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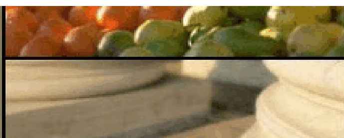

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The Allied-Heublein Joint Venture

by

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The Allied-Heublein Joint Venture

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The Allied-Heublein Joint Venture

One of the most widely publicized cooperative joint ventures involved the world's largest grape cooperative, Allied Grape Growers of Fresno, California. Allied entered into an agreement with Heublein, Inc. in 1968 whereby Heublein acquired a majority interest in Allied's wholly owned wine subsidiary, United Vintners. The parties also entered into a lengthy Supply Contract specifying the conditions under which Allied growers would supply grapes to United Vintners.

Although both parties had expected to benefit substantially from the arrangement, these expectations were dashed quickly and totally. The ink had barely dried on the arrangement when the signing parties became embroiled in a bitter conflict over intent, purpose, and execution of the joint venture. The result was lengthy litigation culminating in a court order declaring the Supply Contract null and void and requiring Allied to sell its stock interest in the venture to Heublein. These events very nearly wrecked the cooperative.

The purpose of this paper is to identify the various sources of conflict leading to the venture's failure, thereby perhaps helping those contemplating similar ventures from repeating these mistakes. The examination will: (1) describe the financial and organizational characteristics of the parties, (2) identify their apparent objectives, (3) describe the legal nature of the venture, (4) detail the joint venture's operations, and (5) identify the sources of conflict between the parties.

The analysis is based on the public records of the Heublein-Allied litigation and a Federal Trade Commission challenge of the venture, interviews with parties familiar with the arrangement, and various public sources. I also received useful insights into the issues involved from the economic experts for the parties in the Allied-Heublein litigation discussed herein: Dr. Leon Garoyan (Allied) and Dr. Ronald D. Knutson (Heublein).

The Joint Venture Partners

Allied Grape Growers

Allied Grape Growers (Allied) is a nonprofit cooperative organized through a predecessor cooperative in 1951. In 1959 Allied acquired United Vintners from the

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Petri family for $25 million and in 1964 acquired for $1 million the Inglenook winery, one of California's finest (Plaintiff's Brief 1978, p. 1). Allied placed these wineries in a wholly owned subsidiary, United Vintners (United).

United crushed the grapes delivered by Allied's 1,600 members—and some nonmembers—and produced all types of wines, including table, dessert, and sparkling. Most of the wines were sold under the Italian Swiss Colony, Petri, Inglenook, and Lejon brands. In 1968 United's sales were $96 million, which made it the nation's second largest winery, making 17.9 percent of all wines sold in the United States. Gallo, the nation's largest winery, made 24 percent of all wine sales in the United States. The third largest winery, Taylor, made only 3.1 percent of all wines (FTC Initial Decision, pp. 492).

Heublein, Inc.

Heublein, Inc. is one of America's oldest companies, founded in 1862 in Hartford, Connecticut, as the House of Heublein. In 1892 it invented the bottled cocktail and in 1939 acquired the rights to the most prominent vodka brand, Smirnoff's. By 1969 Heublein had sales of $520 million and was a leading manufacturer and distributor of alcoholic beverages and specialty food products. Although only the fifth largest domestic seller of alcoholic beverages, it held dominant positions in some segments. It was the leading seller of premium brand vodka (Smirnoff, Popov, Relska, Koskorva, and Arrow brands), the leading seller of tequila (Jose Cuervo and Matador brands), and dominated the market for Cordiales (Irish Mist and three other brands) and domestic prepared cocktails (Impact, p. 32). Heublein made less than 1 percent of wine sales in the United States and about 5 percent of all wine imports. An aggressive merchandiser, in 1970 Heublein was one of the nation's major advertisers and the second largest liquor advertiser (FTC Complaint).

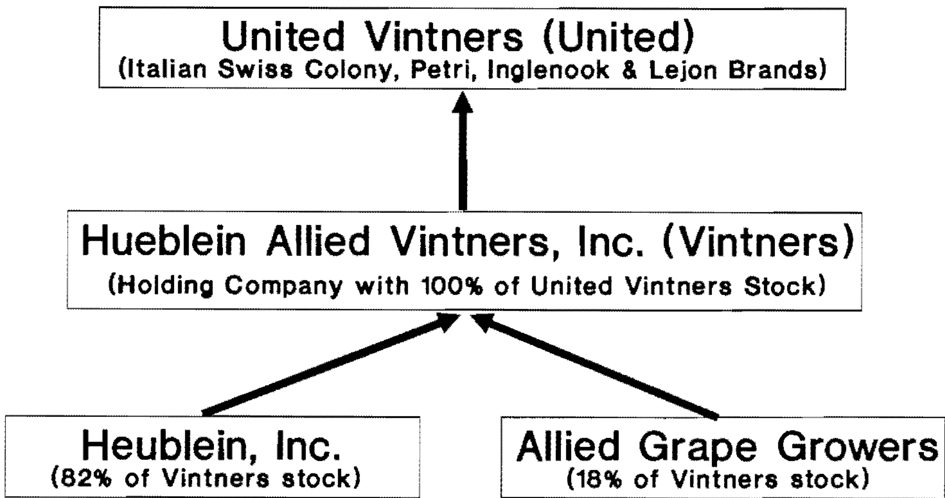
The Joint Venture

The Allied-Heublein joint venture involved two separate agreements. One agreement covered the acquisition of United Vintners by a newly formed holding company, Heublein Allied Vintners, Inc. (Vintners). The agreement was executed September 26, 1968, and the merger was consummated February 21, 1969.

The ownership structure of the joint venture is displayed in figure 1. Heublein received an 82 percent interest in Vintners in return for Heublein stock valued at about $33 million. The $33 million in securities and the remaining 18 percent of Vintners stock were allocated among Allied members according to their proportional interest in the capital fund of the premerger Allied. By 1968, Allied members had accumulated capital credits from patron returns of $25.3 million. The members then contributed the 18 percent stock interest to Allied in exchange for $7.6 million in capital fund credits (Allied Decision, pp. 2-4). Although the Vintners stock did not pay dividends, Allied was to receive 20 percent of the pretax income of Vintners. As a result of these various transactions, Heublein had an 82 percent interest and Allied an 18 percent interest in Vintners, which was the sole owner of United Vintners (United).

In addition to the merger agreement, the parties entered into an 80-year Supply Contract effective September 1, 1968. This was a lengthy and complex document. At Allied's *sole* option, the contract could be terminated or renewed and extended after 20 years and at six successive 10-year terms. Thus, Heublein had agreed to an 80-

Figure 1.—Ownership Structure of United Vintners



year commitment that Allied, alone, could terminate before then. The contract required Allied to deliver and United to accept at least 410,525 tons of grapes annually, which was about 25 percent of California's grape production in 1969. Both parties expected this amount to grow over time (Goldberg 1970, p. 2).

Although the Supply Contract covered a variety of other subjects, two of the most crucial and complicated were the price and profit-sharing provisions. United agreed to pay Allied members the "market price" for grapes, which was defined as the weighted average price for each variety of grapes as reported by the Federal-State Market News Service. Because such prices were not available for all varieties, the agreement had an additional six paragraphs defining the market price in the event the Market News Service did not report such a price. In addition to the market price paid growers, United agreed to pay Allied each year 20 percent of the operating income of United.

Among other provisions of the Supply Contract were those spelling out: (a) the prices to be paid for grapes supplied by growers other than Allied; (b) the treatment to be accorded Allied members' grapes supplied in excess of the agreed-upon tonnage annually; (c) the terms at which United would make loans to Allied for use in making advances to growers; (d) purchase of capital stock upon expiration, termination, or failure to perform under the contract; (e) the provision of additional capital to United by Allied and Heublein; and (f) the arbitration procedures to be followed in the event of disputes relating to the agreement or in the event conditions arose relating to unforeseen circumstances not covered by the Agreement. The arbitration provision called for an arbitration board of three members: one to be appointed by each party and a third to be a full marketing professor from either the University of California at Berkeley or Stanford University.

Each of these and other terms sought to spell out the treatment of matters of mutual interest that would ultimately determine how the benefits and costs of the joint venture would be divided between the parties.

Objectives of the Joint Venture

As with all joint ventures, when consummated both parties expected to benefit from the arrangement. The objectives of the parties were spelled out in 1970 by one of the economic consultants advising in establishing the joint venture. As he saw it, there were two main motives for Allied's participation (Goldberg 1970, pp. 3-4). Most important, in his view, was the capital problem facing growers. By August 31, 1968, Allied members had accumulated $25,319,318 in credits to Allied's capital fund. These credits averaged nearly $16,000 per member and in excess of $200,000 for the largest members (Bedwell). Moreover, credits were expected to continue to grow as the capital needs of the winery grew. Since these credits had very little liquidity, growers were interested in a scheme that would permit them to continue to get the benefits from owning a large winery without tying up a lot of their capital.

The second problem facing Allied was that competing wineries were growing larger and more powerful domestically and internationally. Allied members expected the merger with Heublein to give them a "piece of the action" in the domestic and international markets.

The president of Heublein believed the joint venture could be the next major acquisition since it acquired Hamms Brewing Co. in 1965.[1] He believed that by acquiring an interest in United, Heublein would be in a "position to utilize its marketing skills in a growth market for flavorful moderate-proof alcoholic beverages" (Goldberg 1970, p. 1). Heublein believed the joint venture would enable Heublein to exploit quickly its proven marketing know-how in liquors in a new growth market, which other liquor companies had already entered. Also, the Supply Contract gave Heublein an assured source of grapes for at least 20 years and, at Allied's option, up to 80 years. Although not mentioned by the above authority, Heublein obviously viewed the venture as an efficient way of acquiring a majority interest in the brands and other assets of the nation's second largest winery.

Reasons the Venture Failed: The Allied View

Although the parties to the Allied-Heublein joint venture originally believed it promised benefits to all concerned, the promised benefits failed to materialize, at least in Allied's view. The leading contemporary analyst of the joint venture was enthusiastic about the expected benefits while failing to identify explicitly as "disadvantages" the key problem that ultimately led to its failure.[2] Although it is not clear when Allied first became disenchanted with the venture, its officials subsequently alleged the roots of the problem were in false statements and failure to disclose certain material facts while the venture was being negotiated during 1968-69. Allied felt sufficiently aggrieved to initiate a lawsuit on March 19, 1975, charging that: (a) Hueblein committed fraud when inducing Allied to sell its interest in United Vintners and therefore should be required to return its interest in United to Allied; and (b) Heublein mismanaged United thereby breaching its duties to Allied as a minority stockholder and therefore should compensate Allied for the injury sustained by its members (Plaintiff's Brief 1977). We now turn to an examination of these allegations.

Alleged Misrepresentations by Heublein

Allied claimed that the main reasons the venture failed to live up to its promise were linked to Heublein's exaggerated claims concerning its expertise in the California wine business. Allied claimed it was led to believe that Heublein would be able to operate United Vintners much more successfully than had Allied. Heublein's growth history demonstrated that it had considerable expertise and had achieved strong market positions in vodka, prepared cocktails, and Cordiales. Prior to acquiring United, Heublein produced less than 1 percent of the wine made in the United States. It is not clear, however, that there were significant synergies in marketing wine and Heublein's traditional lines of alcoholic beverages. In any event, Allied claimed that after it sold United to Heublein, United was less successful than when it had operated as Allied's subsidiary. The court records on this matter are sealed. However, whereas in 1968, when Allied was sole owner of United Vintners, it produced about 22 percent of wine sales in the United States, by 1976 Heublein made about 17 percent of such sales (Impact, p. 39). Moreover, whereas between 1968 and 1972 United Vintner's share of wine sales fell from 17.9 percent to 14.5 percent, Gallo's share rose from 24.0 percent to 32.4 percent (FTC Initial Decision, p. 492).

Allied claimed that Heublein withheld other material information that, if known by Allied in 1969, would have caused it to not enter the venture. It claimed Heublein had not told Allied during 1968-69 that the Federal Trade Commission was investigating Heublein's 82 percent acquisition of United Vintners (Plaintiff's Brief 1978, p. 4). This became relevant because the Federal Trade Commission began investigating the merger sometime in early 1969 and subsequently challenged it as a violation of the antitrust laws (see below).

Allied also claimed that Heublein had represented that the 80-year full Supply Contract with Allied was legal. This became an important issue because Heublein, itself, subsequently challenged the legality of the contract, asserting it violated the antitrust laws (see below).

United Violated the Supply Contract

The venture's Supply Contract stated that United shall be required to take from Allied at least 410,525 tons of grapes annually. Allied alleged that as part and parcel of Heublein's false representations regarding its expertise in the wine business, Heublein not only promised to never purchase less than 410,525 tons annually from Allied members, but that Heublein promised that within five years United would purchase about 550,000 tons annually (Plaintiff's Brief 1978, p. 3). Because of its shortfall in wine sales beginning in the early 1970s, in most years thereafter United purchased from Allied less than the required 410,525 tons.

Financial Conflicts of Interests in Dividing United's Net Income

The Supply Contract provided that Allied would annually receive 20 percent of the pretax income of United. This income represented revenues for wines less United's cost of producing and distributing the wines. Allied claimed that Heublein and United engaged in the following practices that unfairly affected United's reported net income.

(1) Although transfer prices always represent a potential source of conflict in joint ventures, to my knowledge Allied did not claim that growers had been treated unfairly

by the formula devised to define the "market price" of the grapes growers supplied United. Allied did claim, however, that growers were treated unfairly under the 20 percent profit-sharing element of the transfer price because Heublein had inflated United's costs and reduced its revenues (see 2-5 below).

(2) Heublein allegedly had inflated United's financing costs by charging United an interest rate of 1 percent above prime, an amount allegedly exceeding the rate paid by Heublein. Heublein lent money to United annually, with a loan balance varying from $80 million to $100 million. Allied also sought damages because the interest rate at times exceeded the usury law of California, which limited interest rates to 10 percent (Plaintiff's Brief 1977, p. 3).

(3) Allied claimed that its members had, in effect, lent large amounts to United interest free because of the way United paid Allied's members for the grapes they delivered: United paid growers one-half of the purchase price of a crop the following December 31 and the other half June 30. This allegedly amounted to an interest-free loan to United by Allied members. However, this treatment appeared to be similar to that received by grape growers selling to independent wineries.

(4) Allied also claimed that Heublein deliberately reduced United's revenues and growth by acquiring for Heublein's own interests three wineries that Allied believed should have been acquired by United, which would have increased the demand for the grapes of Allied members (Plaintiff's Brief 1977, p. 3). Instead, Heublein allegedly kept for itself the benefits of these wineries, at least one of which, Beaulieu Wineries, grew very rapidly after being acquired. Moreover, this situation created potential conflicts of interest in accurately allocating wine marketing and distribution costs between Heublein's wholly owned wineries and United.

(5) Allied claimed that at times United imposed more stringent quality standards on Allied members than were applied by the industry generally. In some instances, after United had rejected a member's grapes the member sold the grapes to other wineries. Indeed, sometimes the rejected grapes were accepted by another winery owned by Heublein, which Allied claimed supported it assertion of arbitrary and unfair treatment of its members. Allied claimed that this treatment had made it increasingly difficult to acquire grapes (Plaintiff's Brief 1977, p. 34). Independent arbitrators subsequently found that United had not used industry standards and were therefore improper under the Supply Contract.

United Did Not Improve Allied Member Returns

United clearly failed to perform as anticipated by both parties when they entered the venture. This was most manifest in United's declining pretax income, of which Allied growers were to receive 20 percent annually as premiums. Whereas initially grower share of profits averaged more than $2 per ton, by the mid-1970s growers received practically nothing. These lower than expected returns and the practices Allied complained of allegedly injured Allied as well as its member growers. It claimed that United's poor performance caused many growers to stop selling through Allied and that as a result Allied was not always able to supply United's needs, thereby making Allied a less viable competitor. For whatever reason, United evidently had been more successful when owned by Allied than after being acquired by Heublein in 1969. Allied supported its claim that United's poor performance was due to Heublein's failings with the fact that during the years that United operated unprofitably, its largest competitor operated profitably.

Reasons the Venture Failed: The Heublein View

Heublein, like Allied, had formed the joint venture expecting to enjoy substantial benefits therefrom. Once the venture foundered, Heublein alleged that Allied had failed to perform as anticipated, thereby undermining the viability of the venture. It also disputed all the charges Allied made against Heublein, as follows.

Heublein Did Not Misrepresent Any Material Facts

Heublein denied Allied's claims that Heublein made various misrepresentations while negotiating the terms of the venture. Heublein said there had been no misrepresentation of its expertise in the wine business, since Allied management knew that Heublein had less than 1.0 percent of the wine business and that its experience was limited to handling foreign imports. This had been stated in a prospectus filed with the Securities and Exchange Commission. Moreover, Hueblein denied that any of the statements or charts used in describing its business to Allied management were false. Heublein performed poorly after 1969 because of changed circumstances in the wine industry beyond its control. It further claimed that United's pre-1969 earnings had been overstated and that Allied members benefited from the venture because United actually subsidized Allied members when unforeseen economic circumstances made United unprofitable. Heublein also claimed it had increased the value of United, and that this was the reason Allied wanted to buy it back (Defendant's Memorandum, p. 8).

Heublein denied that it had purposely misled Allied regarding the Federal Trade Commission investigation. Heublein said it did not know of the investigation before the merger was consummated February 21, 1969, and did not learn of the investigation until it received the FTC's letter February 27, 1969. Moreover, immediately upon learning of the FTC's interest, Heublein promised Allied to take care of the antitrust problem and fulfilled that promise despite Allied's open assistance to the FTC in the effort to get back United (Defendant's Memorandum, p. 9).

Heublein also challenged Allied's claim that it had been misled regarding the probable legal status of the 80-year Supply Contract. Heublein claimed that Allied was fully aware of a potential antitrust problem. A district court subsequently agreed, concluding that Allied's lawyer had recognized in 1968 the possibility that the contract might be illegal and that therefore Allied had assumed the risk of this possibility (Allied Decision, p. 18).

United's Violation of the Supply Contract

Heublein contended that although it had agreed to purchase 410,525 tons of grapes per year, it had agreed to include this provision in the Supply Contract only because it had been misled by Allied. Only after the merger did Heublein learn that this provision was commercially impractical. Heublein claimed it had no willful intent to breach the contact when signing it but had been forced to do so by unforeseen circumstances. Moreover, at times Allied failed to supply as many grapes as United required (Allied Decision, pp. 7-8).

Heublein Had Kept Allied Informed of United's Operations

Heublein denied that it had misled Allied regarding United's current and prospective operations. After all, Heublein said, eight members of the Allied board of directors

also were members of United's board of directors. As such, these directors allegedly had ample opportunity to obtain from United management whatever information was required to make informed decisions (Defendant's Memorandum, pp. 6-7).

Financial Conflicts of Interest in Dividing Net Income

Heublein rejected all Allied's claims on this point, asserting that the interest rate of prime plus 1 percent that it charged United was a market rate and did not violate the California usury law. Additionally, it argued that the law was unconstitutional.

Heublein acknowledged that it purchased for its own operations three wineries after the creation of the venture. But Heublein said that in 1969 and 1971 the parties had executed amendments to the Supply Contract authorizing Heublein to make these purchases. Moreover, it said Hueblein had purchased the Bartolucci Brothers winery in November 1976 for United's benefit at considerable expense (Defendant's Brief, p. 4).

Reasons for Heublein's Poor Performance

In Heublein's view, United performed poorly after 1969, primarily because of changed circumstances beyond Heublein's control. Grape prices rose sharply and there was a declining demand for the sweeter wines on which United had concentrated. Without its backing, Heublein claimed, United would have fared even worse. By 1976 United had "turned" the corner and in unprofitable years it actually had subsidized Allied growers. Even the plaintiff's economic expert acknowledged that United was making progress by 1978 (Defendant's Memorandum, p. 8).

Heublein further claimed that a major reason for United's poor performance was that Allied and other grape associations had attempted and succeeded in raising the price of wine grapes to wineries, including United. Heublein claimed that Allied, Sun Maid Raisin Growers Association, and the Raisin Bargaining Association had conspired to raise grape prices, thereby inflating transfer prices between United and Allied's growers. Although these grape associations were competitors, they had a number of interlocking directors, e.g., the chairman of Allied was a director on Sun Maid's board. According to Heublein, Allied and Sun Maid had cooperated in creating the Wine Bargaining Association in order to raise both raisin and wine grape prices. Sun Maid and the Raisin Growers Bargaining Association allegedly controlled 80 to 85 percent of the raisin market, sufficient to confer monopoly power. This power allegedly increased grape prices to wineries, thereby increasing United's costs (Defendant's Brief, p. 4-6)

The Supply Contract Was Unlawful

In addition to the above responses to Allied claims, Heublein charged that the 80-year Supply Contract violated the antitrust laws because it foreclosed a substantial part of the California market. This argument ultimately carried the day for Heublein, culminating in a district court opinion July 21, 1978, finding that the contract violated Section 3 of the Clayton Act and Section 1 of the Sherman Act (Allied Decision).

The District Court Opinion

After Allied had filed its suit against Heublein on March 19, 1975, the latter filed a counterclaim charging, *inter alia*, that the exclusive Supply Contract between Allied

and Heublein was unlawful. A jury trial, lasting from April 3, 1978, until June 1, 1978, ended in a hung jury. The district court then rendered a declaratory judgment finding the Supply Contract unlawful (Allied Decision).

The court found that the 80-year contract was a full Supply Contract foreclosing the following percentages of five submarkets in which United purchased grapes from Allied valued at $40 million to $50 million per year during 1973-77 (Allied Decision, pp. 6-7):

Market	Minimum Tonnage Foreclosed
Wine-Type Grapes	
North Coast Region	26.0%
Lodi/Modesto Region	20.3
Central San Joaquin Valley Region	11.0
Table-Type Grapes	17.5
Raisin-Type Grapes	37.0
Five Submarkets Combined	24.2%

The court concluded that these shares, when viewed together with other evidence, constituted a substantial foreclosure of various markets. It further found that one of Allied's specific purposes in proposing the contract had been to foreclose markets to competitors. Through such foreclosure it had hoped to stabilize and enhance the level of grape prices. Because the Supply Contract set prices based on those reported by the Federal Market News Service, the contract prohibited United from buying from Allied at prices below the current market price which, in the court's view, gave Allied potential control over price. The court believed that Allied had used the contract to force United to buy 200,000 tons of grapes it did not need and had failed to deliver 500,000 tons that United did need (Allied Decision, pp. 7-9).

The court further found that by lessening competition the contract stifled innovation and product improvement because growers delivering to United were not rewarded for producing superior quality grapes. This result followed, in the court's view, because United "pooled" growers' grapes, thereby preventing United from compensating individual growers on the basis of quality (Allied Decision, p. 9).

The court apparently believed that the vertical integration the parties had sought to achieve in their joint venture was itself suspect. By integrating certain of their marketing and distribution decisions, the parties had agreed to make decisions jointly rather than individually. In the court's view, given the extent of market foreclosure involved, this integration interfered adversely with free market forces. Although it did not examine any potential efficiency or procompetitive aspects of the joint venture, the court may have implicitly done so when it concluded that after 1969, "Allied's motivation and practice was not to look after the best interests of United or to supply the grapes that United required but, rather, to obtain the maximum price possible for its members' grapes" (Allied Decision, pp. 10-11). Not only did Allied seek to raise the prices of its members' grapes, but it sought to stabilize prices for the entire grape industry.

In addition to finding the Supply Contract an unlawful restraint of trade, the court found that Allied had not entered the merger agreement in the mistaken belief that the Supply Contract was lawful. Allied's own counsel had advised it that the Supply

Contract might be unlawful and that if it were found unlawful United would be discharged from performing its obligations under the contract. After receiving this and other advice, Allied management had decided, nonetheless, to sell United to Heublein and enter the 80-year full Supply Contract (Allied Decision, p. 12).

Based on the above, the court concluded that the Supply Contract violated Section 3 of the Clayton Act because: "[T]he evidence establishes that the full Supply Contract is a full requirements contract that may tend to substantially lessen competition in the relevant markets and submarkets for the purchase and sale of grapes" (Allied Decision, p. 18).

The court also found that the Supply Contract violated Section 1 of the Sherman Act because "Allied's purpose for negotiating and entering the Supply Contract was to stabilize grape prices, and that the contract may be used to further this purpose" (Allied Decision, p. 18). The court directed Allied to take no action to enforce the contract and directed Heublein to purchase the Vintner's common stock owned by Allied as provided in the Supply Contract in the event of its termination. Heublein was awarded trial costs and reasonable legal fees and expenses incurred in connection with its counterclaim contesting the lawfulness of the Supply Contract.

It is not clear whether the district court decision would be sustained today, given the legal developments of the 1980s. The court had relied primarily on the Supreme Court decision in *Standard Oil Co. of California v. United States*, 337 U.S. 293 (1949), which involved smaller market shares than those foreclosed by the Supply Contract. On January 23, 1985, the Justice Department issued *Vertical Restraints Guidelines* that adopt a very tolerant view of vertical restraints. But although the antitrust agencies are less likely today than in the past to challenge such restraints, private parties are not constrained from doing so.

FTC Challenge of Heublein's Acquisition of United Vintners

The Allied-Heublein venture was dogged by another antitrust problem. On December 7, 1972, the Federal Trade Commission (FTC) issued a complaint alleging Heublein's 82 percent interest in United Vintners violated Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act. The complaint charged that the merger eliminated substantial actual and potential competition in the wine industry. The requested relief would have required divestiture of Heublein's 82 percent interest in United Vintners with first purchase rights to be given to Allied Grape Growers (FTC Complaint).

The matter was litigated over the next eight years. On July 11, 1975, Heublein reached an agreement with the FTC staff whereby Heublein agreed to divest United Vintners except for certain of its wine operations. In 1976 the Commission not only rejected the staff's proposed settlement, but amended the original complaint by adding as defendants Allied Grape Growers, Inc., United Vintners, and Heublein Allied Vintners, Inc. (Hueblein, Inc., pp. 2913-14).

Following a trial beginning in December 1977, an FTC Administrative Law Judge concluded that the acquisition was unlawful and ordered Heublein to divest United Vintners within one year and not make further mergers involving wineries with more than 10 percent of the market within the following 10 years (FTC Initial Decision, pp. 571-72). Heublein appealed the decision to the Commission. In October 1980, the Commission overturned the Administrative Law Judge's decision, finding that the acquisition did not violate the law. Among other reasons, the Commission found

that complaint counsel had failed to prove that Heublein had such special competitive potential that "its small market share understated its possible future competitive significance" (FTC Decision, p. 581).

Post-1980 Developments

Allied did not appeal the district court's 1978 declaratory judgment. As ordered by the court, Allied sold back to Heublein the 18 percent interest in United. Allied then entered into a nonexclusive Supply Contract with Heublein. During 1979-82, Allied operated solely as a grape marketing cooperative selling to Heublein and others (Bedwell).

The original FTC complaint would have required Heublein to divest United Vintners with first purchase rights to be given Allied. This option disappeared when in 1976 the FTC included Allied in an amended complaint challenging Heublein's 82 percent interest in United Vintners. With the FTC's dismissal of the case against Heublein in 1980, Heublein was permitted to retain United Vintners. Apparently Heublein's wine operations proved less rewarding than it had hoped, since in 1983 it voluntarily sold four wineries, including Italian Swiss Colony, to Allied, which placed the wineries in a wholly owned subsidiary, ISC Wineries, Inc. When the operations failed to turn a profit, in June 1987 Allied sold ISC to Early Industries of California (Bedwell). On October 12, 1982, Heublein, Inc. also disappeared as an independent entity when it was acquired by R. J. Reynolds, the $13 billion tobacco-food processing conglomerate (R.J. Reynolds Industries, Inc., p. 3310).

Since June 1987, Allied has operated solely as a grape marketing cooperative. Its membership had fallen from a peak of about 1,600 members in 1969 to about 500 members in 1989. Allied management attributes much of the decline in Allied's fortunes to the failed joint venture. Of course, history will not be replayed to tell us what Allied's fate would have been had it not entered the joint venture in 1969.

Conclusions

The Allied-Heublein venture should be viewed within the framework of all joint ventures, both those involving cooperative and investor-owned businesses. Such ventures cover a broad spectrum of legal arrangements lying between simple contract integration and ownership arrangements similar to the Allied-Heublein arrangement. Joint ventures differ importantly from contracted arrangements or merger. Contractual arrangements coordinate some activities among separate businesses while permitting each to maintain its corporate identity. Mergers consolidate completely separate firms into a single one. Businesses undertaking joint ventures implicitly reject the alternative forms in the belief that the benefits sought can be achieved through creating a limited-purpose business entity owned jointly by the partners to the venture, while maintaining their separate corporate independence.

Joint ventures often involve more complex arrangements than contract integration or complete merging of two parties. Complexity stems from the requirement that a joint venture must be operated to satisfy often conflicting goals of the parties. The difficulty of resolving satisfactorily such conflicts perforce make joint ventures potentially unstable business arrangements. Such instability is not unique to ventures between cooperative and investor-owned enterprises. One study found that some seven out of ten joint ventures among investor-owned firms fell short of expectations or were disbanded (McKinsey & Co.).

There were several sources of conflicts between Allied and Heublein. Some of these occurred because both parties apparently entered the venture without fully understanding one another's business sufficiently to form realistic expectations concerning potential benefits. To succeed, joint ventures require a great deal of give and take between the parties precisely because it is impossible to anticipate all potential conflicts. Because the Allied-Heublein venture failed almost immediately to perform as well as originally anticipated, the parties did not enjoy a grace period during which to establish a mutually satisfactory relationship. Had United's sales and profits soared in the 1970s to the mutual benefit of the parties, they may have developed the working rules necessary for resolving many of the conflicts that subsequently were contested in court. Of course, insofar as there was merit to Allied's claims of fraudulent misrepresentation during 1968-69, the venture seemed doomed from the start.[3] One wonders, however, why Heublein would enter an arrangement destined to fail. After all, during 1969-78 it entered into four other joint ventures (three foreign and one domestic) with investor-owned businesses that continued to operate through 1981, the year before it was acquired by R. J. Reynolds (Heublein, Inc.).

Quite apart from the above, there seemed to have been several serious conflicts in the goals of the parties. Most of these had a direct or indirect bearing on the net revenue of the venture.

Apparently both parties were satisfied with the formula they had devised to determine the market price at which grapes were transferred to United. Allied was dissatisfied with its net returns from United, not with the mechanism for determining the transfer price of the raw product. However, conflicts arose over the following alleged ancillary practices that also affected the income of Allied growers.

1. Hueblein did not have the degree of expertise required to market wine on the scale of the venture.
2. Heublein charged excessive interest rates on funds lent to United, thereby inflating its costs.
3. Allied growers were denied the opportunity to share in the expanding demand for their grapes when Heublein, rather than United, acquired additional wineries.
4. United refused to acquire all grapes offered by Allied growers by imposing bogus quality standards.
5. Heublein failed to purchase and at times Allied refused to deliver as many grapes as specified in the Supply Contract.

Apparently, the first problem identified above was a serious one, perhaps permeating many aspects of the relationship. The wine market was changing and Hueblein allegedly did not realize or adapt to this, whereas its leading competitor did.[4] A shift was occurring from consumption of sweet wines to dry, table wines. Not recognizing this, Hueblein allegedly contracted to buy sweet grape varieties not suited for wines demanded by consumers. When a party to a joint venture has little experience with a product, there will be considerable and unexpected learning costs. Too often, managers, directors, and farmer-members of a cooperative are overawed by the apparent superior marketing know-how of large, investor-owned businesses, who may survive errors in management and marketing one product only because they have some product lines with large profit margins. It is imperative, therefore, that a cooperative make sure the other party actually has the expertise it promises to bring to the venture.

The second and third allegations mentioned above did not pose problems unique to joint ventures involving agricultural cooperatives. Indeed, they were anticipated to

varying degrees in the Supply Contract, and it should have been possible to resolve them through the arbitration procedures established in the contract.

The fourth and fifth allegations cited above, which involved differences over the appropriate volume of grapes to process annually, may have posed problems unique to ventures between agricultural cooperatives and investor-owned businesses. The conflicts may have arisen because members of an agricultural cooperative typically want to market all their products at the market price. Historically, growers often have joined cooperatives to find a home for their entire crop (Mueller and Tinley, pp. 8-12). In contrast, profit maximizing by a food processor selling in an oligopolistic market requires adjusting the volume of purchases from growers to meet consumer demand as reflected in the firm's share of the market. Heublein said that it had not realized when signing the supply agreement in 1969 that it was impractical to guarantee Allied an assured demand for about 400,000 tons of grapes annually.

Heublein's main complaint regarding Allied's conduct was that it was more interested in the general level of grape prices than in the profitability of United Vintners. Simply put, because of its sponsorship of grape bargaining associations, Allied allegedly behaved more like a bargaining cooperative than as a business partner in a vertically integrated joint venture. If true, this represents another potentially important conflict in joint ventures between investor-owned businesses and agricultural cooperatives.

The Allied-Heublein joint venture ultimately proved fatally flawed because the Supply Contract violated the antitrust laws. But, most probably this antitrust problem would not have been raised had the parties not disagreed on other matters. Very probably in today's antitrust environment the antitrust agencies, which are especially hospitable to vertical agreements, would not challenge the Supply Contract. And although the FTC complaint challenging Heublein's acquisition of United Vintners was initiated independently of the parties, the merger was ultimately approved by the FTC.

The antitrust problems involved here nonetheless demonstrate the antitrust exposure of agricultural cooperatives when they engage in joint ventures. When entering ventures with investor- owned firms, agricultural cooperatives lose the limited protection from antitrust prosecution accorded by the Capper-Volstead Act (Mueller). While the Heublein-United Vintners merger ultimately passed antitrust muster because of the small market shares involved, the antitrust agencies have in recent years blocked at least one venture between an agricultural cooperative and an investor-owned firm. And even when an antitrust agency does not challenge a joint venture, it still may be challenged by private parties, which historically have initiated most antitrust cases involving agricultural cooperatives. Because of these several factors, parties to a joint venture should never overlook their potential vulnerability under the antitrust laws.

Notes

1. The Hamm's acquisition proved a dismal failure. After paying $62 million in preferred stock for Hamm's in 1965, Heublein sold Hamm's in 1973 for $6 million (Heublein, Inc.).

2. The only disadvantages he identified were the probability that: (1) Heublein would be more directly affected by the growing labor turmoil in agriculture; (2) the cooperative would not retain all the profits of the winery though the venture might bring larger total profits; and (3) Heublein would be obliged to get involved in time-consuming agronomic problems of the farmer-stockholders (Goldberg 1972, p. 118).

3. The court did not address this issue.

4. Of course, had Allied continued as sole owner of United, it too may have failed to identify and/or failed to adopt to the changing market.

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