a significant interest in expanding in the wine market. Heublein's acquisition of United is, of course, some evidence of Heublein's interest in the market. But that evidence is of little use in predicting whether Heublein would have purchased a smaller competitor if the United acquisition could not occur. More relevant is the evidence of Heublein's interest, throughout the years preceding the United acquisition, in wine companies having a significantly smaller market share than United. Few corporate policy documents trace this interest, but such evidence should not be necessary where, as here, there is objective evidence that a toehold acquisition or *de novo* [17]expansion would have been likely. Here, in fact, the record evidence of discussions and negotiations with possible acquisition candidates reveals significant interest in the relevant market.

During the late 1960's, the period of Heublein's diversification into numerous alcoholic beverage markets, Heublein also acquired or attempted to acquire several small wine companies. In 1965, three years before the United acquisition, Heublein expressed an interest in acquisition to both the Taylor Wine Co. and Almaden Vineyards, but neither was then available. CX 165–69, 139–42. When Almaden did become available in 1967, Heublein made an unsuccessful bid. CX 144–47. These attempts to enter the market prior to the acquisition of United provide persuasive evidence of Heublein's interest in the market.[35] Heublein had not adopted a policy of "gathering information and watchful waiting,"[36] but rather was actively seeking acquisitions. This evidence also rebuts Respondents' claim that any firm with a smaller market share than United would not have been an acceptable acquisition candidate. Such declarations of an intention to acquire only a market leader, whether drawn from corporate documents or elicited from management at trial, are not highly probative in an actual potential competition case. They offer little help in answering the central question—whether the Respondent would have entered the market by alternative means if the challenged acquisition were prohibited.[37] In this case, Heublein's

[34] *Cf. FTC* v. *Procter & Gamble Co.*, 386 U.S. 568, 580 (1967) (entry into bleach market likely because bleach "is complementary to Proctor's products, is sold to the same customers through the same channels, and is advertised and merchandized in the same manner").

[35] *See, e.g., Brunswick Corporation.*[1979] 3 Trade Reg. Rep. (CCH) (FTC Complaints and Orders) ¶ 21,623 [94 F.T.C. 1174]; *The Bendix Corp.*, 77 F.T.C. 731 (1970), *reversed and remanded on other grounds*, 450 F.2d 534 (6th Cir. 1971) (talks with acquisition candidates persuasive evidence, even though no offers made).

[36] *F.T.C.* v. *Atlantic Richfield Co.*, 549 F.2d 289, 297 (4th Cir. 1977).

[37] *See, e.g., United States* v. *Falstaff Brewing Corp.*, 410 U.S. 526, 575 (1973) (Marshall concurring); *British Oxygen Co., Ltd.*, 86 F.T.C. 1241, 1359 (1977), *reversed and remanded on other grounds*, 557 F.2d 24 (2d Cir. 1977).

unsuccessful overtures to Taylor and Almanden, and even the purchases of Vintage Wines and the Lancers trademark in 1965, show that Heublein was interested in smaller acquisition candidates. The record shows that in 1967 Taylor accounted for 2.8% and Almaden 2.0%, while Vintage would have accounted for approximately .53% of the all wine market. [18]

The record also shows that Heublein had the financial capacity to acquire a smaller wine company, that smaller companies were available, and that such an acquisition offered a feasible means of expanding Heublein's market share. Financial resources would have posed no obstacle to the acquisition of a smaller firm. Heublein ranked among the largest and most profitable companies in the nation.[38] And some of the same factors that provided an economic incentive for the United acquisition—Heublein's experience in the marketing and distribution of other alcohol products, for example—also support the conclusion that it would have been within Heublein's capacity to acquire and successfully run a small wine company.[39]

The record indicates that such smaller candidates were available at the time of the United acquisition, or shortly thereafter. Aside from Gallo and United, the largest firms in the market, the other leading firms each possessed approximately 2% of the market in 1968, clearly a sufficiently small share to qualify as a toehold acquisition.[40] Of this group, one firm, Guild Wineries and Distilleries, accounting for 2.1% of the market in 1968, was available at the time of the United acquisition. Guild approached Heublein with the suggestion of a merger a few months after Heublein learned of United's availability, but Heublein preferred to pursue the United deal. Tr. 4477, 4494, 4512–13.[41] [19]Two other firms in this group became available soon after the United acquisition. Roma, a firm with approximately 2% of the market in 1968 was acquired in 1971, and Franzia Brothers Inc. with 2.2% was acquired in 1973. Of the many smaller firms outside the top ten, several were available at the time of the United acquisition and several others soon thereafter.

[38] In 1967 Heublein stood 346th in the "Fortune 500" ranking of firms by sales and 76th by growth in earnings per share. In 1968 it ranked 5th by five year average profitability. I.D.F. 13–14. *Cf. United States* v. *Phillips Petroleum Company*, 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd*, 418 U.S. 906 (1974).

[39] *See The Bendix Corp.*, 77 F.T.C. 731, 823 (1970), *reversed and remanded on other grounds*, 450 F.2d 534 (6th Cir. 1971).

[40] *See, e.g., Missouri Portland Cement Co.* v. *Cargill, Incorporated*, 498 F.2d 851 (2d Cir.), *cert. denied*, 419 U.S. 883 (1974) (firm with 10% too large to be a toehold); *United States* v. *Black & Decker Mfg. Co.*, 430 F. Supp. 729, 767–68 (D. Md. 1976); Turner, *supra* note 26, at 1367–70.

[41] Mogen David Wine Corp., accounting for 2.5% of the market also approached Heublein with a merger proposal during this period, and Heublein again decided not to pursue the possibility. CX 197–203. But given the uniqueness of Mogen David's products, *see Coca Cola Bottling Co. of New York, Inc.*, 93 F.T.C. 110 (1979), it may have offered a less viable base for expansion in the all wine market.

San Martin Winery with approximately .21% of the market in 1967 approached Heublein with a proposal for merger in 1968, but Heublein preferred to pursue the United acquisition. CX 185-90, 373. Beaulieu Vineyard, with approximately .14% of the market in 1969, was actually acquired by Heublein a few months after United. I.D.F. 78; CX 373. During the four years following the United acquisition, a total of fifteen small firms became available and were acquired by companies other than Heublein. CX 299.

While it is true that none of these firms offered the substantial market share of United, the record offers persuasive evidence that the market share of a smaller firm could be expanded by an acquiring company and thereby contribute to deconcentration. After its acquisition of Almaden in 1967, National Distillers & Chemical Corp. was able to triple Almaden's sales by 1972; its market share doubled, increasing from 2.0% to 3.9%. CX 373. Heublein itself was able to increase Inglenook's sales over five fold during that same period. CX 227. This is persuasive evidence that the acquisition and expansion of one or more small wineries offered a viable alternative route for Heublein.[42] It also indicates that Heublein's acquisition of a smaller firm, instead of United, offered a substantial likelihood of ultimately producing some deconcentration and increased competition.[43]

B. Was There a Probability of a Substantial Lessening of Competition?

Assuming Heublein had the capacity, interest, and economic incentive to expand by acquisition of a smaller competitor, and that such acquisition would have produced pro-competitive effects in a concentrated market, it still does not follow that the acquisition of United would constitute a violation. Section 7 is concerned with the probability [20]of a substantial lessening of competition, and the elimination of a potential entrant or expander leads to a substantial anticompetitive effect only when there is a limited number of other firms reasonably likely to enter or expand in the relevant market.

The reason we are concerned about the size of the universe of entrants goes back to first principles about protection of potential competition. Essentially, we are concerned about the possibility that active competitors in a market, by agreement or tacit collusion, will raise price, diminish product quality, or otherwise fail to respond

[42] *See United States* v. *Phillips Petroleum Co.*, 367 F. Supp. 1226, 1247 (C.D. Cal. 1973), *cert. denied*, 418 U.S. 906 (1974) (relying upon similar evidence to show feasibility of toehold acquisitions).

[43] *See BOC International, Ltd.* v. *F.T.C.*, 557 F.2d 23, 27 (2d Cir. 1977); Fox, *supra* note 28, at 581 (both suggesting that this branch of the *Marine Bancorporation* test requires no elaborate factual proof).

independently to competitive pressures. If any of these things occurred, there would be an incentive for potential competitors to enter or expand in the imperfectly competitive market, and Section 7 is enforced to assure that any such potential competition is not removed by merger. But if there are many other firms roughly as capable and qualified as the party to the merger, and sharing similar incentives to expand from existing toeholds or to enter *de novo,* elimination of any single company as a potential deconcentrator normally will have no significant anticompetitive effect.[44]

Under this analysis, Heublein's elimination is insignificant in competitive terms because the record demonstrates the existence of an unusually large number of strong companies who either made toehold acquisitions or were willing and able to do so at about the time Heublein acquired United.

Two preliminary points warrant consideration here. First, in weighing the evidence on this issue, we place the burden of persuasion upon Complaint Counsel.[45] Since a merger eliminating a potential deconcentrator is anticompetitive only when the universe of other potential deconcentrators [21]is limited, proof of the point belongs upon the party challenging the merger. It would be impractical, however, to require Complaint Counsel to bear the burden of coming forward as well. Proving the negative of this proposition—proving, in other words, that no or only a few other firms were likely potential deconcentrators—would be too burdensome a requirement to be an element of the prima facie case. So we place upon the party defending the merger the initial responsibility of coming forward with evidence that a group of plausibly qualified potential deconcentrators exists. That burden is not discharged simply by naming a long list of companies who might have entered and then leaving it to the plaintiff to disprove the likelihood of entry with respect to each. Rather, the party defending the merger must be able to point to objective factors indicating that the designated firms will likely be willing and able to enter or expand if the market becomes less competitive. Once that has been done, the issue is raised and Complaint Counsel bear the burden of persuading that the universe of potential deconcentrators is limited.

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[44] *See, e.g., F.T.C.* v. *Atlantic Richfield Co.*, 549 F.2d 289, 300 (4th Cir. 1977); *Missouri Portland Cement Co.* v. *Cargill, Incorporated,* 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974); *United States* v. *Crowell Collier & Macmillan, Inc.*, 361 F. Supp. 983 (S.D.N.Y. 1973); Turner, *supra* note 26, at 1382 (if other potential entrants numerous, loss of one insignificant under an actual potential competition theory); *cf. FTC* v. *Procter & Gamble Co.*, 386 U.S. 568 (1967); *Beatrice Foods Company,* 86 F.T.C. 1, 63 (1975), *aff'd,* 540 F.2d 303 (7th Cir. 1976); *United States* v. *Hughes Tool Co.*, 415 F. Supp. 637 (C.D. Cal. 1976) (if other potential entrants numerous, loss of one insignificant under perceived potential competition theory).

[45] On this question of distribution of burdens of proof we follow the suggested approach in V P. Areeda & D. Turner, *supra* note 28, ¶ 1123a at 124-5. *See generally* James, Jr., Burdens of Proof, 47 Va. L. Rev. 51 (1961).

A second preliminary point concerns the definition of factors indicating the likelihood of entry by other outside firms. The membership of the group of other potential deconcentrators should be defined by similar criteria and kinds of evidence as are used to find that the firm at issue was likely to enter or expand. Less certainty of proof should be required with respect to these other firms, however, because the record usually will disclose far less about them than about the parties to the merger at issue.

Firms selling similar products as the firm at issue, and standing in a similar relation to the relevant market—in this case, firms already holding a toehold position in the wine market—would be the most obvious potential expanders.[46] The record here shows that nine major firms selling liquor also had a small share of the wine market at the time of the United acquisition: (1) Joseph E. Seagram & Sons, Inc. (2.5% of the all wine market); (2) National Distillers & Chemical Co. (2.3% of the all wine market); (3) Brown-Forman Distillers Corp. (2.9% of the table wine market); (4) Schieffelin & Co. (.69% of the table wine market); (5) Renfield Importers, Ltd. (.95% of the all wine market); (6) Foremost-McKesson, Inc. (percentage not available); (7) Liggett & Myers, Inc. (.24% of the table wine market); (8) Schenley Industries (2.9% of the all wine market); [22]and (9) Hiram Walker, Gooderham & Warts, Ltd. (percentage not available). All of these firms are of substantial size and likely to have had the same incentive as Heublein to expand their share of the wine market. Although some were financially smaller than Heublein, that does not necessarily make them less likely to expand; all were of substantial size and the capital markets are available to fund potentially profitable ventures.[47]

This list of potential deconcentrators is already formidable, but its criteria are nonetheless probably too narrow. We see little reason for limiting the group of potential entrants to other alcoholic beverage companies with experience in the wine market, since any acquirer could probably count on the acquired company to supply whatever "experience" would be needed. There is thus little basis for arguing that a firm competing in the liquor or beer market and interested in the wine market, but lacking experience there, is significantly less likely to acquire a wine company than a liquor or beer firm already competing in the wine market. A more reasonable definition of the universe of potential entrants in this case may therefore also include liquor or beer companies outside, but with some interest in, the wine

[46] *See generally* Sullivan, *supra* note 10 at 634; V P. Areeda & D. Turner, *supra* note 28, ¶ 1123 at 124-34; Brodley, Potential Competition Mergers, 87 Yale L.J. 1,75-77 (1977).

[47] V P. Areeda & D. Turner, *supra* note 28, ¶ 1123 at 137.

market. The record shows that at least five liquor or beer companies actually entered the wine market by toehold acquisition shortly after 1968: (1) Glenmore Distillers Company; (2) Joseph Schlitz Brewing Company; (3) Scottish & Newcastle Brewers, Ltd.; (4) Northwest Distillers; and (5) Norton Simon, Inc. Since these firms did enter shortly after 1968, it is highly likely they had the capacity, interest and economic incentive to do so at the time Heublein was removed from the list of potential entrants. The number of such firms who did not actually enter, but could have been similarly characterized as likely to enter, is probably larger.

This logic carries further. In this case there is little rational basis for limiting the list of potential deconcentrators to firms with experience in the liquor or beer markets. Seven large firms with experience in neither market actually entered the wine market by acquisition shortly after 1968: (1) Coca Cola Inc.; (2) The Nestle Company; (3) Standard Brands; (4) Pillsbury Company; (5) Pepsico, Inc.; (6) Beatrice Foods Company; and (7) United States Tobacco Co. [23]

We emphasize that this list of potential entrants is made up of companies who either actually held a toehold position in the wine market at the time of Heublein's acquisition of United or entered that market shortly after the merger. This is not just a speculative list of potential candidates with some uncertain capacity and interest—a situation in which we would be much less likely to assume companies were part of the potential competition universe.

We need not now define the minimum number of other potential entrants that makes the loss of one an insignificant lessening of competition. The number present here is overwhelming—substantially greater than any definition that has emerged in the cases or the literature.[48] There were a total of at least 21 companies with capacity, interest and economic incentive comparable to Heublein's to enter or expand in the wine business who either were already in the product market on a toehold basis at the time Heublein acquired United, or who entered shortly before or after that acquisition. Looking at this group, we are unable to conclude that Heublein's acquisition of United would have been likely to substantially lessen competition.[49] That conclusion is buttressed by the fact that the wine market was only moderately concentrated and was rapidly expand-

[48] *See, e.g., United States* v. *Hughes Tool Company,* 415 F. Supp. 637 (C.D. Cal. 1976) (6 other potential entrants made loss of one insignificant); V P. Areeda & D. Turner, *supra* note 28, ¶ 1123 at 123-4 (1980) ("a universe exceeding three similarly well-qualified potential entrants should be presumptively sufficient to obviate concern" and "a universe of six entrants removes any plausible basis").

[49] *See, e.g., F.T.C.* v. *Atlantic Richfield Co.,* 549 F. 2d 289, 300 (4th Cir. 1977); *Missouri Portland Cement Co.* v. *Cargill, Incorporated,* 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974); *United States* v. *Crowell Collier & Macmillan, Inc.,* 361 F. Supp. 983 (S.D.N.Y. 1973).

ing. We hold, therefore, that the ALJ erred in finding a violation of Section 7 on the actual potential competition theory.

In the light of the evidence described above, it is also impossible to conclude that a horizontal violation exists on the theory that Heublein was considering acquisition of smaller companies than United, and that the possibility of toehold expansion makes it a more significant competitor than its small market would otherwise suggest. Standing as one among this large group of other firms also likely to enter or expand, Heublein is simply not a unique competitor, and the loss of its potential for deconcentrating the market is not significant. [24]

V. THE ENTRENCHMENT ASPECTS

Entrenchment analysis considers the possible anticompetitive advantages that a large acquiring firm can confer on an acquired firm over competitors in the acquired firm's market. Although *FTC v. Procter & Gamble Co.,* 386 U.S. 568 (1967), the seminal decision, examined only the adverse competitive effects of substantial advertising and promotional advantages bestowed upon a dominant firm in a concentrated market, the logic of the Court's analysis extends further. Arguably any substantial competitive advantage resulting from the acquiring firm's size disparity or resources may cause a merger to violate Section 7—whether the acquired firm is dominant or not—if that advantage "may substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing."[50]

The ALJ was correct, therefore, in concluding that this acquisition might violate Section 7 on an entrenchment theory even though United was not the dominant firm in the market. Adverse competitive effects conceivably could result from any significant competitive advantage gained by United even if United were not the market leader. Of course, if the acquired company is small and weak in its own market, the advantages obtained by the merger may strengthen it and probably enhance competition.

The ALJ found that the acquisition entrenched United, and thus violated Section 7, because Heublein conferred on United three significant competitive advantages: (1) the ability to obtain substantial, inexpensive financing; (2) the ability to participate in a large advertising and merchandising budget, with its attendant efficiencies; and (3) the possible leverage that Heublein's popular Smirnoff

[50] *FTC* v. *Procter & Gamble Co.*, 386 U.S. 568, 578 (1967). *See* Sullivan, *supra* note 10, at 656. ("It is the effect of renchment, not the particular mechanism, which is central to the *Clorox* analysis.")

vodka and other liquor products might provide to increase wine distribution and sales, either through explicit or more subtle forms of tying. Barriers to entry would therefore be raised and smaller competitors disadvantaged, the ALJ ruled. Despite recent criticism of entrenchment theories based upon such competitive effects,[51] ample precedent still holds [25]that a violation of Section 7 may be predicated upon them.[52] The ALJ was also correct, therefore, in concluding that these kinds of competitive advantages deserved careful scrutiny.

But a violation is not made out simply by arguing that an acquisition might conceivably confer some competitive advantage. Adverse competitive effects cannot be assumed; the record must prove the competitive advantage to be both reasonably likely and significant and, as a result, that competition would probably be adversely affected. Indeed, because adverse competitive effects from "entrenchment" can be rather elusive, it is particularly important that a factual basis be carefully constructed.[53] Highly relevant here would be evidence demonstrating the magnitude of the acquiring company's competitive strengths, the impact of those strengths in the market of the acquired firm, and the inability of the other firms in that market to match those strengths or otherwise compete effectively.[54] Since the record in this case does not show that any advantages conferred on United as a result of the merger would be likely to have a significant competitive effect, we hold that the ALJ incorrectly concluded that the acquisition "entrenched" United and thus violated Section 7. **[26]**

In light of these findings, it is also impossible to conclude that a horizontal violation exists on the theory that Heublein's competitive advantages in the wine market make it a more significant competitor than its small market share would indicate.

[51] *See, e.g., Missouri Portland Cement Co.* v. *Cargill, Incorporated,* 498 F.2d 851, 865 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974) ("more metaphorical than real"); V P. Areeda & D. Turner, *supra* note 28, ¶¶ 1103, 1105, 1109, 1134.

[52] On cheaper capital cost, *see Budd Company,* 86 F.T.C. 518 (1975); *United States* v. *Ingersoll-Rand Co.,* 320 F.2d 509 (3rd Cir. 1963); *United States* v. *International Telephone and Telegraph Corp.,* 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed,* 404 U.S. 801 (1971); on advertising advantages and efficiencies, *see FTC* v. *Procter & Gamble Co.,* 386 U.S. 568 (1967); *General Foods Corporation* v. *F.T.C.,* 386 F.2d 936 (3rd Cir. 1967), *cert. denied,* 391 U.S. 919 (1968); *United States* v. *Black & Decker Mfg. Co.,* 430 F. Supp. 729 (D. Md. 1976); and on the possibility of explicit or subtle leverage, *see Procter & Gamble Co.,* 63 F.T.C. 1465 (1963), *aff'd,* 386 U.S. 568 (1967) (only the Commission decision addressed this point); *United States* v. *Wilson Sporting Goods Co.,* 288 F. Supp. 543 (N.D. Ill. 1968). *Cf. FTC* v. *Consolidated Foods,* 380 U.S. 592 (1965) (merger creating possibility of reciprocal buying may violate Section 7).

[53] *See, e.g., Missouri Portland Cement Co.* v. *Cargill, Incorporated,* 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974); *Carrier Corp.* v. *United Technologies Corp.,* 1978-2 Trade Cas. ¶62,393 (N.D.N.Y.), *aff'd,* 1978-2 Trade Cas. ¶ 62,405 (2d Cir. 1978). *See generally* Turner, *supra* note 26, at 1352-62.

[54] *See, e.g., Sterling Drug, Inc.,* 80 F.T.C. 477 (1971); *Missouri Portland Cement Co.* v. *Cargill, Incorporated,* 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974).

A. Capital Costs

The acquisition did strengthen United's financial position. Heublein provided valuable access to new capital, and helped to arrange and participated in the financing of new production facilities. *See, e.g.,* I.D.F. 62, 63; I.D. 173–4. Heublein directly extended up to $90,000,000 in long term loans. *See, e.g.,* Tr. 2515, 8121–28; CX 555, 562.

The record does not show that at the time of the merger this new access was likely to give United a significant competitive advantage over other firms in the wine market, or that it subsequently did so. Although United did borrow heavily from Heublein, the record does not show that the cost of those loans was significantly cheaper than United had paid before the acquisition.[55] Neither does the record contain evidence that United was able to obtain financing at significantly less cost than its competitors in the wine market.[56]

The evidence does suggest that any "capital cost" advantage was highly unlikely to have existed. Many of United's competitors, as we have already noted, were owned by large distillers and conglomerates, and the financial strength of many equalled or surpassed Heublein's. At the time of the acquisition, three distillers with substantially greater sales and assets than Heublein competed in the wine [27]market: Joseph E. Seagrams & Sons, Inc., National Distillers & Chemical Corp., and Scheneley Industries.[57] And many of the firms that subsequently acquired small wine companies—Coca Cola Bottling Co., Standards Brands, Inc., Norton Simon, Inc., and Beatrice Foods Co., for example—were vast diversified enterprises whose resources dwarfed Heublein's.[58] All of these firms could have matched or surpassed any competitive advantage that Heublein's financial resources offered United. In light of their presence in the

[55] The loans from Heublein actually bore 1/2% higher interest than one of United's two major long term interest bearing loans before the acquisition. The interest rates of the loans from Heublein were set at 1% over the prime rate, CX 562; Tr. 9473; the rate of one of the preacquisition long term loans was 1/2% over the prime rate. CX-555.

[56] The record does contain evidence that in 1975 and 1976 Heublein unsuccessfully attempted to replace its own loans to United of approximately $90,000,000 with bank loans; the effort failed because no bank was willing to extend the loans without charging higher rates. *See* Tr. 8121–25, 9473–6. But this evidence alone does not answer the central question—whether Heublein's financing gave United a significant competitive advantage. The evidence may not even reflect any advantage at all, but rather only a change in conditions in the capital markets.

[57] In 1968 Joseph E. Seagrams & Sons, Inc. had sales of $1,049,593,000 and assets of $733,760,000, National Distillers & Chemical Corp., $957,645,000 and $794,965,000, and Schenley Industries, Inc. $550,348,000 and 9,929,000. RX 475, 509, 537. Heublein had sales of $383,972,000 and assets of $141,171,000. CX 49.

[58] Coca Cola, for example, had sales of $3,559,878,000 and assets of $2,223,924,000 in 1977, the year it acquired -ling Vineyards and the Taylor Wine Co. CX 299; RX 1232. Standard Brands had sales of $1,294,989,198 and ts of $718,517,599 in 1972, the year it acquired Jullius Wile Sons & Co. CX 299; RX 518. Norton Simon had sales ,739,763,000 and assets of $1,418,947,000 in 1977, the year it acquired San Martin Vineyards. CX 299; RX 481. rice Foods, which acquired Brookside Enterprises in 1973, had sales of $5,288,578,000 and assets of 8,875,000 by 1977. CX 299, RX 1232.

market, it is impossible to conclude that Heublein's ability to finance United could have substantially lessened competition.[59]

B. Advertising Efficiencies

There was no substantial evidence in the record justifying the conclusion that Heublein was likely to or did bring to United a significant competitive advantage in advertising, or that the merger was likely to or did increase barriers to entry attributable to advertising or product differentiation. While it is true that Heublein spent heavily for advertising, its expenditures, even without taking inflation into account, were far less than found in either *FTC* v. *Procter & Gamble Co.,* 386 U.S. 568 (1967) or *General Foods Corporation* v. *F.T.C.,* [28]386 F.2d 936 (3rd Cir. 1967), *cert. denied,* 391 U.S. 919 (1968), the decisions pioneering the concept that significant advertising advantages could violate Section 7.[60] More importantly, those decisions did not define large advertising expenditures alone as the threat to competition. The mergers were prohibited because the acquiring companies had access to significant advertising efficiencies—whether from access to cumulative quantity discounts or simply scale efficiency savings—unavailable to the other competitors in the acquired firm's market. Although the record in this case suggests Heublein did benefit from some such efficiencies,[61] there is no evidence whatsoever on how much was saved, nor any evidence indicating that those efficiencies were not available to the other firms in the wine market. Considering the number of other large competitors who were either in the market at the time of the United acquisition, or who entered shortly thereafter, it is highly unlikely that Heublein enjoyed any comparative advantage.

Even if Heublein had enjoyed such an advantage, the record does not show that it would have been of decisive importance or even competitively significant. Advertising was critical to a firm's success

[59] *Compare Sterling Drug Co.,* 80 F.T.C. 477 (1971); *Missouri Portland Cement Co.* v. *Cargill, Incorporated,* 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974); *United States* v. *Black & Decker Mfg. Co.,* 430 F. Supp. 729 (D. Md. 1976) *with FTC* v. *Procter & Gamble,* 386 U.S. 568 (1967).

[60] Procter & Gamble was the "nation's largest advertiser" in 1957, the year it acquired Clorox, *FTC* v. *Procter & Gamble Co.,* 386 U.S. 568, 573 (1967), and General Foods was the third largest in 1961, three years after it acquired S.O.S., *General Foods Corporation* v. *F.T.C.,* 386 F.2d 936, 938 (3rd Cir. 1967), *cert. denied,* 391 U.S. 919 (1968). Procter & Gamble's expenditures for advertising and other promotions totalled $127,000,000 in 1957, 386 U.S. at 573; General Foods totalled $69,000,000 in 1957, the year of the acquisition. 386 F.2d at 938. In 1970, two years after the United acquisition, one advertising publication described Heublein as the 44th largest advertiser in the nation, and fixed its expenditures at $40,500,000. CX 339, 331, 332. Respondent has maintained that its expenditures were even lower. CX 332.

[61] The record contains evidence, for example, that some discounts were available in purchases of local television and radio time, billboard space, and newspaper and magazine space, *see, e.g.,* Tr. 3716, 7987, 8776, 9754–55, and that significant savings could be earned by sharing advertising time or space among several products. *See, e.g.,* CX 501, 87Z–7.

in *Procter & Gamble* and *General Foods* because the product markets were composed of low priced, high turn-over items lacking significant distinguishing characteristics. The wine market differs [29] markedly in this respect from the liquid bleach or steel wool markets; it is composed, as we have already noted, of competing products varying significantly in price, quality and use. Where such product differences exist, an advantage in advertising costs is less likely to be of competitive importance.[62] It is also more likely to be competitively useful, encouraging product variations by informing consumers of a wide range of different products.

An examination of the advertising to sales ratios in the wine market bears out this observation. Especially high advertising expenditures were not necessary for Gallo and United to maintain their leading market shares in 1968 nor for National Distillers to increase Almaden's market share in the years that followed. In 1967 Gallo's advertising to sales ratio was 5.4%, and United's 6.0%. Between 1971 and 1974, the period of Almaden's market expansion, its advertising to sales ratio never exceeded 1.9%.[63] These ratios are significantly lower than those in cases where advertising has been found a critical element of market success, and thus a possible basis for entrenchment under Section 7.[64] Any advantage in advertising costs that Heublein might have brought to the wine market was thus of doubtful competitive significance.

C. Possible Tying or Leverage

Since Heublein's liquor products could be sold through the same distribution channels as United's wines, this acquisition creates the possibility that Heublein could use the popularity of Smirnoff vodka as leverage to coerce its distributors or retailers into carrying United's wines. Whether Heublein issued express threats or exerted more subtle coercion—or even if distributors and retailers voluntarily purchased United's wines to curry Heublein's favor—competition might be lessened by the restricted access to distribution channels imposed upon United's competitors. Section 7 clearly may be violated by a merger creating the possibility that the acquiring firm's reciprocal buying power will give a competitive advantage to

[62] *See, e.g., United States* v. *Black & Decker Mfg. Co.*, 430 F. Supp. 729 (D. Md. 1976); *United States* v. *Crowell Collier & Macmillan, Inc.*, 361 F. Supp. 983 (S.D.N.Y. 1973); *United States* v. *Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968).

[63] *See* RR ¶¶ 291, 292, 331; RAB p. 67 fn.99.

[64] *See, e.g., General Foods Corp.*, 69 F.T.C. 380, 434 (1966), *aff'd*, 386 F.2d 936 (3rd Cir. 1967), *cert. denied*, 391 U.S. 919 (1968) (over 15%).

the acquired [30]firm, whether that advantage may result from explicit or subtle coercion or from voluntary actions.[65] While the issue is less clear, we will assume that Section 7 can also be violated by a merger creating the possibility of a competitive advantage arising from the leverage of a successful product of the acquiring firm.[66] This is especially true when, as here, the acquiring company has a truly desirable product—Smirnoff vodka—in a clearly related line and the acquired company's products already hold a leading market position.

Several considerations suggest, however, that the mere possibility that leverage could occur should not be sufficient to establish a violation. First, it will almost always be the case that leverage is "possible" when firms selling related products merge. At the same time, substantial efficiencies and savings can result from the integration of distribution systems following such mergers—either actual selling or distribution efficiencies or a reduction in transaction costs resulting from customers ability to do business with a single seller. A rule that outlaws mergers upon a showing of the mere possibility of leverage therefore would have significant social and economic costs.[67] Hence "leverage" should be a ground for barring an otherwise unobjectionable merger only when the evidence of probable adverse competitive effects is fairly clear. Second, since any full line forcing or tying produced by the leverage could most likely be later challenged under Section 3 of the Clayton Act or Section 1 of the Sherman Act, the anticompetitive effects that could only be eliminated by prohibiting [31]the merger will often be both insignificant and remote. They would be limited to coercion too subtle to be proven in a subsequent enforcement action, and voluntary purchases by distributors and retailers. In light of possible redeeming economic benefits of mergers integrating distribution systems, and the likelihood that in most cases few significant anticompetitive effects will result from any leverage made possible by them, we conclude that the existence of possible leverage should

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[65] *See, e.g., FTC* v. *Consolidated Foods,* 380 U.S. 592 (1965); *United States* v. *Ingersoll-Rand Co.,* 320 F.2d 509 (3rd Cir. 1963); *Allis Chalmers Mfg. Co.* v. *White Consolidated Indus. Inc.,* 414 F.2d 506 (3rd Cir. 1969), *cert. denied,* 396 U.S. 1009 (1970).

[66] *See* note 52, *supra. See also Coca Cola Bottling Co. of New York, Inc.,* 93 F.T.C. 110 (1979); *United States* v. *International Telephone & Telegraph Corp.,* 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed,* 404 U.S. 801 (1971); Department of Justice Merger Guidelines, ¶ 20 (1968), 1 Trade Reg. Rep. ¶ 4510 at 6889 (1971).

[67] Of course, evidence of efficiencies is not admissible in individual cases in defense of an otherwise illegal merger. *See FTC* v. *Procter & Gamble,* 386 U.S. 568, 580 (1976) ("Possible economies cannot be used as a defense to illegality"). Our point rather is that in looking prospectively at what kind of across-the-board rules should be developed to treat questions of entrenchment by leverage in conglomerate cases, possible loss of efficiencies, along with many other factors, should be taken into account. *Cf. The Pillsbury Co.,* 93 F.T.C. 966 (1979).

be a ground for barring a merger only when the evidence shows that it will probably produce significant adverse competitive effects.[68]

The record in this case will not support such a finding. Smirnoff vodka might have been a powerful leverage tool, but the record contains no convincing evidence showing either that Heublein would probably have exercised that leverage, or that distributors and retailers would have purchased United's wines to win Heublein's favor and thus insure their supply of Smirnoff. There is no evidence that Heublein had ever attempted to use the leverage of any of its products prior to the acquisition of United. Neither is there any evidence that the potential for exercising leverage motivated Heublein's decision to acquire United, that Heublein ever attempted to use its leverage to increase United's sales, or even that Heublein considered it.[69] [32]

A comparison with the record supporting the Supreme Court's determination in *FTC* v. *Consolidated Foods,* 380 U.S. 592 (1965) that the use of reciprocal buying power posed a threat to competition highlights the lack of evidence in the record now before us. In that case, the Court had before it evidence that Consolidated Foods planned a program to apply its purchasing power and implemented that program with systematic coercive efforts, that some customers gave in to the coercive efforts, and that the acquired company succeeded in increasing its market share. While all of these elements need not be proven to establish a violation, the record in this case does not convincingly establish any of them. Indeed, as noted previously, United's market share was down considerably in the years following the merger.

Consideration of the marketing practices of other firms in the wine market supports the conclusion that significant anticompetitive effects were unlikely. The record contains no convincing evidence that other distillers owning wine companies had ever used the

[68] *See* V P. Areeda & D. Turner, *supra* note 28, ¶ 1134 at 202–13 (1980); *cf. FTC* v. *Consolidated Foods,* 380 U.S. 592, 603 (1965) (Steward, J., concurring) ("Clearly the opportunity for reciprocity is not alone enough to invalidate a merger under Section 7."); *United States* v. *International Telephone & Telegraph Corp.*, 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed,* 404 U.S. 801 (1971) (must show reciprocity "is likely to occur"). *But cf. Allis Chalmers Mfg. Co.* v. *White Consolidated Indus. Inc.*, 414 F.2d 506 (3rd Cir. 1969), *cert. denied,* 396 U.S. 1009 (1970); *United States* v. *Ingersoll-Rand Co.*, 320 F.2d 509 (3rd Cir. 1969) (both preliminary injunction cases suggesting necessity only of showing reciprocity is possible).

[69] *Cf. United States* v. *International Telephone & Telegraph Corp.*, 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed,* 404 U.S. 801 (1971) (similar lack of evidenced convinced court that use of reciprocal buying power not likely).

The only evidence in the record suggesting any proclivity for using one product to increase the sales of another is found in two marketing strategy documents describing a 1971 plan to ease the introduction of a new line of United wines, the Vinya line, by requiring retailers to *substitute* some Vinya for their usual purchases of Lancers. *See* CX 115, 352. This is not the kind of leverage that displaces competitors.

leverage of their successful liquor products to increase their wine sales.[70] Neither is there any convincing evidence of substantial voluntary behavior by distributors and retailers to win the goodwill of their major suppliers to the disadvantage of smaller wine producers. If evidence of industrywide practice is to support an inference that the leverage of a particular acquiring firm is likely to be used, that evidence—in the absence of any showing that that company has used its leverage in the past or intends to use it in the future—must be more systematic than the anecdotal testimony in this record. *See, e.g.,* Tr 391, 641–53, 1044, 1057, 4960–68.

Finally, the likelihood of the strategy's appeal is diminished by the lack of evidence indicating that distributors or retailers would have been vulnerable to pressure from Heublein. There is no substantial evidence that they depended upon their major suppliers for substantial credit, leases of facilities, or sales assistance.[71] There are, indeed, [33]many indications that distributors and retailers would have been strong enough to resist any pressure directed at them if it had been attempted and that Heublein's competitors were strong enough to prevent leverage from deadening competition on increasing market concentration.

In sum, then, this record will not support the conclusion that the possibility of leveraged sales created by this acquisition was likely to have produced significant anticompetitive effects.

Final Order

This matter has been heard by the Commission upon the appeals of complaint counsel and respondent from the initial decision and upon briefs and oral argument in support of and in opposition to the appeals. For the reasons stated in the accompanying Opinion, the Commission has determined to sustain respondent's appeal. Complaint counsel's appeal is denied. The motions to supplement the record filed by respondent and complaint counsel are denied. Accordingly,

It is ordered, That the complaint is dismissed.

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[70] *Cf. United States* v. *International Telephone & Telegraph Corp.*, 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed,* 404 U.S. 801 (1971) (suggesting similar evidence would be relevant to show likelihood of reciprocity power being exercised).

[71] *See United States* v. *Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968) (dealers' dependency for credit and assistance made them vulnerable).