

THE VIRTUAL WINE COMPANY

“About one-fifth of Australia's \$10 billion in wine assets are tipped to be shifted into sale/leaseback agreements in the next five years as they accelerate towards becoming virtual businesses. That's the prediction of Phil Ruthven, chairman of business analysis group IBIS.” “Change tipped for wine”, Herald-Sun, 26 July 2004

“How do you set up a wine business which has a higher return on investment than other wine business? The wine industry is a great business, great growth, but what it doesn't have or its downfall is its high capital intensity and that makes it difficult to make high returns on investment.” Maurice Dean, CEO, Cheviot Bridge Limited

Presentation to:

University of NSW “Wine Law Update” CLE Seminar

Friday 29 July 2005

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1. BACKGROUND

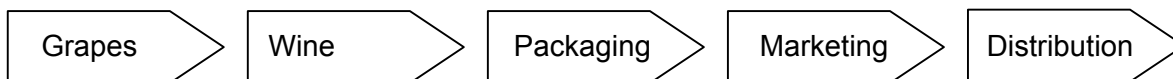
The wine industry around the world seemed to miss out on the Industrial Revolution in some ways, remaining mainly organised along the lines of small, family-owned agricultural businesses.

Other consumer beverage industries, such as carbonated soft drinks, beer and spirits, have become highly concentrated, with a small number of global players dominating the market.

In recent years, we have seen aggregation starting to take place in the wine industry. However, notwithstanding the size of producers such as Constellation Wines, Gallo, and now the merged Fosters/Southcorp operations, these “mega” producers still do not command anywhere near the market share of the leading producers in other beverage industries.

There are a number of reasons for this, but chief amongst them is the highly capital intensive nature of the wine industry in its traditional format.

1.1 The “production chain”



The above simplistic diagram shows the five most basic elements of the “production chain”.

The first two elements are indicative of the key difference between the wine industry and the other consumer beverages referred to earlier. With those other beverages, increased demand can essentially be met by “opening the taps”. With the wine industry, on the other hand, grapes are harvested but once a year (if at all!) and wine can only be made at that time. For the rest of the year, the winery sits idle.

Mention should also be made of the significant lead time of at least 3 – 5 years from planting of grape vines to harvest of the first commercial quantities, not to mention the vagaries of climate, disease and pests which can all have a significant impact on the quality and quantity of those raw materials.

Those wine producers which moved beyond the traditional agricultural business model, followed the example of many other industries in pursuing a policy of “vertical integration” – bringing the various steps in production under common ownership, whether to exercise control over the quality of the various stages and/or to capture the profit margin at each stage.

In some ways the move towards outsourcing is a move “back to the future” – replicating the traditional structure of the wine industry. In long established areas such as Bordeaux and Burgundy, grape growers sold their fruit to a *negociant* who blended fruit (or in some cases, wine) from different grower/suppliers, before selling it to a broker, who then marketed and distributed the wine to merchants.

We are now seeing specialist providers of these (and other) services allowing smaller producers to access the economies of scale which were previously only available to the largest producers.

Why, even some inhouse lawyers from large wine companies are now offering specialist legal services to the wine industry, so everyone can have their own outsourced inhouse counsel!

2. INTELLECTUAL PROPERTY

The recipe for success for most businesses involves building a reputation over many years, with customers becoming familiar with its products, and being able to identify them through consistent use of the same brand name, labels, etc.

With a “virtual” wine company, your intellectual property may be the only thing you actually own, so protection of this becomes absolutely paramount.

In light of this, consider a couple of examples of long-established wine brands getting a rude shock:

- Hickinbotham Wines – The Hickinbothams had been using a silhouette of a man’s head since before my involvement in the wine industry started – so pre-1984. Then, in 2002, they got a nasty letter from Robert Mondavi Wines, claiming that this looks too much like one of their logos, and they must ‘cease and desist’;
- Primo Estate – Joe Grilli had been calling one of his red wines “Moda Amarone” for many years – because he used the same processing methods as used by the Northern Italians to make their wine of the same name – something which he acknowledged on the back label. Yet the Valpolicella trade body suddenly started calling Primo Estate a ‘pirate’ over this “recent” use, and called in the Italian Ministry of Agriculture, the fraud squad and the EU to force Primo Estate to drop this wording (which they did).

These could be seen as having been “sleeping dogs” until the lawyers got their teeth into them. Which, through no coincidence at all brings me to another example:

- New Zealand movie director, Roger Donaldson, had been using the name RD1 for his Gibbston Valley wines – the initials signifying a “rural delivery”. The champagne house, Bollinger, took issue with this, as they use these letters (which stand for “*reçemment dégorgé*” or recently disgorged) for their Bollinger RD range. (Bollinger has “Bollinger RD” and “R.D” registered as trade marks in Australia.) Donaldson said the dispute cost him “a considerable amount of money” until he agreed to change the name of his wines – to “Sleeping Dogs”, the name of his first feature film, shot in 1977 and starring Sam Neill.

Another example of recent court action where the “intellectual property thief” was surprised to find someone claiming he couldn’t use his chosen name was Dr Herodotus Damianos of Long Island’s Duck Walk Vineyards, so-called because it was built on the site of a working duck farm. After 8 years’ trading under that name, he was challenged in November 2002 by Dan Duckhorn, whose eponymous Napa Valley estate had been around for 25 years. Duckhorn claims exclusive rights to the word “duck” and images of ducks on wine labels. (I’ve included this overseas example because I just love the names.)

The list goes on of alleged infringement of intellectual property cases, such as the three Tasmanian examples La Provence (now Providence Vineyards, sued by the French), Freycinet Vineyard (the clash with the giant Spanish cava producer, Freixenet) and Stefano Lubiano (the orange colour of his sparkling wine label raising the ire of Champagne producer, Veuve Clicquot).

Whilst the above cases all seem to be ‘innocent misuses’ of someone else’s intellectual property (at least in the eyes of one party), there are cases where the IP owner (in my opinion) can certainly feel like an aggrieved party.

Having been the “legal custodian” of the Grange trade mark for quite a number of years, I don’t need to look any further than this icon brand for examples (although others may not agree that these seem to be infringements):

- Pengold’s Grange Wormitage – was a bottle of liquid garden fertiliser (made from worm castings – i.e. worm poo);
- Yering Grange – was (initially) a small vineyard in the Yarra Valley, which the owner, a retired bank manager, claimed was “just a hobby” – however, its wines were listed in Thomson’ Liquor Guide, and the vineyard was subsequently sold to a large producer, which could have created scope for dilution of the brand, had not the owner already agreed to cease use of the name;
- Glen Erin Grange – a winemaker in the Macedon Ranges that had an associated restaurant – “The Grange”. In the course of proceedings, it came out that the owner had taken in some partners to extend the business (and the brand “Grange”) not only to foods and preserves, but also to a “vineyard retreat”, accommodation and conference centre;
- Grange salad dressing – proposed by an online wine retailer, and containing “a percentage of real Penfold’s Grange”;
- www.penfoldsgrange.com - registered by a significant wine merchant, and used to attract / direct online traffic to his “online store” – which obviously sold a lot more than just Penfold’s Grange;
- www.sold.com.au - used the image of Penfold’s Grange in promoting its online auction site.

The ‘take-away’ from all these examples is that the ‘winner’ of the dispute is invariably the party that has a registered trade mark (although deep pockets also help).

2.1 Non-protection – Company names, registered business names, domain names

A trap for the unwary is confusing the protection given by a trade mark with the legislative registration system for business names and company names. Domain names, the identifier for websites on the Internet, can also create a false sense of security.

A **trade mark** is a letter, word, phrase, sound, smell, shape, logo, picture, aspect of packaging or combination of these. It identifies a product or a service, distinguishing it from other similar products or services. Registration of the trade mark gives the owner **the exclusive legal right** to use or control the use of the mark for the goods or services for which it is registered.

A **business name** is the name under which a business operates, and registration identifies the owner(s) of that business. Registration is compulsory, in every state and territory from which the business operates, and must be completed before the business starts trading. Unlike trade marks, registered **business names do not provide proprietary rights** for the use of the trading name. From a cynical perspective (i.e. mine), business names are little more than a revenue-raiser for State and Territory governments.

A **company name**, or registrable body, must be registered with the Australian Securities and Investment Commission (ASIC). If a company wishes to trade using a name other than its registered company name, it must register that trading name as a business name. Unlike trade marks, **company names do not give proprietary rights** for the use of the trading name.

Domain names are site addresses on the internet. Domain names ending in .com.au must be derived from the business or company name of a registered Australian commercial entity, or from a registered trade mark (or trade mark application). Unlike trade marks, **domain names do not provide proprietary rights** for the use of the name – they are merely a licence (usually for two years) to the particular web address.

2.2 Trade Marks

As stated earlier, the essence of a virtual wine company is likely to lie in its intellectual property, and chief amongst this category of asset is likely to be your brand, i.e. a trade mark.

At the very start of the business, a key decision is the choice of brand. Although many people consult advertising agencies, brand development agencies, numerologists and astrologers, they often don't think to ask their lawyer.

Which is unfortunate, because there are certain categories of words and expressions for which it is difficult to obtain trade mark protection – and therefore it is hard to stop others from using them (which thereby dilutes the value of your brand).

This is especially the case with wine – which is one of only two products which has its own dedicated chapter in the Trade Marks Office's Examiner's Manual, because there are so many "tricky bits" with registering trade marks for wines.

The two most common types of words used for wine brands are:

- surnames; and
- local place names.

So what is the problem with these types of brands? Generally speaking, a trade mark is not registrable if it is not “capable of distinguishing” your goods or services from those of your competitors. Thus a trade mark cannot easily be registered or protected from use by others if it has an element of descriptiveness about it (for example, describing the function or purpose of your offering, or even the goods themselves – such as wanting to brand a wine “Plonk”). You also cannot register a word that is laudatory, e.g. “superb”.

Surnames and geographic names are words that other traders in the same goods are likely to want to use. Thus, the problems with these type of names are:

- * surnames
 - a surname is not registrable as a trade mark unless it is relatively uncommon (less than 750 people of that name in Australia), or unless you present it in a very distinctive fashion as part of your trade mark;
 - also, the fact that one person has a surname registered as a trade mark does not stop another person with the same name from using their name (provided it is not done in a ‘misleading and deceptive’ fashion).
- * geographic locations
 - once again, as with surnames, it is very difficult to obtain registration of a geographical indication as a trade mark, because it is likely that there will be other producers in the area who have a valid reason for wanting to use the same name. As a result, it would be unfair to grant a statutory monopoly for that name to just one person;

Furthermore, there are also significant restrictions on the registrability of geographical indications (as well as what are known as “traditional expressions” and “ancillary protected expressions”) as a result of the EU/Australia Wine Agreement. This relates to both Australian and European place names, as well as expressions such as “sparkling wine”, “traditional method”, “muscat”, etc. Some of the more unexpected European names which are protected (i.e. which are not supposed to be used on wines in Australia) are “doctor” and “wolf”.

2.3 Copyright

Copyright exists in any “literary, dramatic, musical or artistic work”. The scope of this is very broad; for instance a “literary work” can even include:

- a table, or compilation, expressed in words, figures or symbols; and
- a computer program or compilation of computer programs,

while an “artistic work” can include a painting, sculpture, drawing, engraving or photograph, whether the work is of artistic quality or not.

Therefore, in terms of the wine industry, copyright will exist in:

- the label;
- any drawings or photographs on the label;
- the text appearing on the label;
- any design appearing on your shipper / carton;

- tasting notes;
- advertising and promotional materials;
- etc.

In Australia, copyright comes into being as soon as the work is created – there is no need for registration (unlike the United States).

Furthermore, the “author” of the work is the owner of the copyright – unless the work is created by an employee in the course of his or her employment, and can only be assigned by a written document.

The significance of this (which is often not appreciated until it’s too late), is that businesses often commission the creation of a copyright work, but fail to get a written assignment of it – and as a result they are not actually the owners of the copyright – they have a mere “licence” to use the work, which can be quite restrictive. This is the case even though some or all of the following may be present:

- the basis of the work was all their idea;
- they commissioned the work;
- they paid for the work to be created; and
- they commercialised the work.

In the absence of an assignment, the limitation can include restriction on use of the works to the specific medium (e.g. print) for which it was created, and you can’t then extend its use to other media, such as radio, TV and on the internet, or in different countries.

The moral of this is that, whenever you commission any artwork, even if it is only text, you should always get a written assignment of the copyright – even if it is only a couple of lines in a letter.

In the virtual model, it is likely that all your A&P creative work will be outsourced, so you won’t be able to rely on the ‘employee ownership’ provisions, so you must get a written assignment. When using an agency, you must also include a term in their contract that they must obtain written assignments for any work prepared by consultants, contractors, and other non-employees.

3. VINEYARD ASSETS

3.1 Sale and lease-back

“About one-fifth of Australia's \$10 billion in wine assets are tipped to be shifted into sale/leaseback agreements in the next five years as they accelerate towards becoming virtual businesses. That's the prediction of Phil Ruthven, chairman of business analysis group IBIS.”¹

The key elements of a sale and lease-back of valuable vineyards or winery assets are:

- Because of the nature of most wine businesses as family companies, there is likely to be a strong reluctance to (or to be perceived to) “sell the farm” (which is what a vineyard essentially is). Therefore, the vendor / lessee will want to maintain ongoing control of the property, through the lease interest (including options to renew), and through specified rights to re-purchase the vineyard, whether at the discretion of the lessee, or as a first and/or last right of refusal.
- To be very clear about valuations – ensuring a re-purchase valuation (if not by public auction) is conducted using the same methodology as used to determine the purchase price when the property is first sold.
- Also on valuations – who is entitled to the increase (and from what base) in value of the property while it has been the subject of the lease-back.

Sale and Re-Purchase

Some of the legal issues which need to be addressed in the sale and right to re-purchase include

- Connection with other property: Often, only some parts of a vineyard will be sold, and others retained. If the same infrastructure serves both, it may be necessary to put easements and/or other agreements in place to ensure that the property which is sold is legally entitled to continue to take advantage of this (e.g. pipelines across adjoining property to bring water to the land being sold). Water rights are another element which need to be considered in a similar vein, as they may be the subject of separate ownership to the property.
- Price: how the property is to be valued; at what date; how the valuer is to be appointed, etc. There are two potential valuation methods
 1. the “real” value, assuming a willing buyer and willing seller; or
 2. a “conservative” valuation – using a “forced sale” scenario.

The higher the value that is ascribed to a property, the higher will be the lease payments payable over the term of the lease (including option terms), assuming the lease payments are based on the acquisition costs, to provide the required yield to the lessor.

¹ “Change tipped for wine”, Herald-Sun, 26 July 2004

However, the downside of a high valuation is that if the vendor / lessee defaults under the lease, the lessor could be exposed to a capital loss under a forced sale of the property.

- Timing of Right of first refusal: Can the lessor sell the property at any time, or only after an initial term. And should there be a restriction after expiry of the initial term as well – for example, the property can only be sold in a ‘window’ at the end of a lease term.
- Option Consideration needs to be given to the difference between a right of first refusal (i.e. only when the lessor is seeking to sell) and an option to re-purchase (i.e. any time, at the lessee’s discretion). To give the investors in the lessor certainty, any option would need to only be exercised after a certain period (and perhaps also in ‘windows’, as for the sale by the lessor). Thus, when are valuations conducted, when does notice have to be given of these to the lessee, and when does / must the lessee exercise the option.
- Methodology: How is the option to be exercised.
- Restriction on Use of Funds: The Lessor may wish to restrict the Lessee’s use of the funds to expenditure related to the business / property.
- Environmental issues: Are any warranties and / or indemnities given.
- Terms and conditions: Are the terms of a standard contract to be used for the re-purchase – e.g. the Contract of Sale of Real Estate under the Estate Agents Act 1980 (Vic) or equivalent – so there is no argy-bargy over the fine print.

Lease-back

The type of legal issues which need to be addressed in the property lease include:

- Security The Lessor may want to obtain director’s guarantees or other form of security to secure performance of the obligations of the lessee. There will obviously be a right to terminate the lease, and / or sell the property, but if there has been a downturn in the industry generally, or a significant decrease in the value of the specific property, the lessor may seek to further insulate itself from potential loss.
- Amount of lease payments Are these to be calculated to provide a minimum defined return for the lessor, or by reference to a ‘market rent’ – if the latter, how is this to be determined. Is any consideration given to the importance / value of the property to the lessee (e.g. if intrinsically linked to its ‘trade mark’). Is there a linkage with the price of fruit from that vineyard.
- Vineyard obligations Detailed obligations on the lessee regarding cultivation and maintenance in relation to the existing (and any new) vines, vineyard infrastructure, etc.
- Building-specific obligations Where the property includes the winery, and winery equipment. A lessor normally has obligations for any works required of a capital nature – will this be the case, or are all these costs sought to be imposed on the lessee as operator of the business.
- Statutory issues Is the lease governed by State legislation (e.g. the Retail Leases Act in Victoria) – and what impact does this have on the obligations (e.g. in relation to capital maintenance) sought to be imposed on the lessee.
- Environmental issues: where do the obligations for these issues lie.

- Prescribed use of the property: Should there be a positive obligation on the lessee to continue viticulture on the property – even though it may be (at least in the short term) not economically feasible.
- Repair obligations Both for normal damage, and also near or total destruction, e.g. by bushfire.
- Indemnity of lessor This might relate to ‘normal’ occupier’s liability which would otherwise be imposed on the lessor, and may also relate to industry-specific issues, such as if the vineyard were the source of an outbreak of a catastrophic disease or pest infestation, such as Pierce’s disease or phylloxera.
- Detailed insurance obligations.

Examples

The Beston Wine Industry Trust (Beston) is “a specialist funding vehicle that enables wine companies and grape growers to outsource their fixed assets and therefore release capital for reinvestment in higher returning areas [wine inventories and receivables]”.

Beston listed on the Australian Stock Exchange in July 1999, and now manages sale and lease back arrangements in excess of \$240 million of vineyards and infrastructure assets.

As well as vineyards, Beston invests in crushing, processing and storage facilities.

In October 2003, the Beston Wine Industry Trust announced a capital raising of \$55 million to fund the purchase and lease-back of four vineyard properties, whose purchase prices totaled \$68 million. At the time, Beston already owned (and leased-back) 25 vineyards and 3 wineries, dealing with companies such as McGuigan Simeon, Southcorp, and Evans & Tate in Australia, and Delegats in New Zealand.

The lease terms for this tranche of properties were nine to twelve years each, varying from property to property, with three rights of renewal for a further five years each.

The Timbercorp Orchard Trust has followed a similar model. In 2003, the Timbercorp Orchard Trust:

- acquired developed table grape properties and undeveloped land suitable for table grape development. The total cost to acquire and develop properties, including acquiring water rights is expected to be \$16.7 million.
- acquired Chiquita Brands’ Kangara Estate comprising established wine grape vineyards, established citrus orchards, cleared land suitable for orchards or vineyards, irrigation infrastructure and water rights for a total of \$32.5 million.

Both properties are leased to Timbercorp Limited.

4. CONTRACTING OUT

4.1 Vineyard Management

The first thing to do is to recognise that you can't totally absolve yourself for responsibility for the vineyard – there needs to be some form of guidance given to the manager, even if it is something as simple as, say, a five-year business plan.

This might address such issues as:

- The style of fruit / wine to be achieved from the vineyard
- Or
- The price to be obtained for fruit from the vineyard (either absolute, or net of management costs).
- Any particular practices or regimes (e.g. organic) to be observed.
- How often the plan is to be reviewed and updated

Some of the legal issues to be covered off will include:

- Responsibility for the cost of capital works (trellising, vines, fences, roads, dam walls, etc), who makes the call on their necessity, and whether the manager can impose this on the owner (as the vineyard may become much more expensive to run in the absence of the works being carried out).
- Responsibility for the cost of items such as rates, taxes, etc, specific wine industry levies, and for facilities and services (water, electricity, gas, etc)
- Responsibility for decisions:
 - that may impact on the medium or long term viability of the property
 - relating to expenditures outside those agreed in the business plan, or in excess of a specified minimum figure.
- Insurance – who is responsible for it, what it covers, ensuring all parties are named as co-insureds.
- A licence is granted to the manager to formalise its right to be on the premises.
- Rights to fixtures, fittings, plant, equipment, etc – both those brought on to the land by the manager, and those already there.
- Liability and indemnities.

4.2 Contract Harvesting

Small vineyards (particularly “lifestyle”) vineyards are usually harvested by friends and family, with the remuneration for the pickers being a large lunch and/or dinner (one may run into the other depending on the scale of operation).

However, with larger vineyards (and following the “outsource everything” model) harvesting is usually done by mechanical means. Given that harvest for a grape grower is a once-a-year occurrence, a mechanical harvester is often not seen as a priority, so this is often done by a contractor.

The type of issues which need to be addressed in a relationship with the contract harvester are:²

- Initial inspection – the contractor should come to your vineyard to establish that its equipment is suitable to your site and vineyard infrastructure e.g. gradient of hills, type of trellising, vine spacing, size of headlands, etc. A contractor should carry out such an inspection to accurately price the job.
- There should be some form of agreement which sets out the respective obligations on vineyard owner and contract harvester – which should be determined before harvesting commences (i.e. not on the run) and totally factored into the contract price.
- Management Services – what administrative services must the contractor undertake, such as liaison with the person responsible for delivering the grapes to the winery, which may be a cartage contractor retained by the winery purchasing the fruit, the contract vineyard manager, etc.
- Machinery – machine and operator only, or will the contractor also provide an observer, bins, tractors and bin trailers, etc.
- Is the cost to be calculated by the amount of fruit harvested, or by an hourly rate. If it is the latter, the agreement should define when the time starts (e.g. when the equipment arrives at the vineyard in the morning), and definition of various types of “down time” should also be included.
- If the charge is based on the area of the vineyard, this could be determined by the number of vines, the acreage of the planted area, or the number of lineal metres of planted vineyard. If the vineyard has not been formally surveyed, some form of estimate will be needed.
- Liability issues need to be addressed for things such as MOG (material other than grapes) in the fruit {as this usually leads to penalties or rejection by the purchaser of the fruit}, and damage to trellises and or vines.
 - if the vines are not planted in straight rows, or if there are young and/or grafted vines being harvested, this leads to a higher chance of damage, and consideration should be given to this.

² “Attention to detail and open communication: Keys to Smooth Harvest” Jan O’Connor, Australian and New Zealand Grapegrower and Winemaker January 2005, 54.

4.3 Contract Winemaking

Some of the key legal issues to be addressed in a contract winemaking agreement include:

- A benchmark quality should be set, that is sufficiently objective that the contract wine can be assessed against it. A consistent, commercially available wine can be selected (e.g. Penfold's Bin 407), with 'bench testing' conducted against it.
- Particularly apposite to this issue is having a good dispute resolution procedure in place.
- Another similar issue (it might sound trite, but many agreements do not set them out) is the specifications of the product to be produced. Without these, it is very difficult to argue that wine has not been produced "in accordance with the contract".
- Who is responsible for assessing the fruit quality from which the wine is to be made – the winemaker will want to take at least some responsibility, as he or she will be required to make wine to a certain benchmark quality, and "you can't make a silk purse from a sow's ear".
- Given the 'wine lake' and tightness of storage all around the country, the agreement should set out when the finished product must be collected, and what the winemaker can do if it is not collected.
- To allow forward planning, a winemaker will want accurate estimates to be made of how much fruit will be coming in each vintage.
- The winemaker must commit to providing wine with compliant Label Integrity Program information. (Likewise, the winemaker may require similar declarations from the fruit supplier.)
- Where smaller parcels are involved, the winemaker may reserve the right to blend with other parcels, for both space reasons, and to avoid spoilage issues from undue ullage.
- Delivery scheduling is often a thorny issue – the fruit grower will want to harvest at the optimal time for the fruit, but the winemaker cannot afford every grape in the region to turn up on the same day! Similar issues arise with delivery of different varieties of grapes (particularly where there are small numbers of receipt hoppers, as different varieties need to be kept separate), and small batches of fruit.
- Where the owner wants 'special attention' paid to particular parcels of fruit, or particular fermentation processes or styles to be followed, these need to be documented in the contract.
- The winemaker should seek an indemnity from the fruit supplier for damage caused by the grower's fruit (e.g. MOG, disease, etc.).
- Circumstances and procedures need to be set out as to how and when the owner can reject wine once it has been made, and what measure of damages (or replacement of wine) the owner is entitled to.

4.4 Contract Warehousing

Warehousing, while it cannot improve the quality of your product, can certainly have an adverse impact on product quality if it is not carried out correctly.

The chief winemaker for Orlando Wyndham, Phillip Laffer, estimated that 90% of faulty wine complaints resulted from excessive heat at some stage during the journey from winery to consumer.³ Therefore, you will want your wine stored somewhere that isn't hot for as much of the time as possible – particularly while the wine is still within your control.

Whilst heat is the big factor, other issues which can cause problems include infestations of bugs, security and other environmental factors which can affect the product's packaging, such as smoke and water.

Only the largest of orders are bottled to order. It stands to reason then, that most wine will spend a significant part of its bottled life in a warehouse somewhere (as this paper is dealing only with outsourcing, the issues in owning your own warehouse will not be touched on.)

Some of the issues when making the decision of who, how, where, etc are not legal issues, but are worthwhile considering anyway.

One of these is the question of where the warehouse should be located. The most obvious places are either near where the wine is bottled, to minimize the initial transportation costs, or near your largest client (if relevant) or your route to market (i.e. your port of shipment, if much of your product is exported).

Another is the freight rates to get the wine to the warehouse from the winery, and from the warehouse to the usual destinations – to ensure savings on warehouse rates aren't overwhelmed by additional freight costs.

Some of the legal issues to be considered include:

- Rates: What do the rates cover – e.g. order picking, stretch wrapping and packaging. What about re-packing for damaged goods. Do you have specific needs in terms of packaging, either generally or for specific markets or customers. Is there any extra cost for these.
- Procedures Does the warehouser observe management and/or stock control records, despatch and other procedures that can interface with your own. Likewise, what management information is to be provided, and how. Stock rotation procedures must also be in place.
- Receival and despatch turnaround times.
- Freight services: Will these be provided and, if so, at what cost.
- Disbursements: What disbursements is the warehouser to be liable for (customs, excise, or other fees or taxes), and which of these are to be reimbursed (and how).
- Condition of warehouse: Some of the issues to be covered include:

³ June 2004 Australian Wine Industry Technical Conference.

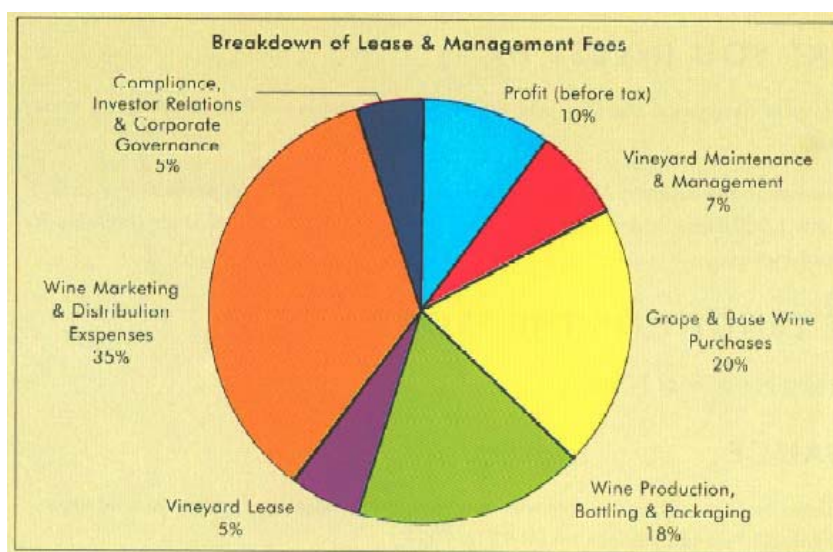
- temperature and humidity – minimum, maximum, diurnal range;
 - dust, damp, animals, vermin, etc;
 - security and fire-protection systems;
 - ability for automation - fork-on, fork-off; pallet stacking, electronic stock updating and tracking, RFTs (radio frequency tags)
 - environmental.
- Responsibility for goods: What disbursements is the warehouser to be liable for (customs, excise, or other fees or taxes), and which of these are to be reimbursed (and how).
 - Ability to assign or sub-contract.

5. EXAMPLES OF VIRTUAL WINE COMPANIES

This paper does not examine the commercial justification of outsourcing some (or even all) elements of a wine business. It examines the key elements which can be outsourced, and considers the legal issues which can arise in each of those steps.

Examples of Australian wine companies who have adopted three quite different models of the “virtual wine company “ model are:

- **T’Gallant** – when Kevin McCarthy and Kathleen Quealy established T’Gallant they put their capital into stainless steel – building their own winery, without owning any vineyards. As with any business, the model evolved over time – and the owners eventually leased vineyards from which they had previously taken fruit. They eventually sold the business to Beringer Blass (Foster’s Group Limited)
- **Palandri** – Palandri have used the tax-effective managed investment scheme (MIS) model to provide the investment funds required to develop the vineyards from which they source their fruit. In a somewhat novel twist on this not-unusual approach, in 2004 Palandri’s MIS project funded not just fruit supply, but its United States marketing program.



http://www.palandri.com.au/PIM_Content/PDS/projectssummary.pdf

- **Cheviot Bridge** – Cheviot Bridge started life as a partnership of grape growers who wanted to move up the value-add chain and produce their own label, rather than rely solely on their contracts to supply fruit to the large wine companies. To this extent, they were following the ‘virtual’ route, as the business did not own the land, nor was it responsible for production of the fruit. Once again, the business model evolved, as the business purchased the “Long Flat” brand from Tyrells. This was funded by an IPO, and the business morphed into a virtual wine company whose major asset was a brand name and distribution contracts.