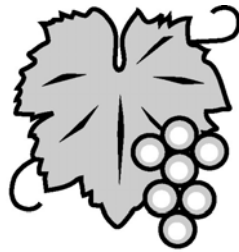


CALIFORNIA ASSOCIATION OF WINEGRAPE GROWERS

CONTRACT NEGOTIATIONS AND CONSIDERATIONS

FOR THE

WINEGRAPE GROWER©



CALIFORNIA
ASSOCIATION of
WINEGRAPE
GROWERS

Material Prepared for the
California Association of Winegrape Growers
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Value
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A. INTRODUCTION

This outline was initially prepared and has been amended several times for the California Association of Winegrape Growers (CAWG). It is intended to be a checklist to be considered by members who are winegrape growers before signing an agreement for the sale of grapes. The outline combines preliminary observations about contracts in general and the importance of a written agreement with a brief discussion of each of the basic terms of a contract for the purchase and sale of grapes.¹ Since this outline was originally prepared the industry has significantly evolved. This version incorporates changes driven by factors such as the expansion of the global market, the entry of many new growers and buyers into the industry, and the experiences gained in at least one more full supply/demand cycle. Other examples of industry evolution include the expanded use of planting contracts, evergreen clauses and the relatively new practices seen with delayed harvest decisions.

This outline may be utilized to evaluate an agreement provided to you for consideration. In addition, you may find it useful in the event that you decide to draft your own agreement. (If you decide to do this, it may be a good idea to have an attorney review the finished product to ensure that it will be enforceable.)

B. OVERVIEW

Generally, it is in the mutual interest of the parties to a commercial transaction to put their agreement in writing. In fact, California Commercial Code section 2201 requires a writing where goods priced at \$500.00 or more are the subject of the agreement. Furthermore, oral agreements are inherently uncertain, invite controversy and offer the grower little protection against a breach by the buyer. Therefore, absent special circumstances, a grower is well advised to put in writing the agreements he reaches with buyers.

Buyers often have a form contract for the seller to sign. There is nothing sacred about a printed form. The parties are always at liberty to change the form or make additions. Depending upon the grower's relative bargaining strength, changes or concessions from the buyer on a

¹ This outline is intended for general information purposes only. It is not meant to be legal advice or a substitute for such advice. You are encouraged to consult an attorney about your specific situation and questions. For further information about resources available to growers, contact CAWG at (916) 924-5370. This outline was originally prepared by Samuel D. Hinkle and William M. Lyons formerly of McCutchen, Doyle, Brown & Enerson. It was revised in 1996 by Kurt A. Kappes and Sean C. O'Connell of Seyfarth, Shaw, Fairweather & Geraldson, Sacramento. It was further revised in 2001 by Dale A. Stern of Kahn, Soares & Conway, LLP, Sacramento, and has been most recently updated (July, 2005) by Dale at his new firm, Stern, VanVleck & Ruehmann, LLP, also of Sacramento. To contact Mr. Stern, please call 916/442-1298 or dstern@dvbsr.com.

particular term may be possible. If alterations to the form are agreed upon, they should be made legibly and in ink. Additionally, the grower and buyer should initial all changes and additions to the typed or printed text. If the effects of any changes made to the proposed form are uncertain or ambiguous, that provision may be construed against the party who made the change.

When numerous or lengthy terms are added to a proposed form, it may be easier (and neater) to attach an Addendum to the contract and incorporate it into the printed form. For example the parties can easily provide, "This Agreement is made this first day of January 2005, between X grower and Y winery and includes the attached Addendum, which is expressly incorporated by this reference." Alternatively, the parties can write on the face of the form agreement [and initial] above the signature block, "This Agreement includes and incorporates the attached Addendum." Be sure that the Addendum clearly designates the specific contract to which it is attached. Thus, the Addendum in the example above would be entitled, "Addendum to Contract of January I, 2005, between X and Y."

In reviewing a proposed contract, the grower should make certain that the language is unambiguous and that the provisions of the contract are consistent with one another. Any ambiguities or inconsistencies which may work to the grower's disadvantage should be brought to the attention of the buyer. The grower should verify that all the relevant blanks of a contract have been filled in - accurately - and that the written contract contains the entire understanding of the parties. If the buyer has agreed to any terms which are not included in the writing, the grower should insist that those terms be added to the written agreement, especially if the written agreement contains an "integration clause, which is discussed in Section B. 15 below.

Before reviewing a proposed new or renewal contract with a winery, a grower should consider their relationship with that winery. It can be looked at as a Relationship Scale where some factors indicate a cautious and conservative review of every line in a proposed contract, while other factors indicate a less rigorous negotiation with the buyer. This doesn't mean that a grower should ever sign a contract with unacceptable provisions, even where the buyer's agent says "Oh, we never enforce that provision". It does mean that some of the potentially ambiguous contract provisions discussed in this outline or in CAWG's Smart Marketer Workshops may be of less concern if the Relationship Scale tilts in favor of more trust.

A simple illustration of the Relationship Scale might look something like this:



The more of these factors that slide to the right on the scale, the more confidence a grower can have in the winery's likelihood of fairly interpreting and applying any flexible, discretionary or ambiguous provisions in the proposed contract. Examples of the factors a grower should weigh when looking at this Scale include:

Individual Factors

Is either the winery or the grower new to the industry?
Does the proposed contract cover a large percentage of the grower's available production where the risk of financial failure is great should the winery default?
Does the winery have a general reputation of treating growers fairly?
Does the winery check out well with CDFA Market Enforcement? With other lenders?
Is the grower's personality risk averse or more adventurous?
If the winery's farming practices or vineyard oversight are defined in the contract, is the grower willing to relinquish the amount of control as stated in that provision?
Are the winemaker and other key personnel stable or short timers?
Are the variety, vintages, appellation and other details in the proposed contract part of the winery's long term program, or something new or experimental?

Experience Factors

How much history is there between the parties? Good, bad or otherwise?
Was the proposed contract negotiated fairly, or was it given to the grower on a "take it or leave it basis"?
What is the duration of the term of the proposed contract? What are the prospects for renewal if both parties are happy with the other's performance?
Does either the proposed contract or the parties' relationship history demonstrate enough flexibility for the parties to modify the contract terms as unforeseen events occur over the duration of the contract?

Industry Factors

What stage of the current industry cycle are we in at this time?
What are the current and projected supply and demand statistics for the industry in general and for the particular variety, vintages and appellation in the proposed contract?
How does the contract price compare to the crush report averages in the grower's district? Some might fear that pricing in the top 5% could indicate a higher likelihood that the winery will look for escape clauses when the industry cycle changes.

Any grower who has attended recent *Smart Marketer Workshops* sponsored by **CAWG** and regional grower associations can attest to the fact that nearly every speaker, whether grower or winery oriented, emphasized the importance of a good working relationship between the parties as the single best indicator of whether they are likely to enjoy a full and prosperous contract term. One winery representative described this fact best when he said something to the effect that his winery would rather have a long term relationship with a grower who produces grapes in the top 30% of quality and works hard on communication and teamwork with the winemaker and field staff than they would with a grower who produces top 2% in quality, but who is uncommunicative, inflexible and unreasonably demanding.

C. BASIC CONTRACT TERMS

1. Date and Names of Parties.

- a. Is the effective date of the contract stated?
- b. Are the exact names and addresses of the buyer and grower specified?
- c. If the buyer is not an individual, is the form of the purchasing entity specified, corporation, partnership, limited partnership, etc.)?
- d. Does the name of the buyer on the contract match the grower's understanding?
- e. Has the grower checked with CDFA – Market Enforcement Branch [(916) 341-6276] to determine the buyer's license category, license status, and disciplinary history?
- f. If the license is held under a different name than the name on the contract, no matter how slight the difference, the contract should be changed to match the correct licensed buyer's name.
- g. Did the buyer's representative negotiate or sign the contract on behalf of the buyer? If yes, has the grower checked with the Market Enforcement Branch to determine whether the representative is a licensed Agent for the buyer, the agent's license status, and disciplinary history?

It is important to remember that a sale of grapes where payment is due at a later date is essentially a loan of a valuable commodity to the buyer. As one would with any other loan of cash or items of value to another, you should check out the credit worthiness of the buyer. Depending on factors such as the Relationship Scale, some growers would be wise to run a credit check in addition to making inquiries with the CDFA Market Enforcement Branch. Some even insist on letters of credit from the buyer's bank or a personal guarantee by the winery's owner before entering a grape purchase agreement where indicators tilt towards "More Caution" on the Relationship Scale.

2. Quantity, Variety and Location of Grapes to Be Sold.

- a. Are the variety and quantity of the grapes clearly specified?
- b. Is the vineyard from which the grapes are to be picked specified?

- c. If the quantity of grapes being sold is not fixed, is the procedure for determining the precise number of tons or acres specified and is the procedure satisfactory?
- d. If the quantity is fixed, and is stated as a number of tons, what happens if the grower's vineyard produces less than that number of tons? Would the grower be obligated to purchase grapes for delivery to the buyer at the contract price?

There is nothing inherently wrong with covering multiple varieties, vineyard blocks and prices in a single contract although many believe that a separate contract for each is easier to interpret and enforce should that be necessary down the road.

Quantity can be expressed in a number of different ways, depending upon the intent and preferences of the contracting parties. The grower and seller may agree, for example, upon a set number of tons of grapes to be sold, in which case the number should be stated clearly in the Agreement. Ordinarily the grower will want his obligation to deliver the stated number of tons to be conditioned upon the total production of his vineyard being equal to or greater than the stated number. The grower should check whether the contract, as written, imposes on him an unconditional obligation to supply the stated number of tons at the contract price, regardless of the vineyard's total production. If such an obligation is imposed and the grower's own production falls short of the stated number of tons, the grower will be contractually bound to purchase grapes for delivery to the buyer, regardless of the then prevailing market price. An assessment of one's potential liability under such a provision will aid in determining whether it makes business sense to agree to the unconditional obligation. (For example, in return for incurring the potential liability, the grower may be given a higher price for his grapes.)

Instead of specifying a particular number of tons of grapes to be purchased, a buyer and grower may want to specify a range of tons to be sold. In either case, the grower should require the buyer to give the grower notice, by a certain date, of its decision as to how many tons within the range it will purchase (assuming the buyer has the right to make that decision under the Agreement). Instead of expressing the quantity of grapes to be sold in terms of tonnage, the parties may agree upon the acreage to be sold.

Finally, if the Agreement covers less than all the grower's grapes, it is wise to include an acknowledgement by the buyer that the grower is free to enter into, and may have already entered into, other grape purchase agreements with other buyers. In this situation, the blocks, rows or other description of the portion of the grapes committed to that buyer should be set forth in the contract.

3. Term and Termination of Agreement

- a. Is the Agreement for a specified term?
- b. Is it renewable? If so, at whose option?
- c. When is notice of renewal required to be given?

- d. Under what circumstances can it be canceled without liability to the other party?

The Agreement should specify whether it pertains to grapes picked in a single season or to grapes picked during a period of years, and whether or not it is renewable. If the Agreement is subject to renewal, provisions for notice of the election to renew are necessary. The grower should ensure that notice of renewal is given, or received, as the case may be, early enough to permit the grower to enter into other contracts in the event of norenewal

It is important for growers to recognize the difference between early termination clauses and evergreen clauses in a contract. The importance derives from the need to understand when notices must be given and what the growers' rights and remedies are when either party gives notice to the other that they intend to trigger the specific clause.

In its most simple terms an early termination clause would be something like, *“this contract shall be for a period of 10 years unless either party gives notice to the other of an earlier termination. Notice can not be given before 2008, and can only be given during the month of February in any year thereafter. Upon notice, the contract shall expire after 2 more harvests.”*

In contrast, a simplistic evergreen clause might provide *“this contract shall be for a period of two years after which it will automatically renew unless notice of termination is given by one party to the other. Upon notice given after January 1 of 2007, the parties shall continue to perform under this contract for two additional harvests. Notice of termination must be given before March 31 of any year.”*

4. **Place, Cost and Time of Delivery**

- a. Is the point of delivery specified?
- b. If not, or if the buyer is permitted to specify a different point of delivery, is a limitation placed on the distance which a point of delivery may be from seller's vineyard?
- c. Who must pay for the freight charges?
- d. Who pays for standby time charges at the vineyard?
- e. Who pays for standby charges at the winery?
- f. Is the time for delivery reasonable?
- g. Who determines when the grapes are to be picked?
- h. Is the buyer required to accept delivery of grapes within a specified number of hours after notification that, in the grower's opinion, the grapes should be picked?

It is in the grower's interest to require the buyer to specify in the Agreement the point of delivery for the grapes and to limit the buyer's ability to designate a different point of delivery.

The Agreement should specify which party is to pay for freight charges incurred in delivering the grapes and should state which party is responsible for standby charges at the vineyard and which party is responsible for standby charges at the winery.

There has been much discussion over the last few years about an increase in the practice of delayed harvest, or “long hang-time”. Growers are rightfully concerned about this, or any practice that increases their risks and lowers their profits. Among the risks associated with delayed harvest are:

- i. lost weight from dehydration means lost income on a per ton contract;
- ii. exposure to crop losses from weather, pests, and diseases;
- iii. exposure to potential rejection and/or deductions because grapes fail to meet stringent quality requirements at the winery.

A buyer’s right to delay harvest often shows up in the “Time of Harvest/Delivery” section of a contract. However, it can also be found in Quality Standards, Vineyard Practices, and a number of other contract provisions. Accordingly, it is important for growers to carefully review a proposed contract to determine whether the grower, the winery, or both working together have the right to determine when harvest may occur, and the latest time by which it must occur. Where a contract states that the parties will “mutually determine” when harvest will occur, a grower must consider the possibility that a winery will object to the grower’s harvest recommendations and insist on a later date. In that scenario, the parties have not “mutually” agreed and a winery could arguably delay harvest for some time. Of course, there can be later scrutiny of whether the winery’s delays were reasonable or inconsistent with the contract, but that doesn’t help the grower in the middle of harvest when they are asked to delay for a week or another couple of degrees Brix.

Several potential solutions to this dilemma have been suggested in the last couple of years. Among those are a contract provision that establishes an absolute maximum sugar level at which harvest must occur; contract provisions that waive any rejection rights or deductions when a grower leaves grapes in the vineyard at the winery’s request; and financial incentives for increased sugar, color, smell and taste concentrations.

Again depending on the strength of the grower’s bargaining position and the tilt of the Relationship Scale, growers should consider as many options as possible in order to reduce or eliminate their risks associated with delayed harvest.

5. Time for Acceptance of Grapes by Buyer

- a. Is the contract clear on what constitutes acceptance by the buyer?

Delivery of grapes to the winery does not necessarily mean that the winery has accepted them. Because the risks of loss, rejection and deductions remain with the grower until the time of “acceptance”, it is important that the contract spells out when that event occurs.

6. **Quality Standards for Grapes.**

- a. Are minimum quality standards specified for the grapes?
- b. Are the standards expressed in precise terms which are capable of objective determination, e.g. degrees Brix, total acid, pH, allowable amounts (by weight) of foreign material and rot?
- c. Is the buyer required to notify the grower of its acceptance or rejection of grapes within a certain amount of time after delivery?
- d. Is there a clear distinction between quality standards that might give rise to a rejection of a load of grapes and those that might lead to a deduction in price?

The Agreement may or may not establish minimum standards for grapes to be delivered under the Agreement. Typically, grapes which do not meet such minimum standards may be rejected by the buyer. If the Agreement contains such standards, the grower may be at the mercy of the buyer. Language permitting the buyer, for example, to reject any grapes which are “unfit for crushing,” or “not of sufficient quality for the winery’s premium program,” or which are “essentially free” from mold or mildew is so vague as to give the buyer an excessive amount of discretion. If minimum standards are used, they should be expressed in precise terms which are capable of objective determination, e.g. degrees Brix, total acid, and pH. An important consideration is whether the grapes are to be tested, for purposes of rejecting or accepting them, on a per load, average or weighted average basis.

In every instance in which the buyer may reject grapes or deduct from the purchase price, the buyer should be required to give the grower immediate notice of its determination so that the grower may seek another test by an independent agency or sell the grapes elsewhere. If the buyer fails to give the requisite notice of rejection or deduction, it should be required to pay for the grapes in accordance with the Agreement.

Growers should beware of contract provisions which give the winery more control over their farming practices than the grower is willing to relinquish. And of provisions that give the winery complete discretion to modify the quality requirements during the years the contract is in effect. It is common for quality standards to be written in words that are fairly general and somewhat vague. Depending on the Relationship Scale growers should only sign a contract with this kind of provision if they are very comfortable that the winery will treat them fairly when the time comes to apply those quality standards to the grapes waiting at the crush facility. It is easy to feel comfortable with some ambiguities in a contract when demand is good and memories of bad weather during harvest have faded in to the past. Growers would be wise to think about how a contract might be interpreted in the event that conditions aren’t so good in the 4th or 5th year of a multi-year deal, and evaluate their willingness to sign the contract today in that light.

7. Weighing and Testing of Grapes.

- a. Is the testing required by the Agreement limited to matters which have an effect on price or on the buyer's right to reject grapes?
- b. Does the Agreement require the grapes to be weighed by a licensed weighmaster and all tests be performed by the Department of Food and Agriculture or County Agricultural Commissioner or one of their deputies or inspectors?
- c. Does the Agreement require the buyer to furnish copies of all weighmaster's certificates of test results to the grower within a certain amount of time?
- d. Is there a provision for retesting at the grower's expense if the grower desires a second test?
- e. In the event of a second test, does the Agreement state that the results of the first and second tests shall be averaged?
- f. Is the buyer required to have all tests of the grapes performed within a specified number of hours following delivery?

Section 55581 of the Code provides that all grapes which are sold to a processor on the basis of weight shall be weighed by a weighmaster licensed under the laws of the State of California and the weighmaster shall issue a certificate of the weight of such grapes which shall be delivered to the grower by either the buyer or the weighmaster. Section 55581 of the Code also provides that the purchase price for grapes sold on the basis of weight must be determined on the basis of the weight shown on the weighmaster's certificate. Therefore, the grower need not accept any weights of grapes which are not evidenced by a certificate of a licensed weighmaster and any contractual provision to the contrary is invalid.

Section 55608 provides that accurate grading and weight receipts must be given by all processors to each producer, or his agent, upon each and every delivery. Each receipt shall state all of the following:

- (a) The date of the receipt.
- (b) The name and address of the producer.
- (c) The name of the processor.

Section 55609 provides that not later than five days after demand, the processor shall give to every such producer so requesting a full and complete statement of such producer's account, which shows all of the following:

- (a) The entire quantities of the product which has been delivered by the producer.
- (b) The grades of the product which has been delivered by the producer.
- (c) The amount which is owing for every lot and for the total amount of the product which has been delivered by the producer.

(1) Sugar Content. If the contract provides for a premium or penalty on the basis of the average percentage of soluble solids in the juice of the grapes delivered, the determination of such percentage must be made by the Commissioner or, where appropriate, the Secretary. If the Agreement specifies a flat price per ton, but permits the buyer to reject loads of grapes having an average percentage of soluble solids less than a specified minimum, Section 41161 of the Code would appear to require that such average percentage be determined by the Commissioner or Secretary. However, in such cases, it is best to state in the Agreement itself that the Commissioner or Secretary shall determine the average percentage of soluble solids for each load of grapes which is tested for sugar content.

Any terms such as "sugar content" or "average percentage of soluble solids" which appear on the Agreement should be defined so as to avoid misunderstandings. Important points to define include the location where sugar content will be tested to determine harvest timing. Disputes occasionally arise as to whether that test may be performed by the grower in the vineyard, or is the official test limited only to the grade stand at the winery?

(2) Amount of Foreign Material. Under Section 41192 of the Code, whenever the percentage of foreign material (or material other than grapes) has any effect on the amount of the purchase price for grapes, the determination of such percentage must be made by the Secretary of the State Department of Food and Agriculture.

Some Agreements permit the buyer to reject any load of grapes containing more than a specified amount of foreign material. Other Agreements permit loads of grapes delivered thereunder to contain some amount of foreign material and provide that each load of grapes containing foreign material in excess of that amount entitles the buyer to deduct the weight of such excess from the net weight of the load in determining the purchase price for such load. The Agreement may also provide that if a load of grapes contains foreign material in excess of some greater amount, then the buyer may reject the load. While Section 41192 of the Code would appear to require that determinations of the percentage of foreign material be made by the Secretary, whether the determination is to be used for purposes of deducting weight or rejecting loads, it is best to state in the Agreement itself that all determinations of the amount of foreign material are to be made by the Secretary of the State Department of Food and Agriculture or one of his deputies or inspectors (the "Secretary").

It is essential that the permissible amount of foreign material be expressed precisely. A specified percentage of foreign material in a load of grapes is a suitable and reasonably concrete measure. Moreover, because the protection afforded by Section 41192 of the Code is conditioned upon the "percentage" of foreign material having an effect on the purchase price of the grapes; it is ill advised to express the permissible amount in anything other than a percentage. Phrases such as "buyer may reject any loads which in its opinion have excessive leaves or stems"

are hopelessly vague and totally contrary to the spirit, if not violative, of Section 41192 of the Code.

If the Agreement gives the buyer the right to reject loads of grapes having foreign material in excess of a specified percentage, the buyer should be required to immediately notify the grower by telephone and in writing of any such rejection. Additionally, the Agreement should specify whether determinations of the percentage of foreign material are to be made on a per load, average, or weighted average basis. Section 1662 of Title 3 of the California Administrative Code required the results of tests for foreign materials to be reported in terms of the weight of the material other than grapes in "ounces, pounds per ton, and percentage."

(3) Amount of Mildew or Rot. Under Section 41192 of the Code, when the percentage of rot has any effect on the purchase price for the grapes, the determination of such percentage must also be made by the Secretary. The discussion of the provisions concerning the amount of foreign material in paragraph (2) above pertains to provisions concerning the amount of mildew or rot as well. Under Section 1662 of Title 3 of the California Administrative Code, the results of tests for "defects," detailed under Section 1661.2 means that evidence of mold, rot or mildew resulting in decomposition, are to be reported as follows: "Defects shall be weighed and reported to the nearest half-pound and percentage. "

(4) Notification of Test Results. The Agreement should obligate the buyer to furnish the grower with a signed copy of the certificate setting forth the results of each test of the grower's grapes for sugar content, foreign material or rot or a copy of the combined inspection certificate and weighmaster's certificate. Section 1662 of Title 3 of the California Administrative Code is quite specific with respect to the required contents of certificates. Among other things, each certificate must be numbered serially, shall provide the name of the grower(s) and shall state the date, time, weight certificate number and the total number of samples taken, including retests or regrades. Significantly, Section 1662 provides that any original or duplicate original certificate shall be invalid if it has been altered in any way, unless the alteration is initialed by an authorized inspector.

The grower may want the contract to require the buyer to notify him by telephone of all test results indicating a load of grapes is subject to a deduction from the purchase price or subject to rejection. In all events, the buyer should be required to notify the grower of any election to reject a load of grapes within a specified amount of time.

(5) Retesting. The Agreement should specify whether the first (irregular) test of grapes for sugar content, foreign material or rot shall be binding upon the parties or whether the grower or buyer may, at his or its sole expense; request a second test to be performed by the Commissioner or the Secretary. In the event of a second test, the Agreement should state that the results of the two tests will be averaged, as required by Section 1658.3 of Title 3 of the California Administrative Code. A provision for more than two tests is impractical and, in the case of tests for sugar content, is prohibited by Section 1658.3. If, however, it is established to the satisfaction of the Secretary or the Commissioner that a test is "not representative of the lot or load of grapes," then Section 1658.3 provides that the nonrepresentative test may be discarded and a new test performed.

8. Price.

- a. What price per ton is the buyer obligated to pay for the grapes?
- b. Would the parties prefer a price provision which provides for variable prices based, for example, on some quantitative aspect of the grapes, e.g. sugar content?
- c. If the exact price is not set by the Agreement, is the date by which it must be set and the method of setting it specified? (Note: By law, the date specified for determining the price can be no later than the January 10 immediately following the delivery of the grapes or the Agreement may be unenforceable. Price terms such as “prevailing price” or “reasonable price” should be used only in conjunction with specific, objective methods for determining the actual price before the January 10 time limit.
- d. Does the Agreement provide for reductions from or additions to a base price? If so, are the adjustments fair so far as the grower is concerned and is there a floor on penalties specified?
- e. If the Agreement is a multi-year contract, does the price provision adequately and accurately reflect the manner in which the price will change from year to year?

The price provision is an essential term of every contract. It should recite the agreed upon price per ton or per acre to be paid for grapes delivered under the Agreement or, alternatively, the agreed upon method for determining the price at a specified future time.

An agreed upon purchase price may be stated in terms of a flat price per ton, or in terms of an alternative flat price per ton or with increasing frequency, on a per acre of grapes produced and delivered basis. Instead of a flat price, the purchase price may be stated in terms of a base price with a premium to be paid, for example, for grapes having a greater sugar content than a specified degrees Brix, or with both a premium or penalty. If the Agreement's price provisions include a penalty, the grower should consider designating a floor below which no penalty will be charged. Further, the amount of the penalty imposed should be tied specifically to a level of Brix or other clearly quantifiable factor. Inclusion of a formula only invites disagreement as to how the formula works.

If the parties agree upon a method for determining price instead of agreeing upon a specific price, the method should be described in detail using examples if possible and the Agreement should require that the price be determined pursuant to the agreed upon method, by a specific date.

If neither a price nor a method for determining price is agreed upon by the grower and buyer and the buyer refuses to pay for the grapes, the grower is protected by Section 55631 of

the Food and Agriculture Code which grants him an automatic Producer's lien on all grapes he has delivered, regardless of the absence of an agreement as to price. The grower's preferred lien is discussed in greater detail in Section B.17, below.

Also, if the Agreement covers more than one harvest, the price provision should clearly and accurately describe the manner in which the price will be adjusted from year to year. If the price is pegged to an independent source of information such as a price index or grape crush report, that source of information should be described in as much detail as possible (e.g. exact name, publisher, approximate date of publication, etc.).

9. **Terms of Payment.**

- a. Are the terms of payment designated? (*Note: If a payment date is not specified in an Agreement, the law provides that payment is due within 30 days of delivery.*)
- b. Is interest on installment payments provided for?
- c. Is interest on delinquent payments provided for? (*Note: Interest charges on delinquent payments must be kept within the fluctuating limits of the usury laws.*)

While Section 55601.5(g) of the Code requires that grape prices be determined by January 10, it is silent with respect to the time for payment of the purchase price. The Code permits the parties to agree, as they see fit, upon a payment schedule. If no time for payment is set by the Agreement, then, under Section 55601 of the Code, a processor of grapes must pay for the grapes within 30 days of the date on which they were delivered or the date on which the processor took possession of the grapes, unless otherwise agreed by the parties.

The Agreement may provide for payment of the entire purchase price on a specific date or it may provide for a schedule of payments on specific dates. A discussion of tax considerations is beyond the scope of this outline. Please note, however, that an individual grower's tax situation may make it advantageous for him to defer payment under the Agreement so as to defer income to a subsequent tax year. Where the purchase price is to be paid in more than one payment, the grower should consider charging the buyer interest, on the balance remaining after the first payment. If interest is to be charged on non-delinquent amounts, a specific interest rate should be agreed upon by the parties and designated in the Agreement.

With respect to delinquent amounts, Section 55881 provides that any delinquent payment of any money due under a contract for the purchase of farm products shall also include a late charge of 5% of the delinquent amount for the first month of delinquency and 1% of the delinquent amount per month for the remaining period of the delinquency. The late charge is payable to the grower, unless the grower has waived, in writing, his right to the charge and his waiver was executed after the buyer had become delinquent. This should be expressly limited to the maximum rate allowed by law.

Finally, it is to the grower's advantage for the terms of payment provision to provide that the buyer shall have no right to withhold or set off any payment due and owing to the grower.

10. **Grower's Warranties.**

- a. Is any warranty limited to the condition of the grapes at the time of delivery?
- b. Are the grapes which are being sold subject to any encumbrances?
- c. Is the grower required to warrant his title to the grapes, and if so, is the warranty which is included in the proposed contract accurate?

Frequently the grower of grapes will be asked to warrant that the grapes, when delivered, will not be "adulterated or misbranded," will not be articles which are prohibited under the provisions of the Federal Food, Drug and Cosmetic Act (hereafter, the "Act") from being introduced into interstate commerce, will not bear or contain pesticide residue prohibited by or in excess of tolerances established by the Act, or by any regulatory authority, and will meet all applicable standards of the Act and the Sherman Food, Drug and Cosmetic Law of the State of California.

Inasmuch as a breach of the foregoing warranty would amount to a violation of law, the grower should have no objection to making the requested warranty. However, the grower should check to see that his warranty is limited to the condition of the grapes at the-time of delivery and that he is not warranting compliance with the law of any state other than California (unless the grower is delivering the grapes in such other state).

The buyer may request that the grower warrant his title to the grapes being sold. If so requested, the grower should read the warranty of title carefully and, if necessary, review any lending agreements or security agreements by which he is bound which may encumber the grower's grapes. It may also be necessary for the grower to consult with his lenders as to the existence of any encumbrances. Each lien and encumbrance known to the grower should be specified as an exception to the warranty of title.

Growers should ensure they understand and are willing and able to comply with any warranties they grant in a contract. Any warranty to the effect that "All grapes are delivered free and clear of any and all liens" should be modified to clarify that the grower is not waiving their Producer's lien as discussed in B. 13, below.

11. **Allocation of Risks and Liabilities.**

- a. Does the Agreement clearly state at which point the risk of loss or damage to grapes shifts from seller to buyer?
- b. Does the liability for damage caused by foreign material in the grapes (i.e., damage to processing equipment) shift to the buyer upon acceptance of the grapes?
- c. Does the grower have adequate insurance against the risks and liabilities to him?

It is important that the Agreement clearly allocates between the buyer and grower all risks of loss or damage to the grapes and all liability for damages caused by the grapes (including foreign material in the grapes). Customarily, the grower bears all risk of loss or damage to the grapes and all liability for damages caused by the grapes until they have been delivered and tested by the buyer. Therefore, all risks and liabilities (including liability for all damages caused to buyer's processing equipment by foreign material contained in loads of grapes which have been accepted by the buyer) should be borne by the buyer and it is prudent to say so in the Agreement.

It would be preferable, from the grower's point of view, to have all risks and liabilities shift to the buyer sooner, such as upon the loading of the grapes at the vineyard for delivery to the buyer or upon the completion of delivery to the buyer. Where the grower can get the buyer to agree to an earlier shifting of risks and liabilities, it is to his advantage to do so.

12. **Security for Growers.**

- a. Is the buyer credit worthy? The grower may want the buyer to supply a credit reference which the grower can check.
- b. In the Agreement, does the grower reserve a purchase money security interest in the grapes sold (and the products of the grapes) in order to secure his right to payment? If so, does the Agreement provide that the buyer will not commingle the grower's grapes with other grapes until the grapes are paid for in full?
- c. If the grower is concerned about the credit worthiness of the buyer, does the grower take a security interest in other property or equipment of the buyer?
- d. Does the Agreement provide that the buyer will execute UCC-1 Financing Statements or other documents necessary to perfect the grower's security interests?
- e. Does the Agreement provide that the grower may accelerate all payments due in the event the buyer breaches the Agreement?
- f. Is a personal guaranty necessary to protect the grower? If the buyer is an entity (corporation, partnership, etc.) that is controlled by an individual, the buyer may want the controlling individual to provide a personal guaranty of the buyer's payment obligation.

If the grower is concerned about the buyer's ability to pay for the grapes, the grower may want to take certain precautions before selling the grapes and may also want to insert certain protective provisions in the Agreement. Before entering into the Agreement, the grower should consider asking the buyer to supply credit references which the grower can check. In addition, the grower may want to request the office of the California Secretary of State (or other

State if the buyer's business is not located in California) to run a search of the UCC-1 Financing Statements that have been filed relating to the property of the buyer. In this way the grower can determine the nature and extent of existing liens against the buyer.

In the Agreement the grower can reserve a purchase money security interest in the grapes sold (and the products of the grapes), in order to secure his right to payment. Depending on the grower's relative bargaining strength, he may also be able to take a security interest in other collateral (such as a piece of equipment) of the buyer. The Agreement should describe the specific events of default which would allow the grower to enforce its security interest. Generally, these would include any breach of the Agreement by the buyer (including failure to pay for the grapes) and any sale or assignment of the collateral. The Agreement should specifically state that the grower may accelerate all payments due upon an event of default.

Finally, "the Agreement should state that the buyer will cooperate with the grower in executing and filing UCC-1 Financing Statements covering the grapes and other collateral. Such Financing Statements must be filed with the California Secretary of State (or other state if the grapes or other collateral will not be located in California) in order to "perfect" the grower's secured position. Failure to perfect may weaken the grower's position vis-à-vis other creditors of the buyer.

13. Remedies.

- a. Does the Agreement contain a provision concerning special remedies in the event the buyer wrongfully refuses to accept grapes? May the grower resell the grapes in the event of rejection by the buyer without prejudice to the grower's rights against the Buyer under the Agreement?
- b. Does the Agreement state that such remedies are in addition to any other remedies the grower may have in law or equity?

Some Agreements provide for special remedies which will be available to a party in the event of a breach by the other party. For example, an Agreement might provide that if the buyer fails to accept delivery of grapes within 72 hours after notice by the grower that such grapes should be harvested, then, "in addition to all other remedies provided by law, equity or this Agreement, the grower may sell such grapes elsewhere and recover from the buyer the excess, if any, of the price buyer agreed to pay for such grapes and the price obtained elsewhere, without voiding the Agreement with respect to any other grapes."

Unless the grower's remedies provided for in an Agreement are intended to be exclusive, the Agreement should state that such remedies are not exclusive.

Apart from the usual legal remedies available to a litigant for breach of contract, California growers are entitled to pursue two special remedies in the event a buyer of grapes fails to pay for the grapes as agreed:

(1) Producer's Lien. Section 55631 of the Code grants to every producer of farm products including grapes, in addition to all other rights and remedies provided by law, a lien upon all grapes grown by the grower and sold by him to a processor under contract, whether expressed or implied, and a lien upon all processed or manufactured forms of such grapes. The amount of the lien is the agreed purchase price, if any, of the grapes sold. If there is no agreed price and no agreed method for determining the price, the amount of the lien is the "value" of the grapes as of the date of delivery. Any portion of the grapes, or of the processed or manufactured forms of the grapes, in excess of the amount necessary to satisfy the total amount owned to growers under contract, is not encumbered by Section 55631 of the Code.

Under Section 55633, the Producer's lien is given preference over all other liens except: (a) liens for wages and salaries for personal services rendered by any person to any processor in connection with the processing of the grapes delivered; and (b) liens of warehousemen (persons engaged in the business of storing goods for hire).

The Producer's lien attaches to the grapes on the date of delivery or, in the case of a series of (deliveries, on the date of the last delivery. At any time following refusal or failure by the buyer to make payment for the grapes when due, the grower may bring suit to enforce his lien. Growers should contact CAWG if they are interested in additional information about their rights and obligations under the Producer's lien laws. Several past publications and Smart Marketer workshops have covered this issue in more detail than space permits in this outline.

(2) CDEA Market Enforcement Branch. In addition to the Producer's lien on their grapes, the Code empowers the Secretary to suspend or revoke the license of any processor of grapes or their agent for any violation of certain sections of the Code including the refusal or failure to make payment when due for grapes delivered.

A producer wishing to initiate an investigation or hearing by the Secretary should contact the Market Enforcement Branch office closest to the grower or the Branch's main office in Sacramento. The Branch's staff will assist the grower in completing a "Verified Complaint" form. The complaint must be filed with the Branch within nine months after the processor's breach of its contract with the grower.

If the Secretary finds that the processor breached its contract with the grower, the Secretary may suspend or revoke the license of the processor or handler. If the Secretary finds that money is owed by the processor to the grower, the Secretary's order, issued following a hearing, should specify the amount of money owed. Then, if the grower is unable to recover such amount from the processor the Secretary may suspend or revoke the processor's license.

14. **Assignability.**

- a. Can the grower assign his rights and obligations under the Agreement to another grower?
- b. Can he sell or lease his vineyard without breaching the Agreement?

Ordinarily, the grower wants to be able to assign his rights under the Agreement and he should check the Agreement to make certain it is not made unassignable by its terms. The assignability of the grower's rights can be significant. For example, in the event of a sale by the grower of his vineyard, he may want to be able to assign his rights under the Agreement to the purchaser of the vineyard. Conversely, in the event of a sale by the buyer of its winery, the grower may want the buyer's obligation under the Agreement to be binding upon the purchaser of the winery.

15. Severability of Provisions.

- a. Does the Agreement provide that if any provision of it is held to be invalid or unenforceable, the validity and enforceability of the remaining provisions shall not be affected?
- b. Is there any provision of the Agreement which is such an integral part of the contract that in the event it was found void the grower would want the entire Agreement to terminate?

In the event one provision of the Agreement is found to be void, it is usually in the interest of both parties that the balance of the Agreement remains in effect. Agreements commonly state that if any part of the Agreement is found to be illegal or unenforceable under applicable law, all of the remaining parts shall be considered severable, shall remain in full force, and effect, and shall be enforceable. If there is any particular provision of a contract which the grower does not want to be severable, such as the price term, the grower may add a proviso to the severability clause to that effect.

16. Integration Clause; Modification.

- a. Does the Agreement provide that it represents the entire agreement of the parties and that it supersedes all prior or contemporaneous understanding of the parties, whether oral or written, with respect to the grapes being sold?
- b. Does the Agreement provide that it may only be modified or waived by a written instrument, signed by the party against whom the modification or waiver is sought to be enforced?

In order to avoid the uncertainties of alleged oral "side agreements," it is advisable, to state in the written Agreement that it is intended as a complete and exclusive statement of the parties' understanding. Such statements of exclusivity are referred to as "integration clauses" and are often combined with a requirement that any modification of the written Agreement also be in writing.

17. Conditions Beyond the Control of Either Party.

- a. Does the Agreement permit the grower (not just the buyer) to escape the contract if his business is interrupted or interfered with due to a cause beyond his control, e.g. frost?

Some Agreements contain a provision permitting one party, or both parties, to terminate the contract, or escape liability for a failure to perform, when the party's business is interrupted or interfered with due to conditions beyond the party's control and performance is thereby made impossible.

Some of the form contracts used by wineries provide relief from performance only for interruptions of the winery's business due to causes beyond its control. Therefore, if a proposed Agreement was drafted by the buyer, and if it contains a clause concerning conditions beyond the control of the party, the grower should determine whether or not the protection afforded by the clause is available to him and, if it is not, seek an amendment to that effect.

18. **Applicable Law and Forum (Arbitration).**

- a. Does the Agreement specify what state's law will govern interpretation of the Agreement (ordinarily California if the grapes are grown and sold in the state)?
- b. Are some or all disputes under the Agreement⁶ referred to arbitration?
- c. Is the arbitration to the grower's advantage?
- d. Does the attorneys' fees provision of the Agreement, if there is one, apply to arbitration proceedings?

The Agreement may, but need not, specify the law which will govern the interpretation and enforcement of the Agreement. Ordinarily, if the Agreement is entered into in California and if the grapes being sold are to be grown and delivered in California, then California law should govern.

The grower may wish to have disputes under the Agreement settled by arbitration rather than in court. Arbitration proceedings are less formal and may be comparatively faster and less costly than judicial proceedings. Arbitration allows the parties to appoint a person with expertise in wine grape sales as the decision maker and permits the parties to resolve their disagreements in private. (Unlike arbitration proceedings, all court proceedings are matters of public record in the absence of a protective order.) Arbitration proceedings are thought to be comparatively less contentious, which is an important consideration for parties with ongoing business dealings. The principal disadvantages of arbitration are that parties who agree to arbitrate effectively waive their rights to a trial by jury and the integrity of an arbitration award is largely dependent upon the integrity of the arbitrator. Therefore, the method by which an arbitrator is selected is of paramount importance.

If the grower believes that, on balance, it is to his advantage to refer some or all disputes under the Agreement to arbitration, he should add an arbitration clause to it.

Under their Commercial Arbitration Rules, both the American Arbitration Association (AAA) and Judicial Arbitration and Mediation Service (JAMS) will ordinarily appoint a single arbitrator to decide any dispute which has been referred to them, unless the Agreement between the parties provides otherwise. Thus, if a buyer and grower wish to have disputes arbitrated by a panel of three arbitrators, for example as opposed to a single arbitrator, they must say so in the arbitration clause. (While a panel of arbitrators is more expensive, it has the benefit of reducing the risk of an unfair or erroneous decision.)

If the buyer and grower prefer more limited discovery than that permitted by the Commercial Arbitration Rules, or prefer the certainty of spelling out the Agreement the procedures which will govern any arbitration between them, a different (and much lengthier) arbitration clause will be required.

If a proposed Agreement already contains an arbitration clause, the grower should make certain that the procedure for choosing the arbitrator (or the arbitration panel) is fair, that the Agreement prohibits any person having a financial or business relationship with either of the parties from serving as arbitrator, that the Agreement specifies the rules which will govern the arbitration, and that any attorneys' fees provided for by the Agreement are not limited to legal actions. (See the attorney's fees provision quoted in Section B.19, below.) If an arbitration clause is silent with respect to governing rules, and if the parties cannot agree at the time of arbitration upon governing rules, Section 1282.2 of the California Code of Civil Procedure provides the manner in which arbitration proceedings governed by California law shall be conducted.

19. Attorneys' Fees and Collection Costs.

- a. Is there a provision for the prevailing party in any arbitration or other dispute to recover their attorneys' fees and collection costs?

Unless attorneys' fees are provided for expressly in the Agreement, the grower will not be entitled to an award of his attorneys fees in the event he prevails in an arbitration proceeding or lawsuit brought to enforce the Agreement. California law follows the rule that, absent a contract between the parties and absent a special statute awarding fees, each party to a lawsuit bears the cost of his own legal fees. Therefore, if the grower wants to be able to collect attorneys' fees from the buyer in the event of an arbitration proceeding or lawsuit in which the grower prevails, the Agreement must contain an attorneys' fees provision. In addition to attorneys' fees, it is to the grower's advantage to have a contractual right to collect from the buyer any costs incurred in collecting delinquent payments from the buyer.

20. Manner of Notice.

- a. How and where is notice to be given under the Agreement?
- b. Are the time limits for notice appropriate and manageable?

A section of the Agreement should be devoted to the manner and time within which notices are to be given under the Agreement.