

Win-Win Grape Contracts

How growers can negotiate long-term relationships

by: Paul Franson

Winegrape buyers who pay by the acre, rather than the ton, have more say about farming practices.

- Grapegrowers and winemakers are working better together than ever before, and this is good news for those looking to enter into grape contracts
- Though grapes can be bought at a price per acre, setting a price per ton is the most common agreement.
- Contracts almost always require changes, so be reasonable.

In the not-so-good old days, growers and wineries often seemed like adversaries, and old timers remember the era when an attitude of us vs. them ruled wine regions like Napa Valley.

Thankfully, that time has passed. Though wineries and growers may disagree about prices, conditions and issues like hang time, they regard each other as natural allies, and most work well together.

One situation when relations may be sticky, however, is during contract negotiations. Though some brag that they don't need contracts, merely handshakes, most realize that having a clear written agreement is the best way to avoid misunderstandings down the line.

A seminar on this topic at a Napa Valley Grapegrowers conference this spring caught our attention. Negotiating a "Win-Win" Grape Contract was presented by John Mackie from the law firm Carle Mackie Power & Ross, and Jim Verhey of Silverado WineGrowers, who also drives the growers' excellent educational seminars.

The duo--a grower and a lawyer--presented two sides of the issues. Verhey, the managing director of a large and successful vineyard management company and substantial vineyard properties, as well as a small-scale grower on his own, offered broad insight. He emphasized that a good contract isn't a one-way street, but ideally is the basis for a long-term relationship.

A key part of the talk was a sample "good" grape purchase agreement. It's too long to reproduce here, but you can get a copy from the Napa Valley Grapegrowers' website, napagrowers.org, under Programs: Members Services.

Verhey warned, however, "Do not use this example of a grape purchase agreement or any provisions therein without consulting your own attorney. Nothing we will present constitutes legal advice." In this article, we will cover the main points of interest.

Basic terminology

Any contract includes "boilerplate"--standard terms and language that are picked up and used with little if any change. These include:

- Purchase and sale
- Harvest and delivery
- Representations by grower
- Representations by winery
- Force *majeure*
- Right to resell grapes
- Notices
- Amendment and waiver
- Modification
- Severability
- Further assurances
- Counterparts
- Governing law
- Entire agreement

There are many options for addressing the most important provisions, notably grape prices, payment terms, terms of agreement, how to deal with disputes and litigation costs, and use of the vineyard name.

Obviously, the price of grapes is one of the most sensitive provisions. Prices are quoted either in price per ton or price per acre. Verhey said that 90% of the many contracts he negotiates are in price per ton. "The winery selling high-priced wines is more likely to want an acreage contract so it gets more control over the farming practices," he said.

Even this gets complicated. You can specify a price per ton for each year of term; a price per ton for the first year and then an escalation based on fixed escalation rates, consumer price index (CPI) or other inflation index; a change in average price for the local area (e.g. District 4 for Napa) from the last two grape crush reports (Table 10); changes in selected index, such as state posted price list or average price per ton for District 4 from the last grape crush report plus or minus some percentage.

Verhey said the most popular method is based on the average increase during the past two years--or the Napa Valley average price plus or minus a certain amount, often with a minimum and maximum price. He reminded attendees, however, that half of Napa Valley grapes sell for less than the average price, something no one wants to consider.

Tonnage Pricing Statistics, 2008		
Cabernet Sauvignon total tonnage	24,306.4	
Tonnage sold within 3% of \$5,000	2,218.4	
% of tonnage sold within 3% of \$5,000	9.1%	
Equivalent grape price per ton	\$5,000	
% above average	4.7%	
Percentile compared to all others	71.1%	
Napa Valley Cabernet Sauvignon:	Price per ton	Per bottle
Average	\$4,689	\$46.89
Median (50th percentile)	\$4,500	\$45.00
75th percentile	\$5,375	\$53.75
95th percentile	\$8,333	\$83.33
Source: Frank, Rimerman + Co. LLP/Napa Valley Grapegrowers		
The price for winegrapes typically is directly proportional to the price per bottle of wine.		

Another possibility is a price per ton based upon the retail bottle price of the brand your grapes go into. Growers Andy and Dave Beckstoffer suggested a level of 100 times the bottle price, which research has shown tracks well for many more expensive wines. A \$40 wine, for example, should be filled with grapes selling for \$4,000 per ton.

Verhey noted that even if not many contracts are based on retail prices, this formula provides a good starting point to negotiate prices.

Some wineries want acreage contracts, where they pay a certain amount per acre, independent of tonnage. They prefer this as it gives them more control of the farming practices used, such as the amount of leafing, green harvesting and obviously, picking date. The price per acre is likely to be based on "normal year expectations."

Some of the aspects to consider in acreage contracts are allocation of the risks between grower and winery for unusual conditions and the responsibility for "extra" farming costs that might occur in this case.

Getting paid

Obviously, growers and wineries often would prefer different payment terms. The most typical are net 30 days after the last harvest, generally for whites, or 50% 30 days after the last harvest and the remainder by a specific date such as Dec. 31, Jan. 15 or Jan. 31.

Verhey warned growers to be cautious about extended or revised payment terms, and to charge interest on outstanding balances. He also suggested checking credit worthiness and reminded growers that they have an automatic grower lien on the wine produced from their grapes.

Contracts can be for a fixed term or evergreen. Verhey prefers evergreen contracts with a two - or three - year cancellation clause. "This gives you time to work out issues, and also allows both parties to find alternative buyers and sellers."

Lawyer Mackie also discussed the options for disputes and litigation costs, including mediation, non - binding and binding arbitration and litigation. He noted that responsibility for legal costs should be specified in the contract.

One interesting topic is use of vineyard names. They can be quite valuable, and use should be specifically covered. Is it an exclusive right, for example, or can other wineries use the same name? Does the winery pay a premium for use of vineyard name, including separate charges beyond the grapes? Does the grower exercise any control?

Lee Hudson, owner of the Hudson Vineyard in Carneros, negotiates the opportunity to taste wines that wineries want to vineyard - designate as being made from his grapes, and Hudson can veto the usage if he doesn't like the wine.

Anticipate problems

Potential areas of problems and conflict dominated the remainder of the session.

Conflicts can arise over viticultural practices. Verhey strongly recommended co-creating an annual farming plan, but in any case, the grower and winery should be in agreement on language and requirements. The contract should specify the obligation of the grower to implement the recommendations of the winery and assign responsibility for "extra costs" that could result from this demand.

Getting together

Verhey also included an obligation to meet, communicate and agree periodically during the crop year. Mackie agreed: "Problems arise when

the winery and grower don't talk."

Grape quality is another potential problem. The contract should ensure that the grower and winery agree on expectations of quality level and harvest decision process, with a process for resolving disputes so there's an alternative to confrontation at the weigh station. Among the possibilities if the winery doesn't accept the grapes are pricing adjustments, custom crushing the grapes for the grower to keep as wine or a release for the grower to sell the grapes elsewhere.

Both parties should agree in advance on using a "local" inspector, because state inspectors may not be available or as knowledgeable as a local inspector. They should also agree on a rejection process that fully covers the mechanics, rights and obligations of each side, including load-by-load inspection, keeping evidence and records, and providing notice of rejection and the reasons for it.

Termination of a relationship should be a last resort for the grower and winery; but if the relationship isn't working, the contract should provide a mechanism to part amicably. Any termination process should provide time for the winery to find a new source of grapes, and for the grower to find a new buyer for his own grapes.

A possible cause for termination is sale or change in management of either party. Assignment provisions in the contract can be very touchy, because there is no way to know whom the assignee might be. Any provision should be mutual. It should consider requiring approval by the other party, but also require that "such approval cannot be unreasonably withheld" for fairness.

Mackie warned growers to watch out for a number of other provisions that can be included in a contract. He said, "Lack of production capacity for winery" should never be considered a force *majeure* (an extraordinary event or circumstance beyond the control of the parties such as a war, strike, riot, crime, or an event described by the legal term "act of God," e.g., flooding, earthquake, volcano) able to absolve the winery of responsibility for taking the grapes. "Smoke taint" from fires has rarely been covered by contracts, leading to questions last year. (See "[*When the Smoke Cleared*](#),")

Likewise, watch out for contracts that allow consequential damages. No grower should be held responsible for any consequential costs, expenses or losses once the grapes start fermentation, unless the grower is guilty of gross negligence or willful misconduct.

A last warning is that "sole discretion" by either party should rarely be used, and only in cases where its application is truly justified. "Consider substituting the concepts of 'reasonable judgment' or 'good faith' in lieu of 'sole discretion,'" Mackie said.

Verhey said that a "good" grape purchase contract must be thorough and fully agreed to by both parties. "Short contracts aren't necessarily good contracts," he said. They need to be balanced: "One-sided contracts are a recipe for disaster or litigation," he added. They also should be flexible, because circumstances will change and the changes will need to be addressed.

"The best contracts allow for changing times," he said, adding, "I've rarely signed any contract that hasn't required some changes."

Verhey's final suggestion: "A contract is no substitute for constant communication." Talk often and there will be little need to try to enforce the contract.