Issues arising under grape contracts

The key considerations for drafting a Grape Supply Agreement

There is technically no such thing as a ‘grape contract’. However, an agreement for the sale and purchase of grapes is an ordinary contract drawn by the parties to reflect their particular bargain. Mark Hamilton, from Grope Hamilton Lawyers, explains.

A WELL-DRAFTED Grape Supply Agreement would, in a perfectly operating market place with balanced supply of and demand for grapes, be a balanced agreement, providing equity and certainty for both the winery and the grape grower.

In this ideal market place, the advantages for the winery would be:

- A constant supply of premium or the desired quality grapes;
- Consultation as to the management of the vineyard; and
- Familiarisation over time with particular characteristics and traits of the particular vineyard to enhance winemaking.

The advantages for the grapegrower would be:

- A consistent source of income;
- To allow for the development of new or replacement vineyards with certainty of income for the future;
- To allow the grower to obtain ‘free’ expert consultation with respect to vineyard management; and
- To permit an association to develop between the grower and winery by allowing the grape grower to meet the wine maker’s quality parameters and volumes whilst receiving a fair long term price.

Wine Lawyer

Mark Hamilton
Grope Hamilton Lawyers

When drafting a Grape Supply Agreement consideration should at least be given by the parties to the following aspects to ensure that the agreement is workable:

- Specification of any quality criteria to be achieved;
- Terms for payment bearing in mind the provisions of the Grape Prices Act 1991 (SA);
- Estimated yield per hectare;
- Harvesting time and techniques;
- Term of agreement;
- Delivery;
- Rejection of fruit;
- Further option terms;
- Termination of Agreement;
- Notice Provisions;
- Assignment of Agreement;
- Price fixing mechanism;
- Retention of title type provisions under the Personal Property Securities Act; and
- Dispute resolution mechanisms

There is no thing as a ‘grape contract’ as such. An agreement for the sale and purchase of grapes is an ordinary contract drawn by the parties to reflect their particular bargain. There is no standard format prescribed by legislation.

There are a limited number of mandatory requirements such as compliance in South Australia with the minimum grape payment timing requirements under the Grape Prices Act 1991 (SA) and associated regulations.

This includes a timing schedule in relation to payment of the grapes and a condition that no wine producer may purchase any grapes of a subsequent vintage when any amounts are outstanding with respect to the previous vintage.

From a winemaker’s perspective, the drafting of every well considered grape contract will take into account domestic and international requirements relating to wine quality characteristics and traits. For example, any spraying withholding period to ensure that wine characteristics do not exceed proscribed chemical levels or contact proscribed chemicals.

Some of these requirements are mandatory, and vary from wine export market to wine export market, and some are voluntary quality measures which individual wineries adopt as part of their marketing differentiation.

Environmental credentials have become very important in the world of selling wine.

There are accreditation programs which wineries can comply with or join so as to establish "green" credentials of their brand.

Covenants in well considered grape contracts will therefore be drafted to both prohibit certain behaviours by grape growers, where mandatory requirements are involved, and so as to encourage desired behaviours by grape growers to fit it with the winemaker's desired wine characteristics and quality outcomes.

A grape contract should be drafted, from a winemaker's point of view, to reflect these desired outcomes in order to ensure that the grower delivers what the winery requires. The quid pro quo in economic theory is that the grower receives a fair price, reflecting not just the market price but also the cost of producing grapes to the relevant specifications.

The contract will not have its desired outcome, in terms of mutual interest, if this balance of interests is not recognised and addressed.

For example, if a winery only requires stock standard Riverland type fruit of fair average quality then the grape contract will be simple and straightforward and the price payable will reflect the average market price, if the market is operating efficiently.

If, however, the winery has strict requirements, which involve reduced crop loads and higher costs for growers, then the grape price payable under the contract will be higher than the average market price if the market is working efficiently.

The problem comes particularly at the high end and the low end of the grape supply cycle. For example, where the winery has all the market power, due to grape oversupply, and can impose strict requirements and low prices (such has occurred during recent years).

Conversely, where there is a grape shortage, as in the mind 1990s onwards, where wineries were willing to pay up to $1000.00 per tonne for standard Riverland grapes (sometimes overcropped and over irrigated).

In an oversupply situation the wineries are able, through grape contract provisions, to impose significant quality provisions, with broad rights of fruit rejection. In an under supply situation, the power shifts to the grower and grape contracts are consequently simpler and less onerous from the grower's point of view.

Since 1998, in particular, through to the Global Financial Crisis, the pendulum of market power gradually swung in favour of the wineries with the result that, in the case of a number of large producers, the contractual terms became progressively more restrictive and in some instances, onerous in the sense that the rights of rejection have expanded significantly – and the ability of wineries to, for example, dictate pruning and crop thinning practices increased. This occurred in tandem with low and decreasing prices. Since then, however, some "green shoots" have emerged in the marketplace due to a change in supply and demand.

Anecdotally, in the period leading up to the GFC, 'a tale of two cities' emerged with some winemakers appearing to use their market power to extract maximum commercial outcomes and others acting out the "better guy" role by continuing with "balanced" contracts paying fair but middling market prices.

These balanced contracts did not include a plethora of requirements or rejection points. Anecdotally, these good guys tended to be the larger "middle ranking" and family companies and higher price point smaller specialist producers.

As the oversupply situation continues to ease, and undersupply presumably emerges in the next decade (given the current absence of vineyard planting and the grubbing out of 24,000 hectares) the pendulum will presumably shift somewhat in favour of grape growers resulting in less proscriptive, simpler contracts. There is evidence of this happening now.

The most skilful commercial lawyers, growers and wineries will look at contractual negotiations over grape contracts in a commercial context including desired end use outcomes and the current market conditions relating to supply and demand for grapes. This is remembering that what is critical is establishing a good working relationship, and that the contract, when written, is put in the bottom drawer and hardly referred to.

From a grower's point of view, an onerous, low priced grape contract for more than one year can act as an impediment to the vineyard value. The length of the contract term is an important commercial consideration as it can avoid the need to 'hand' sell each year, but may come at a real cost.

Mark Hamilton of Grope Hamilton Lawyers provides specialist national legal services to the Australian wine industry. He has a lifetime of wine sector experience through his involvement with Hamilton's Ewell Vineyards. He can be contacted on (08) 8231 00898 or 0412 842 359 or by email at mhamilton@gropehamiltonlawyers.com.au. See www.gropehamiltonlawyers.com.au. GW

INDICATIVE PRICING COUNTDOWN

AS THE COUNTDOWN to the 2017 winegrape harvest continues, wineries have been actively searching and growers are hoping for a good return.

"There's far more interest at this time of the year than is usual, starting back in July, because wine stocks have declined and the export demand for Australian wine is growing," said Mike Stone, Murray Valley Winegrowers executive officer.

Market observers, including Rabobank, have hailed the 'return of life' of Australia grape prices.

"Hope is for a price increase. Demand is up and we are hearing that growers are getting contacted by wineries so we are hoping for good prices. As it has been below cost for many years," said Brian Simpson, Riverina Winegrapes Marketing Board chief executive officer.

Yet some growers remained cautious as they waited for the release of indicative prices.

"There's been lots of talk and very promising signs; so good prices are the expectation. But we're not seeing any evidence of a price rise yet," said Stone.

"It's promising that wineries are wanting to source fruit now, but it's disturbing that prices generally aren't included in the conversation. Growers could be signing supply agreements now for 2017 without being informed of prices until harvest starts, by which time it's too late to make other arrangements."

In South Australia's Riverland growers are paying attention to market signals.

"We've got the scale and versatility to adapt on a competitive basis," said Chris Byrne, Riverland Wine executive officer. "We are always on top of the very basics; things like rootstock trials, new clones for emerging varietals so we are well placed to hang on into recovery."