



Potential contract winemaking pitfalls

THE PREVIOUS WINE-EXPORT DRIVEN growth cycle, culminating in the Global Financial Crisis in 2007, saw the emergence of a substantial contract winemaking sector as part of the services infrastructure which sprung up to support the then expanding Australian wine industry.

USERS OF CONTRACT WINEMAKING

Contract winemakers service not just small growers and wine companies where the economies of scale associated with small production do not justify building or equipping separate wineries, but also large wine companies, whose production facilities are fully utilised or



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distant from the relevant wine region, or because of timing issues during vintage.

The industry was, during the previous expansion phase, struggling to keep up with the significant capital and logistics required to expand winery facilities at the same rate as sales.

Although wine companies have become increasingly expert at protecting the quality of grapes being transported from vineyard to winery, there may be quality or logistical imperatives which

dictate that it is preferable to crush the grapes to must or process the grapes to wine nearer the vineyard.

This may, for example, be contracting out making of medium or lower price point export wine. Some large companies withdrew from buying grapes from irrigated areas some years ago, only to emerge as purchasers of bulk wine under contract from contract winemakers.

Entering into these contracts for large wine companies is one way of creating something analogous to a type of 'off balance sheet' financing arrangement by taking on the contingent liability associated with performance of the contract – thereby giving the grower and the contract winemaker a contractual

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basis for financing their business.

To contract out or not is a cost/benefit assessment to be made by the individual winery – as against the alternative of the winery borrowing money (or raising more share capital) and having the logistical problems and risks associated with winery expansion to contend with.

Factor in the depreciating nature of winery assets, and the demand upon wineries for funding stockholdings, and the contracting out of a part or aspects of the winery's winemaking process may make a lot of business sense.

CONTROL OVER WINEMAKING PROCESS

By far the major pitfall with contract winemaking is a lack of direct control over the winemaking process – with the attendant potential effect on wine quality.

Assuming (of course) that the wine company selects a reputable, professional, well organised and capitalised contract winemaker, then by far the most important thing to do is to set up and maintain a constant dialogue and reporting system in relation to the winemaking process.

The best practices approach is to regard the contract winemaker and winery as part of the organisation, to set written product specifications, written winemaking techniques and to actively supervise and be involved in the winemaking process – in the same way that the wine company would if it were making the wine itself, utilising its own facilities.

This involves setting up written reporting procedures and maintaining (for example) weekly or fortnightly visits and meetings with the contract winemaker.

INVOLVEMENT IN WINEMAKING PROCESS

Some contract winemakers provide services far away from the clients' vineyards. The clients may, in those circumstances, rarely make the journey to the winery for tastings and have little idea how their wines are treated. It is vital to make this effort.

With or without a written winemaking contract, a classic mistake is to simply arrange for the grapes to be delivered to the winery – and to leave the contract winemaker to it.

Professional contract winemakers who wish to build a long term relationship with wine companies will in fact want to involve the wine company or grape grower in the winemaking process so that they can identify their desired wine style and deliver the required results.

Whilst it is true to a large extent

that 'wine is made in the vineyard' – particularly with ripe, premium fruit – it is also unquestionably true that there is much 'winemaker's magic' (of the legal kind) which winemakers can wave over wine during the winemaking process to improve the result.

FUTURE OUTLOOK

Given the plethora of small wineries producing up to 250 tonnes, contract winemaking is here to stay. The owners of large contract winemaking facilities have gone through the boom and bust cycle over the past decade or so. Many facilities are now owned by different parties.

Although opinions will differ, a wine company must produce 500-plus tonnes before even a modest winery investment would begin to make anything like sense, on purely financial grounds. Even then, there would be limited scope for having much sophisticated equipment. I would suggest that realistically, this would need to be 2000 plus tonnes, and even then it may be driven more by personal sentiment, or 'brand story', than pure economics.

WRITTEN CONTRACTS

A new generation of written contracts for contract winemaking have emerged in recent years – the advantages of negotiating a written contract are as always that it enforces upon the parties the discipline of considering 'up front' the process and issues which may arise during the intended business relationship.

From the contract winemaker's perspective, it also helps with forward planning, and therefore financing, if a reasonable percentage of the winery's intake is secured by forward contract. This is vital to a contract winemaker's survival.

NO BRAND IMAGE OR STORY WITH CONTRACT WINERY

You know this but, for the record, when dealing with a contract winemaker, do not expect any 'history' or old stone buildings. You will be lucky if there are some immature trees planted along the dirt road in.

Expect concrete and a farm of stainless steel tanks on an excavated, flat site – without anything else in sight except that which is strictly required to crush grapes and to produce and store wine. This is an accountant's ideal winery.

Expect the winemaking plant to be outside – with a small heater in the laboratory, which may be a Nissen hut, to keep the winemakers from catching pneumonia.

If you use a contract winemaker, then you'd better take your overseas distributors and journalists to your vineyard.

Contract winemaking businesses are essentially financing operations which depend upon total efficiency and volume through-put, for their existence. They have no goodwill, and are purely a barometer of supply and demand in the industry. Some very good operators have failed financially during the past 15 years. It is a tough business indeed, when you consider that many such operators also participate in the bulk wine market.

CONTRACT STORAGE FARMS

Hand in hand with contract winemaking, there is an increasing trend of contract storage farms. Watch for this to expand over time, both for reasons associated with wineries seeking to preserve working capital for stock, but also because many wineries will wish to preserve the historical look and feel of their wineries and vineyards – and feel that it would be counter-productive to their branding strategy and image to gradually convert the whole of their properties to tank farms. This is becoming a significant issue for many wineries who rely upon their history and brand story.

LEGAL ADVICE ADVISABLE

When entering into a written contract with a contract winemaker, get some legal advice to ensure that your interests are protected – and try to ascertain the financial standing of the contract winemaker and those associated with it.

Make sure that your wine is made and kept separate from other customers.

If you do not have a winemaker on staff, and you are making a reasonable quantity of wine, consider employing an independent consultant winemaker to assist you in your dealings with the contract winemaker.

Ensure that you get a registered Personal Monies Security Interest in relation to the wine made from your grapes to avoid potential arguments with liquidators or receivers.

Also ensure that your interests are insured and also that the contract winemaker has indemnity insurance in place to meet your claim if your wine is spoiled due to contract winemakers' neglect or default.

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