

## Building and Enforcing a Better Grape Contract in Uncertain Times

Agreements that begin with a simple handshake must be followed with concrete protections for both the winery and the grower.

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**WE HEAR IT SAID** often enough: The wine business is built on a foundation of good relationships...the best contracts are those based on a solid framework of communication. These maxims are no doubt true. But how does one translate these touchy-feely observations into a grape contract that is simple and secure, especially in these difficult times?

It's actually not that hard, and you don't need a 20-page agreement to get you there—although you do need a lot more than a handshake and good intentions. What follows are some of the essential building blocks as well as some tips on the almost inevitable road-blocks moving into the 2010 harvest.

### No Need to Feel Insecure

The granting of a simple security interest from winery to grower in the contract is essential, even if it is often trumped by a secured lender. After execution of the agreement, the grower will then file a financing statement (called a UCC-1) with the secretary of state and/or the county, depending on the state, describing the collateral for any third party who later does a lien search, thereby perfecting its lien. The advantages of a perfected UCC security

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interest over the statutory grower's lien (discussed below) is that it allows for a faster form of foreclosure (called "non-judicial foreclosure") and self-help repossession while also providing for notice from a secured lender of a foreclosure. In addition, of all of the liens, the UCC lien most clearly covers non-grape/wine products and proceeds. If a lender is first in line (i.e., first to file) before the grower and does not execute a subordination agreement, the grower may still get paid, in whole or in part, in the event there is sufficient equity in the assets to pay off both the lender and grower, too.

A personal guaranty should be explored as well, especially for new wineries attempting to secure a high-end supply of grapes. In this or other contexts, a guaranty could be given by the winery owner in exchange for a waiver of the grower's lien by the grower—a quid pro quo that could have significant benefits for both sides.

### Somebody to "Lien" on

The statutory producer's (aka grower's) lien in California was given more teeth in a 2006 case, *Frazier Nuts, Inc. v. American Ag Credit*. The court in that case held that the grower's lien attaches to cash proceeds or receivables on any sale of the attached wine. Translation: The grower's lien now trumps the winery's secured lender. Prior to this, if the winery co-mingled or sold the wine under the lien, the lien rights were gone forever. The *Frazier Nuts* case is extremely helpful to the grower, both in the ordinary course and in the bankruptcy context, where the grower's lien is superior to most liens except wage/salary and warehouseman's liens.

But beware of the limitations of the lien in the custom crush context as it is only valid against a winery with a processor's license issued by the **California Department of Food and Agriculture** (CDFA). If the winery does

not have a CDFA processor's license, they should acknowledge this in the grape contract, and the grower's rights under the UCC and other remedies should be beefed up instead.

But what if the winery is in distress and simply cannot pay without first selling the wine, but the grower does not want to rely solely on the survival of the grower's lien? Have the sale handled through an escrow or have the winery post a bond or letter of credit if possible.

As far as enforcement is concerned, the grower's lien can be enforced by filing a complaint with the CDFA for non-payment or even for the fear of breach in anticipation of harvest, otherwise known as "Anticipatory Repudiation." However, the downside is that the grower must file a lawsuit (a judicial foreclosure), and there is no right of repossession or self-help as with a UCC lien arising from the grant of a security interest (as discussed above).

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## Grape Contracts

In addition, the grape market over the last year and into 2010 makes enforcement even more challenging. As with many contract claims, the measure of damages is based on the contract price minus the sale price (or value) of the later-processed wine. Today and moving into the 2010 harvest, the wine price/value might be significantly less than the contract price. This is why the grower's lien should not be relied on exclusively as it may not provide full security for the bargained-for price of the grapes.

a license to the winery to use the name of the grower's vineyard on the bottle and base the license fee on the bottle price—that way, the grape price itself is not a function of the bottle price, but the grower and winery both get to participate in the potential upside.

### Can we talk?

Communication needs to be more than just a noble goal of the parties but required in the body of the contract itself. For example, contractual provisions requiring regular meetings

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### Price Formulas and Pitfalls

The traditional "per ton" contract is the most common form of winery-grower agreement but is also more prone to disputes in recent years over viticultural practices, hang time, etc. One way to avoid these issues is to incorporate a so-called Dehydration Adjustment into the contract, which provides an increase in price for each degree of Brix over the contract maximum. Alternatively, the winery and grower can agree on tonnage in the vineyard prior to harvest. Simple provisions with examples can achieve these results.

It is also important to be aware that a grape contract price formula based on the wine's bottle price is generally a violation of The Clare Berryhill Grape Crush Report Act of 1976, which requires that prices under grape contracts be set prior to January 10 of each year. An alternative to avoid a Berryhill Act problem is to have the grower grant

regarding viticultural practices, updating of exhibits regarding such practices at least annually and appointing a third party tie-breaker in the event of a deadlock are just some of the menu of options for fostering increased communication, trust and security.

### Giving and Getting Some Love

If a winery has given any indication of its inability to pay (or even if the grower hears a rumor from a trusted source), a grower can demand "adequate assurances" of future performance under UCC §2-609, which is generally done by way of an adequate assurances letter asking the winery whether it can in fact accept delivery and pay for the fruit in accordance with the contract terms. If the winery does not provide adequate assurances (based on commercially reasonable standards which tend to favor the grower), the

grower can treat the winery as having breached the contract under the Doctrine of Anticipatory Repudiation. Options in such a case are as follows:

**Pre-Harvest.** The grower can file a CDFA complaint while at the same time attempting to find other buyers, if possible, in order to fix the amount of their loss as the grower has a duty to reasonably mitigate damages. Keep in mind that a processor's license is not required for the purchase of bulk wine, only grapes, so leverage through CDFA is limited if a winery wants to go out and buy bulk wine to avoid its obligations under the contract in advance of delivery. In addition or in the alternative, the grower can commence legal action by way of a mediation or lawsuit (depending on what the contract provides) for the recovery of damages. The measure of these damages will be based on the difference between the price the grower is able to obtain for the grapes

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(called "cover") and the contract price. Often, however, a winery can propose a reasonable settlement by taking some grapes or paying some portion of the measure of damages in order to avoid a full-on legal war.

**Post-harvest.** The grower should advise the winery of its grower's lien, file a complaint with CDFA and/or commence legal action. Again, a settlement is always preferred if the parties can come to some middle ground.

## Avoid Disputes Early On

So when it comes to negotiating, drafting or amending your grape contracts, think about your warm relationship and clear communication but be sure to build in concrete protections for both parties that help avoid disputes before they happen, help the winery get the grapes it bargained for at a fair price and help the grower get timely payment for their considerable labor.

In the words of Tenzin Gyatso, the 14th Dalai Lama, "Dialogue is the most effective way of resolving disputes." I would only add that in addition to dialogue for both resolving and avoiding disputes, a thoughtful contract goes a long way, too. **WBM**

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