AUSTRALIAN COMPETITION & CONSUMER COMMISSION

Wine grape market study

Interim report

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accc.gov.au

Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

Table of contents

Glossary

ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences.
AWRI	Australian Wine Research Institute.
Australian Grape and Wine Inc (AGWI)	national grower and winemaker representative organisation formed in 2019 following amalgamation of WFA and AV.
Australian Vignerons (AV)	former grower representative organisation which amalgamated in 2019 with WFA to form Australian Grape and Wine Inc.
Broker	facilitates buying and selling of grapes and/or wine on behalf of growers, winemakers and other clients.
Bulk wine	wine that is transported in containers, such as stainless steel or bladder containers, rather than in bottles or other smaller packaging. It is packaged at its destination, sometimes after blending with other wines. Bulk wine is usually commercial wine, and on average is sold at a much lower price than bottled wine.
CCA	*Competition and Consumer Act 2010.*
CCW	CCW Co-operative Limited, a co-operative of approximately 600 growers in the Riverland (previously known as Consolidated Co-operative Wineries).
Code	Australian Wine Industry Code of Conduct – a voluntary code which took effect on 1 January 2009.
Code Management Committee (Code Committee)	the committee responsible for administering the Code. The Code Management Committee replaced the Code Administration Committee on 1 November 2011.
Collective bargaining group (CBG)	a group of suppliers, such as wine grape growers, who join together and use their bargaining power to negotiate with buyers, such as winemakers. Such groups have to be authorised by the ACCC or would be in contravention of the CCA.
Commercial wine	lower quality wine than premium wine, often made with grapes from warm climate regions. Often defined as wine retailing for less than $10 per bottle.
Contract processing	a business arrangement where one party pays another party to process grapes owned by the first party. Contract processing services are used

	by growers wanting to make wine, winemakers who don't have a winery in a particular region or who are short on processing capacity, and virtual winemakers.
Cool climate regions	all Australian wine regions except for warm climate regions are referred to as cool climate regions, despite this description not closely corresponding to the climate in some cases. Grapes from cool climate regions are more likely to be used in premium wines than grapes from warm climate regions.
Geographical indication (GI)	defined by Wine Australia as "a word or expression used in the description and presentation of a wine to indicate the country, region or locality in which it originated or to suggest that a particular quality, reputation or characteristic of the wine is attributable to the wine having originated in the country, region or locality indicated by the word or expression".[1] The names of wine-growing regions are protected under the *Wine Australia Act 2013*. Wine Australia keeps the Register of Protected Geographical Indications and Other Terms.
Grower survey	in July and August 2018, the ACCC invited growers to provide feedback about competition issues through an online survey. We received responses from 262 wine grape growers from a range of regions. A report of results is available at: https://www.accc.gov.au/winegrapes
Independent grower	grower who has no ownership or other controlling interest in a winery.
Indicative price	Regional Indicative Price provided by Code signatories for each variety of wine grape to growers in the Hunter Valley, Riverina, Murray Valley and Riverland by 15 December, and to growers in other regions by 15 January each year.
Matter other than grapes (MOG)	leaves, sticks and other items detected in a load of grapes delivered to the winery weighbridge.
Murray Valley	combination of the Murray Darling and Swan Hill GI protected regions in southern NSW and northern Victoria.
Murray Valley Winegrowers (MVW)	a levy-funded association representing growers and winemakers in the Murray Valley.
Must	the grape juice and skin mixture created at the first stage of the winemaking process, containing the skins and prior to fermentation.

[1] Wine Australia, *Compliance Guide for Australian Wine Producers*, https://www.wineaustralia.com/WineAustralia/media/WineAustralia/PDF/Selling-wine/Wine-Australia-Compliance-Guide-June-2016.pdf

National Vintage Report	a report published by Wine Australia each August, describing volumes crushed and prices paid by variety in each region in the previous harvest.
NMI	National Measurement Institute.
Non-quality adjusted price	the per-tonne price offered by a winemaker to a grower for wine grapes, before adjustments are made (if any) as a result of quality assessments.
Premium wine	higher quality wine than commercial wine, often made with grapes from cool climate regions. Often defined as wine retailing for more than $10 per bottle.
Quality adjusted price	the per-tonne price paid by a winemaker to a grower for wine grapes, after adjustments are made (if any) as a result of quality assessments.
Quality adjusted weighted average price	the average per-tonne price paid to growers in a particular warm climate region by a winemaker, including any quality-related price adjustments.
Quality assessment	any assessment of grapes for the purposes of determining: whether the winemaker will accept or reject the grapes, how much the winemaker will pay the grower for the grapes, and the timing of harvest.
Region	a wine-growing region defined in the Register of Protected GIs and Other Terms.
Riverina	a GI protected warm climate region in southern NSW within the Big Rivers zone.
Riverina Wine Grapes Marketing Board (RWGMB)	a levy-funded association representing growers in the Riverina.
Riverland	a GI protected warm climate region in south-eastern SA within the Lower Murray zone.
Riverland Wine (RW)	a levy-funded association representing growers and winemakers in the Riverland.
Rollover clause	provides that a new contract term (generally of a specified length) will automatically commence if a termination notice is not given within a certain timeframe prior to a contract expiring.
Unfair contract terms (UCT) law	introduced to assist consumers and small businesses that may have limited bargaining power, by prohibiting businesses from using UCTs in standard form contracts.
Veraison	onset of grape ripening.
Virtual winemaker	winemaker which uses contract processing services rather than owning a winery.

Warm climate regions	the three regions regarded as warm climate are: Riverina (NSW), Riverland (SA) and Murray Valley (Murray Darling/Swan Hill – NSW/Vic).
Wine	Defined by Wine Australia as “the product of the complete or partial fermentation of fresh grapes, or a mixture of that product and products derived solely from grapes”.[2]
Wine Australia	Brand name of the Australian Grape and Wine Authority, an Australian Government statutory authority governed by the *Wine Australia Act 2013 (Cth)*.
Wine Equalisation Tax (WET)	a tax of 29 per cent on the wholesale value of wine, designed to be paid on the last wholesale of wine (which is usually between the wholesaler and retailer). In 2004 a WET producer rebate was introduced to allow producers to offset their WET liability.
Wine Grape Growers Association (WGGA)	Former national grower representative organisation which became Australian Vignerons in September 2016. AV subsequently amalgamated with WFA to form AGWI in February 2019.
Winemaker	a business which processes wine grapes to make wine, usually in one or more wineries owned by the winemaker. Winemakers range in size from very large to very small.
Winemakers’ Federation of Australia (WFA)	former national winemaker representative organisation which amalgamated in 2019 with AV to form Australian Grape and Wine Inc.
Winery	a facility used to commercially process grapes into wine.

2 Wine Australia, *Compliance Guide for Australian Wine Producers*, https://www.wineaustralia.com/WineAustralia/media/WineAustralia/PDF/Selling-wine/Wine-Australia-Compliance-Guide-June-2016.pdf

Executive summary

The Australian wine industry consists of a diverse range of participants, including an estimated 2500 winemakers and more than 6000 wine grape growers, producing wine grapes on an area in excess of 135 000 hectares spread across most states but predominantly in southern Australia. Wine production was estimated to be 1.29 billion litres in 2018, and during the 2017−18 financial year 849 million litres was exported, valued at $2.8 billion.[3] The Australian wine industry is estimated to employ more than 175,000 people, and directly and indirectly contribute over $40 billion annually to the Australian economy.[4]

Approximately two thirds of annual wine grape production occurs in what are referred to as the 'warm climate' grape growing regions, which include the Riverina, Murray Valley and Riverland wine regions, located in southern NSW, north western Victoria and South Australia.[5]

In these regions, growers operating generally small-scale grape farms typically produce grapes under contract to a relatively small number of very large-scale winemakers, with the bulk of the wine produced from these grapes destined for export markets.

The contractual arrangements between growers and winemakers in these regions has frequently been the subject of concerns raised with the ACCC, as has the level of competition between winemakers for growers' grapes. These issues were the subject of a market study conducted by the ACCC, the interim results of which are reported here.

Context of the market study

The Australian wine grape industry is unique when compared to other agriculture sectors in a number of ways, including:

- Considerable variance in the quality and price of grapes and the wine produced from those grapes. Grape prices range from under $300 per tonne for some varieties in warm climate regions, to over $8000 per tonne for some premium quality varieties in cool climate regions.
- The broad diversity of businesses of the approximately 2500 winemakers in Australia. These range from the very small, single label wine producers, to the likes of Treasury Wine Estates with a market capitalisation of around $11 billion.
- Long lead times associated with grape growing and winemaking. Newly established vines take at least three years to produce fruit, and wine is not be ready for sale for between six months and five years after grapes are harvested.

Similar to other Australian agricultural industries, however, the wine grape industry is characterised by imbalances in bargaining power between major buyers (winemakers) and growers. The industry is also significantly exposed to export markets, in which market conditions and prices can change significantly from year-to-year. The ability of growers to respond to changing markets is limited, given the long lead times associated with wine grape production. This can result in prolonged periods of over or under supply of grapes, as the recent history of the Australian wine industry reveals.

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3 Australian wine sector at a glance, 2018. Wine Australia.

4 Gillespie Economics, 2015.

5 The delineation of warm and cool climate regions is not necessarily a direct indication of the climate, for example there are regions with climates which may be considered to have warm weather, though are referred to in the industry as 'cool'. Warm regions are also known as 'inland' or 'commercial' regions, while cool regions are sometimes called 'premium' or 'boutique' regions.

After a period of strong annual production growth which extended from 1990 to 2005, a ten-year period of oversupply of grapes and low grape prices began in 2006 and the industry has only recently emerged from this situation.[6]

Since 2014, international demand for Australian wine has increased. This has been driven by several factors including increasing demand from China, and a downturn in European, South African and Chilean production. At the same time, Australian production has remained relatively static and growers have exited the industry. The resulting correction to the sustained demand/supply imbalance in Australia has resulted in some recovery in grape prices since 2014, but they are still well below the long-run average.

The impact of the decade-long period of oversupply remains evident in many of the contracting practices that currently exist between growers and winemakers. In particular, it resulted in growers placing great importance on securing a buyer for their grapes over the medium to long term.

The ACCC has found that growers have often traded away the benefits of competition in order to ensure they have a buyer of their produce, and, as a result, have needed to agree to potentially unfair and uncertain contract terms. In addition, growers were frequently reluctant to raise concerns with the ACCC because of fear of retribution. This points very strongly to a market which is not functioning well.

Issues and implications

The ACCC has identified a range of concerning practices resulting from the bargaining power imbalance and information asymmetry in grower-winemaker relationships, including:

- growers being largely price takers and unable to effectively negotiate with winemakers
- a lack of transparency and certainty over pricing and quality assessment procedures
- multi-year supply agreements without price certainty or verifiable price benchmarks
- delayed payment terms for growers, sometimes up to nine months after delivery of grapes
- imbalances in supply agreements which disproportionately allocate transactional risk to growers, allow winemakers to act unilaterally and have the potential to cause significant detriment to growers, and
- a low level of competition between winemakers acquiring grapes in warm climate regions.

These industry features result in practices which ultimately produce inefficient outcomes in grape production and pricing.

The ACCC is considering options to improve industry contracting practices, to foster stronger competition between winemakers, and to provide a greater level of certainty and transparency to growers. Increased competition for grapes and improved price transparency will benefit growers, enabling them to make better-informed production decisions. In particular, growers will be better placed to decide which winemaker or winemakers to supply, which grape varieties to grow, how much key inputs such as water and fertiliser to apply, how to optimise other viticultural decisions.

The interim findings and recommendations arising from this market study focus on encouraging practices that will facilitate more efficient grape production and processing. As such, these recommendations are focused on improving the efficiency of the industry as a whole.

6 Based on Wine Australia data.

The unique characteristics of the wine industry present a challenge in developing recommendations. Recommendations should reform industry practices and address market failures and unfair practices, yet not have unanticipated adverse impacts, particularly on smaller winemakers, cool climate grape growers or on product innovation.

Australia's competition and consumer laws are capable of addressing isolated behaviours and conduct which harm competition and efficiency in the industry. These include the business-to-business unfair contract terms laws and prohibitions on misleading or deceptive conduct, and unconscionable conduct. However, taking enforcement action under these laws is often not the most effective way to address systemic behaviours that undermine competition and efficiency in an industry. Such behaviours are often better addressed through an industry code of conduct, which can establish minimum behavioural standards, and provide mechanisms to efficiently address code breaches.

The Australian Wine Industry Code of Conduct (the Code) is a voluntary code of conduct which was established in 2008 by industry participants, in an attempt to address some of the ongoing issues highlighted in this market study.

Despite the Code's shortcomings and the lack of participation by some significant winemakers, the ACCC has found the Code has provided an avenue for dispute resolution for some individual growers, and has been used by some growers to their benefit on some occasions.

The ACCC has made an interim recommendation which aims to improve the Code. However, to be an effective mechanism to improve industry practices, participation by major winemakers is essential. This applies in particular to the Riverina region where none of the major winemakers are signatories to the code. In the absence of a significant improvement in voluntary code participation in the near future, the ACCC may need to recommend that the code be made mandatory.

In examining contracts between winemakers and growers, the ACCC has identified a range of contract terms which we consider may be unfair under the Australian Consumer Law (ACL). The ACCC will be investigating these, separate to this market study. Growers should contact the ACCC if they consider that their supply agreement contains provisions which are unfair (see chapter 5 for more detail on unfair contract terms). The ACCC also encourages winemakers to review their grower supply agreements in this regard, particularly new agreements or those that are up for renewal.

While agreement terms found by a court to be unfair are void and unenforceable, there are currently no financial penalties under the ACL for unfair contract terms. The ACCC is advocating for legislative reforms in this area. Winemakers found to have unfair contract terms in their agreements with growers may face financial penalties in the future.

The ACCC will consult on this Interim Report and welcomes submissions from all interested parties. We invite submissions by 28 June 2019.

Interim findings

There is limited competition for wine grapes

Competition for warm climate grapes primarily occurs within or close to a given grape growing region because of:

- transportation costs relative to the value of the grapes
- grape perishability
- bio-security regulations, such as those relating to phylloxera.

Relatively close geographic proximity results in some level of limited competition between winemakers across the Riverland and Murray Valley regions. In contrast, winemakers in the Riverina do not appear to face competition from winemakers located outside the region. This is because of their geographical isolation from other similar wine regions and resulting prohibitive transportation costs.

Competition is inhibited by market concentration and contracting practices

The ACCC observed low levels of competition for grapes. This may be attributed to a number of factors:

- the high degree of market concentration in wine making
- a lack of price transparency
- limited switching between winemakers by growers.

Markets for grapes are concentrated. A few large winemakers acquire the majority of grapes in each region, and many small scale winemakers buy relatively small volumes. This is particularly the case in the Riverland and Riverina where there are one or two dominant buyers of grapes.

The recent period of oversupply continues to impact competition through agreements negotiated at that time, as well as many growers' prior experiences of not being able to sell their fruit. The ACCC heard that most growers prioritise securing a grape buyer in the medium term over receiving the best price. This suggests that they value certainty of sale in all years, over having the flexibility to seek higher prices in periods when market conditions are more favourable.

A lack of transparency in market pricing restricts growers from reliably assessing how competitive a given winemaker's price offer is. Winemakers do not publicise the prices they pay, and use confidentiality terms to prevent growers from disclosing their indicative and final prices to other growers and winemakers. Increased price transparency is likely to lead to greater competition between winemakers to the benefit of growers.

Many growers face barriers to switching winemakers. These result from prevalent use of multi-year agreements, roll over clauses, long notice periods, adverse treatment of growers who switch, and restrictions on sale of excess production. Many winemakers incorporate at least two or three such barriers in their supply agreements and business practices, thereby discouraging growers from switching.

Collective bargaining is an arrangement where, after obtaining ACCC approval, two or more competitors come together to negotiate with a supplier or a customer over terms, conditions and prices. Collective bargaining is not widely used in the industry. The ACCC found examples of small collective bargaining groups, which have experienced some success in negotiating better outcomes for growers and attracting more competition into a region. However, knowledge of collective bargaining and its potential benefits appears to be low in the industry overall.

Growers that responded to the market study expressed interest in participating in collective bargaining in the future. They may find benefit in doing so provided winemakers are open to engaging with them. A potentially significant shortcoming of collective bargaining is that there is no requirement for winemakers to engage with a grower collective.

The state of competition in wholesale and retail wine markets

The vast majority of warm climate grapes are used for commercial, low value wine destined for export markets. Australian winemakers competing in global markets are price takers.

Australian wine represents a relatively small share of global wine exports, and mostly consist of near homogenous commercial wine, easily substitutable with wine from South America, South Africa or other regions.

In the domestic market, winemakers face a highly concentrated retail sector with four major retailers accounting for around 80 per cent of total liquor retailing in Australia. Domestic winemakers compete in the wholesale market with one another, the large retailers' private label wines and imports. This competition puts downward pressure on winemakers' margins, restricting their ability to negotiate higher wholesale prices or pass on cost increases to retailers.

The quality assessment of wine grapes is a key issue for growers

The ACCC found a high degree of variation in the quality specifications imposed on growers in warm climate supply agreements. While there are some common specifications such as sugar levels, material other than grapes, and testing for disease, there are also significant differences. These differences relate to whether and how colour measures are applied to red wine grapes, and whether or not subjective taste assessments and other measures are undertaken.

Growers have concerns about quality assessment

Growers have raised concerns about the transparency, consistency, timing and subjectivity of quality assessment methods employed by winemakers. In addition, growers have indicated that they lack visibility and understanding of quality assessment processes and have complained about the difficulty and impracticality of disputing quality assessment results.

These shortcomings likely contribute to mistrust around quality assessment processes and outcomes, with some growers claiming that quality assessments are conducted arbitrarily or for ulterior motives.

There is a lack of transparency and certainty in quality assessments

Generally, grape supply agreements and grower manuals issued by winemakers clearly set out quality assessment specifications and relevant penalties and bonuses. However, they do not always specify when testing will occur, or the precise methods that will be used. Some winemakers also retain in their supply agreements a broad unilateral right to change quality specifications during the season, which creates uncertainty for growers.

Timing of deliveries has a significant impact on grower remuneration

The timing of harvest is one of the most important factors influencing grape quality and volume and, consequently, the price paid for grapes. Winemakers generally have absolute discretion over the timing of harvest, which allows them to control when deliveries are made to their wineries. This exposes growers to the risk of quality deterioration or volume loss, and consequently, reduced payment.

Colour assessment is a complex issue

Some growers have alleged that colour assessments used for red wine grapes are unreliable and lacking in scientific credibility, and are used by winemakers to manipulate prices. However, academic literature and experts consulted by the ACCC support the view that while colour assessment is not a perfect measure, it correlates to some characteristics sought by winemakers that may otherwise be assessed using subjective sensory methods.

Standardisation of sugar measurement and colour testing instruments

Some growers contended that price determination using colour assessment breaches the legislation and regulations administered by the National Measurement Institute (NMI), Australia's peak measurement body. They believe this to be the case because the equipment used is not standardised or formally verified.

The NMI has confirmed to the ACCC that it does not conduct audits on sugar or colour assessment instruments for grapes, because registered standards do not currently exist for these instruments. The ACCC notes that NMI has standardised testing instruments for quality assessments of cane sugar and grains, which has been beneficial to those industries.

Price transparency in the industry should be improved

Australian warm climate grape prices are strongly correlated with international wine export prices, which can change significantly year-to-year based on global supply and demand. Australian grape prices can also be influenced by climatic events affecting the harvest in a particular season.

Prices offered by winemakers are also influenced by the strength of competition for the grapes, the quality and condition of the grapes, features of the agreement, previous prices and local pricing trends.

There are a range of pricing mechanisms used in grape supply agreements, including variable price agreements where the price is determined by the winemaker close to harvest, annual or multi-year agreements where a fixed price is determined in advance, and spot market agreements which are entered into a short time before harvest. Prices offered under each type of supply agreement can differ because of changing market conditions.

Wine Australia publishes some information about general market conditions and historical average pricing by region and variety. However, information about individual winemakers' prices is not easy for growers to access and is only made publicly available some months after the season has finished and final prices have typically been set. This makes it difficult for growers to assess whether the price offers they receive are competitive, and which winemaker to switch to (if any). The lack of information likely leads to inefficient production outcomes.

Winemakers use a range of procedures for informing growers about the prices they will offer. Signatories to the Code release an indicative price by 15 December in the warm climate and Hunter Valley regions, and a final price close to harvest. The requirement to publish indicative prices has been controversial among growers and winemakers, and has been cited as a disincentive that discourages some winemakers from signing the Code.

The ACCC has found that:

- final prices are often similar to indicative prices
- indicative prices are used by some growers as a starting point for negotiation with winemakers
- indicative prices are released too late in the season to significantly influence growers' production decisions
- winemakers claim they are unable to provide reliable indicative prices early in the season because of the uncertainty associated with export market conditions
- the spread of prices received by growers for particular grape varieties is significantly greater in cool climate regions than in warm climate regions. This is primarily because of the greater variation in grape quality and wine values in the cool climate regions

- of the three warm climate regions, the spread of prices received by growers is lowest in the Riverland and highest in the Riverina.

The ACCC is making interim recommendations to improve the transparency of pricing announcements in the wine grape industry (outlined below). With greater transparency, indicative pricing announcements are likely to benefit growers by fostering greater competition between winemakers. In the absence of indicative pricing, winemakers will have the incentive to delay announcing any price information until close to harvest when growers will have limited or no opportunity to react.

Supply agreements are varied and typically favour winemakers

A wide variety of supply agreements exist

In the three warm climate regions, there are a number of winemakers of varying sizes, producing different products and operating under different business models. Consequently, there is no consistent supply agreement model used within the industry, or in different parts of the industry. Multi-year variable price agreements, often with two to five year terms, are the most common supply agreement in warm climate regions.

Growers have different preferences in dealing with winemakers. Some growers diversify their supply to reduce risk in one or more ways, including:

- producing more than one variety of grapes
- dealing with more than one winemaker (often via having certain vines that are contracted to each winemaker)
- having a written contract or contracts in place for some of their vineyard blocks, but also selling some grapes on the spot market.

In most warm climate regions, growers supply under written contracts. However, informal annual and multi-year oral agreements do exist in the industry and are more common in the Riverina than in other regions. This appears to be attributable to the fact that:

- no winemakers in the Riverina are Code signatories (Code signatories are required under most circumstances to have written contracts)
- many growers feel compelled to continue supply under existing oral agreements because of an industry culture that places a significant emphasis on loyalty to winemakers.

The ACCC considers that supply arrangements should be in writing. Written contracts ensure that growers have transparency and certainty over their rights and obligations, including how price is determined, quality specifications, and payment terms.

There is a bargaining power imbalance between growers and winemakers

Growers tend to be in a significantly weaker bargaining position compared to large winemakers. The following factors contribute to this bargaining power imbalance:

- Significant information imbalances result in winemakers having a better understanding of the price a grower will be willing to accept.
- Winemakers view grapes as a largely homogenous input for lower value wines. Winemakers can therefore purchase suitable grapes from many different sources, which weakens growers ability to negotiate based on product differentiation.
- Grapes shrivel if left on the vine past their prime, and quickly deteriorate following harvest. Consequently, growers are unable to delay harvest or delivery to find a better price.

- Despite improved market demand for most varieties in recent years, many growers are concerned that commercial grapes could become oversupplied again. Fear of being penalised in the future for seeking to negotiate terms or dispute quality assessment results mean that growers are not fully benefitting from their improved bargaining positions.

Some unfair contract terms may exist in supply agreements

The ACCC identified a number of terms in grape supply agreements which may be considered unfair contract terms under the ACL. The ACCC is continuing to examine these agreements and seeks feedback from industry participants about these terms.

Contractual terms that are deemed by a court to be unfair under the ACL are void and unenforceable.

The supply agreements seen by the ACCC varied markedly, not only with regard to how dealings are structured, but also to the types of terms that were included in different supply agreements. However, the ACCC has concerns about a number of similar types of terms across many of the written grape contracts seen during the market study.

Right to renew clauses

The ACCC considers clauses that require growers to enter into new supply agreements with winemakers upon expiry of their existing agreements, but do not require winemakers to match competitor offers, are likely to be unfair. Such clauses may prevent a grower from entering into a new agreement with a different winemaker on better terms.

Ability to vary agreements

The ACCC considers terms that allow winemakers broad unilateral discretion to vary terms of supply agreements are likely to be unfair.

The ACCC is particularly concerned about terms that allow winemakers to vary the quality assessment parameters and final price without limitation.

Price and quality assessment parameters are key aspects of annual and multi-year grape supply agreements. Changing these during the life of the agreement may result in a significant reduction in the value of the agreement and cause financial detriment to the grower who has planned production around the agreement they entered into.

Any legitimate basis for varying these terms, such as in response to regulatory changes, should be clearly stated in written agreements and/or require agreement from the grower.

Payment terms

The ACCC is concerned that lengthy payment periods which are prevalent in grape supply agreements may be unfair.

Growers supplying to Code signatories and growers based in South Australia have the protection of minimum payment terms set out in the Code and the *Wine Grapes Industry Act 1991* (SA) (WGI Act) respectively. These appear to have been intended to be bare minimum payment standards, but have instead become the industry norm in SA and regions where there is significant participation in the Code. In the Riverina, where there are effectively no Code signatories, growers are often subject to even longer payment periods.

The ACCC is most concerned about potential unfairness arising from terms that provide for lengthy payment periods in supply agreements offered by well-resourced large winemakers.

In this instance, winemakers are in a much better financial position to bear the cost of holding inventory than are growers. These terms are particularly concerning when growers do not have the opportunity to negotiate higher prices in exchange for delayed payment.

The ACCC considers that lengthy payment terms should be phased out of most supply agreements between growers and winemakers.

Termination clauses

The ACCC has concerns about clauses that allow winemakers to terminate agreements with growers where grapes become surplus to their requirements, for any reason, and at short or immediate notice.

Such clauses benefit the winemaker, allowing them to push demand risk back to growers. This negates what most growers consider to be their key priority under supply agreements: having a guaranteed buyer.

While winemakers have an interest in reducing risk, the ACCC considers that winemakers, in particular large winemakers, are in a better strategic position than growers to anticipate changes in, and manage demand risks.

The voluntary code has not resolved key industry problems

Overall, the Code has not been effective in addressing industry problems, primarily because of a lack of signatories.

The Code's key benefit to growers and winemakers is providing a structured process for dispute resolution concerning price and quality assessments of grapes. However, many large winemakers are not signatories to the Code, which means that many growers do not have access to its dispute resolution mechanisms.

While the dispute resolution mechanisms set out in the Code are providing a benefit to the industry, they should be improved to address shortcomings, including:

- quality assessment decisions made at wineries and other types of contractual disputes are not currently covered
- growers are reluctant to progress to stages of dispute resolution requiring the appointment of an independent expert because of the potentially high costs and perceived biases towards winemakers
- there are very few independent experts that can be appointed, and they are not located in warm climate areas where disputes are more common. This may impact on dispute resolution timelines and add to potential cost concerns.

Since the 2017 season, there has been a marked increase in growers utilising the processes under the Code. This has mainly been to dispute prices. A significant number of respondents indicated to the ACCC that they found the process to be effective in assisting them to negotiate better prices with winemakers.

Interim recommendations

The ACCC's interim recommendations are below. We will consult on the proposed recommendations before publishing our final report in September 2019.

The recommendations relate to the warm climate regions, which are the focus of this market study. However, the ACCC considers that recommendations 1, 3, 6, 7 and 8 may also provide benefits if applied in cool climate regions.

The ACCC will review the progress of the industry in adopting the final recommendations approximately 12−18 months after the release of the final report.

Quality assessments

1. **The ACCC recommends the National Measurement Institute (NMI) and the Australian Wine Research Institute (AWRI) work with industry to develop uniform standards for testing and measuring grape sugar levels and colour.**

   Winemakers' testing equipment and processes would then be capable of being independently audited by the NMI, including in response to complaints from growers.

2. **The ACCC recommends that winemakers should use well-documented and objective testing and sampling techniques for quality assessments.**

   Despite the limitations to objective measures, and the importance of sensory assessment, the ACCC considers that reliance on subjective measures to determine payment amounts should be decreased wherever possible.

3. **The ACCC recommends that supply agreements should clearly outline the testing and sampling methods that winemakers will use to assess grape quality.**

   This will increase the transparency regarding quality testing methods, allowing growers to make more informed decisions when entering into agreements.

Price transparency

4. **The ACCC recommends that winemakers be required to provide indicative prices to an independent body by 8 December for all grapes intended to be purchased from growers in warm climate regions during the subsequent harvest.**

   The independent body would then make all pricing information simultaneously available (publicly) on 15 December [or alternative dates considered suitable by industry]. Winemakers would also be required to provide indicative prices to their growers on this date.

   Indicative prices should be provided to an independent body and released simultaneously, to avoid the risk that this increased price transparency could result in the largest winemakers using indicative pricing announcements in a concerted manner which could inhibit price competition.

5. **The ACCC recommends that, after communicating final prices directly to growers, winemakers be required to provide final prices (both the non-quality adjusted price and a quality-adjusted weighted-average price) to an independent body which will then make that pricing information publicly available on 1 May [or another date considered suitable by industry].**

   As above, the ACCC recommends that this applies to all grapes purchased from growers in warm climate regions.

   This would increase visibility over final prices offered by each winemaker over time and increase competition between winemakers in the medium term.

   In relation to recommendations 4 and 5, the ACCC seeks industry feedback regarding:

   - whether Wine Australia would be the most appropriate body to receive and publish pricing information and if not, what alternative body would be appropriate
   - whether this requirement should be legislated or alternatively a requirement of the Code
   - whether this requirement should exclude winemakers under a certain size
   - whether prices under certain supply agreements should be excluded (such as fixed-price multi-year agreements)
   - whether prices should be published without identifying the winemakers who provided the price
   - whether the suggested dates are appropriate dates for the publication of the relevant prices.

Payment periods

6. **The ACCC recommends that long-term payment periods should be phased out of standard form contracts and an industry standard be introduced to require payment in full for grapes no later than 30 days after delivery.**

   The ACCC considers that an appropriate means of introducing this change is through amending the requirements of the Code, as well as through amendments to SA WGI Act.

   The ACCC seeks industry feedback regarding:

   - any types of winemakers or supply agreements that should be exempt from new requirements, such as winemakers under a certain processing capacity
   - the timeframe for transitioning to 30 day payment terms.

The Voluntary Code of Conduct

7. **The ACCC recommends that the Code be substantially strengthened, and that all winemakers in Australia with crushing capacities above 10 000 tonnes become signatories to the Code.**

   The Code should be amended to:

   - provide a structured process for the review of adverse quality assessment decisions made at the winery (including at the weighbridge)
   - provide a structured process for arbitration of contractual disputes, as well as other types of disputes that may arise out of supply agreements. This will improve access to impartial dispute resolution procedures and help address the power imbalance between the two parties
   - guarantee equal representation of growers (including grower representative bodies) and winemakers on the Code Management Committee.

The ACCC will review the progress of the industry in adopting the final recommendations approximately 12−18 months after the release of the final report, and if winemakers do not sign up to the Code, the ACCC may recommend to Government that the code be made mandatory.

The ACCC seeks industry feedback regarding:

- the ACCC's position of not recommending a mandatory code of conduct at this time
- an appropriate arbitration model that ensures disputes are resolved fairly, efficiently and without imposing significant costs on the parties
- the feasibility of taking, holding and testing retention samples if a winemaker downgrades or rejects a delivery of grapes in order to assist dispute resolution
- potential changes to the processes and timeframes for dispute resolution under the Code.

Contracting practices

8. The ACCC recommends that winemakers review their standard form contracts and remove any unfair contract terms.

The ACCC has identified a number of potential unfair contract terms in supply agreements and may take enforcement action against winemakers who retain unfair terms in standard form contracts.

A careful review of contract terms by winemakers is likely to result in greater compliance with the unfair contract terms laws.

The market study

Rationale for conducting this market study

ACCC market studies

The ACCC undertakes in-depth market, sector or industry reviews with the aim of improving our understanding of industry practices and dynamics in those sectors. We publish our findings in reports to help inform consumers and industry participants, encourage public debate over competition and consumer matters, and inform policy consideration.

Market studies may also provide the ACCC with information that can lead to investigations of potential breaches of the CCA. However, these investigations are undertaken separately to the market study itself.

Wine grapes market study

The purpose of this study was to conduct an in-depth review of the Australian wine grape industry and to identify any market failures or issues that may be preventing the functioning of competitive markets and resulting in detriment to market participants. This market study is focussed on the three warm climate grape growing regions (see chapter 2).

Competition and consumer issues in the agriculture sector, including a focus on analysis of the wine grape industry, are current ACCC priorities, as set out in our annual Compliance and Enforcement Policy.[7]

The ACCC considers close examination of the industry is warranted, based on feedback from confidential complaints received by the ACCC, the findings of previous inquiries, the outcomes of targeted ACCC consultations with industry (outlined below), and the broader context of the market.

Previous government reviews

The wine sector has been the subject of a number of government reviews, including the Senate Rural and Regional Affairs and Transport References Committee inquiries in 2005 and in 2016.[8] These inquiries considered competition, contracting practices and the effectiveness of the voluntary Australian Wine Industry Code of Conduct (the Code).

Industry consultation

The ACCC has consulted with industry in a range of ways before and during the market study. The ACCC thanks all parties who provided information for their time and contributions.

Horticulture and viticulture workshops

In 2016, the ACCC held six workshops in regional Australia focusing on understanding competition and fair trading issues in the horticulture and viticulture industries. The ACCC subsequently published a report outlining the issues raised during the workshops and

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7 *ACCC Compliance & enforcement policy and priorities*, 2019, https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities.

8 https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Completed_inquiries/2004-07/wine/report/index;
https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry: The 2016 inquiry made 12 recommendations including phasing out the current wine equalisation tax (WET) rebate, independent review of the existing voluntary Code, and reconsideration of a mandatory industry code of conduct if targets for update of the current voluntary Code are not met.

broader engagement with the industries.[9] The ACCC committed to undertake further work on these issues as part of our focus on competition and fair trading in the agriculture sector.

Grower survey

In July and August 2018, the ACCC invited wine grape growers to provide feedback about competition issues in their industry through an online survey. The survey posed a range of multiple-choice questions to allow growers to share their experience. The survey also included a free text question for growers to provide information on any other industry issues, or to provide further information or context about their responses. We received responses from 262 growers from a range of regions across NSW/ACT, VIC, QLD, SA and WA. Of these, 134 growers provided further feedback through free text comments.

The survey helped the ACCC to learn about the interactions between growers and buyers of wine grapes, and to identify issues in these relationships that required particular attention. The responses highlighted various ways in which the market may not be functioning effectively across Australia. The responses also indicated that some concerns, including concerns relating to contracting practices, competition and pricing, are generally more prevalent in warm climate regions than in cool climate regions. A report of survey results is available at the ACCC's wine grapes market study website https://www.accc.gov.au/winegrapes.

While promoting the survey, ACCC staff spoke with approximately 70 regional organisations representing wine grape growers.

Submissions

The ACCC published an Issues Paper on 26 September 2018. The Issues Paper outlined the key issues relevant to the market study, including:

- markets for the sale and purchase of grapes
- contracting practices between growers and winemakers
- the voluntary code and dispute resolution processes
- transparency and timing of pricing information
- quality assessment.

We requested feedback on the Issues Paper by 2 November 2018.

We received 15 submissions to the Issues Paper, including submissions from growers, grower representative bodies, winemakers and winemaker representative bodies.[10]

We have also received further written feedback, information and documents from winemaker and grower representatives throughout late 2018 and early 2019.

Winemaker information requests

The ACCC sent voluntary information requests to Australia's largest winemakers (by revenue), seeking information on issues relevant to the market study including winemaker operations, sales channels, supply channels, competition, contracting, pricing and payment, quality assessment, and the Code. Seven winemakers responded to the request, including two winemakers that also made submissions to the Issues Paper.

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9 ACCC, October 2016, *Perspectives in horticulture and viticulture*, https://www.accc.gov.au/publications/perspectives-in-horticulture-and-viticulture.

10 Including two winemakers who also responded to our request for information.

In addition we sought information on grape pricing and volumes purchased by region from 28 winemakers for the 2015, 2016, 2017 and 2018 seasons. We received responses from 15 winemakers. Similar information is publicly reported in the Wine Australia National Vintage Survey on an aggregated basis, but receiving the information in a disaggregated form allowed us to perform a more detailed competition analysis. The ACCC also received information directly from Wine Australia.

Grower forums

The ACCC held two grower forums in November 2018. The forums took place in:

- Griffith (NSW) – 13 November 2018 – 16 grower attendees
- Mildura (VIC) – 27 November 2018 – 29 grower attendees.

The forums were attended by ACCC staff and Deputy Chair Mick Keogh. The ACCC heard a range of views from growers regarding issues in the industry.

Meetings

During 2018 and early 2019 the ACCC held in-depth telephone and face-to-face conversations with a wide range of parties including:

- grower and winemaker peak industry associations (Australian Vignerons and Winemakers Federation of Australia, now Australian Grape and Wine Incorporated)
- six regional industry associations from warm and cool climate regions
- eleven winemakers of various sizes, including seven site visits
- six academic researchers or research organisations who specialise in the industry
- three state and federal government bodies
- approximately 20 growers and former growers
- the CCW Co-operative
- a wine broker.

Public sources of information

In addition to information received through consultations, we have relied on public information. A key source of data has been data from Wine Australia including the annual National Vintage Report, annual Price Dispersion Report, and quarterly Export Report. We recognise that the depth of market reporting provided by Wine Australia depends on the provision of quality information from market participants.

We have also frequently referred to data collated in *Growth and Cycles in Australia's Wine Industry* by Kym Anderson which is available from the University of Adelaide.[11]

Further, we have relied on monthly market reports by Ciatti, as well as other public information sources cited throughout the report.

Lack of response from some stakeholders

This market study was self-initiated by the ACCC and as such the ACCC did not have the power to compel market participants to provide documents and information. The study relied on information provided to the ACCC by industry participants on a voluntary basis.

[11] *Growth and Cycles and Australia's Wine Industry – a statistical compendium,* Kym Anderson, University of Adelaide Press, 2013.

In many instances, the ACCC was unable to obtain information from stakeholders to the desired level of detail. While many industry stakeholders were forthcoming and cooperative, some stakeholders (including some grower representatives, winemakers and industry organisations) did not engage with the ACCC to the extent requested. However, the ACCC has still been able to undertake a detailed assessment of the market, and make a range of evidence-based findings and recommendations.

This market study had a broad objective of improving the efficiency of wine grape markets and ensuring the industry can optimise opportunities for future growth. It was therefore disappointing that certain stakeholders did not cooperate with the ACCC.

The market study has, nonetheless, revealed the categories of information that would be relevant to future assessments of competition issues arising under the CCA. In specific circumstances where the ACCC considers there may have been a breach of the CCA, it has the capacity to compulsorily obtain information and documents to inform its investigations.

1. Industry Background

Key points

- Wine production, from grape growing through to winemaking, involves a complex, multi-year production cycle with a range of technical challenges, costs and risks.
- There are over 6000 growers in Australia producing over 100 grape varieties, with approximately equal volumes of red and white grapes.
- The vast majority of growers are small operators, and most have run at a financial loss for several years. Many growers supplement their income with additional employment and diversified crops.
- Winemakers cover a broad spectrum of different business models although there some observable trends correlating with their size.
- The winemaking market is highly concentrated, with one per cent of businesses accounting for over 80 per cent of wine production.
- By volume, most Australian wine is exported. Domestic consumption has generally been stable, so the primary drivers of grape prices in recent years have been international market conditions.
- The domestic retail liquor market is highly concentrated, with four retailers accounting for over 80 per cent of sales by value. Direct channels like cellar doors sales collectively amount to 10 per cent of all domestic sales.
- The industry is emerging from a prolonged cyclical downturn characterised by an oversupply of grapes and wine, unfavourable exchange rates and poor international market conditions.
- The regulatory environment in the wine grapes market is centred around the *Wine Grapes Industry Act 1991* (SA) (WGI Act) and the voluntary Australian Wine Industry Code of Conduct (Code).

1.1. Wine production is a complex multi-year process

Wine production, from grape growing through to winemaking, is a multi-year process with many technical challenges and costs, and a range of agricultural, financial and economic risks. This section outlines the timeframes and technical steps of the process.

1.1.1. Grape growing occurs in an annual cycle

Grape vines take around three years from planting until they begin to produce the necessary quality and quantity of grapes for commercial sale. They begin to produce larger quantities after four or five years, and this stabilises after around eight to 15 years. It can take up to 10 years for vines to reach peak quality for some premium varieties. Vines can live for many decades. Older vines tend to produce less output than younger vines, but produce higher quality grapes.

Growers may decide to plant a particular variety in response to advice or commitments from a particular winemaker, or independently, based on predictions about market trends. When planting new vines, growers must make decisions about the orientation of vineyard rows, the spacing and trellising of the vines, and treatment of the soil. Growers have indicated that input costs for new plantings are similar across varieties, and it can cost $25 000 to $40 000 per hectare to pull out and replant a block of vines.

Once the vines mature, they are managed through each yearly growing cycle, as outlined in figure 1.1.[12] The exact timing of the cycle, growing techniques and required inputs vary from region to region, but are broadly similar. The climate and weather events in a particular season will also affect the required inputs. For example, in a very wet season the vines may require increased monitoring for and management of disease, and in a very dry season the water requirements can be much greater.

Figure 1.1 Australian grape growing cycle

<table>
<tr><td>Autumn/ Winter</td><td colspan="2">Grower activities include irrigation, spraying to control weeds, fertilisation, pruning, trellis maintenance and staking/anchoring/training.</td></tr>
<tr><td>Spring</td><td>Bud burst occurs around late September and flowering occurs in November or December. Grapes begin to grow rapidly and the growth rate then slows down until veraison (the beginning of ripening).

The grower sprays and trims at various points between bud burst and harvest.</td><td rowspan="2">The grower waters vines around one to five times a week through drip or furrow irrigation or other means, depending on region and weather.

The level of irrigation (or rain) immediately before harvest can strongly impact grape size.

Industry participants have indicated that increases in yield tend to correlate with decreases in quality.</td></tr>
<tr><td>Summer</td><td>Veraison (the beginning of ripening) occurs around 6 February, around 60 days after flowering. The grapes soften and accumulate sugar. Acids degrade and colour begins to appear in the skin of pigmented varieties. Berries expand, and flavour and aroma compounds build up.

The grower may thin the leaves, depending on desired level of sun exposure.

Depending on region and variety, peak quality occurs from about mid-January to early April. If grapes mature beyond their peak, particularly red grapes, they begin to dehydrate. This results in lower yields, more difficult harvests and higher sugar levels. The grapes then take on a ‘jammy’ quality which is suitable for fortified wines but is usually not desirable for other wines.</td></tr>
<tr><td>Summer/Autumn</td><td colspan="2">Winemakers generally determine the timing of harvest based on the maturity of the grapes and the winemaker’s capacity to receive and handle grapes (see section 3.5).

Harvesting generally occurs at night, particularly for white grape varieties. After harvest, the grapes must be kept as cool as possible and crushed within hours to prevent oxidisation, fermentation or other spoilage.

Harvesting machinery can cost several hundred thousand dollars, and tens of thousands of dollars to maintain each year. Some large-scale growers have their own harvesting equipment, which they may lease to other growers in the area, or they may co-own machinery as part of a syndicate. Other growers must arrange to hire harvesting machinery, sometimes with the help of a winemaker. Harvesting machinery can be in high demand during peak periods and can be difficult to obtain at short notice. Some growers also engage casual staff to assist with harvest.</td></tr>
</table>

12 For more information see Bryce Rankine, 2004, *Making Good Wine*, Pan Macmillan Australia, chapter 2.

1.1.2. Winemaking is a complex multi-step process

Winemaking is a complex multi-step process beginning with the receipt of grapes at the winery, and ending with packaging of the final product. Winemakers have submitted that it typically takes at least half a year for the earliest white wines to reach the consumer market, and longer for wines that require ageing. The finished wine is influenced by many factors, and the steps in production differ depending on the variety and style of wine to be produced. The production process usually follows a broadly similar pattern to that shown in figure 1.2.

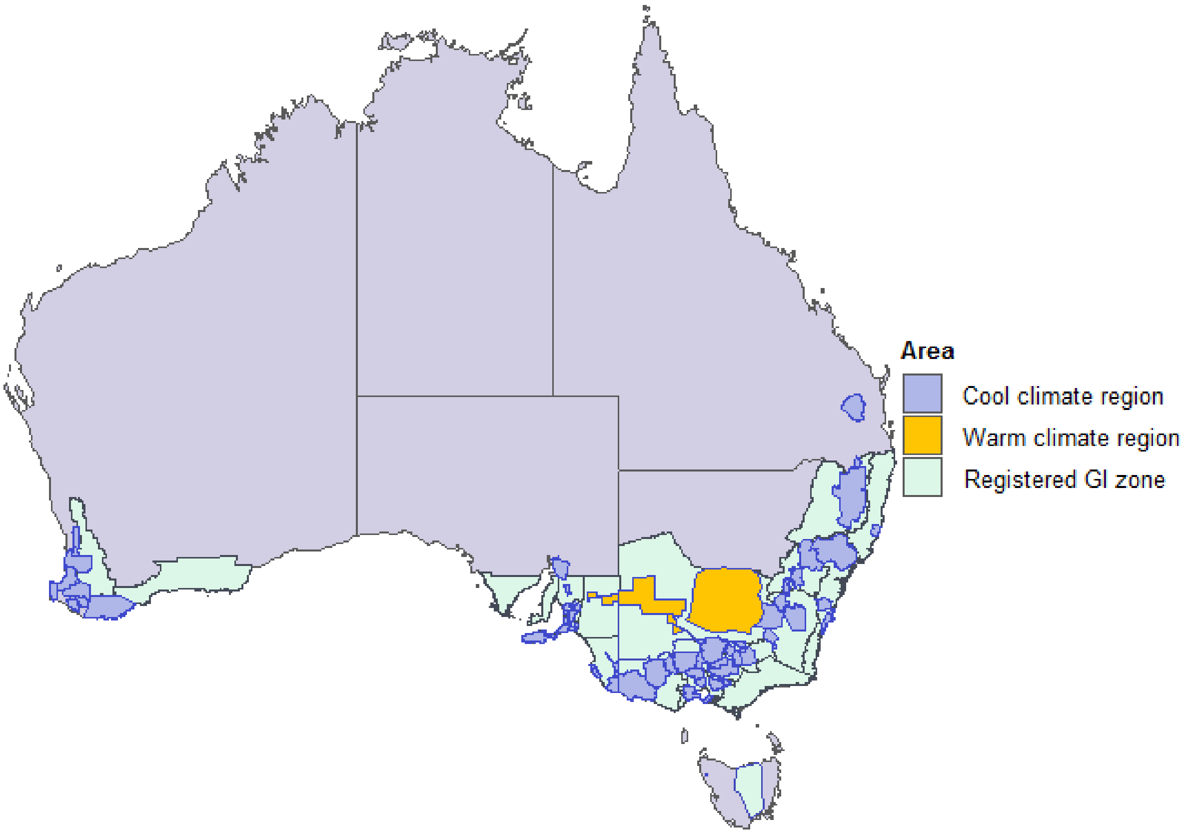
Figure 1.2 The process involved in winemaking

Crushing	• Upon arriving at the winery weighbridge, the grapes are weighed and quality assessed, before being crushed and destemmed. • Additives that assist with stabilising and preserving the wine, and yeast cultures may be added as this stage.
Fermentation on skins and pressing (reds only)	• For red varieties, the must is partially fermented in contact with the skins to extract colour. • The must is then drained and the skins are pressed to extract juice. The juices may be combined.
Clarification	• The juice is settled and decanted to clarify it and remove sediment. Decantation can be conducted through centrifuging or filtering.
Fermentation	• The juice is fermented into wine. • Further additives may be used at this stage to assist with fermentation or to adjust the flavour profile or acidity.
Filtration	• The wine is stabilised, decanted and coarse-filtered. • Further additives (such as sweeteners, ascorbic acid or sodium dioxide) may be added.
Aging	• Wines may be aged in oak barrels (most red wines), steel containers (white wines) or plastic containers. The choice of barrel or other container and the length of fermentation depend on the desired style. Red wines may also be aged after bottling.
Filtration	• If necessary, the wine is sterile-filtered and fined to clarify.
Packaging	• The wine is packaged into bottles or into bulk packaging. • Bottling can occur within three to six months of harvest for white wines and within one to two years of harvest for red wines. • There are a range of bottle and cap types used, depending on the type of wine and target market.

1.2. Australia has many diverse wine regions

Australia grows over 135 000 hectares of grapes across 65 geographical indication (GI) regions, as shown in figure 1.3.[13] These regions are mostly concentrated in south eastern Australia, including in SA, VIC, NSW, TAS and southern QLD. There are also wine grape growing regions in the south western corner of WA.

Figure 1.3 Australian wine grape growing regions



Source: Wine Australia.[14]

Australian wine regions can be broadly classified as warm or cool climate. This market study focuses on the warm climate regions. Chapter 2 examines the differences between warm and cool climate regions and details the characteristics of individual warm climate regions.

1.3. The wine supply chain involves a range of transactions

The Australian wine sector incorporates a range of participants, from small family farms through to large corporate winemakers and major retailers. This section details the characteristics of the growing and winemaking steps of the supply chain. Figure 1.4 summarises the key features of the wine supply chain.

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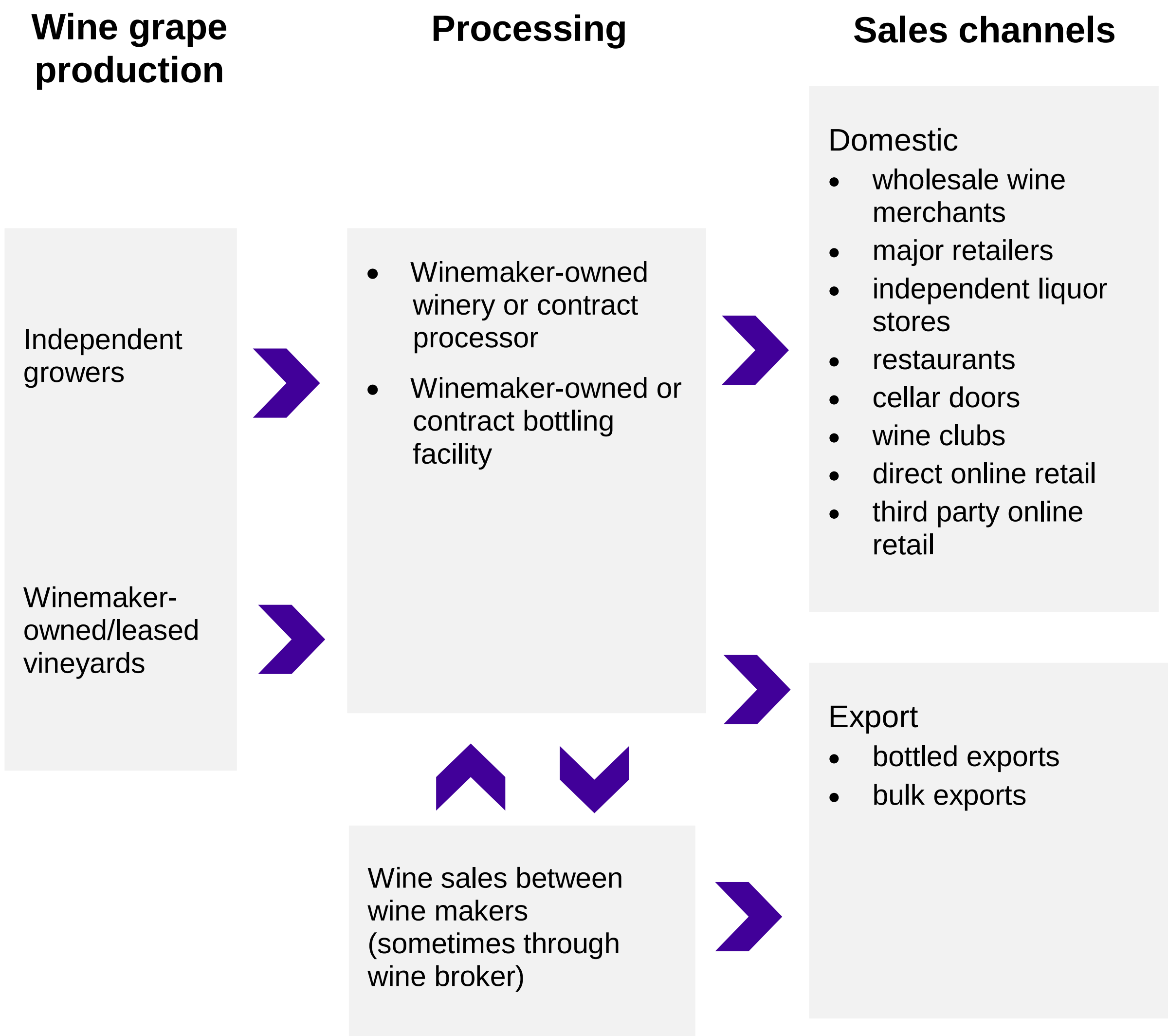
13 Wine Australia, *Australian wine sector 2018 at a glance*, https://www.wineaustralia.com/market-insights/australian-wine-sector-at-a-glance; Wine Australia, *Geographical indications*, https://www.wineaustralia.com/labelling/register-of-protected-gis-and-other-terms/geographical-indications.

14 *https://www.wineaustralia.com/labelling/register-of-protected-gis-and-other-terms/geographical-indications. The registered GI zones shown exclude state-wide zones and South Eastern Australia (SEA). SEA includes all of NSW, VIC, TAS, and ACT, part of SA and part of QLD.*

Figure 1.4 The wine supply chain involves a range of transactions



1.3.1. Vineyards tend to be small scale

There were reported to be 6251 wine grape growers in Australia in 2018[15], producing over 100 red and white wine grape varieties.[16] The five most widely grown varieties are Shiraz, Cabernet Sauvignon, Chardonnay, Merlot and Sauvignon Blanc, and these comprise 75 per cent of national vineyard plantings.[17] In 2018, 52 per cent of grapes crushed and wines produced were red varieties, and the remaining 48 per cent were white varieties.[18]

Grape growing businesses are mostly small operations, and many are family-owned. About 80 per cent of grape growing businesses operate on farms of less than 50 hectares, and almost 98 per cent employ fewer than 20 people.[19]

15 Wine Australia, *Australian wine sector 2018 at a glance*, https://www.wineaustralia.com/market-insights/australian-wine-sector-at-a-glance.

16 Wine Australia, *Market insights – Australian grape and wine production*, https://www.wineaustralia.com/market-insights/australian-grape-and-wine-production.

17 Wine Australia, *Australian wine sector 2018 at a glance*, https://www.wineaustralia.com/market-insights/australian-wine-sector-at-a-glance.

18 Wine Australia, *National Vintage Report 2018*, 'https://www.wineaustralia.com/market-insights/national-vintage-report, p. 3.

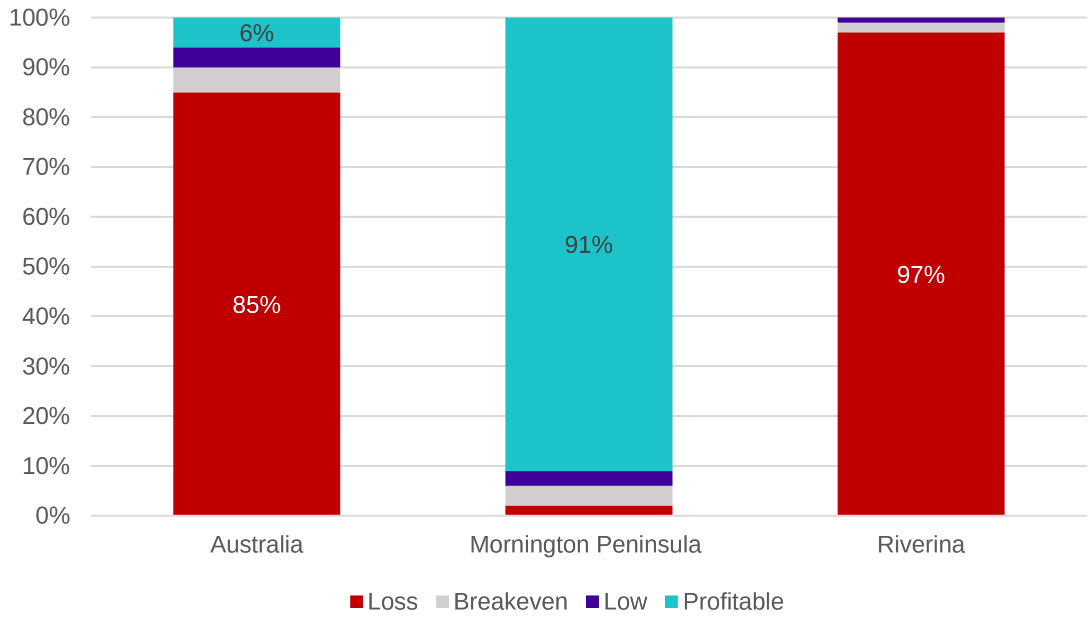
19 Includes table grapes. IBIS World, 2019, *Industry report A0131: Grape growing in Australia*, p. 24.

Most growers in warm climate regions are not involved in wine production, in contrast to many (but not all) cool climate growers. Warm climate growers generally supply grapes to winemakers under supply agreements and are paid based on volume and quality. Under most supply agreements, growers are exposed to various risks relating to grape production, harvest, grape price and finance (see chapter 5).

1.3.2. Many growers do not cover their production costs

Analysis by the Winemakers' Federation of Australia (WFA) shows that 77 per cent of growers made a loss in 2012, 84 per cent made a loss in 2014 and 85 per cent made a loss in 2015.[20] However, profitability varied greatly between different wine regions. For example, an estimated 97 per cent of Riverina growers made a loss in 2015, compared to 2 per cent of Mornington Peninsula growers (see figure 1.5).[21]

Figure 1.5 Average profitability of Australian, Mornington Peninsula and Riverina growers (2015)



Source: WFA.[22]

A comparison of WFA's estimated regional production costs with the 2018 average grape prices suggests that in certain regions most growers continued to make a loss in 2018.

In warm climate regions, growing costs tend to be lower and yields tend to be higher, but grape prices tend to be lower per tonne than in cool climate regions. We present a closer analysis of grower profitability in the warm climate regions in chapter 2.

1.3.3. Winemakers have a diverse range of business sizes and models

Australian winemakers comprise a diverse range of business sizes and models, from family-owned boutique winemakers to publicly listed multinational companies operating wineries and vineyards across Australia and overseas. Collectively, winemakers produce

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20 WFA, July 2015, *Vintage Report*, https://www.agw.org.au/media-and-events-centre/vintage-report-/, p. 5.

21 Ibid, p. 10, 22 and 24.

22 Ibid.

wines of different varieties, regions and styles for a wide spectrum of sales channels, market segments and prices.

In this report we refer to winemakers of various sizes as follows:

- **small winemakers**: those crushing less than 500 tonnes of grapes per year
- **medium winemakers**: those crushing 500−10 000 tonnes of grapes per year
- **large winemakers**: those crushing 10 000 tonnes of grapes or more per year, including some major corporate winemakers who crush more than 100 000 tonnes.

Small winemakers tend to produce higher value wines than large winemakers. In 2016−17, small winemakers sold wine at an average price of $11.41 per litre, compared to an average of $6.60 per litre for all winemakers.[23] Collectively, small winemakers accounted for 18 per cent of domestic sales volumes, but 35 per cent of domestic sales value. Similarly, small winemakers accounted for 3 per cent of export sales volumes, but 10 per cent of export sales value.[24] In addition, compared to large winemakers, small winemakers tend to:

- grow a greater proportion of their own grapes (see section 1.3.5)
- be more reliant on contract processing (see section 1.3.7)
- export a smaller proportion of their wine (see section 1.4.1).

In addition to traditional winemakers, major domestic retailers like the Woolworths-owned Endeavour Drinks Group and the Coles Liquor Group are also significant winemakers and purchasers of wine grapes.

1.3.4. The winemaking market is heavily concentrated

The Australian winemaking market is heavily concentrated, with many small winemakers and a small number of very large winemakers.

The four largest winemakers have a combined market share of around 37 per cent based on revenue.[25] In 2014, 75 per cent of winemakers processed less than 100 tonnes of grapes.[26] More than 90 per cent of winemakers were small winemakers and only 1 per cent were large winemakers.[27] However, as of 2009, large winemakers produced 83 per cent of wine and winemakers who processed less than 100 tonnes produced less than 1 per cent of wine, as shown in figure 1.6.

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23 Wine Australia, *Small Winemaker Production and Sales Survey 2017*, https://www.wineaustralia.com/market-insights/small_winemaker_survey, table 4, p. 3; Wine Australia, *Australian wine: Production, sales and inventory report 2016-17*, https://www.wineaustralia.com/market-insights/australian-wine-production,-sales-and-inventory-report, p. 3.

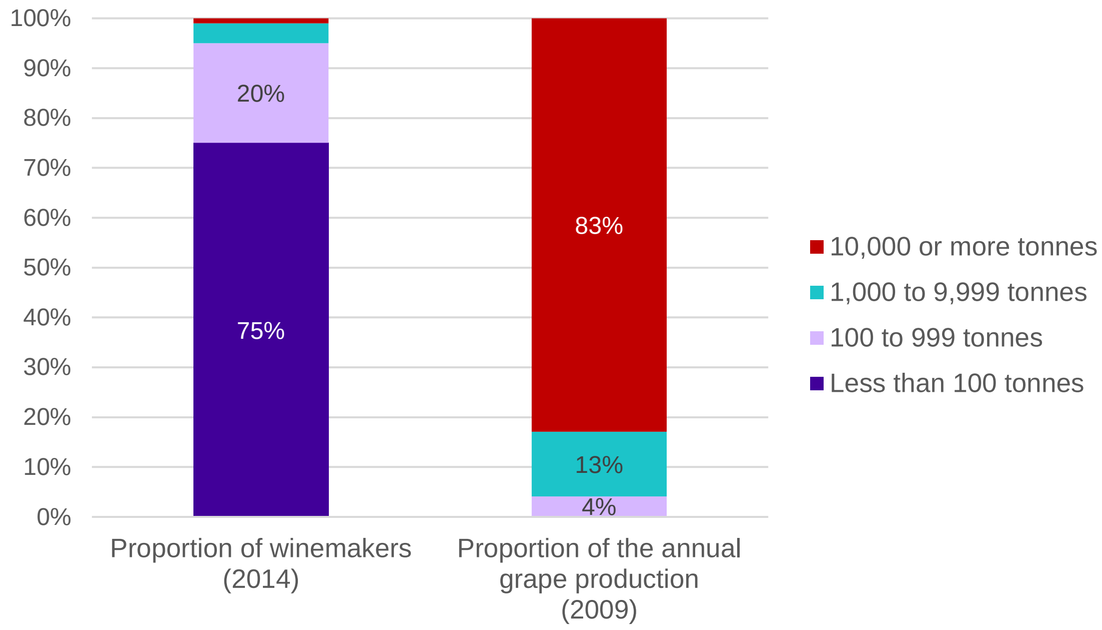
24 Wine Australia, *Small Winemaker Production and Sales Survey 2017*, https://www.wineaustralia.com/market-insights/small_winemaker_survey, p. 6.

25 IBIS World, 2019, *Industry report C1214: Wine Production in Australia*.

26 Kym Anderson, 2015, *Growth and Cycles in Australia's Wine Industry: A Statistical Compendium, 1834 to 2013*, University of Adelaide Press, https://doi.org/10.20851/austwine, table 21(d), p. 219.

27 Ibid, table 21(c), p. 219.

Figure 1.6 The winemaking market is heavily concentrated



Source: Anderson 2015.[28]

The skew toward large winemakers is highlighted by the fact that the three largest winemakers alone accounted for 41 per cent of all grapes crushed and 40 per cent of all wine produced in 2009.[29]

Considered individually, the warm climate regions are even more concentrated. Between one and three large winemakers buy half or more of the grapes in each warm climate region. We discuss market concentration in each region and its implications in chapter 6.

Similar levels of concentration are also seen in the Australian wine export market, in which the five largest winemakers account for an estimated 87 per cent of volume.[30] In contrast, small winemakers, despite making up over 90 per cent of all winemakers by number, account for only three per cent of export volumes.[31]

In recent years, the trend has been towards even greater consolidation of large winemakers and increased new entry of small winemakers. This is discussed in section 1.5.3.

1.3.5. Vertical integration into grape production has remained steady

Most major winemakers have some degree of vertical integration in grape production, sourcing most grapes from independent growers but also using grapes produced in vineyards that they own or lease.

In recent years, the level of vertical integration has remained relatively stable. The proportion of grapes grown by winemakers was 31 per cent in 2018, compared with 33 per cent in 2017 and 30 per cent in 2012.[32] Some large winemakers submitted that their vineyard investment is weighted towards particular varieties which are more difficult to source from growers

28 Ibid, table 21(d), p. 219.

29 Ibid.

30 Wine Titles, 2018, *Wine Companies*, https://winetitles.com.au/statistics-2/wine-companies/, based on data from *The Australian and New Zealand Wine Industry Directory 2018*.

31 Wine Australia, *Small Winemaker Production and Sales Survey 2017*, https://www.wineaustralia.com/market-insights/small_winemaker_survey, p. 6.

32 Wine Australia, *National Vintage Report 2018*, https://www.wineaustralia.com/market-insights/national-vintage-report, p.1; Anderson, 2015, table 66, p. 331.

located in cool climate regions. This is reflected in the comparatively lower average yield in winemaker vineyards in 2012 (8.6 tonnes per hectare), compared to non-winemaker vineyards (12.3 tonnes per hectare).[33]

Vertical integration enables winemakers to guarantee their supply of grapes of particular varieties, grades and other attributes from particular regions. Vertically integrated winemakers are also partly shielded from price competition for these grapes, although they face an opportunity cost when deciding to use or sell them. They have control over vineyard management and production decisions that could impact grape quality and yield, but are also exposed to the associated agricultural risks. Because of their size, large winemakers are generally better able to manage the risks associated with grape growing than small independent grape growers.

Small winemakers are generally more vertically integrated than large winemakers. On average, small winemakers grew 67 per cent of the grapes they crushed in 2016/17.[34] Around half of small winemakers (52 per cent) self-supply more than 90 per cent of their own grapes. In contrast, around one-fifth of small winemakers (18 per cent) have minimal vertical integration and purchase more than 90 per cent of their grapes from growers.

1.3.6. Most major Australian winemakers have wineries in warm climate regions

Wineries require major capital investments by winemakers. Specialised equipment is required at each step of the winemaking process. Much of the equipment, such as the crusher, is only used for a small part of the year. In addition to winemaking equipment, some winemakers also have their own bottling facilities, while others outsource bottling.

Some winemakers have undertaken substantial capital investment in wineries or bottling facilities in warm climate regions since 2016. Most significantly, a new entrant has recently constructed and begun operating a winery in the Murray Valley with 80 000 tonnes' approved capacity and the potential to expand to 168 000 tonnes' capacity.[35]

The wineries with the largest capacities are located in the warm climate regions. Most major winemakers have at least one winery with sufficient capacity to process large volumes of grapes in the warm climate regions.[36]

Some major winemakers also have smaller wineries in cool climate regions. These are often attributed to specific wine brands, and were generally gained through acquisition rather than new construction. Depending on its market segment focus, a large winemaker's smaller wineries can collectively account for a significant proportion of its total production. For example, one major winemaker has as much production capacity in its cool climate wineries as its warm climate winery, even though the warm climate winery is one of the largest capacity wineries in Australia.

1.3.7. There is a limited amount of contract processing in the industry

Contract processing refers to the outsourcing of one or more steps of the winemaking process to a separate winemaker.

33 Anderson, 2015, table 65, p. 327 and table 66, p. 331.

34 Wine Australia, *Small Winemaker Production and Sales Survey 2017*, https://www.wineaustralia.com/market-insights/small_winemaker_survey, p. 16.

35 See Alexandra Treloar and Kellie Hollingworth, 8 March 2019, *ABC News*, 'Chinese winemaker Weilong begins first harvest and crushing of export-only wine in VIC, https://www.abc.net.au/news/2019-03-08/chinese-winemaker-weilong-first-crushing-at-australian-home/10880558.

36 See Wine Titles, 2018, *The largest wine processing facilities*, https://winetitles.com.au/statistics-2/wine-companies/the-largest-wine-processing-facilities/, based on data from *The Australian and New Zealand Wine Industry Directory 2019*.

Most Australian winemakers retain their wineries for their exclusive use, but some offer contract processing services for a fee. One winemaker submitted that offering contract processing services allows it to make use of unused processing capacity and diversify its demand risk and payment cycle. Its services are often used by larger-scale growers seeking to capture a greater proportion of supply chain profits, or seeking flexible harvest times to avoid the risk of weather events affecting the quantity and quality of their harvest.

Many small winemakers use contract processing because of the high capital cost of winemaking equipment. In 2016-17, 41 per cent of small winemakers relied on contract processing for their entire production, and an additional 10 per cent relied on contract processing for a proportion of their production.[37]

In contrast, the largest winemakers generally have multiple winery and vineyard assets, so they only rely minimally on contract processing, such as to make up for marginal shortfalls in processing capacity. However, at least one major winemaker engages contract processors for a significant proportion of its production. This winemaker submitted that the use of contract processing allows it to avoid transport costs and the risk of quality degradation when sourcing grapes from regions where it does not have a winery.

1.4. Australian wine is sold to international and domestic sales markets

The markets for Australian wine can be broadly divided into export and domestic, each having distinct characteristics and demand factors. This section details these distinctions and their implications for winemakers and growers.

1.4.1. The export market is the primary driver of demand

The value and volume of Australian wine exports in a given year is a function of multiple international and domestic factors including:

- the relative value of the Australian dollar
- the volume and quality of exports from other major wine exporting countries
- international economic, political and regulatory conditions
- consumer and cultural shifts within target markets
- local supply conditions in Australia.[38]

In 2018, Australia exported 850 million litres of wine at a value of $2.82 billion. Australia's top five export markets by value in 2017−18 were China ($1.14 billion), the United States ($425 million), the United Kingdom ($389 million), Canada ($210 million) and New Zealand ($93 million).[39] By volume, 63 per cent of wine produced in Australia was exported in 2018.[40]

Larger-scale winemakers have a greater reliance on export markets. In 2016−17, an estimated 14 per cent of small winemaker sales were exports, compared to 60 per cent for all winemakers.[41]

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[37] Wine Australia, *Small Winemaker Production and Sales Survey 2017*, https://www.wineaustralia.com/market-insights/small_winemaker_survey, table 11, p. 31.

[38] See Gillespie Economics, 2015, *Economic Contribution of the Australian Wine Sector*, https://www.wineaustralia.com/market-insights/australian-wines-economic-contribution, p. 12-13.

[39] China includes Hong Kong and Macau. Wine Australia, *Export Report December 2018*, https://www.wineaustralia.com/news/media-releases/export-report-december-2018.

[40] Wine Australia, *Export Report December 2018*, https://www.wineaustralia.com/news/media-releases/export-report-december-2018.

[41] Wine Australia, *Small Winemaker Production and Sales Survey 2017*, https://www.wineaustralia.com/market-insights/small_winemaker_survey, p. 5.

Australian winemakers exported a greater volume but lesser value of bulk wines than bottled wines in 2018 (480 million litres/$560 million for bulk wines and 361 million litres/$2.24 billion for bottled wines).[42]

Bulk wine may be blended with local or other region wines and then bottled at destination. This finished wine may then be labelled as Australian, local or other region wine depending on the proportion of wines used in the blending process, labelling laws and marketing strategy.[43]

The fact that wine is transported in bulk does not in itself indicate that it is of a lesser quality than bottled wine. Premium wines are also sometimes transported in bulk for various reasons.[44] Transporting bulk wine is generally cheaper than transporting bottled products and it may also be subject to lower import taxes.[45]

On average, bulk wine is sold at a much lower price per litre than bottled wine. In 2018, the average export price of bulk wine was $1.17 per litre, compared to $6.20 per litre for bottled wine.[46] This is partly because it is an unfinished product, and partly because a large proportion of bulk wine consists of commercial wine. Commercial wine is sometimes sold at very low prices without differentiation by variety, year or region.

Many winemakers who export bulk commercial wine consider the product to be relatively homogenous. They therefore focus on obtaining a large volumes of grapes that meet basic quality standards, rather than more expensive grapes with more distinctive characteristics.

1.4.2. The domestic retail market is highly concentrated

Approximately 40 per cent of wine produced in Australia is sold in the domestic retail market.[47] Australian wines account for over 80 per cent of domestic wine sales.[48] The remaining proportion consists of imported wines, amounting to around 95 million litres per year, of which two-thirds comes from New Zealand.[49]

Wine is sold in retail outlets at various price points. Retail pricing is a primary factor in consumer decision making, and consumers generally choose their wine with a particular price point in mind.

The domestic retail market has become increasingly concentrated over the past five years, largely as a result of Woolworths and Coles having grown their presence in the liquor retailing market. Together, the four largest retailers, which also include Metcash Limited and Aldi, have an 84 per cent share of the liquor retail market.[50] We present analysis of the implications of this in chapter 6.

Additionally, the four largest retailers each source wine which they market using numerous 'private label' brands.[51] Private labels are exclusive to individual retailers, and are therefore not subject to direct price competition from other retailers. One retailer submitted that it

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42 Wine Australia, *Export Report December 2018*.

43 For example, under the *Wine Australia Regulations 2018*, wines may be labelled as being of a specified Australian geographical indication if at least 85 per cent of its volume is sourced from grapes from that geographical indication. Different countries have different minimum labelling requirements.

44 See, for example, Vinex marketplace, https://app.vinex.market/.

45 For discussion of advantages of transporting in bulk see Wine Network, 2012, *Bulk Wine vs. Bottled Wine*, http://www.winenetwork.co.nz/site/news/industry-articles/bulk-wine-vs-bottled-wine.

46 Wine Australia, *Export Report December 2018*.

47 Wine Australia, *Market Insights – Australia*, https://www.wineaustralia.com/au/market-insights/australia-domestic

48 Ibid.

49 Ibid.

50 IBIS World, 2019, *Industry report G4123: Liquor retailing in Australia*, p. 22-25.

51 The Real Review, March 2019, *Who Makes My Wine?*, https://www.therealreview.com/who-makes-my-wine/.

earns higher profit margins on private label wine brands, and that private label wine brands are used to promote customer loyalty.

Retailers source private label wines under a number of different arrangements, including purchasing finished wines, and purchasing unfinished bulk wines to be blended with other wines and bottled. At least one major retailer also owns a traditional winemaking company that sources grapes and produces its own wines. Private label sales have increased significantly, from an estimated 5 per cent in 2005 to an estimated 16 to 25 per cent in 2016.[52] A report commissioned by Wine Australia suggests that supermarket preference for producing private label wine has contributed to downward pressure on grape prices.[53]

Direct channel sales represent an estimated 10 per cent of domestic wine sales.[54] The largest sources of direct sales are cellar doors (estimated 44 per cent of direct channel sales in 2017) and wine and loyalty clubs (14 per cent).[55]

Wine tourism is a selling point and source of income for many winemakers. It is estimated that 88 per cent of Australian winemakers operated a cellar door retail outlet in 2017. Of these, 86 per cent also provided food, and some also offer vineyard or winery tours and hosting services for functions and exhibitions.[56] Small-scale winemakers generally have a greater reliance on direct channels than large-scale winemakers.[57]

1.5. Recent market conditions have reflected cyclical international factors

Recent market conditions have been characterised by relatively stable domestic sales and fluctuating international demand for Australian wine (see figure 1.7).[58] This dynamic, together with a prolonged oversupply of grapes and wine, has increased the exposure of the industry to cyclical international demand factors.

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52 Senate Rural and Regional Affairs and Transport Reference Committee, 2016, *Australian grape and wine industry*, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry/Report, p. 36.

53 Gillespie Economics, 2015, *Economic Contribution of the Australian Wine Sector*, https://www.wineaustralia.com/market-insights/australian-wines-economic-contribution, p. 12.

54 Wine Australia, *Cellar Door & Direct to Consumer Survey Report 2018*, https://www.wineaustralia.com/market-insights/cellar-door-and-direct-to-consumer-survey-report, p. 16.

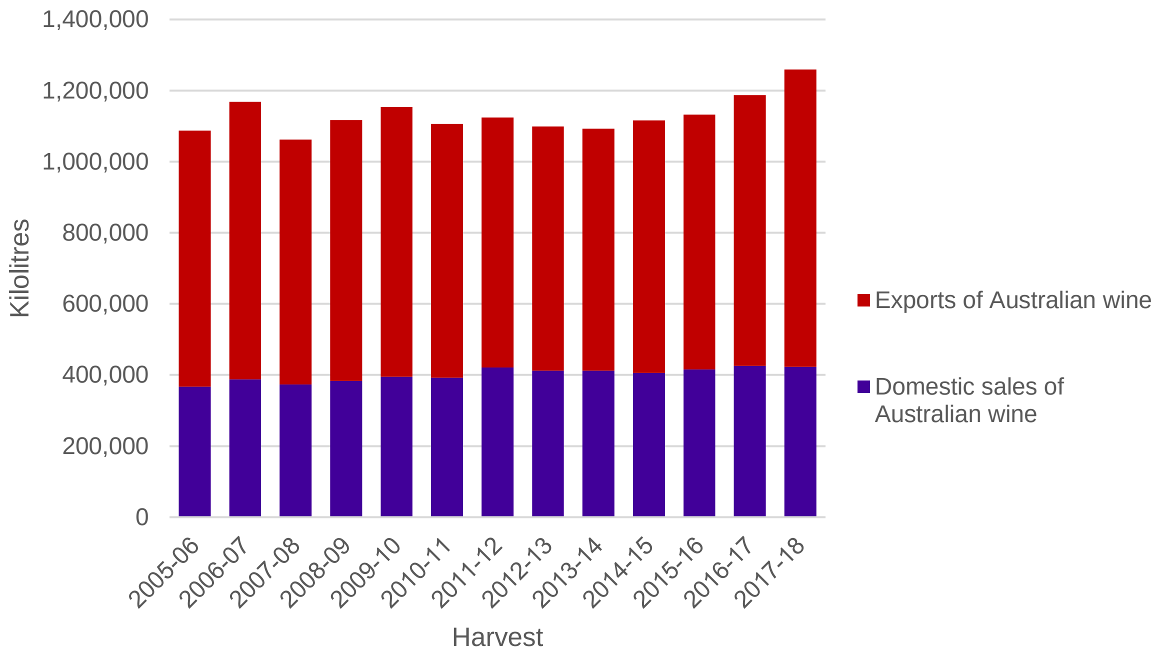
55 Ibid, p. 19.

56 Ibid, p. 23.

57 Ibid, p. 16.

58 See also: Anderson, 2015, table 34(a), p. 246.

Figure 1.7 Domestic and export sales of Australian wine since 2005−06



Source: Wine Australia.[59]

This section examines the most recent market cycle for the Australian wine industry, its primary drivers and its implications for growers and winemakers.

1.5.1. Supply and demand has followed long cycles

Supply and demand movements in the Australian wine market have historically followed long cycles lasting two or more decades.[60] During the most recent cycle, which began in the late 1980s, the volume of exports and total vineyard area substantially and rapidly increased, peaking in the late 2000s.[61]

In 1995, the Australian wine industry published an industry target of a three-fold increase in the real value of wine production by 2025, with 55 per cent of the production destined for export markets. Although some market participants considered the targets to be optimistic, the rapid and continued growth in wine production and exports meant that the industry was halfway to achieving its 30-year target in just 5 years.[62]

This rapid growth was mainly driven by the combination of a low Australian dollar exchange rate and a technological competitive advantage in efficient wine production. The expansion also benefitted from several government initiatives providing assistance to growers and winemakers, including the wine equalisation tax (WET) rebate discussed in section 1.6.3.[63]

The strong demand for Australian wine drove average export prices to increase from under $2.00 per litre in 1986 to over $5.00 per litre in 2001 in nominal terms, while the industry also rapidly increased its wine production. Between 1991 and 2004, overall production increased

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59 *Australian wine: Production, sales and inventory 2017-18*, appendix 1.

60 Anderson, 2015, identifies five cycles: 1855-1882, 1882-1915, 1915-1967, 1967-1986, 1986-present.

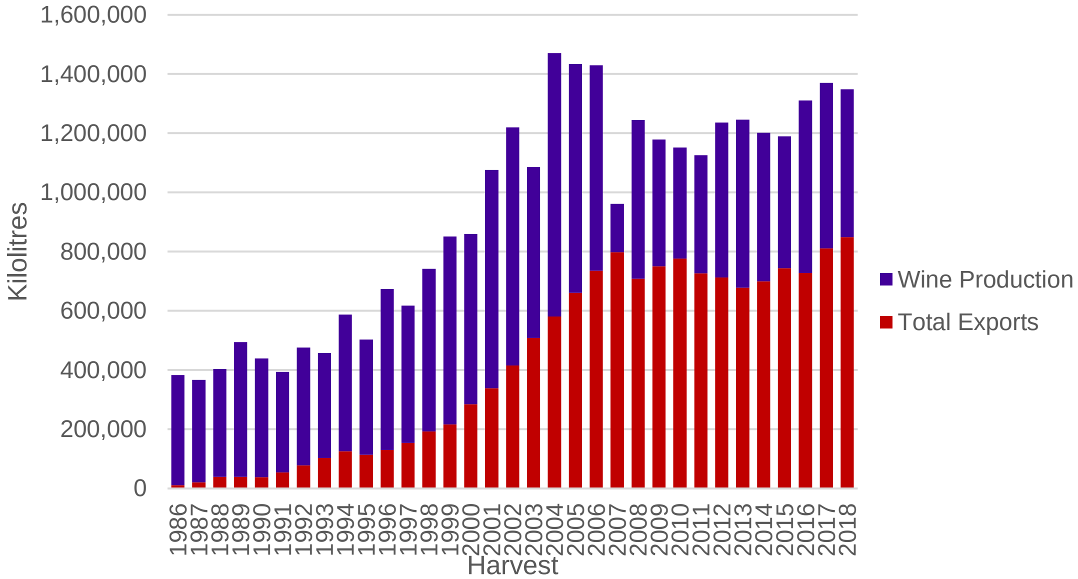
61 Anderson, 2015, chart 1, p. 84.

62 Ibid, p. 24.

63 Ibid, p. 23.

from less than 400 million litres to over 1.4 billion litres, and total exports rose from just over 65 million litres to over 640 million litres (see figure 1.8).

Figure 1.8 Australian wine production and wine exports by year



Source: Anderson 2015[64] and Wine Australia.[65]

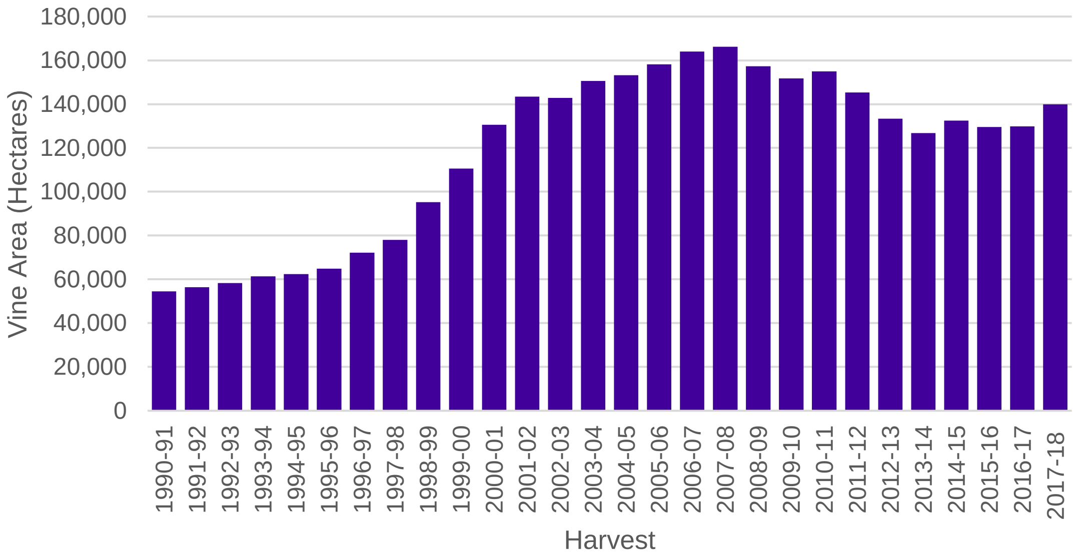
Growers benefitted immensely from the flow-on demand for grapes. From 1986 to 2001, the average grape price rose from slightly above $200 per tonne, to over $1000 per tonne (in nominal terms), and total vineyard area more than doubled over this same period (see figure 1.9).[66] We present a more detailed analysis of grape prices and their main drivers in chapter 4.

64 P. 175, table 9 and page 183, table 11.

65 *Production Sales and Inventory Report 2017-18*, appendix 1.

66 Anderson, 2015, chart 17, p. 94.

Figure 1.9 Total Australian vineyard area by year



Source: ABARES.[67]

1.5.2. Multiple factors resulted in a severe market correction

Coinciding with the rapid increase in grape and wine production in Australia in the early 2000s was a rise in production and exports by other winemaking countries, mainly Italy, Spain, Chile and Argentina.[68] This quickly resulted in greater competition in export markets. Additionally, the Australian dollar significantly appreciated after 2001, reducing the international price competitiveness of Australian wine.[69] These two factors contributed to diminished export demand for Australian wine, and lower prices for grapes.[70]

The stronger Australian dollar also encouraged wine imports and therefore increased competition for Australian wines in the domestic retail market. Since 2009, New Zealand Sauvignon Blanc has been the highest selling white wine in Australia. The surge in wine imports from New Zealand was partly driven by the application of the WET rebate to New Zealand wines sold in Australia.[71]

Demand for Australian wines, and consequently grapes, also softened in response to a number of international market factors. These factors included the global financial crisis in 2008, an oversupply of European wines flowing into the global market, and an erosion of Australia’s natural advantage in producing low cost wines.

However, earlier market signals had already stimulated structural increases in grape and wine production. This contributed to a prolonged and severe oversupply of grapes and wine. Wine export prices and grape prices fell (see figure 1.10), even though export volumes continued to increase until 2007 (see figure 1.11).[72]

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67 *Agricultural commodity statistics 2018,* table 22.1, ‘Summary of Australian statistics for wine grapes’.

68 International Organisation of Vine and Wine, *OIV Vine and Wine Outlook 2008-2009*, appendix R.

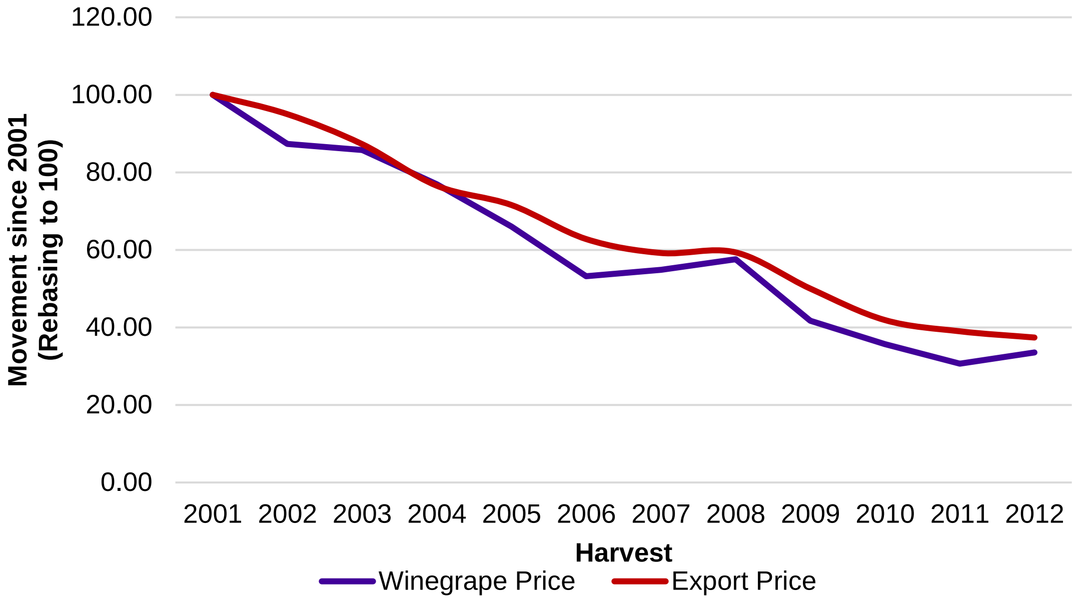
69 See Anderson, 2015, table 23(a), p. 97.

70 Ibid, p. 1.

71 Ibid, p. 25. See section 1.6.3 for discussion of the WET rebate.

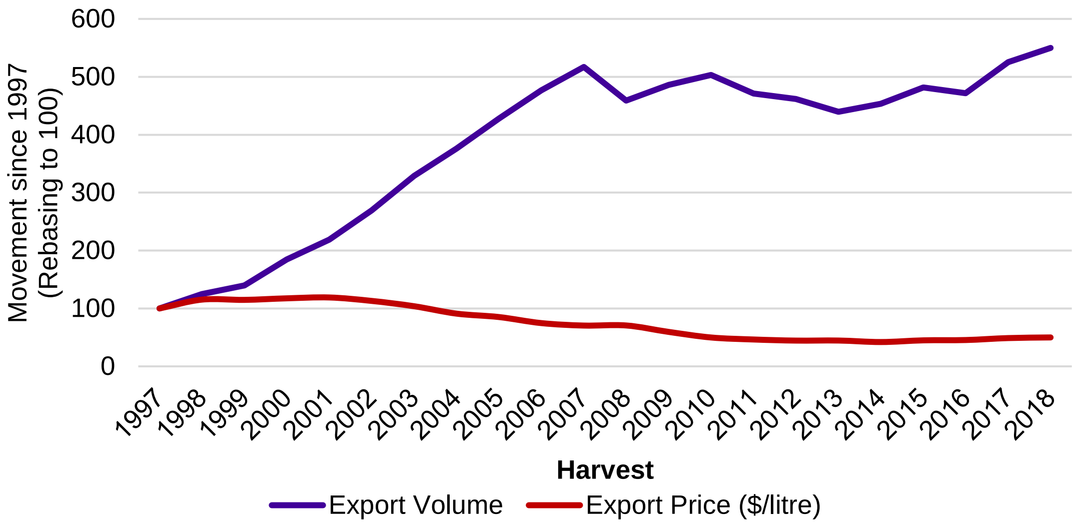
72 Ibid, chart 17, p. 94.

Figure 1.10 Movement of wine export price and grape price from 2001 to 2012 (AUD)



Source: Anderson 2015.[73]

Figure 1.11 Movement of wine export volume and wine export price from 1997



Source: Anderson 2015[74] and various Wine Australia publications.[75]

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73 P. 203, table 15 and p. 258, table 37.

74 P. 183, table 11 and p. 203, table 15.

75 Wine Australia, *Production Sales and Inventory Report 2017-18*, Appendix 1, Wine Australia, media release, 'Australian wine exports see rise in volume and value in 2014', Wine Australia, media release, 'Australian wine exports jump 14 per cent to $2.1 billion', Wine Australia, Market bulletin, Issue 91, '2017: A record-breaking year for Australian wine exports', Wine Australia, media release, 'Figures show continuing strong international demand for fine Australian wine'.

Meanwhile, increased consolidation in the Australian and global retail markets and vertical integration by some retailers into winemaking led to further tightening of profit margins for winemakers and growers. The constraints on winemakers to pass on increased costs to their wholesale customers is analysed in chapter 6.

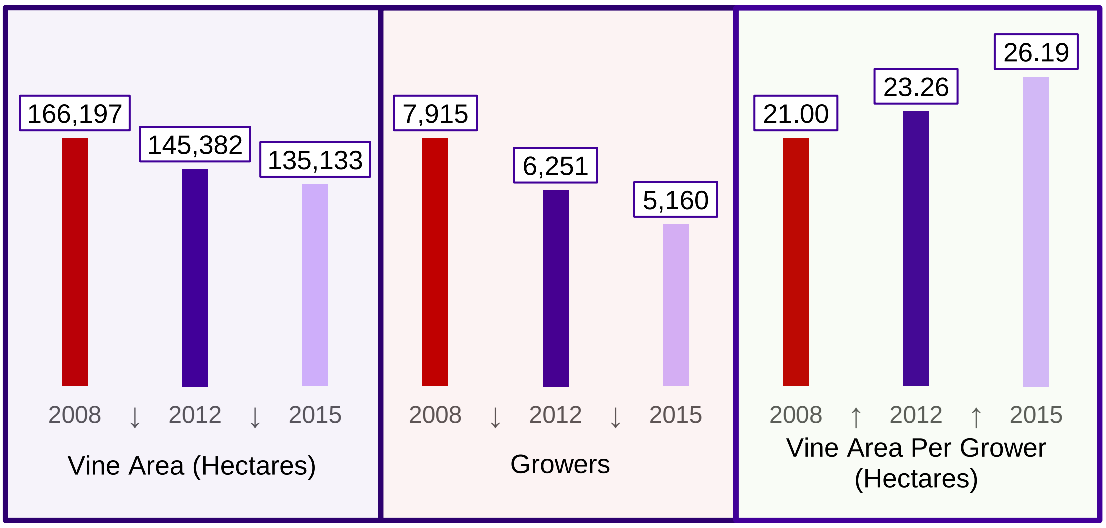
1.5.3. There was consolidation and exit in the grape and wine industries

Vineyard and winery asset values plummeted after 2007 because of the collapse in grape and wine export prices. Some vineyards were sold at unimproved land values, even though the average vineyard planting cost was about $30 000 per hectare.

In 2009, the Australian wine industry, represented by four industry bodies, Australian Wine and Brandy Corporation, Wine Research Development Corporation, Winemakers Federation Australia (WFA) and Wine Grape Growers Australia (WGGA), published a joint statement recognising the need to rebalance supply and demand in the wine industry, and launched the 'Wine Restructuring Action Agenda'. The Agenda included initiatives to increase information transparency to regional associations, growers and winemakers regarding the viability of the industry and their businesses. It also included an initiative to consult with the Commonwealth and state governments regarding exit packages and land use proposals that could incentivise growers and small winemakers to exit the industry.

Since 2008, a large number of growers exited the industry, and there has been significant consolidation of vineyard assets. Between 2008 and 2015, the total vineyard area fell by 19 per cent and the total number of growers dropped 35 per cent. This led to a 25 per cent increase in average vineyard area per grower (see figure 1.12).

Figure 1.12 Changes in vineyard area, number of growers and average vineyard area per grower



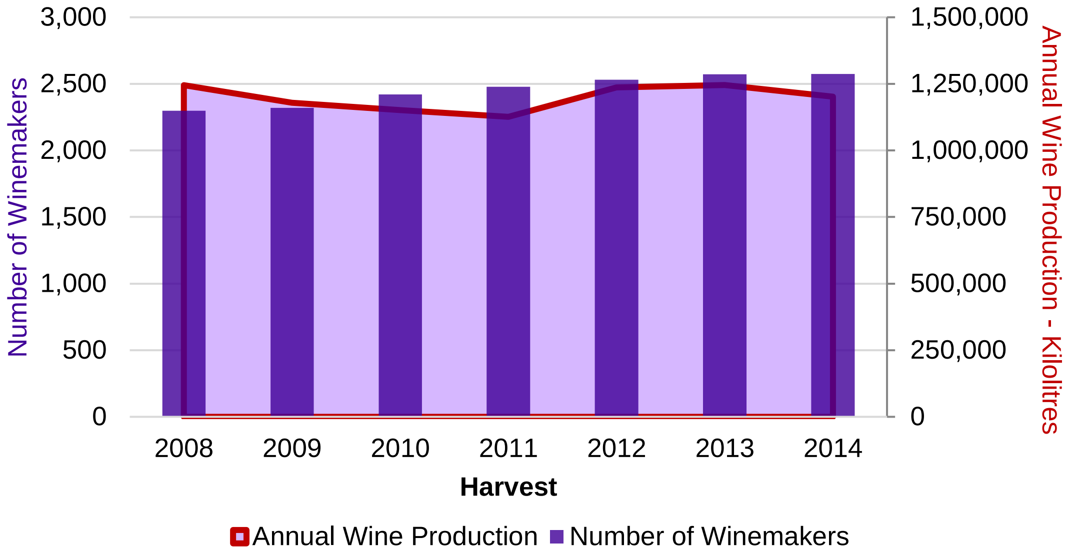
Source: Anderson 2015[76] and Australian Bureau of Statistics.[77]

In contrast, there has been a significant increase in the number of winemakers and relatively stable levels of wine production since 2008 (see figure 1.13).

76 P. 149, table 2 and p. 317, table 62.

77 1329.0.55.002 - Vineyards, Australia, 2014-15, table 3, 'Vineyards production, area and number of businesses – Geographical Indication (GI) Region–2014-15'.

Figure 1.13 Number of winemakers and annual wine production (2008−2014)



Source: Anderson 2015.[78]

The new entrants are predominantly small winemakers, while there has been substantial consolidation among large winemakers. Between 2006 and 2014, the number of winemakers crushing 20 000 or more tonnes of grapes decreased from 23 to 13[79], while the number of winemakers crushing less than 1000 tonnes increased from 1827 to 2330.[80]

1.5.4. Recent demand conditions have gradually improved

The volume of Australian wine sales has increased over 14 per cent from a decade low of 1.18 billion litres in 2013−14 to 1.35 billion litres in 2017−18. This increase in sales has almost entirely been driven by exports, which have increased over 22 per cent over the same period. Meanwhile, domestic sales volumes have remained mostly stable.

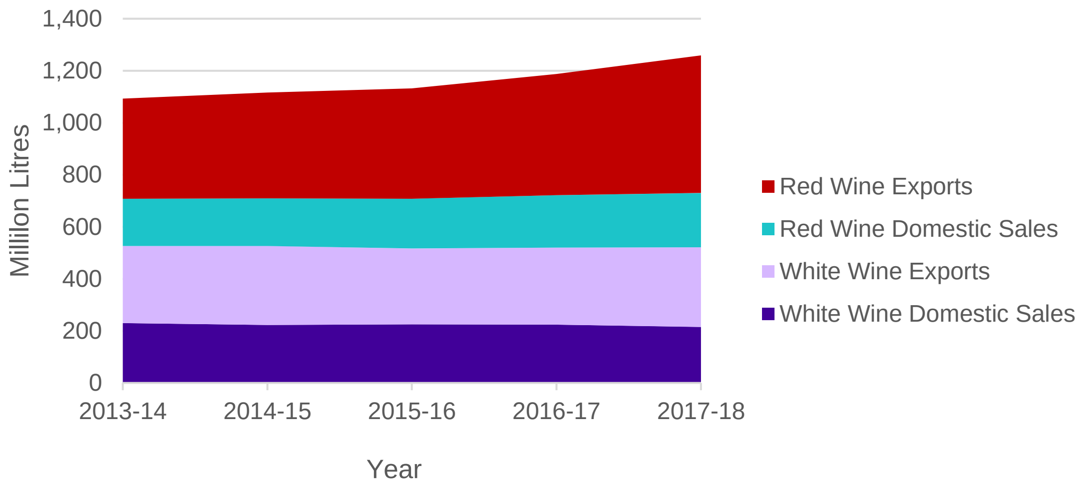
As seen in figure 1.14, this increase in exports has been almost entirely driven by red wine. Red wine exports increased over 37 per cent from 385 million litres in 2013−14, to 529 million litres in 2017−18.

78 P. 218, table 21(a) and p. 178, table 9.

79 Ibid, table 21(c), p. 219.

80 Ibid.

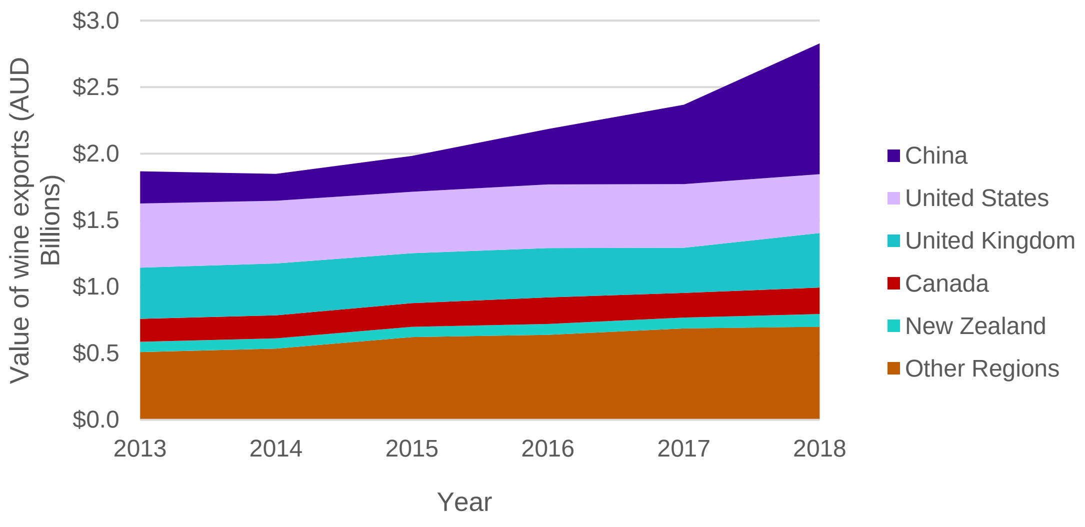
Figure 1.14 Total wine sales volumes by red/white and domestic/export splits



Source: Wine Australia.[81]

It is likely that this increase in red wine exports was driven by a surge in sales to China, following the commencement of the China-Australia Free Trade Agreement (ChAFTA) on 20 December 2015 (see figure 1.15). The ACCC understands most Australian wine exports to China are red wines.

Figure 1.15 Total wine export value to major export markets



Source: ABARES.[82]

There was also a significant increase in the number of Australian wine exporters following the commencement of ChAFTA (see figure 1.16).[83] Wine exporters can be winemakers or other entities exporting Australian wine.[84]

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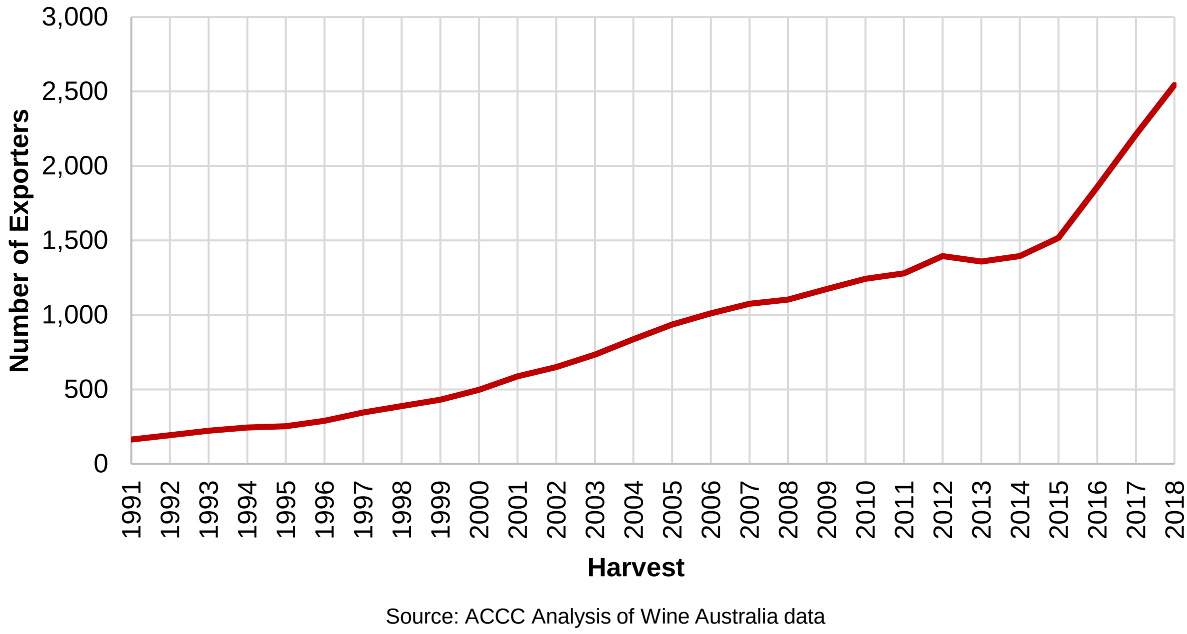
81 *Australian wine: Production, sales and inventory 2017-18*, p. 13 – appendix 1.

82 *Agricultural commodity statistics 2018*, table 22.3, 'Australian wine exports, by type and major destination'.

83 Wine Australia, *Export Report June 2018*, https://www.wineaustralia.com/news/media-releases/growing-the-usa-market-is-the-focus.

84 See Wine Australia, *Licence to export*, https://www.wineaustralia.com/selling/further-information/exporting-wine/licence-to-export.

Figure 1.16 The number of Australian wine exporters



Source: Wine Australia data disclosed to the ACCC.

Australian wine exports have also benefitted from reduced wine supply in the global bulk wine market, the result of poor harvests in Europe and Chile in 2016 and 2017.[85] Additionally, since 2012, the Australian dollar has generally depreciated in value against the currencies of the major wine exporters, increasing the price competitiveness of Australian wine in the global market.

This revival in demand for Australian wines has contributed to a slight increase in the average grape price since 2014.[86] We present analysis of the factors influencing grape prices in chapter 4.

Despite these improvements in global demand, and wine and grape prices, the changing market conditions make it challenging for the ACCC to assess the underlying potential for competition between winemakers. These concerns are addressed in chapter 6.

1.6. Regulatory environment and previous reviews

The Australian wine industry has been the subject of a number of reviews and changes to its regulatory environment in the past 30 years. These have included government measures that encouraged new vineyard plantings in the 1980s and 1990s, wholesale sales tax measures that dampened domestic sales and legislative and regulatory changes that led to greater standardisation and codification of trading practices. This section details some of the changes to the regulatory environment that continue to shape the industry today.

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85 Wine Australia, 'Australian wine: Production, sales and inventory 2017-18', https://www.wineaustralia.com/report-downloads/f319068d-ed51-4d7a-bb9b-05db9c74e6fa, page 9; see also The Guardian, 26 August 2017, 'France faces worst wine grape harvest since 1945', https://www.theguardian.com/world/2017/aug/25/france-faces-worst-wine-grape-harvest-since-1945.

86 Wine Australia, 'Australian wine: Production, sales and inventory 2017-18', https://www.wineaustralia.com/report-downloads/f319068d-ed51-4d7a-bb9b-05db9c74e6fa, p. 6.

1.6.1. State-level regulation

The wine grape industry has previously been subject to various state government regulatory measures. For example:

- In VIC until 1990, under the Wine Grapes Processing Industry Act 1978 the Wine Grape Processing Industry Negotiating Committee could establish grape prices and nominate grape graders to assist with quality assessment.
- In NSW until 2000, the Riverina Wine Grapes Marketing Board previously held various statutory powers relating to pricing and payment terms, as described in section 2.2.1.

SA is the only state that has retained wine grape industry-specific regulation. The SA WGI Act establishes timeframes for payments for wine grapes and interest rates for late payments, and requires winemakers to pay in full for all grapes received in previous years before accepting further deliveries of grapes. This is discussed in section 5.4.4.

The WGI Act also allows the relevant Minister to recommend a price for wine grapes grown in South Australian wine grape production areas and sold to winemakers.[87] The ACCC understands that to date, this power has not been used.

1.6.2. Voluntary Australian Wine Industry Code of Conduct (Code)

The Code is a voluntary industry code established in 2008 by WGGA and WFA that sets out minimum standards for wine grape purchase agreements and provides dispute resolution mechanisms for disputes relating to price and quality assessment. We examine the Code and its impact on the wine grape market in chapter 7.

1.6.3. Wine equalisation tax (WET) rebate scheme

All sales of wine in Australia attract the WET, which is a tax of 29 per cent on the wholesale value of wine. As wine may be bought and sold many times during the production process, the WET is normally applied on the last wholesale wine transaction, which is usually a transaction between a wholesaler and a retailer.[88] The WET was introduced in 2000 along with the Goods and Services Tax (GST), replacing the Wholesale Sales Tax (WST) which had been operating since 1974.[89]

In 2004 the WET rebate was introduced. The WET rebate allows wine wholesalers to offset their WET liability by exempting some of each wholesaler's wine sales from the WET. It was originally capped at $290 000, but the cap was increased to $500 000 in 2006 and reduced to $350 000 in 2018.[90] The WET rebate was designed to benefit small wine producers in rural and regional Australia, who would benefit from having their WET liability reduced or completely offset. It was also intended to replace state and federal cellar door subsidies, but VIC and SA retained their cellar door rebates after its introduction.[91]

By 2015 the ATO believed the WET rebate was not being claimed as initially envisaged. A number of schemes had arisen for improperly accessing the rebate, including artificial blending, contractual and business structural arrangements, for the sole purpose of

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87 WGI Act, section 5.

88 Australian Taxation Office, *Wine equalisation tax*, https://www.ato.gov.au/business/wine-equalisation-tax/.

89 Australian Government Department of the Treasury, *Wine equalisation tax rebate*, discussion paper, August 2015, https://treasury.gov.au/sites/default/files/2019-03/C2015-045_WET_Rebate_Discussion_Paper_2015.pdf, p. 3.

90 Australian Taxation Office, *Producer rebate*, https://www.ato.gov.au/business/wine-equalisation-tax/producer-rebate/.

91 Australian Government Department of the Treasury, *Wine equalisation tax rebate*, discussion paper, August 2015, https://treasury.gov.au/sites/default/files/2019-03/C2015-045_WET_Rebate_Discussion_Paper_2015.pdf, p. 6.

accessing the rebate. The schemes took advantage of broad eligibility criteria for claiming the rebate, and sometimes involved claiming the rebate multiple times on the same wine.[92]

The WET rebate may have distorted production in several ways.[93] Industry participants criticised the WET rebate for subsidising inefficient winemakers and growers, encouraging overproduction of bulk wine, inhibiting industry restructure, eroding the value of premium wine, and discouraging mergers.[94] The 2016 Senate Inquiry recommended that the government phase out the WET rebate.[95]

Several integrity changes to the WET rebate took effect from 1 July 2018.[96] The maximum amount that producers can claim was reduced to $350 000, and there are tightened eligibility criteria and circumstances in which the rebate will apply.[97] The changes restrict many bulk wine exporters and other cheap wine producers from accessing the rebate[98] and are designed to realign industry incentives. They are intended to ensure that wine producers are the beneficiaries of the rebate and not wine traders and retailers[99], and to stop the rebate being claimed multiple times on the same wine throughout the supply chain.[100]

Several industry stakeholders submitted that the WET rebate scheme has had a significant impact on industry dynamics, and that they expect to see structural changes in the industry as a result of the recent changes to the scheme.

92 Ibid, pp. 18-22.

93 Explanatory Memorandum to Treasury Laws Amendment (2017 Measures No 4) Bill 2017: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r5922.

94 See, for example, Rob Dossor, 2016, *Wine equalisation tax rebate*, https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201617/Wine.

95 Senate Rural and Regional Affairs and Transport Reference Committee, 2016, *Australian grape and wine industry*, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry/Report.

96 Explanatory Memorandum to Treasury Laws Amendment (2017 Measures No 4) Bill 2017: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r5922

97 Australian Taxation Office, *Wine equalisation tax*, https://www.ato.gov.au/business/wine-equalisation-tax/; Treasury Laws Amendment (2017 Measures No4) Bill 2017.

98 IBIS World, 2019, *Industry report C1214: Wine Production in Australia*, pages 8-9.

99 Explanatory Memorandum to Treasury Laws Amendment (2017 Measures No 4) Bill 2017: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r5922

100 The Hon Kelly O'Dwyer, Minister for Revenue and Financial Services, media release August 2017, *Uncorking the Benefits for Wine Producers*, http://kmo.ministers.treasury.gov.au/media-release/080-2017/.

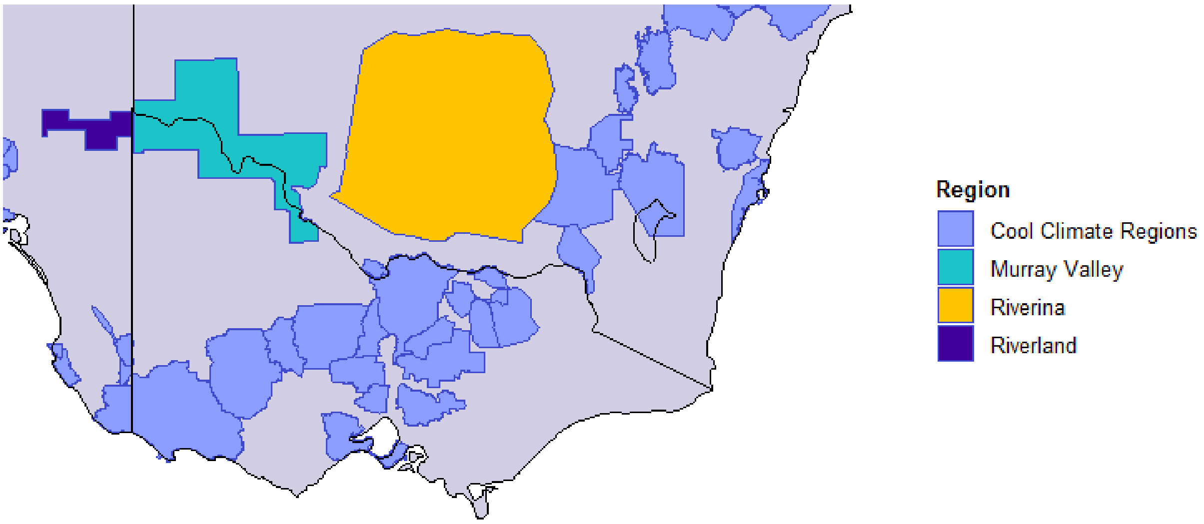
2. Warm climate grape growing regions

Key points

- This market study focuses on the three 'warm climate' grape growing regions: Murray Valley, Riverina and Riverland.
- Two-thirds of Australian wine grapes (by volume) are grown in the warm climate regions.
- Winemakers generally consider there to be little differentiation between grapes of a given variety produced within a warm climate region.
- Grapes from warm climate regions generally sell for lower prices and in a narrower price range than grapes grown in cool climate regions.

This market study focuses on what are referred to in the industry as warm climate grape growing regions.[101] The three warm climate regions are the Riverland, Murray Valley (which includes the Murray Darling and Swan Hill regions) and Riverina (see figure 2.1). Around 1500 growers operate in these regions, which produce approximately two thirds of Australia's wine grapes. All other wine regions are broadly classified as cool climate, despite differing widely in their individual climates and grape characteristics.

Figure 2.1 Map of warm climate grape growing regions



Source: Wine Australia.[102]

The warm climate regions have very different environmental conditions, production volumes and input costs than the cool climate regions. They also produce a perceived lower quality of grapes, as reflected in lower prices per-tonne.

In warm climate regions the majority of grapes are produced by growers who have written or verbal supply agreements with a major winemaker. By contrast, cool climate regions have a greater presence of small winemakers growing their own grapes.

[101] Warm regions are also known as 'inland' or 'commercial' regions, while cool regions are sometimes called 'premium' or 'boutique' regions.

[102] *Geographical Indications*, https://www.wineaustralia.com/labelling/register-of-protected-gis-and-other-terms/geographical-indications.

These production characteristics have a major influence on grape prices, the commercial relationships between growers and winemakers, and the extent of competition between winemakers (which is analysed in chapter 6).

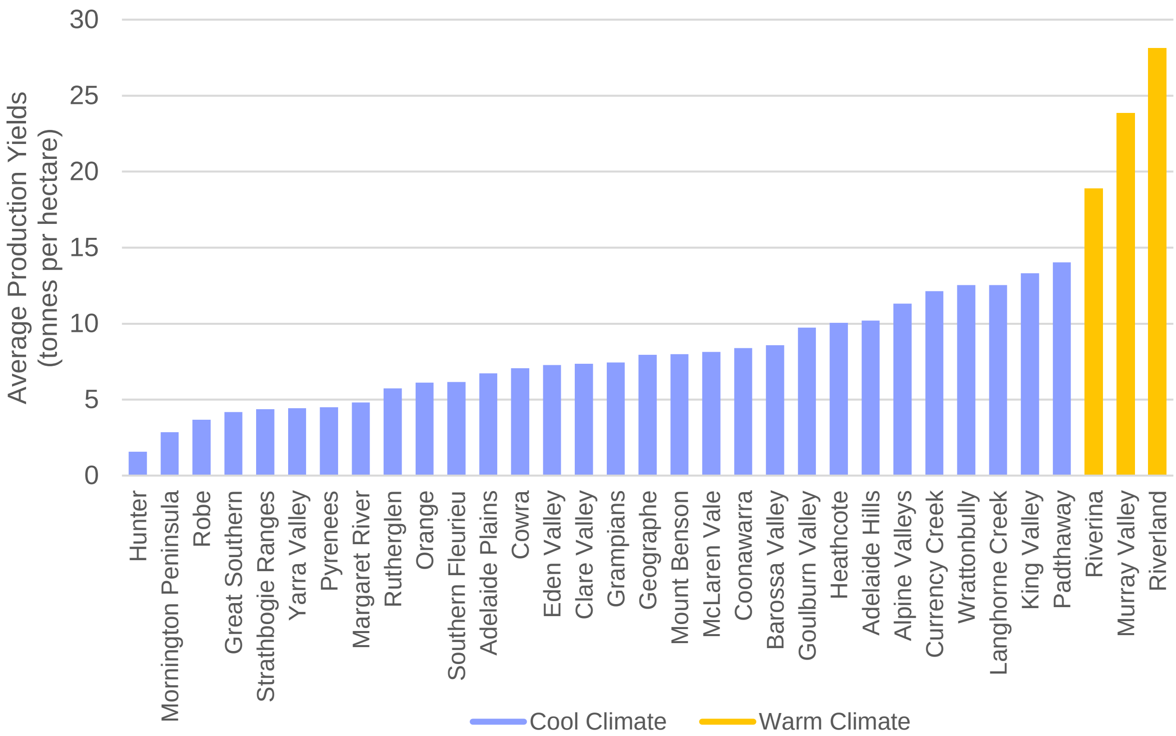
2.1. The characteristics of warm climate regions magnify competition issues

2.1.1. Warm climate regions have higher yields and lower production costs

Compared to cool climate regions, warm climate regions have higher average temperatures, longer growing seasons and the vines grown there are less prone to disease. Warm climate regions also tend to produce significantly higher yields (figure 2.2). In 2018, grapes from the warm climate regions accounted for 67 per cent of grapes processed in Australia, despite vineyards in these regions only covering 37 per cent of total national vineyard area (figure 2.12).

Vineyards in cool climate regions tend to operate on a smaller scale, sometimes with less mechanisation, and tend to have lower yields.

Figure 2.2 Average tonnes per hectare in top 32 growing regions



Note: Warm climate regions illustrated in orange columns.

Source: ACCC analysis of Wine Australia data.[103]

2.1.2. Warm climate grapes are predominantly used for bulk wine

Winemakers tend to place less emphasis on the distinct qualities of the grapes grown by individual growers in warm climate regions: instead they focus on differentiating by variety.

103 https://www.wineaustralia.com/market-insights/regional-snapshots.

Most of the largest processing facilities are in warm climate regions. The majority of wine produced in these regions is exported. The wine is commonly exported in bulk, in bladder-lined shipping containers to be bottled at the destination. It may be bottled alone, or blended with locally made wine. Much of the remainder is retailed domestically in lower priced casks or bottles. Wine produced using grapes from warm climate regions is generally not marketed by reference to its region of origin. In some cases, the label refers to South Eastern Australia rather than a particular region.

In contrast, grapes from cool climate regions are used to produce wine sold at a wider range of price points than those from the warm climate regions. A proportion is also exported, either in bulk or bottled. In their submissions to the ACCC, winemakers indicated that when producing cool climate wines they are looking for attributes relating to flavour, region, variety and price to use across their product portfolio. Winemakers will often work with individual vineyards to achieve these attributes.

Brand recognition has a role in the extent to which wines and grapes from cool climates attract a premium price. Labels for cool climate wines often specify the region the grapes were grown in, particularly for regions with high brand recognition such as the Barossa Valley or the Mornington Peninsula. Grapes and wines from cool climate regions with lower brand recognition, while generally attracting a higher price than grapes from warm climate regions, will not attract the same prices as grapes from well-recognised cool climate regions.

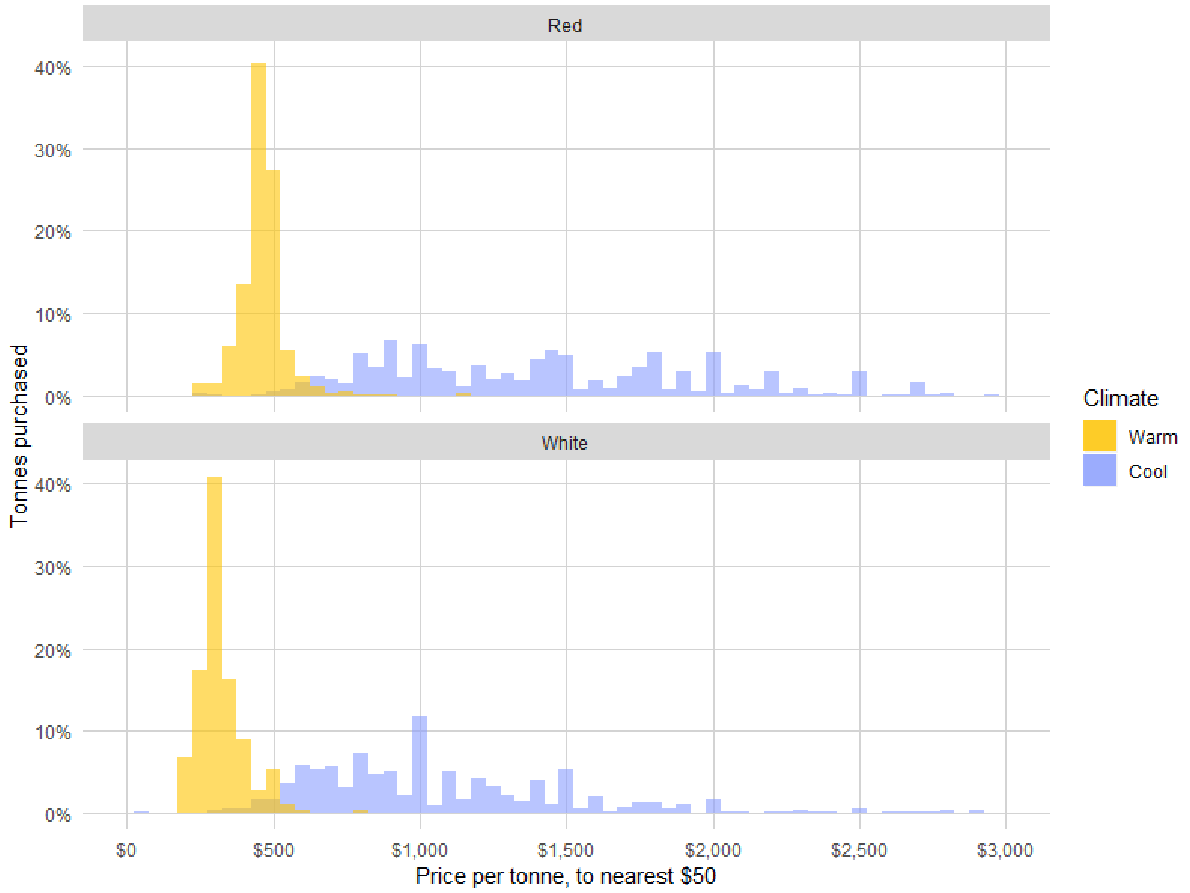
A small proportion of wine from warm climate regions is used in mid-range or premium wine. The *Wine Australia Regulations 2018* allow winemakers to include up to 15 per cent of volume derived from grapes grown in a region other than the region of origin on the label.[104] This enables wine makers to reduce production costs for cool climate wines by blending them with wine from warm climate regions.

2.1.3. Warm climate grapes generally sell for lower prices and in a narrower price range

As a result of the high volumes supplied and lower level of quality differentiation, grapes grown in warm climate regions generally sell for lower prices and in a narrower price range than grapes grown in cool climate regions (figure 2.3).

[104] Wine Australia Compliance Guide, https://www.wineaustralia.com/WineAustralia/media/WineAustralia/PDF/Selling-wine/Wine-Australia-Compliance-Guide-June-2016.pdf, p.4.

Figure 2.3 Comparison of grape prices by region and type (2018)



Note: Excludes prices above $3,000 per tonne.

Source: ACCC analysis of Wine Australia's *Price Dispersion Report* 2018 and data supplied by winemakers.

The overlap in prices between warm and cool climate regions evident in figure 2.3 is only for a small proportion of the grapes. The majority of warm climate grapes sell at significantly lower prices than cool climate grapes of the same variety. In 2018, 80 per cent of warm climate grapes sold for between $254 and $502 per tonne. By contrast 80 per cent of cool climate grapes were sold between $681 and $2139 per tonne. This pattern applies to red and white grapes, and the six most popular varieties (figure 2.4).

Figure 2.4 Price ranges of 80 per cent of grapes sold by type and variety ($ per tonne)

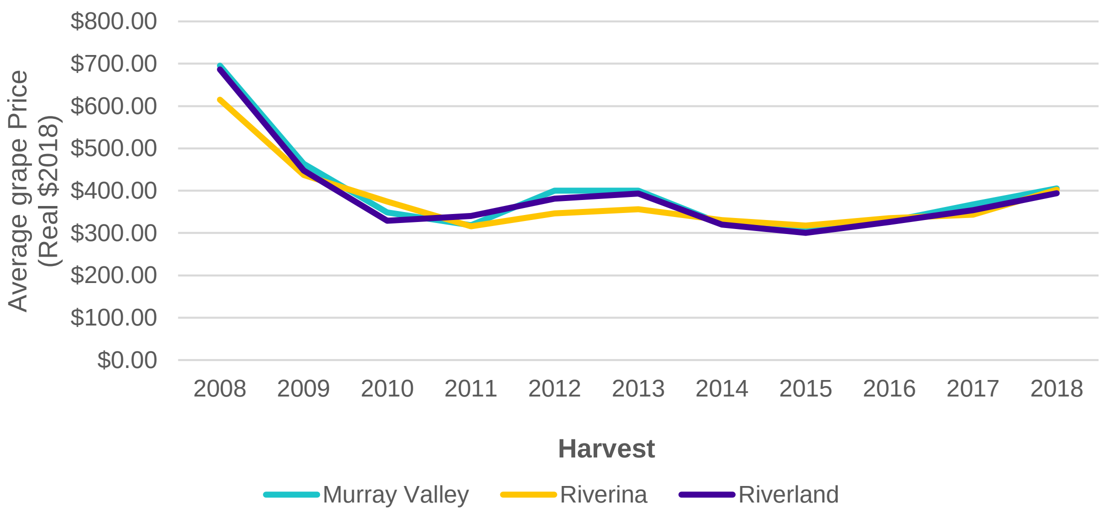
Type/variety	Warm climate grapes	Cool climate grapes
Red	$380 to $530	$800 to $2300
White	$242 to $420	$599 to $1614
Shiraz	$399 to $540	$850 to $2500
Cabernet Sauvignon	$400 to $530	$800 to $2035
Merlot	$358 to $503	$586 to $1200
Chardonnay	$314 to $370	$535 to $1900
Sauvignon Blanc	$380 to $435	$725 to $1503
Pinot Gris	$490 to $528	$850 to $1849

Source: ACCC analysis of Wine Australia's *Price Dispersion Report* 2018 and data supplied by winemakers.

2.1.4. Average prices are similar across warm climate regions

Average grape prices in each of the warm climate regions are relatively similar in most years, as shown in figure 2.5. Riverland and Murray Valley prices are the most closely correlated, which is likely to be because of their geographic proximity to each other (see chapter 6). Although the Riverina is further away, average Riverina prices are also broadly comparable with Riverland and Murray Valley prices and follow the same trends.

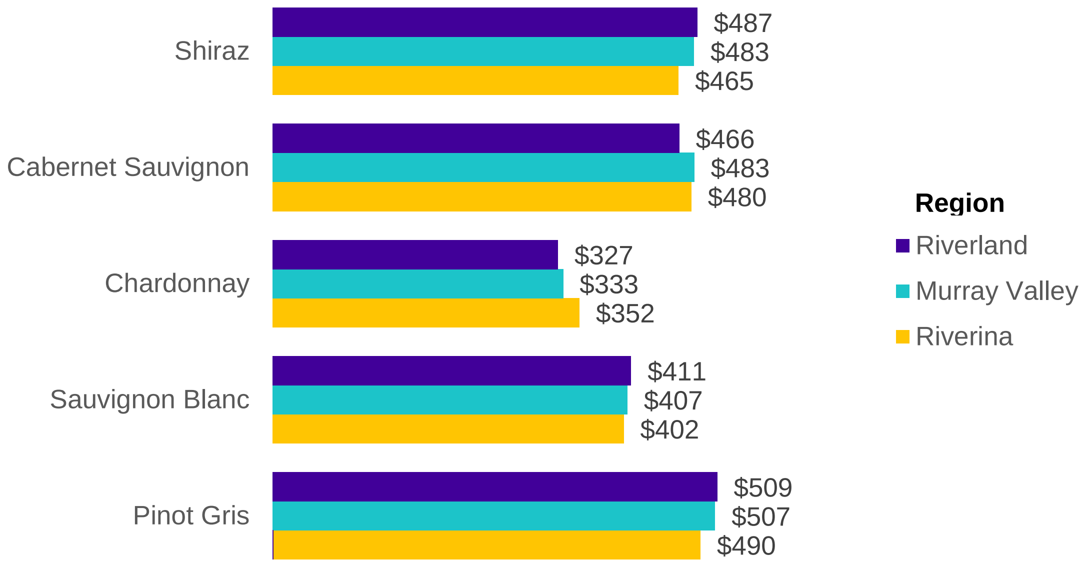
Figure 2.5 Average grape prices in the warm climate regions (2008−2018)



Source: Data supplied by Wine Australia.

In addition, in 2018, the average prices for particular commonly grown varieties in warm climate regions were also similar, as shown in figure 2.6. Warm climate regional average prices were within five per cent of each other for Shiraz, Cabernet Sauvignon, Sauvignon Blanc and Pinot Gris, and within eight per cent for Chardonnay.

Figure 2.6: Average grape prices per tonne by warm climate region and variety (2018)

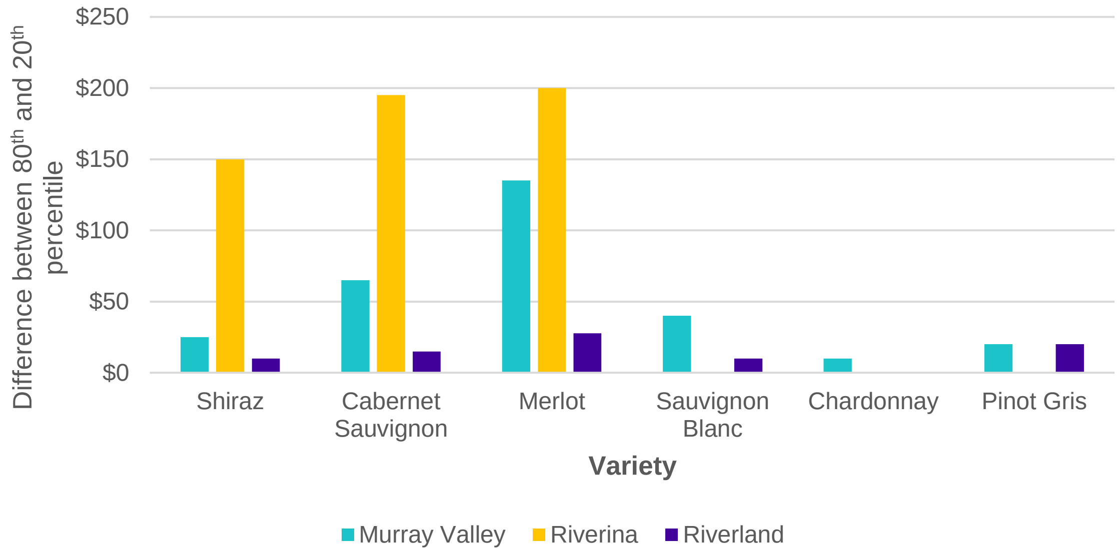


Source: Data supplied by Wine Australia and industry.

2.1.5. The level of price dispersion varies across warm climate regions

Although average prices are comparable between warm climate regions, there are differing levels of variation in prices within each region, as illustrated in figure 2.7. Price dispersion tends to be greater for red varieties than for white varieties. Price dispersion for red varieties is especially high in the Riverina.

Figure 2.7: Difference between 80th and 20th price percentile by region and variety

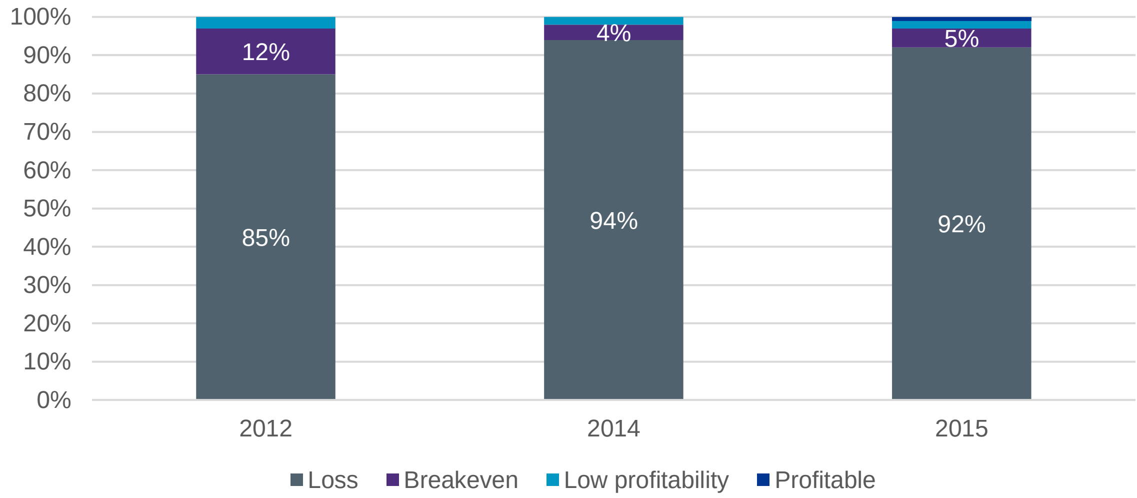


Source: Data supplied by Wine Australia and industry.

2.1.6. The profitability of warm climate growers is lower than cool climate growers

Estimates prepared by the Winemakers' Federation of Australia (WFA) indicate that in the later years of the recent grape oversupply and price downturn, a significantly greater proportion of warm climate growers were making a loss compared to growers in cool climate regions. In the three years for which estimates are available, 2012, 2014 and 2015, the vast majority of growers in warm climate regions made a loss (figure 2.8). In the cool climate regions more growers were profitable, with under half making losses and around a third considered profitable each year (figure 2.9).[105]

Figure 2.8 Warm climate grower profitability 2012, 2014 and 2015



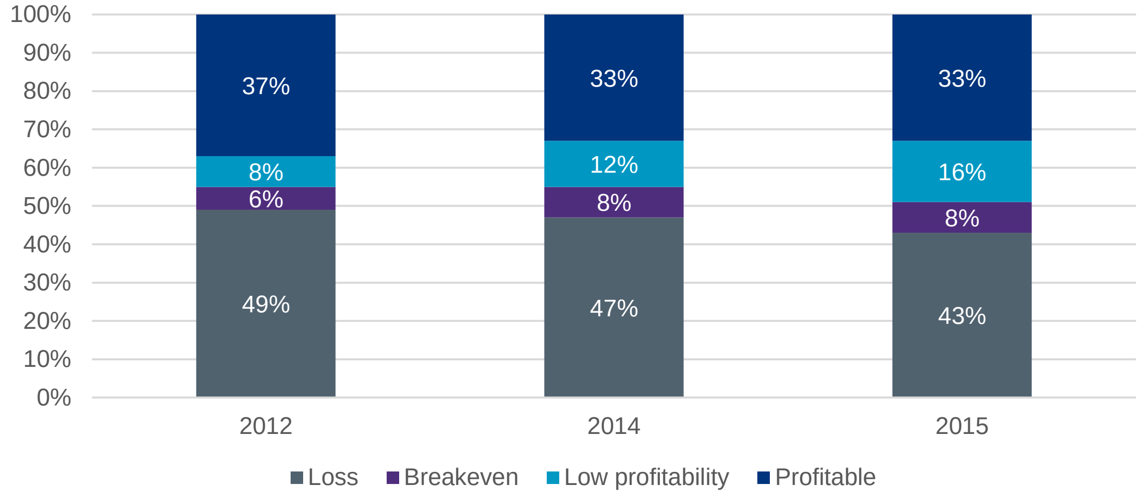
Note: Breakeven is defined as profit between 0 to $100 per tonne, low profitability is defined as profit between $100 and $300 per tonne and profitable production is defined as profit of greater than $300 per tonne.

Source: WFA.[106]

[105] Profitability is estimated by WFA based on Wine Australia price dispersion data combined with average yields and costs per hectare by region based on consultations with Wine Grape Growers Australia and CPI movement. WFA, *Vintage Report*, July 2015, https://www.agw.org.au/assets/vintage-reports/Vintage-Report-and-Production-Profitability-2015.pdf.

[106] *Vintage Report,* July *2015,* https://www.agw.org.au/assets/vintage-reports/Vintage-Report-and-Production-Profitability-2015.pdf.

Figure 2.9 Cool climate grower profitability 2012, 2014 and 2015



Note: Breakeven is defined as profit between 0 to $100 per tonne, low profitability is defined as profit between $100 and $300 per tonne and profitable production is defined as profit of greater than $300 per tonne.

Source: WFA.[107]

In 2015 only one per cent of warm climate growers were considered profitable, compared to 33 per cent of cool climate growers. However, there were significant deviations between different cool climate regions. For example, in 2015, 99 per cent of Tasmanian growers were reported to be profitable, while 94 per cent of Hunter Valley growers made a loss.

There are also significant differences between the profitability of growers from each of the three warm climate regions. For example, Riverina growers produce at a lower average yield per hectare, which significantly increases their growing costs per tonne in comparison to the Riverland and Murray Valley regions.

Figure 2.10: Estimated growing costs and profitability in warm climate regions, 2014

	Proportion of growers making a loss	Growing costs	Average yield
Riverland	94 per cent	$393−472 per tonne	19.6 tonnes per hectare
Murray Valley	89 per cent	$397−477 per tonne	19.4 tonnes per hectare
Riverina	98 per cent	$545−654 per tonne	14.2 tonnes per hectare

Source: WFA.[108]

Based on the above figures and assuming that growing costs have not decreased since 2014, it is likely that the majority of warm climate growers were still unprofitable in 2018 (see figure 2.11).

[107] Ibid.

[108] Ibid.

Figure 2.11: Comparison of estimated warm climate region growing costs and average grape prices

	Growing costs in 2014	Average grape price in 2018
Riverland	$393−472 per tonne	$391 per tonne
Murray Valley	$397−477 per tonne	$402 per tonne
Riverina	$545−654 per tonne	$399 per tonne

Source: WFA.[109]

2.1.7. Many warm climate growers require additional income sources or have exited the industry

In support of the above finding that the majority of warm climate growers operate at a loss, many growers have reported needing to find paid employment to supplement their income. Many growers have also submitted that they have been forced to diversify their businesses in order to service debts and remain viable.

A 2017 ABARES report using data from its 2014−15 irrigation survey found that 86 per cent of grape farms in the Murray−Darling Basin produced three different crops (most commonly grapes, citrus and another horticulture crop).[110] Despite this, the grape industry was still the least diversified of all irrigated industries covered by the survey.[111]

In addition, a significant proportion of warm climate growers exited the industry during the years of the grape oversupply and price downturn, particularly in the Murray Valley and Riverina. We discussed the degree of exit in the three warm climate regions in the context of recent changes to market conditions in chapter 1.

2.2. Each of the warm climate regions has unique characteristics

Each warm climate region has its own industry association, with all or most of its membership comprising growers who have no ownership or other controlling interest in a winery. These are referred to in this report as 'independent growers'.

Figure 2.12 shows key information for each of the warm climate regions, including the number of growers, vineyard area, volume of grapes produced, and the main varieties.

Figure 2.12 Characteristics of the warm climate regions (2018)

	Riverina	Murray Valley	Riverland	Total
Number of growersa	300	310	900	1 510
Vineyard area (ha)	18 765	15 700	19 024	53 489
percentage of national	14	9	14	40
Volume of grapes harvested	333 682	345 458	526 235	1 205 375

109 Ibid and *Vintage Report*, July 2018, https://www.wineaustralia.com/getmedia/fce5bf18-468b-4e1b-a478-d6ca231d40f6/VintageReport2018_full.pdf.

110 http://www.agriculture.gov.au/abares/Pages/grapes.aspx#grape--production-in-the-murraydarling-basin.

111 Ibid.

(tonnes)				
percentage of national	19	19	29	67
Main grape varieties (%)	Chardonnay (23) Shiraz (19) Cabernet Sauvignon (9) Semillon (8) Pinot Gris/Grigio (6)	Chardonnay (28) Shiraz (18) Cabernet Sauvignon (12) Pinot Gris/Grigio (8) Merlot (7)	Chardonnay (27) Shiraz (15) Cabernet Sauvignon (14) Colombard (6) Merlot (5)	

Notes: [a] The number of growers excludes wineries which grow grapes. The remaining data is for all growers.

Source: Information provided by various wine industry bodies, including Wine Australia[112] and Murray Valley Winegrowers' Incorporated.[113]

As outlined below, there has been varying degrees of vineyard rationalisation for each region over the 2000s and 2010s for a number of reasons, including the oversupply of grapes and the mechanisation of harvesting.

2.2.1. Riverina

Riverina growers are represented by the Riverina Wine Grapes Marketing Board (RWGMB), which is funded by a levy payable by all independent growers producing more than 20 tonnes per harvest, under the NSW *Agricultural Industry Services Act 1998*.[114] As independent growers have to pay the levy, they become members of the RWGMB by default.

The RWGMB has operated in the Riverina since 1933. It was given statutory powers from 1976, which allowed it to set minimum grape prices and conditions of payment, to pursue late payments by winemakers, and to require that payments to growers be made through it. However, in 2000 it lost its power to determine minimum prices for grapes, and in 2012 it lost its ability to set and enforce terms and conditions of payment.[115] Since 2012 it has operated solely as an agricultural industry services committee.

RWGMB estimates that independent growers, and therefore its membership, represents 65 per cent of grape production in the region. RWGMB currently has just under 300 members, which is about half of the 568 members it had in 2000.

Many growers in the Riverina have unwritten agreements with winemakers. This is in contrast to the other warm climate regions, and is likely to have stemmed from the culture of grower loyalty towards winemakers in the region. A large number of growers have supplied the same winemaker for many years.

None of the major winemakers in the Riverina are signatories to the Code.

112 *Regional Snapshots*.

113 *Murray Darling & Swan Hill - Wine Grape Crush Report 2018.*

114 For further detail, refer to the *Agricultural Industry Services Act 1998 (NSW)* and the Agricultural Industry Services Regulation 2015 (NSW).

115 RWGMB, *History of the Wine Grapes Marketing Board*, https://www.wgmb.net.au/index.php/blog/board-information; RWGMB, 2015, *Submission to the Senate Inquiry into the Australian Grape and Wine Industry*, https://treasury.gov.au/sites/default/files/2019-03/C2016-027_Riverina_Wine_Grapes_Marketing_Board.pdf.

2.2.2. Murray Valley

Murray Valley Winegrowers' Incorporated (MVW) is a grower representative association with about 310 members. MVW represents 100 per cent of independent growers and accounts for an estimated 70 per cent of grape production in the region.

MVW's activities are funded by a compulsory levy on independent growers. The levy is collected by the Murray Valley Wine Grape Industry Development Committee, a statutory body established in 1994 under the *Agriculture Industry Development Act 1990* (Vic). Although this is a Victorian Act, it also applies to the part of the region in NSW.[116] As independent growers have to pay the levy, they by default become members of MVW.

Additionally, MVW advises there is a voluntary levy which most growers pay which is used to fund the association's administration costs.

MVW has advised it had 1294 members in 2006, which indicates a 76 per cent decrease in grower numbers over the last 13 years.

The majority of growers have multi-year supply agreements with one or more winemakers.

Three of the major winemakers with wineries in the Murray Valley are signatories to the Code: Treasury Wine Estates, Accolade and Trentham Estate. Other buyers of grapes in the region are also signatories, including Pernod Ricard and Brown Brothers.

2.2.3. Riverland

Riverland Wine (RW) represents both growers and winemakers in the Riverland region. It has 980 members, of which about 900 are independent growers. It is Australia's largest grape growing region in terms of the number of growers, vineyard area and the volume of grapes crushed.

In 2010 the Riverland Wine Industry Development Council and the Riverland Winegrape Growers Association combined to form RW. These organisations retained their separate structures within the combined organisation.[117]

RW's activities are financed through two funds created under the *Primary Industry Funding Schemes (Riverland Wine Industry Fund) Regulations 2016* (SA). One of the funds is financed by a levy on growers and the other is financed by a levy on winemakers. The funds are intended to be used to assist growers, winemakers and the industry as a whole.

From 2000 to 2018 the number of growers in this region fell by 21 per cent. By contrast, the number of growers in SA's cool climate regions increased by 47 per cent over the same period.[118]

Of the major winemakers with a winery located in the Riverland, Accolade is the only Code signatory. Pernod Ricard, another major buyer of grapes in the region, is also a signatory.

CCW Co-operative Limited

Annual and multi-year agreements are particularly prevalent in the Riverland, with RW estimating 90 per cent of growers are contracted to a cooperative or to a winemaker. This is

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116 For further detail, refer to the *Agricultural Industry Development Act 1990 (Vic)*, the Victorian Murray Valley Grape Industry Development (Extra-Territorial) Order 2016 (Vic), the *Agricultural Industry Services Act 1998* (NSW) and the Agricultural Industry Services Regulation 2015 (NSW).

117 http://www.riverlandwine.com.au/about-riverland-wine/about-us/history-of-riverland-wine.html.

118 Vinehealth Australia, Wine Australia, *SA Winegrape Crush Surveys*, 2000 and 2018.

largely because approximately 57 per cent of the region’s growers supply to Accolade under 15-year rolling contracts with CCW.

These supply agreements are a legacy of the time when CCW owned a winery in Berri which was supplied by its members. After CCW divested the winery, it entered a long-term supply agreement with the buyer, which transferred to subsequent owners. The owner is now Accolade and the winery has expanded to be the largest in Australia.

The supply agreements require CCW to purchase, and the grower to supply, all grapes from defined parcels of land. In turn, Accolade has a grape supply agreement with CCW. CCW negotiates prices and specifications on behalf of the growers.

These agreements have a significant impact on the competitive dynamics of the Riverland wine grape market.

As CCW has an agreement to sell its grapes to Accolade, it cannot threaten to switch supply to another winemaker. This means a large proportion of the Riverland’s grapes are not available to be purchased by other winemakers. Accolade’s pricing decisions are made based on the terms of its supply agreement with CCW, rather than by the threat of losing those grapes to other winemakers offering better prices and terms.

3. Quality assessment

Key points

- Grape quality assessment measures, methods and procedures vary significantly depending on the winemaker, variety, location and intended use of the grapes. The characteristics assessed can relate to the maturity, purity, condition, flavour and/or character of the grapes.
- Based on quality assessments in the vineyard or at the winery, winemakers determine when the grapes will be harvested, whether they will be accepted or rejected, and whether the winemaker will adjust grower payments.
- Growers lack transparency about the quality assessment process and the end use of their grapes. Final results of the quality assessment process and related grape price sometimes do not meet grower expectations, but it is difficult for growers to dispute them.
- Some winemakers reserve the right to unilaterally change specifications and/or wait to compare the amount of anthocyanins (colour levels) in the grapes against others in the region before confirming the price. This creates uncertainty for growers.
- Quality assessments sometimes return inconsistent results because they involve a degree of subjectivity, or they are not carried out using best practice.
- Measurement of colour levels in red grapes is controversial, but the ACCC understands that such measurements can indicate the quality of the final product when carried out using best practice.
- There is no registered standard for measurement of sugar and colour levels in grapes under national trade measurement legislation. The ACCC considers that standardisation of the equipment and methodology used for testing sugar and colour levels would increase grower confidence in quality assessment results.
- Winemakers have complete discretion over the timing of harvest, but growers bear significant risks associated with harvest scheduling.

3.1. Growers are concerned about quality assessment practices

3.1.1. Quality assessments can significantly impact grower payments

Winemakers conduct various wine grape quality assessments in the vineyard and at the weighbridge, as described in section 3.1.4, to ensure that particular grapes will be suitable for the winemakers' product lines. Growers harvest and deliver grapes at a time specified by the winemaker, and are paid a per-tonne rate which can be adjusted depending on the quality assessments.

Quality assessments can have a significant impact on grower payments because they are used to determine the following:

- *Whether the winemaker will accept or reject the grapes*: Winemakers can reject grapes that do not meet particular quality requirements, based on assessment of a sample from the vineyard section or delivery load.
- *How much the winemaker will pay the grower for the grapes*: Winemakers generally establish a price per tonne of grapes by variety for each warm climate region. The price is then adjusted for particular batches of grapes based on how samples perform against a range of quality specifications.

- *The timing of harvest*: Winemakers consider grape maturity assessment results, such as sugar levels, in determining the harvest date. Growers bear the associated timing risks, as discussed in section 3.5.

In this report, 'quality assessment' refers to any assessment of grapes for the purposes listed above.

Winemakers also sort grapes into processing streams or make other decisions based on various specifications which do not directly affect acceptance, rejection or payment amount. Examples include titratable acidity (TA) and pH assessments, or taste tests that are used for internal purposes only. Such assessments are not a focus of the market study as they do not impact the transactional relationship between growers and winemakers.

3.1.2. Growers have raised concerns about quality assessment procedures

This chapter discusses warm climate grower concerns about the transparency and reliability of quality assessment procedures. Growers have reported that they lack:

- visibility over the quality assessment process
- the ability to dispute results
- certainty about how results will translate to payment adjustments
- control over the timing of harvest, which impacts the final quality assessment.

These concerns result in a lack of trust in the quality assessment process and exacerbate the power imbalances between growers and winemakers referred to in chapter 5.

Many of the concerns relate to entrenched and widespread industry practices in the quality assessment process.[119] However, not all winemakers engage in the practices discussed.

3.1.3. Winemakers use a wide range of quality assessment procedures

There is a general consensus among growers, winemakers and experts that quality assessment is best thought of as determining the 'fitness for purpose' of grapes. It is an assessment of whether the grapes possess the characteristics that will achieve a desired product type or style, rather than of the 'level of quality' of the grapes on a linear scale.[120]

As such, quality assessment measures, methods, procedures, targets and thresholds vary between winemakers. They also depend on the grape variety, the region and the intended use.

Testing methods include chemical laboratory testing as well as sensory assessments such as visual or taste tests. Testing can relate to:

- *maturity*: such as sugar levels, TA, pH and flavour ripeness[121]

[119] For earlier discussions of the concerns see, for example: Mardi Longbottom et al, May/June 2013, 'Grape quality assessments: a survey of current practice', Wine & Viticulture Journal, AWRI, p. 33-37; and Senate Committee Report, Rural and Regional Affairs and Transport References Committee, October 2005, The operation of the wine-making industry, ('2005 Senate Report') p. 35-38.

[120] Feedback the ACCC heard from growers and winemakers is consistent with academic literature. For references to fitness for purpose see, for example: *Proceedings: Australian Society of Viticulture and Oenology (ASVO) and Wine Industry Suppliers Australia (WISA) Seminar: Objective Measures of Wine and Grape Quality 'ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality'*, 25-26 July 2012: Robert G Dambergs, 'Validation of an industry vineyard assessment system', page 14; Paul Smith, 'Recent advances in objective chemical measures of wine quality', p. 44; Paul K Boss, 'Towards the prediction of wine outcomes from grape compositional measures', p. 60; Terry H Lee OAM, 'What does the future hold for Australian vineyard managers?', p. 65.

[121] Note: Sugar levels are usually measured by refractometry on a juice sample. They are measured as total soluble solids (TSS) expressed in degrees Brix (grams of soluble solids per 100 grams of juice). The result is divided by 1.8 to convert to degrees Baumé. The number of degrees Baumé approximately corresponds with the alcohol percentage in the wine after fermentation.

- *purity*: such as level of disease, foreign material and contamination
- *condition*: such as level of uniformity, spoilage and damage
- *flavour and character*: such as colour and sensory assessments.[122]

Some specifications may be thought of as quality control specifications, which are used to ensure there are no defects in the grapes. These include thresholds for matter other than grapes (MOG), disease and contamination. Some winemakers focus on these specifications and do not assess flavour and character, particularly in warm climate regions.

Flavour and character specifications are more commonly assessed in cool climate regions, and contribute to a more direct 'grading' process which differentiates batches of grapes from one another. Under this process a grade is assigned to each batch of grapes (e.g. A, B, C, D or E), and higher graded grapes are priced above lower graded grapes.

3.1.4. Quality assessment occurs in the vineyard and at the weighbridge

Figure 3.1 provides a timeline of commonly used quality assessment processes.

Figure 3.1 Quality assessment of wine grapes

In the vineyard – throughout the season

- In-vineyard assessments occur throughout the season, particularly after veraison, to monitor progress and predict the likely quality and volume of grapes.
- Factors measured can include maturity factors such as sugar and colour levels, quality control factors like disease and vine health, assessments relating to taste, and vineyard attributes like shoots and leaf size. Warm climate assessments are often less frequent and comprehensive than cool climate assessments. Many winemakers also require growers to submit yield estimates during the period from November to January.
- Winemakers provide varying levels of viticultural advice during in-vineyard assessments. However, most supply agreements provide that winemakers will not be responsible for the outcomes of growers' viticultural decisions.
- In-vineyard assessments are typically carried out by winemaker representatives, such as grower liaison officers (GLOs) who are sometimes viticulturists, but growers may self-report for some measures. Samples may be tested on-site, or taken to a laboratory at the winery for analysis.

In the vineyard – final 'pre-harvest' assessments

- Most winemakers conduct a final in-vineyard assessment between two days and two weeks before harvest.
- Final in-vineyard assessments are primarily used to schedule a harvest date. At least one winemaker also finalises its assessment of all of the parameters that can be assessed before delivery to determine any related price adjustments or rejections.
- Factors measured are similar to vineyard assessments throughout the season, but with a focus on maturity factors like sugar levels, colour levels and/or 'flavour intensity'.

[122] See Wendy Allan, 2003, *Winegrape Assessment in the Vineyard and at the Winery*, Winetitles, prepared for and endorsed by the Winegrape Growers' Council of Australia (WGCA) and the Winemakers' Federation of Australia (WFA) Liaison Committee.

At the weighbridge

- A final assessment to determine whether there will be quality-related price adjustments or rejections occurs upon delivery of grapes to the winery.
- The characteristics assessed at the weighbridge usually relate to MOG, contamination, disease, fermentation, taints, temperature, varietal integrity and adherence to documentary and procedural requirements. It is not possible to test some of these parameters at the vineyard because they relate to aspects of harvested grapes. Testing for taints may be completed shortly after the weighbridge assessment, if a taint is suspected but not readily confirmable at the weighbridge.
- At the weighbridge most winemakers also conduct a final assessment of maturity factors that have previously been measured in the vineyard, such as sugar levels.
- Samples are generally taken from each truck load, and assessed at the weighbridge and/or in the winemaker's laboratory. Growers usually receive a harvest docket recording the tonnes delivered and basic quality indicators such as sugar levels.

Post-weighbridge

- Some winemakers make 'bonus' payments (for premium grade grapes) based on quality assessments conducted throughout the winemaking process, including after fermentation.

3.2. Quality assessment lacks transparency

3.2.1. Growers lack trust in quality assessment procedures

Warm climate growers have expressed distrust in quality assessments and submitted to the ACCC that some are made arbitrarily or with ulterior motives. Growers submitted that winemakers have:

- used the process primarily to minimise the price they pay growers and the quantity of grapes they accept, rather than to meet market expectations
- filled their quota for a particular grade of grape and subsequently 'downgraded' other fruit that would otherwise have met the grade
- at times of oversupply, used the process to get out of their obligation to purchase grapes under a supply agreement.

Winemakers have told the ACCC that they do not engage in these behaviours, and that there is no incentive to deliberately downgrade grapes. However, some winemakers have suggested that other winemakers have engaged, or have an incentive to engage, in the practices described.

3.2.2. Quality assessments lack transparency

Some grower representatives submitted that quality specifications are not clearly communicated in supply agreements. The ACCC found that quality specifications and associated price penalties or bonuses are generally clearly set out in supply agreements or grower manuals. However, the mechanisms or techniques that will be used to determine compliance, the standards that will be applied to ensure accuracy, and the points in time when testing will occur are not always specified.

In addition, growers have limited visibility over the testing process itself. Much of the testing process usually occurs at the winery (for samples taken from the vineyard as well as samples taken at the weighbridge), making it inaccessible to growers. Growers have also told the ACCC that winemakers provide insufficient information and evidence to justify adverse quality assessment decisions.

This lack of transparency causes problems by:

- Decreasing the accuracy of market signals reaching growers, as discussed in chapter 6.
- Reducing growers' ability to dispute quality assessment decisions: it is difficult for growers to form a view, supported by evidence, about whether their grapes meet the specifications.
- Discouraging new entrants (growers) and mobility in the market (switching winemaker).[123]
- Exacerbating power imbalances between growers and winemakers, as discussed in chapter 5.
- Increasing the risk of grower and winemaker expectations being misaligned. Consequently growers' financial planning may be based on unrealistic expectations about coming payments.

The ACCC recommends that supply agreements should clearly outline the testing and sampling methods that winemakers will use to assess grape quality. This will increase the transparency regarding quality testing methods, allowing growers to make more informed decisions when entering into agreements.

3.2.3. Final results can be inconsistent with prior feedback

As discussed in section 3.1.4, quality assessment is conducted in a number of stages at the vineyard and in the winery. Growers have told the ACCC that final assessments of their grapes sometimes do not match expectations established at previous appraisals. Final results may also conflict with growers' own viticultural experience, or independent testing.

In contrast, winemakers have submitted that:

- Quality assessments are undertaken several times throughout the growing season so that both parties are fully informed.
- Growers provide their input during quality assessments.
- Winemakers seek to manage grower expectations and educate them about the differences between grape grades.
- Most of the grapes that winemakers receive meet the winemaker's quality requirements, and winemakers do not frequently 'downgrade' grapes.
- 'Downgrading' grapes without an appropriate reason would not be an effective business practice.
- Some winemakers finalise all quality assessments in the vineyard, and only conduct quality control assessments at the weighbridge, so the grapes cannot be 'downgraded' at the weighbridge.

3.2.4. Final results are difficult to dispute

An unexpectedly poor quality assessment result at the weighbridge is more difficult for the grower to dispute than if they had been informed of this at the vineyard, because:

[123] Winemaker representatives submitted that growers with long-term relationships with winemakers understand their requirements and therefore are better able to provide grapes according to specifications.

- with the exception of CCW growers (see box 3.1), growers or their representatives are generally not present at the weighbridge, making it difficult to form a view about whether the unexpected result is justified. Growers submitted that best practice would require them to be present at all assessments, but that the fast pace of harvest means that this usually does not occur
- grapes are highly perishable after being picked, and must be crushed as soon as possible. This makes it almost impossible to find an alternative buyer for the grapes by the time they reach the weighbridge
- it is logistically difficult to remove the grapes from the winery, particularly after they have been tipped into the crusher
- in some cases there may be a delay between the rejection and the time the grower is notified
- one major winemaker stipulates that their determination at the weighbridge will be final
- The Code sets out a detailed procedure for settling quality disputes in the vineyard, including determination by an independent expert. However, for quality disputes at the weighbridge the Code states that they should be resolved within 12 hours and does not require the appointment of an independent expert to resolve the dispute.[124]

While the ACCC understands that it is not always feasible for all testing to be carried out and to have the final price determined in the vineyard, vineyard assessments should be as indicative as possible of the final result.

Box 3.1 - CCW grower representation at the weighbridge

CCW is a member-owned and controlled co-operative of around 600 growers in the Riverland that has a supply agreement with Accolade (see chapter 2).

CCW employs two viticulturists who provide technical support to growers during the season. A viticulturist can attend the weighbridge during harvest, usually at the request of CCW or Accolade, if notified of an issue. The viticulturist can assist growers in the event of a potential quality-related price deduction.

CCW representatives have told the ACCC that this measure has given growers more confidence in Accolade's quality assessment results at the weighbridge, and resulted in less conflict between growers and Accolade.

However, the ACCC notes that services like this are not available to non-CCW growers because of the resources that would be required for grower representative organisations to provide such a service.

3.2.5. Growers want transparency over grape end use

Some growers have told the ACCC that being formally advised of the end use of their grapes would provide a better understanding of their product quality, and strengthen their ability to negotiate prices. For example, a grower who has evidence that their grapes have been used in a high quality wine could ask the winemaker, or a competing winemaker, to pay a higher price for their grapes in the following season.

Some winemakers already share this information with growers, particularly for cool climate grapes or for supply agreements where payments are linked to the final product.

Growers submitted that, to comply with labelling requirements, winemakers already keep detailed records tracking which grapes are used in which products. However, the ACCC

[124] See Australian Wine Industry Code of Conduct, clause 3.3. See chapter 7 for more discussion of the Code, and section 5.5 for discussion of dispute resolution processes.

acknowledges there may be an administrative cost associated with sharing the information with growers. In addition, growers would need to consider that their grapes may have been blended with those of a different quality to produce the final product. Further, winemaker processing and marketing decisions will impact the wine produced and the destination market.

3.3. Quality assessment lacks certainty

3.3.1. Quality specifications are subject to change

Some supply agreements provide winemakers with a broad unilateral ability to change quality specifications throughout the season or between seasons. Growers are generally not in a position to dispute such changes.

A number of warm climate growers submitted that winemakers have used this to ‘shift the goalposts’ during the growing season or during the supply agreement term in relation to quality, quantity, colour or sugar thresholds. Growers have also suggested that some specifications are only enforced during times of oversupply.

The resulting uncertainty reduces grower ability to accurately assess the benefits and risks before entering a supply agreement. Changes to specifications may result in growers receiving lower payment than anticipated, negatively affecting their profitability. It also affects their ability in the long run to make optimal decisions about the varieties they grow and, in the shorter term, the inputs they use and other production decisions.

In effect, such agreements enable winemakers to share some of the demand risk of changing consumer preferences with the grower, by adjusting the grape quality parameters being sought under the grape supply agreement.

One winemaker submitted that it requires the ability to change specifications as a result of legislative or other changes, such as if withholding periods for chemicals change, and that it has not sought to vary specifications during the past few years. Another winemaker submitted that in practice it would only change specifications to benefit growers in the event of unusual seasonal conditions.

3.3.2. Some growers do not know how results will impact payment until after harvest

One large winemaker adjusts payments based on how the level of colour (milligrams of anthocyanin per gram of berry weight) in the grapes compares to the regional weighted average.[125] It pays more for grapes with colour levels that are higher than average, and less for grapes with colour levels that are lower, in a particular region and season.

For this winemaker, within a single region and red grape variety, the amount paid for grapes that have the highest colour levels can be $200−$300 per tonne more than (and in some cases double) the amount paid for grapes with the lowest colour levels. This winemaker specifies minimum and maximum amounts that it will substitute for the regional average in years where the regional average is particularly low or high. They may (at their discretion) decrease the minimum to improve grower payments in an excessively low colour year.

This method of calculating payment can cause a period of uncertainty for the grower, as the winemaker reserves the right to adjust payments months after harvest. Growers do not have access to other growers’ colour measurements. They cannot independently determine the effect of their grapes’ colour level on their likely payment because they do not have access to the regional average.

Growers appear to lack information about, and understanding of, the method and rationale for calculating payment in this way, and are unable to verify the regional average calculated

[125] Note: Grower concerns about the accuracy of colour measurements are discussed in section 3.4.4.

by the winemaker. Some growers also appear to lack good information about how to grow grapes to produce good colour readings.

The winemaker told the ACCC that the purpose of colour-based payment adjustments is to reward growers producing the best quality grapes, and that weighted averaging corrects any strong seasonal variations that shift all grape colour levels up or down. Winemaker representatives submitted that if they failed to adjust against averages, or cap or normalise colour results it would cause financial difficulties in years where colour was high across the region.

The ACCC considers that methodologies for comparing a grower's colour levels to regional averages should be clearly and transparently communicated, in as much detail as possible. The information provided when prices are communicated should include a clear statement of the maximum and minimum prices that would be possible following colour-based adjustment.

3.3.3. Some assessed quality factors are beyond growers' control

Some winemakers continue to assess grape quality throughout or after processing, particularly for cool climate grapes. Growers may receive a 'bonus' payment that is contingent on the quality or performance of the final product.

Growers generally have no control over winemaking processes that might impact the quality of the final product, creating uncertainty over the outcome. One winemaker using this process outlines in its contracts that this is not a pure assessment of the quality of the grapes because the grapes may be blended with others before the assessment.

The ACCC does not necessarily have concerns with bonus payments, so long as they are in addition to the component of the price that directly reflects the grapes' value and quality.

3.4. Growers have questioned the integrity of quality assessment

3.4.1. Growers have received inconsistent results

Inconsistent or unexpected results have caused growers to question the integrity of quality assessment techniques. For example, some said they received different results when the same grapes were tested by different winemakers or independent assessors.

Growers, winemakers and other industry stakeholders can submit grape, juice or wine samples for compositional testing on a fee-for-service basis to the Australian Wine Research Institute's (AWRI) Commercial Services or other testing laboratories.

Inconsistent or unexpected results can occur when testing methods are not objective, or when testing is not carried out using accurate equipment, sampling and procedures.

Box 3.2 - Objective quality measurements

Objective quality measurements are impartial, and can be clearly described and accurately and consistently reproduced. They do not rely on subjective judgement by an assessor and they are able to be reliably carried out in the same way, with the same result, by different parties.

To be effective for growers and winemakers, objective measurements should be meaningful (related to value and relevant to the specifications of the result being sought), simple (easy to perform), affordable, timely, robust (precise, reproducible and repeatable), related to something that can be controlled, and transparent.[126]

In contrast, subjective quality assessment techniques rely partly or fully on personal opinion or discretion, and are not reliably reproducible by different assessors. Generally, the more a quality assessment relies on the discretion of the winemaker, the harder it is for the grower to dispute the result.

In contrast, when objective quality assessment methods, understood by both winemakers and growers, are used accurately and transparently, they can reduce the potential for mistrust or misuse. This is because the results can be verified by the grower, winemaker or a third party in the event of a dispute.

In addition, growers can more confidently make production decisions to improve their crops, thereby delivering a desirable product to winemakers and increasing their profits, if they can measure progress against objective, transparent criteria.

3.4.2. Many quality assessment techniques involve a degree of subjectivity

Growers have raised concerns about the subjectivity involved in some quality assessment techniques. For example, sensory assessments (involving tasting, smelling or carrying out visual assessments of the berries) usually involve a degree of subjectivity, even if conducted according to defined parameters.

Sensory assessments can involve evaluation of grape colour, aroma, flavour, taste and mouthfeel by assessing the grape, pulp, skin and seeds.[127] They are commonly used for grapes destined for premium wines that are strongly defined by their distinctive sensory profiles, but can also be used for commercial grapes. Not all winemakers use sensory assessments to determine prices.

In some cases, limitations can be a barrier to assessing quality without relying on winemaker discretion. Although the commonly used chemical measures (such as sugar and pH) are objective, winemakers have submitted that it is impossible to assess the quality of grapes using these measures alone.

Winemakers contend that subjective measures are appropriate where there are no objective measures for certain qualities, and that the chemical interactions that contribute to wine flavour are not well understood. Academic literature supports the view that the existing standard objective techniques are relatively unsophisticated.[128]

[126] See Wendy Cameron, 25-26 July 2012, 'Objective measures of grape and wine quality', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 5.

[127] Susan E P Bastian, 25-26 July 2012, 'Wine grape descriptive analysis to examine sensory impacts of different vineyard management strategies and berry quality', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 29.

[128] For example, Paul Smith, 25-26 July 2012, 'Recent advances in objective chemical measures of wine quality', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 48; Paul K Boss, 25-26 July 2012, 'Towards the prediction wine outcomes from grape compositional measures', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 60.

There appears to have been little change in the way quality is assessed since the early 2000s despite years of ongoing research.[129] Researchers have identified a need to develop rapid, objective and affordable methods of measuring flavour and aroma compounds that correlate well with the sensory characteristics of the final wine.[130] The ACCC believes that industry should support research into affordable and reliable ways to measure wine grape specifications.

Despite the technological limitations of objective measures, and the importance of sensory assessment, the ACCC considers that reliance on subjective measures to determine payment amounts should be reduced wherever possible. For example:

- Sensory assessments that affect payment should be conducted according to criteria and predefined scales that can be understood by the grower and should be capable of being reassessed as accurately as possible by a third party.[131]
- Where objective measures are available to measure the same or similar characteristics or outcomes, those should be used instead of subjective measures.
- Where a sensory assessment is unavoidable because of technological limitations, and it cannot be conducted according to clearly defined criteria, results should only be used for internal purposes and should not influence payments to growers.

The ACCC recommends that winemakers should use well-documented and objective testing and sampling techniques for quality assessments.

Despite the technological limitations to objective measures, and the importance of sensory assessment, the ACCC considers that reliance on subjective measures to determine payment amounts should be reduced wherever possible.

In addition, winemakers using sensory assessments should engage with growers to ensure they understand the specifications being assessed as thoroughly as possible.

3.4.3. Objective quality assessments should be carried out accurately

Appropriate calibration of equipment is required

Quality assessments will not necessarily be accurate and representative just because an objective test, such as a quantitative measurement of sugar or colour, is used. Accurate calibration of equipment and correct administration of testing methods are important for the accuracy of results.[132]

Growers have complained about unreliable sampling

Appropriate sampling techniques are also important. Variability can occur from vine-to-vine, bunch-to-bunch within a vine, and grape-to-grape within the vineyard[133], and between loads of grapes at the weighbridge. The ACCC understands that measurement of highly variable specifications, such as colour, requires particularly rigorous sampling when compared to less variable specifications, such as sugar content.[134]

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[129] For example, Longbottom et al, 2013, found little change in the methods used to assess grape quality from 2003 to 2013 (see p. 34). The methods described in Allan, 2003, appear to be current based on industry feedback to the ACCC. The 2005 Senate Report noted that there has been a strong research focus on developing better and quicker assessment of grape quality since about 1990, at [3.35].

[130] Boss, 2012, p. 64; Lee OAM, 2012, p. 67; Cleary et al, 25-26 July 2012, ‘A perspective on grape chemical quality assessment to support streaming and harvest decisions’, *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 59.

[131] See, for example, the 20 specific criteria in Erika Winter et al, 2004, *Winegrape Berry Sensory Assessment in Australia*, Winetitles.

[132] Standardisation of equipment is discussed in section 3.4.5.

[133] Krstic, 2001, p. 1.

[134] Allan, 2003, p. 6.

Growers have told the ACCC that winemakers have used unreliable sampling processes in the vineyard such as:

- collecting limited samples within a single row of vines to represent the whole vineyard
- choosing grapes from sections of the vine that are likely to be at an extreme end of the scale (such as the ends of rows)
- engaging untrained/inexperienced staff to conduct the sampling process.[135]

When carried out transparently, representative sampling can lead to greater certainty and trust in the results of quality assessment at the vineyard and the weighbridge.

Sampling inaccuracies are more likely to harm growers than winemakers, as growers are generally penalised for failing to meet requirements, but are not correspondingly rewarded for exceeding them. Poor sampling can harm growers in the following ways:

- *In the vineyard:* this can build up grower expectations and increase the risk of later 'downgrading' at the weighbridge, and can also cause inefficient harvest scheduling
- *At the weighbridge:* this can increase the risk that the grower will be underpaid for the grapes. Disputes are generally more difficult to resolve at the weighbridge than in the vineyard, as discussed in section 3.2.4.

Growers lack the ability to dispute sampling procedures

Growers have a limited ability to dispute sampling methods because many supply agreements do not specify the methods to be used. Some supply agreements make reference to 'representative samples', 'random selection' or a specified minimum sample size, but do not provide further details about how this will be achieved.

In addition, there is a lack of accessible and consistent industry standards on sampling. The existing industry-agreed standards for quality assessment, discussed in box 3.3, emphasise the importance of obtaining representative samples and refer to other sources, but do not provide detailed information on sampling techniques.[136]

Box 3.3 - Existing industry standards for quality assessments

In 2003, the Winegrape Growers' Council of Australia and the Winemakers' Federation of Australia endorsed a summary of appropriate quality assessment techniques titled *Winegrape Assessment in the Vineyard and at the Winery* (Assessment Guide).[137] The Assessment Guide was designed to represent current best practice and to evolve over time. However, the publication has not been updated since its creation in the early 2000s.

The Assessment Guide is referenced by the Code. Signatories are required to state in their supply agreements which quality standards apply to the grapes being purchased. It also requires that any method that is inconsistent with the methods described in the Assessment Guide be described and the process for determining harvest time be specified.[138]

Where insufficient information about sampling is provided, this can create a real or perceived opportunity for winemakers to consciously or unknowingly select an unrepresentative sample. This risk is underlined by the provision of detailed sampling instructions from

[135] Growers have expressed also similar views in other forums. See, for example, Longbottom et al, 2013, p. 35; Academics have also referred to a need for better sampling efficiency. See, for example, Peter Dry et al, 25-26 July 2012, 'Vineyard characteristics used in assessment schemes: theory and practice', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 9.

[136] Allan, 2003, refers to Krstic et al, 2003, *Growing Quality Grapes to Winery Specifications* (CRCV project 1.1.2 Compendium of Winegrape Specifications and Measurement) for best practice sampling techniques.

[137] Ibid.

[138] Australian Wine Industry Code of Conduct, clauses 2.8.1, 2.8.2 and 2.8.3.

winemakers who require growers to submit samples from the vineyard. Other risks associated with a lack of transparency in quality assessment are discussed in section 3.2.2.

3.4.4. Some warm climate growers are concerned about colour assessment

Colour assessment is a controversial measure generally only used for red wine grape varieties.

Some winemakers use subjective, visual assessment which involves crushing a grape between the assessor's fingers to assess colour. This raises concerns about reliability.[139]

Colour, in terms of milligrams of anthocyanins present in each gram of berries, is also commonly measured using spectrophotometry or near infra-red spectroscopy.[140] Athocyanin measurements were adopted by some medium to large winemakers in the early 2000s. Today at least one winemaker uses them as a determinant of prices (in combination with other quality parameters), as described in section 3.3.2.

Growers have submitted that these tests are unreliable. Some growers view colour assessment as a mechanism lacking in scientific credibility, used by winemakers to manipulate prices. In contrast, other growers told the ACCC that they are in favour of colour assessments based on anthocyanins because they have consistently received better prices as a result.

Winemakers acknowledge there are technical difficulties in developing and maintaining calibrations of colour measurement equipment, and that results can vary depending on sampling methods. However, they have also reported that these methods are the most effective and objective available, and are reliable enough for commercial use.

Academic literature and experts consulted by the ACCC support the view that while measurement of anthocyanins is not perfect, it correlates in some degree to some characteristics sought by winemakers that may otherwise be assessed using subjective sensory methods.

Although there is a correlation between colour and certain quality specifications, academic and industry literature suggests using colour as one of many assessment measures in a multivariable approach to increase the integrity of quality results.[141]

3.4.5. The standardisation of measurement equipment would increase grower confidence

Growers have raised concerns that colour measurement using spectrophotometry or near infra-red spectroscopy is in breach of the legislation and regulations administered by the National Measurement Institute (NMI), Australia's peak measurement body, because the equipment used is not standardised or formally verified.

The NMI has confirmed to the ACCC that there is no registered standard for wine grape sugar or colour level measurements, consequently, they cannot assess instruments to verify that they will operate appropriately. The measurement legislation does, however, broadly require all measurements to be accurate.

The ACCC believes there would be benefit in the NMI reassessing the possibility of standardising wine grape sugar and colour measurement techniques.

The standardisation of equipment would increase grower confidence in testing by establishing clear requirements for calibration and use of equipment and allow the NMI to

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[139] See section 3.4.1.

[140] For discussion of these methods see AWRI, *Measurement of grape colour,* https://www.awri.com.au/industry_support/winemaking_resources/laboratory_methods/chemical/colour/

[141] Allan, page 5; Patrick G Iland and Renata Ristic, 25-26 July 2012, 'Chemical and physical measures of grape quality – how far can they take us?', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality,* p. 24; Francis et al, May-June 2005, 'Objective measures of grape quality – are they achievable?', *The AWRI Report*, p. 16.

investigate potential breaches of the standards and take enforcement action where necessary. We note the process of standardisation, if it were to go ahead, would likely take multiple years and require extensive industry engagement and support.

The ACCC recommends the NMI work with the industry to develop uniform standards for testing and measuring grape sugar levels and colour. Winemakers' testing equipment and processes would then be capable of being independently audited by the NMI, including in response to complaints from growers.

3.4.6. Growers have raised concerns about assessment of vineyard attributes

Some major winemakers assess vineyard attributes such as canopy density and vine layout in a way that can affect payment. Growers have disputed the relevance of these attributes to the quality of the final product.

Academic literature is not conclusive regarding the relationship between vineyard specifications and the quality of the resulting wine. One study suggests that features like leaf health, fruit distribution and berry size can be significant indicators of other characteristics.[142]

There is an element of subjectivity in many types of vineyard attribute assessment, and therefore reliance on such assessments to determine price should be minimised.[143] However, the ACCC considers the use of such assessments is a commercial decision for the winemaker, providing that:

- the specifications that impact on price/rejections are transparent from the time the supply agreement is entered into
- as far as possible, the specifications are transparently, accurately and objectively measured.

Winemakers wish to purchase grapes that will satisfy their wine production needs and increase their profits. Consequently, they are unlikely to measure vineyard specifications that they consider to be arbitrary.

3.5. Winemakers control timing of quality assessment and harvest

3.5.1. Winemakers have discretion over the timing of harvest

The timing of the harvest of wine grapes is one of the most important factors influencing grape quality and the prices received by growers.[144]

Harvest dates are generally determined by winemakers at their absolute discretion. This is based on assessments of maturity submitted by growers and/or field officers, as well as the winemaker's capacity to receive the grapes. Winemakers are in a better position than growers to consider the ripeness of all of the grapes they are purchasing, and their processing capacities.

Although some winemakers consult growers on the harvest schedule, growers usually have little or no ability to influence or dispute their allocated harvest booking time. As a result, growers with initially similar quality grapes could receive significantly different payments because of scheduling decisions made by the winemaker.

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[142] Dambergs, 2012, p. 16-17.

[143] Dry et al, 25-26 July 2012, 'Vineyard characteristics used in assessment schemes: theory and practice', *ASVO/WISA Proceedings: Objective Measures of Wine and Grape Quality*, p. 9 notes, for example, that bunch clumping is regarded as a negative characteristic in many assessment schemes, but does not appear to be quantified.

[144] See, for example, M P Krstic et al, 2001, 'Sampling for wine grape quality parameters in the vineyard: variability and post-harvest issues', *Proceedings: Eleventh Australian Wine Industry Technical Conference*, page 1; Mark P Krstic, 2003, 'How ripe are my grapes?' *ASVO Proceedings: Grapegrowing at the Edge, Managing the Wine Business, Impacts on Wine Flavour*, p. 20; Dambergs, 2012, pp. 16-17.

3.5.2. Growers bear the risks associated with the timing of harvest

Growers' lack of control over the timing of harvest exposes them to the risk that their profit will be reduced, as they:

- cannot ensure their grapes will be assessed and weighed when they are at, or close to, their most profitable condition. Particular patches of grapes may be at their peak for as little as a few days. Grapes in each region tend to mature around the same time, and harvest has recently become compressed in some regions because of changes in climate[145]
- bear the risk of a weather event damaging the crop in the lead up to harvest, but are unable to manage this risk through discretion over harvest timing. Even if final assessment occurs in the vineyard, winemakers reserve the right to reassess if there is a major event before harvest, such as heavy rainfall or high temperatures
- are unable to prevent harvest from occurring late in the season, when the grapes can become dehydrated. In some cases, the grapes can lose up to 30 per cent of their volume.[146] Consequently, harvesting late in the season can result in the grower losing revenue because grapes are sold by weight.

Due to capacity limitations, some winemakers face significant constraints in scheduling harvest because they must stagger deliveries to reduce bottlenecking within the winery. Consequently, they are usually unable to receive all grapes at the time they are at optimum quality.

Mechanical breakdowns or other delays in the winemaker's receival process can also necessitate harvest delays for some growers. Winemakers lack incentives to improve their intake capacities because growers bear the loss of profits caused by the lower yields associated with late harvests.

Winemakers submitted that they seek to schedule harvest times to ensure sugar levels are within an optimum range. They have an interest in harvesting grapes in optimal condition to fulfil their product requirements, and some winemakers have addressed significant delays by diverting grapes to alternative facilities to prevent spoilage.

The incentive for winemakers to prioritise harvest timing for growers is also reduced to the extent they are able to 'correct' quality problems with over-ripened grapes, such as by adding water (see box 3.4). The ACCC understands that research into the effect of adding water to wine has so far been limited and is ongoing[147], and that risks associated with the addition of water include the possibility of taints, salts and dilution of flavour, acidity and nutrients.[148] Winemakers have submitted that excessively high sugar levels cannot be corrected by adding water, except for wine of an extremely low quality.

[145] See Wine Australia, 2017-2019, *Managing the impact of vintage advancement and compression*, https://www.wineaustralia.com/research/strategy-4-improving-resource-management/climate-adaptability/awri-1701-4-1-1; C Jarvis et al, 20 November 2018, 'Advancement of winegrape maturity continuing for winegrowing regions in Australia with variable evidence of compression of the harvest period', *Australian Journal of Grape and Wine Research*, volume 25, issue 1, 2019; Jessica Schremmer, 22 November 2018, 'Climate change 'creeping up' on winemakers and putting pressure on grapes, says scientist', *ABC News*, https://www.abc.net.au/news/2018-11-22/climate-change-creeping-up-on-winemakers/10519206; Christopher Davies and Christine Bottcher, 14 March 2019, 'A warning for wine-lovers: climate change is messing with your favourite tipple's timing', *The Conversation*, https://theconversation.com/a-warning-for-wine-lovers-climate-change-is-messing-with-your-favourite-tipples-timing-112865.

[146] See Alexandra Laskie, 6 June 2018, 'Water into wine: new law allegedly used to force grapes to dry out on vine', *The Weekly Times,* https://www.weeklytimesnow.com.au/agribusiness/wine/water-into-wine-new-law-allegedly-used-to-force-grapes-to-dry-out-on-vine/news-story/1e83413b880555e5109032cb4df75c14.

[147] Wine Australia, 11 March 2017, *What actually happens when you add water to must*, https://www.wineaustralia.com/news/articles/water-to-must; AWRI, *Winemaking Treatment – Water Addition*.

[148] Geoff Cowey, April 2017, 'Adding water to high sugar must', *Australian and New Zealand Grapegrower and Winemaker*, pp. 88-89, https://www.awri.com.au/wp-content/uploads/2018/03/s1911.pdf; Geoff Cowey, April 2017, 'Making water additions to high sugar must', *AWRI Technical Review*, pp. 9-12, https://www.awri.com.au/wp-content/uploads/2011/07/Technical_Review_Issue_227_Cowey.pdf.

Box 3.4 - Changes to the Food Standards Code

A recent change to the *Food Standards Australia and New Zealand Code* (Food Standards Code) has allowed a limited amount of water to be added to wine from 2018. This was designed to help winemakers through shorter, warmer seasons that produce grapes with higher sugar content, to reduce the chance of problems arising during fermentation.[149]

Growers have argued that this incentivises winemakers to delay harvest timing and allow the grapes to dehydrate, resulting in lower weights and therefore lower payments to growers. Grower representatives noted in the media in 2018 that growers considered that their grapes were left to hang on vines for longer than normal and felt the system was being abused. One grower said they were told to wait to pick until the sugar level was extremely high because 'the flavours weren't there'.[150] Growers disagreed with statements from winemakers that the delay was because of a heatwave.

Winemakers have publicly denied delaying harvest with the intention of adding water later.[151] One winemaker described the practice to the ACCC as 'unethical' and emphasised that it would damage the winemaker's relationship with its growers. Winemaker representatives submitted to the ACCC that it is not a common or prevalent practice.

Under most supply agreements, growers can be penalised for sugar levels not meeting minimum thresholds, but are not rewarded for exceeding them. Some growers have suggested they should receive a bonus payment if their grapes reach high sugar levels, to compensate for lost volume and incentivise winemakers to harvest on time.

Winemakers have reported that some growers have attempted to mitigate the risk of late harvest by overstating the ripeness of the grapes to the winemaker. These winemakers submit that these growers preferred to risk being penalised for sugar levels being too low, instead of risking significant losses in volume because of the sugar level being too high. This has led to the harvest of unripe grapes by some growers and delay in harvesting ripe grapes by other growers.

The ACCC considers that clear communication and transparency around harvest timing is critical to maintaining trust between growers and winemakers.

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149 AWRI, *Winemaking Treatment – Water Addition*, https://www.awri.com.au/industry_support/courses-seminars-workshops/seminars-workshops/cabernet-sauvignon-winemaking-trial/winemaking-treatment-water-addition/; Laskie 2018.

150 Laskie 2018.

151 Pernod Ricard Winemakers and Accolade wines in Laskie 2018.

4. Pricing

Key Points

- Winemakers use a range of measures to estimate the volume of grapes they need to meet demand and to inform their strategy for pricing and buying grapes.
- The major influences on warm climate grape prices are bulk wine export prices and local harvest conditions.
- Supply agreements can be fixed price, variable price or spot price. The most widely used are variable price terms where the winemaker sets the price close to harvest, often by reference to a 'fair market price'. Prices offered under 'fair market price' terms are not benchmarked against any visible, objective or verifiable measures.
- Signatories to the Australian Wine Industry Code of Conduct (Code) are required to provide an indicative price to growers before the final price is released. Growers and winemakers have raised concerns about how this operates in practice.
- There is no strong evidence that indicative prices are always conservative offers. However, the final prices received by growers are likely to be higher than indicative prices.
- Growers do not have access to reliable grape price information (especially individual winemaker prices).
- The ACCC recommends introducing a new indicative price mechanism to improve price transparency and market efficiency.

This chapter discusses how winemakers make grape pricing decisions, pricing mechanisms used in grape supply agreements, and factors influencing the prices received by growers. In the context of price transparency, we also consider how winemakers in warm climate regions inform growers of their prices.

Price transparency is important for market efficiency. It allows growers to make informed decisions using accurate information (including decisions about inputs and who to supply). Growers can currently access publicly available aggregated market information but not specific purchase prices offered by individual winemakers.

4.1. Winemaker pricing decisions are based on market forecasts

Winemakers forecast the volume of wine they expect to sell at a range of price points. These forecasts influence their purchase decisions for different varieties and qualities of grapes.

4.1.1. Winemakers forecast demand for their end products

The largest winemakers have devoted teams, processes and software for demand planning in key sales regions.

Winemakers consider the following factors in forecasting demand:

- *For winemakers that export into overseas markets:* changes in international bulk and bottled wine prices, foreign exchange rates, and geopolitical influences.
- *For winemakers that wholesale into the domestic market:* sales trends, competitor activity and customer decisions.

Most winemakers maintain long-term (three to five years) and short-term (12 months) demand forecasts for their individual product lines.

4.1.2. Winemakers forecast grape requirements and plan how to source grapes

Winemakers use forecast end product demand as a basis to plan grape requirements. To meet forecast demand for grapes, winemakers create plans that specify the volume of grapes (by grade, variety and region) they require.

Winemakers seek to buy the grapes they require at the lowest price that will allow them to make an acceptable profit margin. When considering the lowest price they can pay for a particular batch of grapes, winemakers consider a range of factors including:

- *The level of competition for the grapes*: winemakers may pay higher prices if they believe growers would otherwise sell the grapes elsewhere (where growers have not pre-sold their grapes under an annual or multi-year supply agreement), or if growers are able to successfully negotiate or dispute the initial price offer.
- *The quality and condition of the grapes*: quality assessment processes can lead to price variations as discussed in chapter 3.
- *Other features of the supply arrangement*: for example, a winemaker purchasing grapes on a multi-year fixed price agreement may offer a conservative price to shield itself from the risk of adverse market changes. The various pricing mechanisms used by winemakers are discussed in section 4.3.
- *Previous prices and local pricing trends*: winemakers commonly refer to the annual Wine Australia National Vintage Report from previous years to predict prices for the upcoming harvest.[152]

Winemakers have a number of options if they forecast excess demand:

- If the shortfall is identified well before harvest, they may approach existing or new growers to purchase additional volumes on multi-year or annual supply agreements.
- If the shortfall is identified immediately before or during harvest, they may attempt to purchase grapes in the spot market or purchase grapes, must or juice from other winemakers.
- If a shortfall is identified after harvest, they may purchase bulk wine from other winemakers.
- Winemakers may also use existing inventory of wine from previous years to alleviate a shortfall in production. Their ability to do this is limited by labelling restrictions that require at least 85 per cent of wine labelled with a certain year to be sourced from grapes harvested in that year.[153]

Where winemakers forecast excess supply for a particular season, they may attempt to resell grapes, must or juice on the spot market, sell excess bulk wine to other winemakers or store excess production for subsequent years.

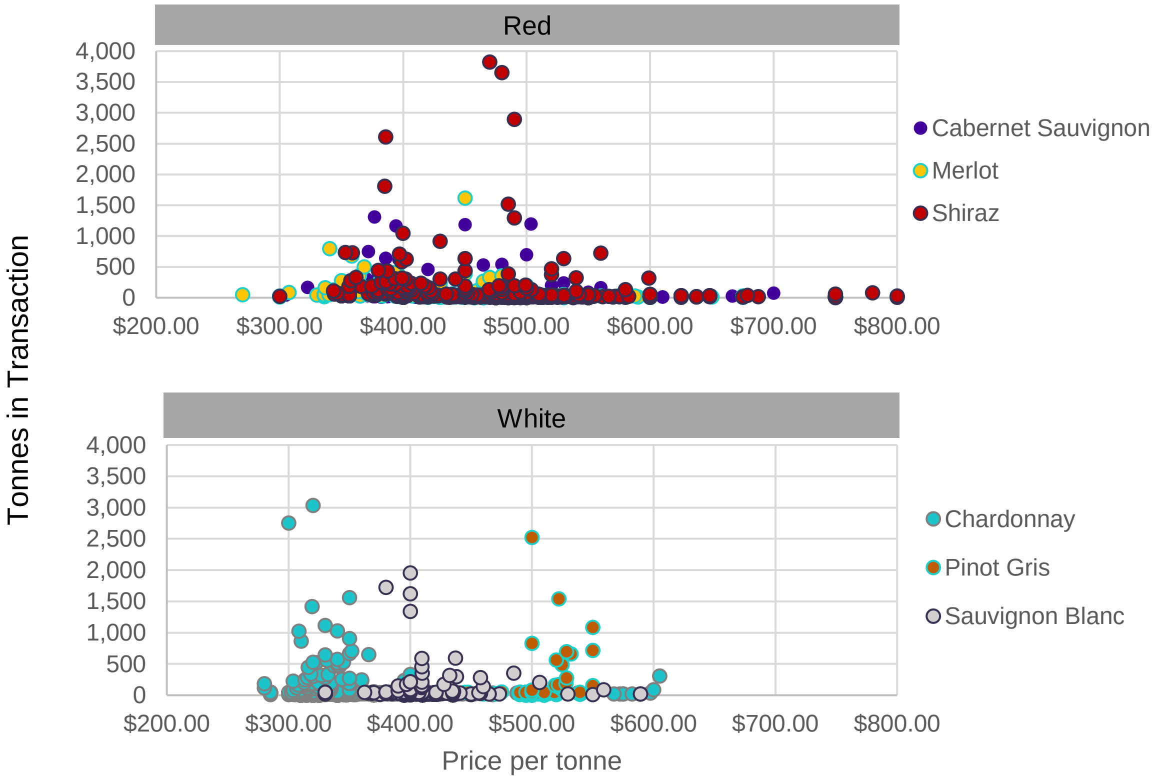
[152] The Wine Australia National Vintage Report describes the volumes crushed and prices paid by variety in each region in the previous harvest.

[153] *Wine Australia Regulations 2018*, reg 27.

4.1.3. Winemakers do not generally consider transaction size when determining prices

Winemakers do not appear to consider transaction size as a determinant of the price they will pay for a particular batch of grapes. As shown in figure 4.1 below, growers selling large volumes of grapes generally receive the same or similar prices as growers selling small volumes. This suggests that larger scale growers do not have better bargaining power than smaller scale growers.[154]

Figure 4.1 Dispersion of warm climate grape prices by size of transaction, 2018 harvest



Source: ACCC analysis of industry-supplied data.[155]

4.2. Large scale factors affect supply and demand

Australian grape prices are largely determined by conditions in international markets which drive demand, and seasonal factors in domestic markets which affect supply.

4.2.1. Global market conditions drive demand for Australian grapes

International supply and demand conditions largely determine the prices for Australian wine exports, and therefore have a strong impact on grape prices.

According to the International Organisation of Vine and Wine, Australian wine exports accounted for eight per cent of the global market by volume in 2017.[156] The international

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154 See chapter 5 for discussion of bargaining power imbalances between growers and winemakers.

155 The Visualisation excludes transactions below $200 or above $800 per tonne, and above 4000 tonnes.

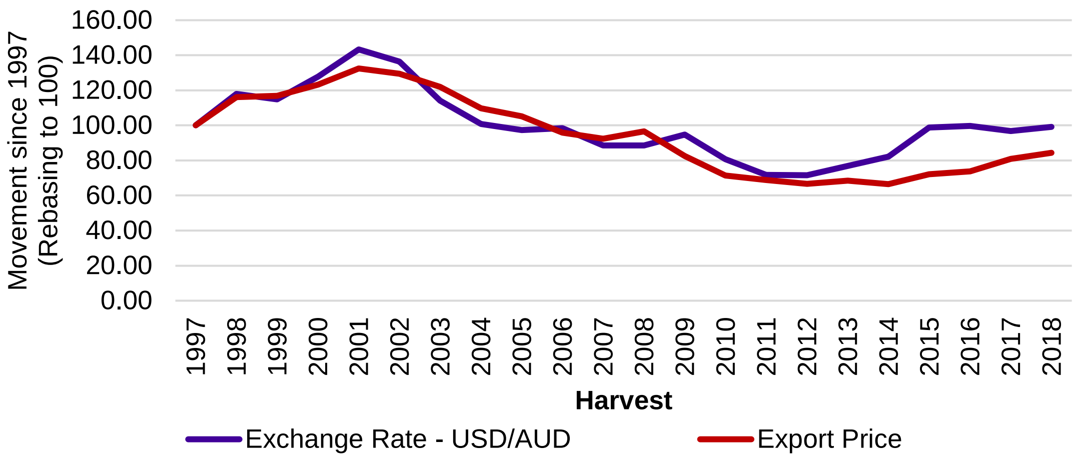
wine trade is dominated by Spain, Italy and France, which together account for over 55 per cent of global market volumes.[157] Significant volumes of wine are also exported by Chile, South Africa, Germany and the United States.[158]

Harvest results in these countries affects the amount of wine available on the global market and, in turn, impact the prices that international wholesalers are willing to pay for Australian wine. The impact is particularly strong for commercial wine that is not defined by reference to its geographical origin, because this wine is easily substitutable for wine from other countries.

Direct changes in the level of export demand also influence Australian grape prices. For example, the global financial crisis in 2008 reduced worldwide demand for wine and resulted in a significant decline in wine export prices and grape prices (see figure 4.3 below).

Since 1997, the average Australian wine export price has been strongly correlated with the exchange rate, with a weaker Australian dollar tending to coincide with higher export prices (see figure 4.2).

Figure 4.2 Exchange rate USD to AUD compared to export price 1997–2018



Source: Anderson 2015[159] and various Wine Australia publications.[160]

In turn, the wine export price is strongly correlated with average grape prices (see figures 4.3 and 4.4).

[156] http://www.oiv.int/public/medias/5958/oiv-state-of-the-vitiviniculture-world-market-april-2018.pdf, p. 12

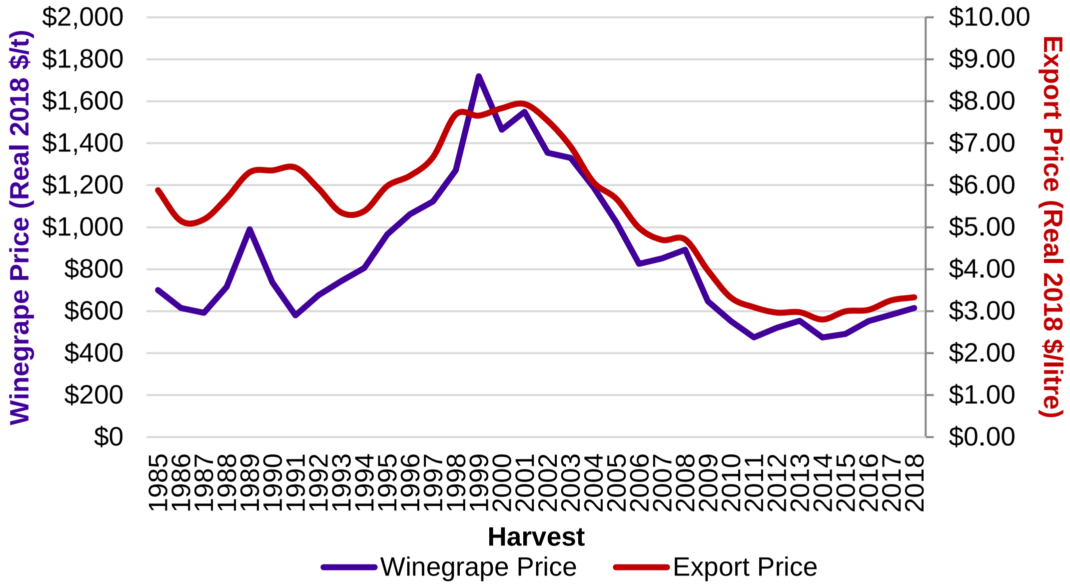
[157] http://www.oiv.int/public/medias/5958/oiv-state-of-the-vitiviniculture-world-market-april-2018.pdf, p. 12

[158] http://www.oiv.int/public/medias/5958/oiv-state-of-the-vitiviniculture-world-market-april-2018.pdf, p. 12

[159] P. 203, table 15.

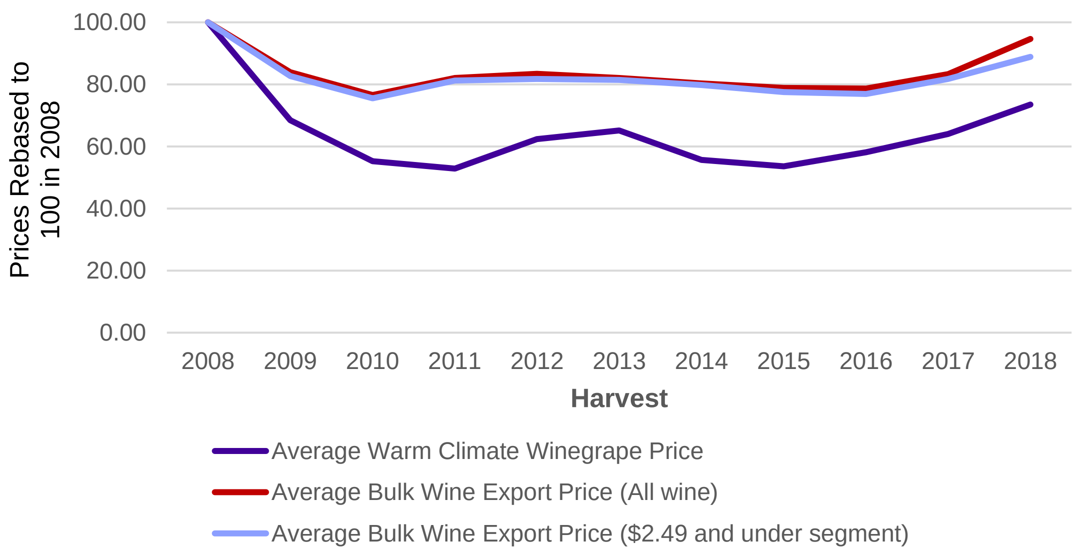
[160] Wine Australia, media release, ‘Australian wine exports see rise in volume and value in 2014’, Wine Australia, media release, ‘Australian wine exports jump 14 per cent to $2.1 billion’, Wine Australia, Market bulletin, Issue 91, ‘2017: A record-breaking year for Australian wine exports’, Wine Australia, media release, ‘Figures show continuing strong international demand for fine Australian wine’.

Figure 4.3 Wine export prices compared to average grape prices 1997–2018



Source: Anderson 2015[161] and various Wine Australia publications.[162]

Figure 4.4 Bulk wine export prices compared to average warm climate grape prices 2008–2018



Source: ACCC analysis of Wine Australia data.

These correlations support feedback from winemakers and growers that the export bulk wine price is the most significant factor influencing warm climate grape prices.

161 P. 203, table 15 and p. 258, table 37.

162 Wine Australia, media release, 'Australian wine exports see rise in volume and value in 2014', Wine Australia, media release, 'Australian wine exports jump 14 per cent to $2.1 billion', Wine Australia, Market bulletin, Issue 91, '2017: A record-breaking year for Australian wine exports', Wine Australia, media release, 'Figures show continuing strong international demand for fine Australian wine'.

4.2.2. Domestic and seasonal factors influence the supply of Australian grapes

The availability of grapes by volume, region, quality and variety strongly influences prices. This can be affected by a range of factors, including the prevalence of different varieties and the responsiveness of the industry to demand trends, weather and climate conditions.

Seasonal deviations from expected harvest yields can impact the level of market supply and the amount of inventory held by winemakers. This, in turn, influences grape prices.

4.3. Pricing mechanisms in grape supply agreements

Under most grape supply agreements, the winemaker sets prices for each variety of grapes on a per tonne basis.

The set price in a given region for each grape variety may be the same, or it may vary.[163] However, price variation is more common in cool climate regions.

The three main pricing mechanisms used in transactions between winemakers and growers are variable price, fixed price and spot price terms.

4.3.1. Variable price mechanism

The ACCC understands that variable price agreements are the most widespread pricing mechanism in warm climate regions. Under these agreements, the grower agrees in advance to supply a specified tonnage of grapes to the winemaker, at a price to be determined by the winemaker close to harvest, for one or more years.

The price is generally at the complete discretion of the winemaker. It is often defined in the agreement as a 'fair market price'. However, it is not determined by reference to any specified source of information, and is generally taken to mean a price that the winemaker considers reflects the market value of the grapes. In this sense, the grower is a price taker and is reliant on the winemaker's discretion. However, in some instances, growers can dispute the winemaker's determination, as described in section 4.4.3.

Compared to growers on fixed price agreements, growers supplying under variable price agreements have less price certainty throughout the life of the agreement.

4.3.2. Fixed price mechanism

Under fixed price supply agreements, prices are determined upfront at the formation of the supply agreement. Compared to other pricing mechanisms, fixed price terms give growers and winemakers greater price certainty when entering into the agreement.

However, parties to multi-year fixed price agreements carry the risk that the agreed price will significantly differ from the market price, especially when market conditions are changing quickly. To alleviate this risk, at least one major winemaker uses agreements that apply a fixed price mechanism for a specified number of years and then revert to a variable price mechanism for the subsequent years of the agreement term.

4.3.3. Spot market price mechanism

The Code defines spot market agreements as those entered into less than 10 business days before harvest. Prices under spot market agreements are determined a short time before harvest, at the time the agreement is entered into.

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[163] 'Price offered' is distinct from the quality-adjusted price paid to each grower.

Spot market growers are subject to the same price uncertainty faced by growers on variable price agreements. Spot market growers carry the risk of not finding a buyer for their grapes, but they are sometimes able to secure higher prices than those offered under annual or multi-year contracts, depending on market conditions.

4.4. Existing price notification practices vary significantly

There are various ways that winemakers notify growers of potential and actual prices, particularly under variable price agreements.

Price notification practices differ most between winemakers who are signatories to the Code and those who are not. For winemakers who are not signatories, they can also differ significantly from winemaker to winemaker, and region to region.

4.4.1. Price notification procedures outside the Code vary significantly

Major winemakers who are not signatories to the Code submitted that they use practices including:

- notifying growers of final prices by 30 January
- holding meetings with growers in the period after harvest and providing feedback on market conditions and the potential impact on prices for the coming season
- releasing a price list three quarters of the way through the growing season
- not offering variable price agreements, and instead providing prices up front as part of a fixed price multi-year agreement.

4.4.2. Price notification procedures under the Code are more standardised

Winemakers who are signatories to the Code notify growers of prices using the procedure outlined in the Code. In addition, some signatories provide more detailed or earlier price information to growers than the Code requires.

The price notification procedure outlined in the Code only applies to agreements that require 'a price offer or a negotiation as part of the calculation of the price'.[164] At least one signatory to the Code mostly uses multi-year fixed price agreements and therefore is not obligated to provide indicative prices for those agreements.

Indicative price notifications are not binding

For variable price agreements, the Code requires signatories to notify growers of an 'Indicative Regional Price' (commonly known as an 'indicative price'), which is defined in the Code as:

> *"Indicative Regional Price" means, in relation to a variety of winegrapes, an indicative fair market price for that variety of winegrapes from that region for the next vintage which:*
>
> - *is not* winegrape grower or vineyard specific;
> - is set by the winegrape purchaser acting reasonably;
> - is not an offer capable of being accepted by a winegrape grower or binding on the winegrape *purchaser, and*

[164] Code, Section 2.4.1.

- *is not a guarantee of the final price that will be offered to the winegrape grower*.[165]

Signatories must provide indicative prices to growers in the Hunter Valley, Riverina, Murray Valley and Riverland regions by 15 December each year. For growers in other regions, signatories must use their best reasonable endeavours to provide indicative prices by 15 January.[166] If a grape supply agreement is entered after the relevant deadline, the signatory must provide an indicative price at the time the agreement is entered into.[167]

Winemakers provide indicative prices directly to individual contracted growers through email, mail, phone or Grapeweb.[168] Winemakers do not publish their indicative prices, and typically require growers to treat the prices confidentially. This makes it difficult for growers to gain an accurate understanding of market prices. However, despite the confidentiality requirements, Australian Vignerons and the Winemakers' Federation of Australia (WFA) submitted that there is a tendency for pricing information to quickly become common knowledge.

Some winemakers have indicated that they also engage in informal conversations with individual growers throughout the growing season about prices.

The indicative price often becomes the starting point for informal negotiations about the final price that winemakers will offer. However, indicative prices are not a guarantee of the final price and are not binding.[169] As such, they are generally not subject to formal negotiation, and cannot be disputed under the dispute resolution sections of the Code.[170] The ACCC has found that final prices are usually similar to indicative prices, as detailed in section 4.5.4.

Final price notifications occur close to harvest

Signatories to the Code must make a final price offer:

- As soon as practicable and, at the latest, before the anticipated harvest date for the grapes (if the signatory undertakes a pre-harvest vineyard inspection before making a final offer)
- At least 10 business days before the anticipated harvest date for the grapes (if the signatory does not undertake a pre-harvest inspection before making a final offer).[171]

The ACCC is aware of one large Code signatory that commits to providing a final price offer to growers at least five business days before harvest is expected to commence. Other Code signatories have indicated that they provide price information within the deadlines outlined in the Code.

4.4.3. The Code provides for a dispute resolution process for final prices

The Code contains a price dispute resolution procedure that growers can use to challenge a signatory's final price, but not its indicative price. As a result, price disputes under the Code generally take place close to harvest, after the final price has been released. Growers have said they lack the time to resolve disputes during harvest, and this restricts the usefulness of the dispute resolution process.

165 Code, appendix 1 – Definitions.

166 Code, sections 2.4.1; 2.4.1.1; 2.4.1.2.

167 Code, section 2.4.1.

168 Grapeweb is an online system used by winemakers and growers to communicate and organise grape production information.

169 Code, appendix 1 – Definitions.

170 Code, part 3.

171 Code, section 2.4.2.

Despite this, one winemaker provided an example of a dispute over the indicative price that involved use of the preliminary dispute resolution steps outlined in the Code. The dispute resulted in a higher final price being agreed upon by the parties.

The dispute resolution procedure under the Code is discussed in more detail in chapter 7.

4.5. The industry has raised concerns with indicative pricing under the Code

The indicative price requirement was intended to assist growers in managing inputs prior to harvest and aid the search for alternative buyers.

However, it is commonly agreed within the industry that the indicative price requirement has been unpopular among both winemakers and growers. WFA submitted that the indicative price provision is a key obstacle preventing more winemakers from signing the Code. In 2014, the Code Management Committee (Code Committee) described the indicative price provisions as a 'major disincentive' to winemakers considering signing the Code.[172]

This is consistent with feedback that some non-signatory winemakers and growers provided to the ACCC. Australian Vignerons questioned whether the benefits of indicative pricing outweigh the risks, noting that it is not a binding price offer, and Murray Valley Winegrowers (MVW) submitted that it does 'more harm than good'. One winemaker submitted it would support removing the indicative price provisions from the Code.

Key concerns that have been raised about indicative pricing are that it:

- may have the effect of anchoring artificially low prices or facilitating price signalling
- occurs at an inappropriate time for both growers and winemakers
- deters some winemakers from signing the Code.

4.5.1. Stakeholders suggested that indicative pricing encourages price signalling

Growers have expressed concern that indicative prices set a benchmark that leads to lower final prices.[173]

In 2014, the Code Committee reported that grower representatives believed indicative price provisions had 'encouraged lower across-the-board prices'.[174] Similarly, CCW Co-Operative Limited submitted that the indicative price requirement is counterproductive for its negotiations with Accolade because it creates a lower starting point for negotiations.

Australian Vignerons submitted that indicative pricing sets a base or minimum price point that other buyers use as a reference. Winemakers acknowledged growers' concerns about price leading in the Code Committee's annual report in 2014.[175]

WFA has expressed concern that by releasing indicative price information, signatories to the Code would be at risk of inadvertently engaging in anti-competitive concerted practices (as described in box 4.1). WFA submitted that indicative prices generally become a minimum price for the particular season.

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172 Code Committee, *Annual Report* 2013-2014, p. 7.

173 AV submission https://wfa.org.au/assets/submissions/Submission-ACCC-Wine-grapes-Market-Study-Issues-Paper-2018-AV.pdf p. 9.

174 2014 annual report, page 7, 8: http://www.wineindustrycode.org/AWICoC%20Annual%20Report%202013-14%20(SEP%202014)%20v4.pdf

175 2014 code annual report page 8: http://www.wineindustrycode.org/AWICoC%20Annual%20Report%202013-14%20(SEP%202014)%20v4.pdf

The ACCC considers that, without more evidence, the confidential sharing of estimated price information between a winemaker and a grower is not likely to be an anti-competitive concerted practice within the meaning of subsection 45(1) of the *Competition and Consumer Act 2010* (CCA). The current practice of winemakers confidentially providing indicative pricing to growers is for the purpose of assisting their negotiations, and does not involve engagement between multiple winemakers who could act in concert to manipulate prices.

We do not consider that this practice is likely to have the purpose, effect or likely effect of substantially lessening competition because the information is provided directly to individual growers for the purpose of informing the grower of likely prices. The provision of indicative pricing information is more likely to have a pro-competitive effect, allowing growers to better understand market signals and test the market.

Box 4.1 - Anti-competitive concerted practices

From November 2017, subsection 45(1)(c) of the CCA provides that a person must not engage with one or more persons in a concerted practice that has the purpose, or has or is likely to have the effect, of substantially lessening competition.

The concept of a ‘concerted practice’ involves communication or cooperative behaviour that does not require all of the elements of an understanding but involves more than a person independently responding to market conditions.

A concerted practice will contravene section 45 of the CCA if it has the purpose, or has or is likely to have the effect, of substantially lessening competition. A business is at risk of engaging in an anti-competitive concerted practice if it replaces or reduces competitive, independent decision making by cooperating with its competitors regarding business decisions such as how it determines the price for its products.

4.5.2. Winemakers raised concerns that indicative pricing encourages sharing of confidential information

WFA submitted that growers generally share indicative prices with other growers and feed the information back to winemakers during price negotiations. WFA expressed concern that growers or grower representative groups may be engaging in anti-competitive concerted practices by sharing, or facilitating the sharing, of confidential indicative price information.

The ACCC has considered these concerns, and has concluded that the sharing of indicative price information by growers in this way is not an anti-competitive concerted practice because it does not have the purpose, and does not have and is not likely to have the effect, of substantially lessening competition in a market.

The sharing of price information among individual growers is unlikely to have any substantial effect on competition for the following reasons:

- In contrast to a situation where growers have no pricing information, the sharing of information allows growers to gain some understanding of demand and the prices winemakers may be willing to pay for grapes. This assists, to some extent, to address information asymmetries that cause bargaining power imbalances between growers and winemakers. The sharing of price information between growers is more likely to be pro-competitive.
- The vast majority of these growers operate under multi-year agreements and have no option to exercise bargaining power by refusing to supply. Accordingly, growers cannot realistically act in a coordinated or cooperative manner by refusing to accept lower prices as they are contractually bound to supply regardless of the price they are paid.

For similar reasons, widespread sharing of price information by grape grower associations amongst members is also unlikely to substantially lessen competition. Rather, it is likely to increase competition to the extent it improves growers' ability to negotiate with buyers and provides incentives for winemakers to respond competitively to rivals' price offers.

4.5.3. Growers and winemakers have problems with the timing of indicative price notifications

The timing of the release of indicative prices is the result of a compromise between growers and winemakers during negotiation of the Code.[176]

Grower representatives have suggested that indicative pricing should occur earlier in the year to better support grower decision making.[177] For example:

- AV submitted that, in practice, the indicative price requirement does not allow growers enough time to adjust their inputs or search for alternative buyers. AV submitted that growers have committed almost all of their annual discretionary expenditure (except late irrigation, freight and harvest costs) by the time indicative prices are notified.
- MVW submitted that most costs, including labour, water, fertiliser and pest and disease prevention, are incurred before growers are notified of indicative prices. MVW submitted that the majority of growers' spending for the season occurs from June to November.
- In 2010, the NSW Standing Committee on State Development recommended that the *Wine Grapes Marketing Board (Reconstitution) Act 2003* be amended to require winemakers to publish indicative prices by 30 June (the middle of the pruning period) each year, with effective safeguards to ensure the system provides an accurate source of information to growers.[178] This recommendation was not adopted.

One winemaker acknowledged that some growers find the timing too late to react with vineyard inputs or viticulture interventions.

However, at least one winemaker submitted that earlier price information would be more conservative and less accurate. A non-signatory to the Code said that even the current timeframe can limit a winemaker's ability to account for agricultural risk and can send incorrect signals to the market. A signatory to the Code submitted that 15 December is already too early for winemakers to gauge relevant factors like actual yields and quality.

Similarly, WFA submitted that it is difficult for winemakers to know in December what their eventual production mix will be, how much wine they will sell, and at what prices. Therefore, it is difficult to provide an accurate picture of the price that will be offered at harvest.

There is a conflict between the interests of winemakers and growers in relation to the timing of the release of pricing information. A resolution on the timing of indicative price information will need to balance interests, and may not completely meet the needs of either group. The ACCC seeks feedback on the timing of the release of indicative prices (see section 4.6.4).

4.5.4. Final prices are often very similar to indicative prices

The ACCC obtained data on indicative and final prices offered to warm climate growers in 2015, 2016, 2017 and 2018 in order to understand the relationship between indicative and final prices. It was difficult to obtain comprehensive data. Almost all of the records that we

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176 NSW Standing Committee Report, 2010, para 5.19, https://www.parliament.nsw.gov.au/lcdocs/inquiries/2002/101130%20Final%20report.pdf.

177 Code Committee, *Annual Report* 2013-14, p. 8.

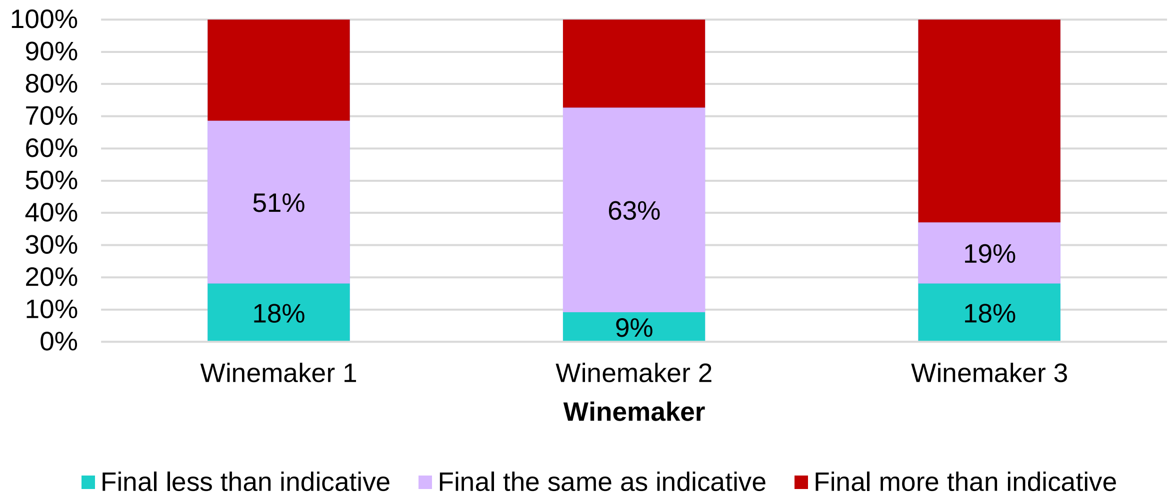
178 NSW Standing Committee Report, 2010, para 5.21, 5.22, recommendations 3 and 4 https://www.parliament.nsw.gov.au/lcdocs/inquiries/2002/101130%20Final%20report.pdf.

were able to analyse relate to the Riverland, and most of the transactions relate to 2015, 2017 and 2018, with very few transactions in 2016.

On the basis of this data, we found that final prices are likely to be higher than indicative prices (see figure 4.5). This is consistent with industry feedback.

Since final prices are also sometimes lower than indicative prices, there is no strong evidence that indicative prices are always conservative offers, as suggested by both winemakers and growers. However, a reason why some final prices paid are lower than indicative prices could be that price penalties associated with quality assessments have been applied to particular batches of grapes.

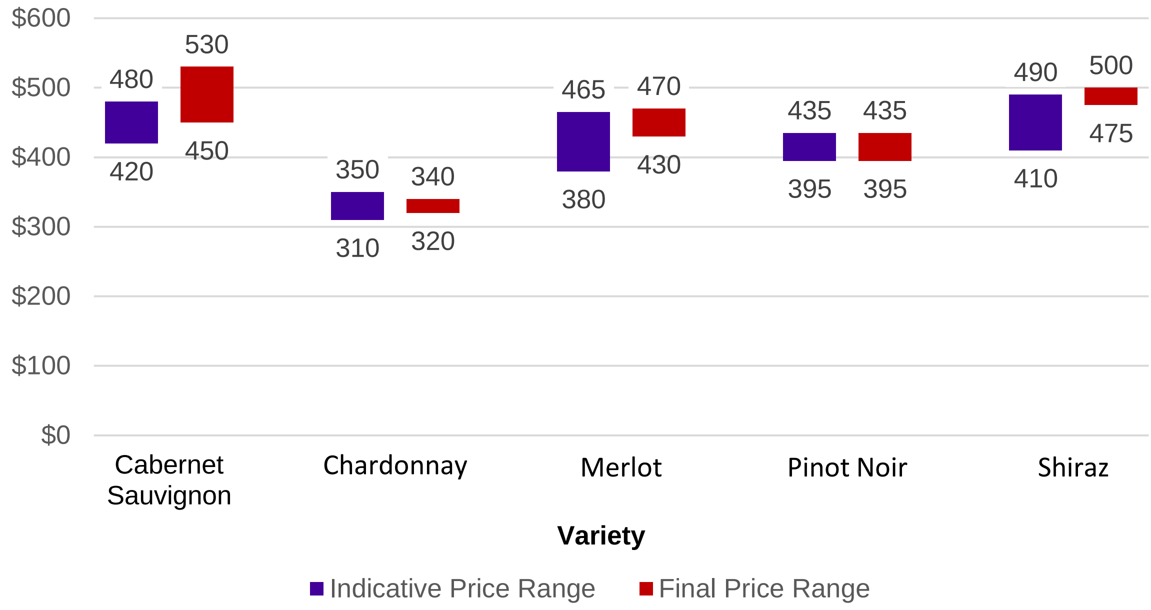
Figure 4.5: Relationship between final prices and indicative prices for three major winemakers



Source: ACCC analysis of industry-supplied data.

In addition, the ACCC found that indicative prices offered by different winemakers are typically similar for a given variety (figures 4.6 and 4.7).

Figure 4.6: Range of final and indicative prices, most commonly traded varieties, Riverland 2018 (bottom 5 per cent and top 5 per cent of prices removed)



Source: ACCC analysis of industry-supplied data combined with Wine Australia data.

Figure 4.7: Range of final and indicative prices, most commonly traded varieties, Riverland 2017 (bottom 5 per cent and top 5 per cent of prices removed)

Source: ACCC analysis of industry-supplied data combined with Wine Australia data.

4.5.5. The industry has not adopted a settled approach to price transparency

Despite acknowledging the benefits of increased price transparency, reviews of the indicative price provision in the Code have found that it has resulted in unintended consequences.

Code Management Committee reviews

The Code Committee has undertaken a review of the indicative price provision several times. Recent Code Committee annual reports note that indicative pricing remains a contentious and complicated issue.[179] The Code Committee has postponed its next review of the Code until after the publication of this market study.[180]

Other price transparency measures

Price transparency measures outside of the Code have been used with varying levels of success.

For several years in NSW the *Wine Grapes Marketing Board (Reconstitution) Act 2003* required winemakers to provide a schedule of indicative prices to the RWGMB by 30 January each year. The requirement was removed in 2007 with the support of RWGMB and local winemakers. The requirement had proved unworkable because winemakers provided very low prices that did not reflect real market conditions.[181]

4.6. Grape pricing is not transparent and should be improved

The ACCC considers that, despite the concerns raised about indicative pricing in its current form under the Code (see section 4.5), it is important to address the lack of price transparency in warm climate regions.

Production and investment decisions made by growers are an important determinant of industry efficiency. If growers are more informed about market conditions in making those decisions, the industry will be more productive, resulting in improved welfare for growers, winemakers and consumers.

Transparent pricing information helps markets to operate efficiently by providing clear signals about the allocation of resources. With transparent price information, growers can make well-informed business and risk management decisions, negotiate more effectively, and adapt to changing consumer trends.

Currently, much of this information is not available to growers in time to inform decisions.

4.6.1. Price transparency encourages competition and can lead to increased market efficiency

When growers can access and compare accurate pricing information from multiple winemakers, this enables them to determine which winemaker will provide the best price, or has historically provided good prices, before committing to sell to a particular winemaker. This ensures that winemakers compete effectively for grapes and the market operates efficiently.

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179 Code Committee, *Annual Reports 2013-2014, 2014-2015, 2016-2017 and 2017-2018*.

180 Code Committee, *Annual Report 2017-18*, p 9.

181 NSW Standing Committee Report, 2010, para 5.16, https://www.parliament.nsw.gov.au/lcdocs/inquiries/2002/101130%20Final%20report.pdf.

While growers cannot be certain what price they will receive when they commit to variable price agreements, historical pricing information can help them compare winemakers' past performance, as an approximate indication of future performance. In addition, growers benefit when they can understand the actual price they will receive as accurately and as early as possible in the growing season.

4.6.2. Growers have access to broad market information

Growers can access information about global trends published by wine brokers and trading platforms such as Ciatti and Vinex. Growers with an understanding of the relationship between global wine price trends and domestic grape prices can estimate how the trends may impact the prices they receive. Some grower representative bodies also assist with distributing and interpreting this market information.

Some winemakers also provide information about general market conditions to growers. However, growers have expressed concern that winemakers have an incentive to focus on presenting information that supports lower prices.

4.6.3. Growers have limited access to individual winemaker price information

There is generally a lack of information available to growers about prices offered by particular winemakers each year. More than half of the warm climate growers who responded to the ACCC grower survey indicated that they strongly disagree with a statement that they receive pricing information early enough to make informed decisions.

Winemakers generally require growers to keep price information (including indicative and final prices) confidential. This creates a barrier to growers assessing the market and negotiating a higher price. Despite this, it appears that pricing information is often shared among growers.

The Wine Australia National Vintage Report is published each August. The report is a major source of pricing data and is of value to the industry. However, it is not provided until several months after harvest, limiting its usefulness.

Further, because data is provided voluntarily to Wine Australia (in June or July) by winemakers, it has several shortcomings:

- *Accuracy*: It relies on winemakers providing accurate data (it is not audited). In addition, the ACCC understands that not all winemakers provide information about price adjustments, such as quality bonuses, that occur after the data is provided, distorting the results.
- *Comparability*: The ACCC understands that some of the prices include freight costs, while others do not.
- *Response rates are falling*: In 2018, it captured around 85 per cent of all grapes crushed, down from 88 per cent in 2016 and 2017, and 92 per cent in 2015.[182]

The usefulness of the data in the Wine Australia National Vintage Report to inform grower switching is also limited because it is aggregated. Prices paid by individual winemakers cannot be ascertained. This leaves growers considering entering a variable price agreement with a particular winemaker with limited means of determining how that winemaker has performed in the past compared to its rivals.

[182] See National Vintage Report 2018, p 8, National Vintage Report 2017, p 6, and National Vintage Report 2016, p 4, and National Vintage Report 2015, p 8.

4.6.4. The ACCC recommends that winemakers be required to provide price information

The ACCC recommends that winemakers be required to provide indicative prices to an independent body by 8 December for all grapes intended to be purchased from growers in warm climate regions during the subsequent harvest. The independent body would then make all pricing information simultaneously available (publicly) on 15 December [or alternative dates considered suitable by industry]. Winemakers would also be required to provide indicative prices to their growers on this date.

Indicative prices should be provided to an independent body and released simultaneously, to avoid the risk that this increased price transparency could result in the largest winemakers using indicative pricing announcements in a concerted manner which could inhibit price competition.[183] To further reduce the risk of a concerted practice through price signalling, the ACCC recommends that this body report to the ACCC any suspicious price movements that may indicate winemakers are misusing this mechanism to engage in a concerted practice.

This recommendation applies to all grapes purchased from growers in warm climate regions.

The ACCC also recommends that winemakers, after communicating final prices directly to growers, be required to provide these (both the non-quality adjusted and a quality-adjusted weighted-average price) to an independent body, which will then make that pricing information publicly available on 1 May [or another date considered suitable by industry].[184] As above, the ACCC recommends that this applies to all grapes purchased from growers in warm climate regions.

This would increase the transparency of final prices offered by each winemaker over time and increase competition between winemakers in the medium term.

The ACCC seeks feedback about:

- Whether Wine Australia would be the most appropriate body to receive and publish pricing information and if not, what alternative body would be appropriate.
- Whether this requirement should be legislated or alternatively be imposed under the Code.
- Whether this requirement should exclude winemakers under a certain size.
- Whether prices under certain supply agreements should be excluded (such as multi-year fixed price agreements).
- Whether prices should be published without identifying the winemakers.
- Whether the suggested dates are appropriate dates for the publication of the relevant prices.

The ACCC also seeks feedback on whether the spot market would benefit from price transparency measures such as identification of prices for spot market transactions.

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[183] Box 4.1 explains the nature of anti-competitive concerted practices.

[184] The non-quality adjusted price is the per-tonne price paid by a winemaker to a grower for grapes, before adjustments are made (if any) as a result of quality assessments. The quality-adjusted price is the per-tonne price paid by a winemaker to a grower for grapes, after adjustments are made (if any) as a result of quality assessments. The quality-adjusted weighted-average price is the average per-tonne price paid to growers in a particular warm climate region by a winemaker, including any quality-related price adjustments.

5. Contracting practices

Key points

- Grape supply agreements between growers and winemakers vary widely.
- In warm climate regions multi-year variable price written supply agreements for a maximum tonnage are the most common type of supply agreement.
- Most growers prefer the certainty of multi-year supply agreements.
- A significant number of growers do not have written supply agreements, despite their desire for certainty.
- Growers are vulnerable to accepting supply agreements with sub-optimal terms, which winemakers may rely on to the detriment of growers.
- The ACCC is continuing to consider contract clauses that may raise concerns under the business-to-business unfair contract terms laws.

The ACCC's analysis of contracting practices focusses on grower concerns about terms that have the potential to cause an imbalance in the rights and obligations of the parties, and detriment to growers. While certain concerns were commonly expressed by growers, these issues do not apply to all winemakers uniformly.

This chapter discusses:

- the types of supply agreements used in the industry
- how growers trade with winemakers
- the allocation of risk between growers and winemakers in supply agreements
- bargaining power imbalances between growers and winemakers which increase the likelihood that growers accept supply agreements with sub-optimal terms
- potentially unfair contract terms
- dispute resolution mechanisms in supply agreements and under the Code.

5.1. A broad range of supply agreements are used

The ACCC consulted with 13 winemakers and over 100 growers across the Riverina, Riverland and Murray Valley regions concerning their contracting practices and analysed 17 standard form supply agreements used by winemakers.

Multi-year variable price supply agreements are the predominant type of agreement used in warm climate regions. However, a wide variety of models exist.

A number of winemakers offer a variety of supply agreement models to growers. The existence of a range of models indicates that growers in warm climate regions have some degree of choice in how they deal with winemakers.

5.1.1. Annual or multi-year variable price supply agreements are most common

Annual or multi-year supply agreements with variable prices are most common for warm climate grapes. Under these supply agreements the grower commits to supply, and the winemaker commits to purchase, a specified tonnage of grapes of a particular variety well in advance of harvest.

Growers have a secure purchaser, but take on a high degree of price risk. The price that growers receive is not determined until close to harvest, though some of these supply agreements impose limits on the amount that the price can be varied each year. This is discussed in chapter 4.

5.1.2. Annual or multi-year fixed price supply agreements provide greater price certainty

Some winemakers offer supply agreements that specify a set tonnage at a fixed price. Growers are not exposed to fluctuations in demand or price for the duration of the supply agreement, but are generally unable to negotiate an increase if the spot market price increases above the fixed price in the supply agreement.

5.1.3. Rolling supply agreements often require long notice periods to terminate

A number of winemakers offer multi-year variable price supply agreements on a rolling basis. These supply agreements require multiple years of notice for a grower or a winemaker to terminate after the initial term has expired. These agreements often have an initial term of three to five years.

5.1.4. Spot market agreements are entered close to harvest

Growers may wait until close to harvest before entering an agreement. By doing so they can assess price offers once market signals such as harvest size, regional quality and winemaker requirements, are relatively clear.

These supply agreements are often oral or short written agreements that set out the basic transaction details, including the tonnage and price. Quality specifications are generally less prescriptive than under annual and multi-year supply agreements. Rather, the purchaser offers a price for the grapes as inspected.

5.1.5. Oral supply agreements are highly variable

The prevalence of oral supply agreements varies between winemakers and regions.

The proportion of growers supplying under these arrangements varies from winemaker to winemaker, and such agreements may be long, medium or short-term.

Some winemakers have long-term, ‘handshake’ supply agreements with growers, informing them of price and quality specifications each year. However, many growers have described having significant uncertainty about the price and quality assessment parameters, noting that these may change from year to year.

Some winemakers use oral agreements but still have written guides for growers setting out quality specifications.

5.2. Supply agreement preferences vary among growers

Growers expressed varied views about the form of supply agreements they prefer to have with winemakers and whether they prefer to supply grapes to more than one winemaker.

Aided by improved demand, growers are increasingly choosing to deal with more than one winemaker to allow for diversification of risk. This may be achieved by selling different varieties, or grapes from different patches of land, to different winemakers. Some growers also choose to have one or more supply agreements in place for some of their production, and sell some grapes on the spot market.

Nevertheless, a significant proportion of growers still expressed concern about selling grapes to more than one winemaker because of fear that they would be viewed as disloyal. In particular, they expressed reluctance to remove some of their supply from their long-term winemaker because, if an oversupply situation were to occur again, they believe they would be amongst the first growers to have their supply agreement terminated by the winemaker.

The majority of growers expressed a preference for multi-year supply agreements, rather than being exposed to demand risk under short-term agreements or spot market sales. This appears to stem from uncertainty experienced during the years when grapes were in oversupply. Growers who did not have multi-year supply agreements were more likely to have exited during periods of oversupply.

A small, but increasing, number of growers prefer the flexibility of selling on the spot market, accepting offers from different winemakers each year. At present, these growers appear to be receiving better prices and payment terms than those committed to supply under multi-year arrangements. However, these growers are exposed to demand risk, and some incurred substantial losses in years when the market was over-supplied. The majority of growers consulted in the Riverland and Murray Valley had multi-year variable price supply agreements, although some had also reserved patches of vines for spot market trading. A very small number had chosen to trade only in the spot market.

A small proportion of growers with oral supply agreements considered that such agreements provided greater flexibility. However, most growers expressed the view that oral supply agreements do not provide sufficient certainty. Where they have a choice, most growers would be unlikely to sell all their grapes under oral supply agreements. When growers enter into such supply agreements, the financial and agricultural risks to which they are generally exposed are exacerbated, as:

- The winemaker may dishonour the supply agreement by not purchasing the grapes.
- Quality specifications are unknown at the time of agreeing to supply, and the winemaker may consequently impose arbitrary quality specifications at the end of the season.
- The winemaker may seek to impose conditions of trade that were not initially disclosed.

Growers in the Riverina expressed the most concern about a lack of good alternative options for trading their grapes, and not having written supply agreements in place with winemakers. This is unsurprising as oral supply agreements are more common in the Riverina than in other warm climate regions. This is likely attributable to a number of factors:

- No winemakers in the Riverina are signatories to the Code, which requires written supply agreements for grape trading. Consequently winemakers are under less pressure to formalise the terms of their supply arrangements.
- There is a real risk growers will not be able to supply a winemaker again if they decide to switch to supplying another winemaker. Accordingly, growers feel compelled to continue multi-year supply arrangements even if they are not satisfied with them. The resulting stagnancy may contribute to less pressure being applied to winemakers to formalise or improve trading terms.

The ACCC found that most large and medium winemakers consider that it is important to have multi-year written supply agreements in place with growers to ensure they have sufficient security over grape requirements. Winemakers need to ensure they can produce key product lines, and the high fixed costs of processing facilities necessitate processing certain volumes for efficient use.

However, a number of winemakers told the ACCC that they tend not to offer written supply agreements. One winemaker said that it has offered written agreements in the past but growers indicated that they preferred the flexibility in who they sell to in order to ensure they were offered a fair market price.

The ACCC observed that growers who expressed a preference for informal oral supply agreements were generally those that produced larger quantities of grapes and traded on the spot market.

While oral supply agreements are not always a matter of concern, the ACCC considers that written agreements should be entered into for all types of grape supply arrangements. This ensures that growers have transparency and certainty over their rights and obligations, including how and when price will be determined, quality specifications and payment terms.

The Code requires written supply agreements for trading grapes. Accordingly, the ACCC's concerns regarding growers not having written supply agreements would largely be addressed by winemakers in warm climate regions becoming signatories to the Code. This recommendation is discussed in detail in chapter 7.

5.3. Bargaining power is imbalanced in favour of winemakers

The imbalance in bargaining power between winemakers and growers stems from a number of factors including the largely generic nature of warm climate grapes, the perishable nature of grapes, the size of growers compared to the size of major wineries, winemakers having better access than growers to market information, and engrained practices arising from the period when grapes were oversupplied.

This imbalance in bargaining power results in growers being unable to negotiate better supply agreement terms and reduces their ability to dispute unfavourable decisions.

5.3.1. Information asymmetries put winemakers in a stronger bargaining position

Winemakers are better able to estimate the price growers are likely to accept, in comparison to growers who are frequently unable to determine what constitutes a fair market price.

This results from winemakers having better access to market information than growers. In addition to having superior access to information about market prices and likely demand, winemakers have information about how the season is proceeding for a large number of growers. In contrast, as winemakers generally do not make public price announcements and supply agreements commonly require growers to keep prices confidential, growers have a limited understanding of potential competing offers.

Multi-year supply agreements also limit growers' ability to negotiate in response to changing market signals. As growers under these supply agreements cannot readily switch winemakers, their bargaining power is further undermined.

5.3.2. Growers rely more on winemakers than winemakers do on individual growers

Growers are significantly more dependent on their transactions with winemakers than winemakers are with individual growers.

The major buyers (large winemakers), process between 10 000 and 100 000 tonnes of grapes per season. In contrast, the ACCC understands the majority of growers produce less than 2000 tonnes per season.

Further, warm climate grapes are primarily acquired as a bulk commodity of a generalised nature. There is generally little differentiation between individual growers' grapes. Winemakers can acquire what they view as being the same product from many growers in a region.

As a result, a winemaker relies on a grower for only a small proportion of their requirements, and can substitute their grapes relatively easily. In contrast, a grower relies on a winemaker (or a small number of winemakers) to buy all of their production and cannot easily substitute buyers. This weakens growers' bargaining power.

5.3.3. Grapes are highly perishable, reducing grower bargaining power

By harvest many growers know their winemaker's final price offer, although this is often subject to quality assessment to be conducted at the winery (as outlined in section 5.4.3). The timing of the quality assessment after the grapes are harvested and the perishable nature of grapes makes growers less likely to dispute unfavourable quality assessments, weakening their bargaining position in comparison to the winemaker.

5.3.4. Historical oversupply of grapes continues to impact grower bargaining behaviour

The recent prolonged period of oversupply of grapes further weakened the bargaining position of growers, reducing growers' ability to negotiate better supply agreement terms or engage in effective dispute resolution.

Despite improved market conditions for most varieties in recent years and some grape varieties being in short supply, many growers are concerned that warm climate grapes could become oversupplied again, enabling winemakers to revert to more opportunistic behaviour.

Fear of being penalised in the future for seeking to negotiate terms or dispute quality assessment results may mean that growers are not fully benefitting from their improved bargaining positions.

5.3.5. Supply agreements affect how risk is allocated

Uniform concerns were not observed across the supply arrangements we examined. The supply agreements varied markedly, both in relation to how negotiations are structured and the types of terms included. Regardless, some consistent themes became apparent in relation to risk allocation and liability. These are discussed below.

Winemakers tend to bear greater risk if demand changes

Most supply arrangements provide growers with a secure buyer for grapes grown on defined patches of land for up to a maximum tonnage of grapes. Consultation with growers demonstrated that demand security appears to be of primary importance when entering into supply agreements.

Multi-year supply agreements provide winemakers with security of supply, ensuring that they can fulfil forecast demand for particular products. They also ensure that winemakers have sufficient throughput to use processing assets efficiently.

However, winemakers remain exposed to significant demand risk in their dealings with buyers at the wholesale level. Winemakers have told the ACCC that, while they have ongoing trade relationships with domestic and international retailers, they have very little security regarding volumes and prices. Many winemakers provided examples of having product lines delisted at short notice by major domestic and international retailers.

In the event that changed demand from wholesale buyers results in a winemaker's forecast demand for a product being incorrect, they are still bound to purchase grapes under existing supply agreements. Accordingly, winemakers bear more of the demand risk in the transaction.

At the same time, processed and bottled wine is a durable product that can be stored for a considerable period of time. This reduces demand risk for winemakers.

Grape price fluctuation risk is largely borne by growers

Under most supply agreements, price risk is largely borne by growers, with the price for each season being determined close to harvest. Price is discussed in detail in chapter 4.

Growers carry the agricultural production risk

Growers carry the risk of growing the grapes. Growers are responsible for ensuring vines receive water, nutrients and care as well as protection from potential disease and pests. The costs associated with this include purchasing water, fertilisers, agricultural chemicals (such as pesticides, herbicides and fungicides) and the cost of labour and machinery (such as for pruning and spraying). Such costs are subject to change.

For instance, water costs have increased markedly in recent years. Given the fact that wine grapes are permanent plantings, wine grape growers have no choice but to bear these costs. Unlike some other agricultural producers that rely on irrigation, wine grape growers do not have great flexibility in terms of choosing to use their water allocations or trade them in a given season when water prices are very high.

Because growers are price takers, there is no realistic mechanism to pass on increasing costs of agricultural inputs.

Performance risk is mitigated in some circumstances

Force majeure clauses in supply agreements release growers or winemakers from legal liability whilst that party is prevented from fulfilling its contractual obligations by certain extreme circumstances beyond its control. Winemakers have told the ACCC that under these clauses, growers are not required to perform the contracts if unable to because of extreme weather or unavoidable disease events.

Winemakers have discretion over harvest timing

All supply agreements considered by the ACCC give winemakers the discretion to determine harvest schedules. This is discussed in detail in chapter 3.

Often, several varieties of grapes mature and are ready for harvest at the same time. While winemakers determining harvest schedules unilaterally appears to be appropriate in circumstances where winemakers have limited capacity to accept delivery of grapes from many growers in a relatively short timeframe, the timing of harvests being at the discretion of the winemaker means growers carry a high degree of quality risk arising from a potentially delayed harvest. In addition, growers are restricted in their ability to harvest early to avoid forecast adverse weather events.

While winemakers carry some quality risk of processing grapes that are not of optimum quality, winemakers have greater ability to use winemaking techniques to standardise or bring up the quality of wines. While this naturally carries some cost for the winemaker, the grower bears more of this risk in individual transactions.

Significant financial risk is transferred to growers

Most supply agreements provide for long periods before final payment is made, resulting in growers bearing significant financial risk. Winemakers are commonly not liable for full payment until nine to twelve months after taking delivery of the grapes. This is discussed in detail in section 5.4.4.

5.4. Possible unfair contract terms under the Australian Consumer Law

Box 5.1 - Business to business unfair contract terms law (UCT law)

The small business UCT law was introduced to assist small businesses (such as farmers) that may have limited bargaining power, by declaring any unfair terms in standard form small business contracts void. To be a 'small business contract', at least one party to the contract must employ fewer than 20 persons and the upfront price payable under the contract must not exceed $300 000 or, if the contract has a duration of more than 12 months, $1 million.

The vast majority of supply agreements are standard form, involving limited or no negotiation of terms.

The UCT law applies to a standard form small business contract entered into or renewed on or after 12 November 2016. To be unfair, a term must:

- cause a significant imbalance in the parties' rights and obligations under the contract and cause detriment (financial or otherwise) to a party if it were to be relied upon
- not be reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term.

A court must consider the contract 'as a whole' when determining whether a term is unfair.

Where a term is found by a court to be unfair, it is void and unenforceable. The contract will continue to bind the parties if it is capable of operating without the unfair term.

The identification and removal of unfair terms increases the fairness of the affected supply agreements.

The ACCC is continuing to examine certain contract terms in the context of the UCT law. These terms fall into the following categories:

- Certain first right of refusal clauses.
- Terms that give winemakers broad rights to unilaterally vary terms of the agreement.
- Terms that provide for a lengthy period of time before growers receive final payment.
- Terms that give winemakers broad rights to terminate agreements.
- Terms that give winemakers broad scope to make unilateral and detrimental quality determinations, or reject grapes.

The ACCC seeks feedback from industry participants about these terms and any other terms in supply agreements which may be unfair.

5.4.1. First right of refusal clauses raise potential concerns

The ACCC has identified two types of first right of refusal clauses that raise potential concerns.

- Clauses that require growers to sell excess grapes to winemakers but do not require winemakers to match competitor offers.
- Clauses that require growers to enter into new supply agreements with winemakers but do not require winemakers to match competitor offers.

First right to purchase excess grapes

Most supply agreements nominate a maximum tonnage of grapes the winemaker is required to purchase. Growers can employ strategies to limit production to this maximum tonnage, such as thinning during flowering or reducing irrigation. However, there are factors outside growers' control such as rainfall or temperature that also impact production volumes. This can result in excess tonnage.

The ACCC has observed clauses which give winemakers the option to purchase these excess grapes at a discount, and do not require winemakers to match competitor prices.

The winemaker has discretion in exercising the option; they are not obliged to take excess fruit, but have the opportunity to purchase excess fruit when grapes are in high demand. Additionally, the grower does not have a guaranteed buyer for their excess grapes, and loses the opportunity to benefit from higher spot market offers if the winemaker purchases them.

Conversely, the ACCC understands that there is a link between the quantity of grapes produced on a given plot of land and the quality of those grapes. Accordingly, winemakers may have a legitimate interest in limiting the quantity of grapes supplied by a grower.

The ACCC will engage in further analysis to determine whether or not such terms may be unfair and seeks feedback from industry participants about these terms.

First right to renew the supply agreements

The ACCC has identified a contract term that does not permit a grower to enter into a new supply agreement with a competitor (including on better terms), until the first winemaker has determined it will not renew its supply agreement for a further term. This may prevent a grower from entering into a new agreement with a different winemaker on better terms. The ACCC considers that such terms may be unfair.

5.4.2. Winemakers can unilaterally vary supply agreement terms

Winemakers have a broad, unilateral ability to vary quality specifications

While most supply agreements contain price grids which set out the quality specifications affecting price relatively clearly, most also give winemakers the broad unilateral ability to vary quality specifications. This can occur under the agreements in a number of ways, including by winemakers:

- Sending final price offers that change quality specifications. Most supply agreements viewed by the ACCC allow for the winemaker to set out final quality assessment parameters in final price offers, which can be different to what is stated in the supply agreements or associated materials such as grower manuals or guides.

- Amending grower manuals that set out quality specifications.

Some winemakers have indicated that the ability to vary specifications is necessary to allow winemakers to make changes in response to unanticipated amendments to regulatory requirements. However, the supply agreements viewed by the ACCC are not limited in this way, leaving potential variations at the discretion of the winemaker.

The ACCC is concerned that the ability to vary specifications has the potential to cause detriment to growers, not only because of the uncertainty and cash flow issues raised by growers, but also because it distorts the comparison of winemakers' offers on entering into supply agreements.

The ACCC considers that quality assessment parameters form a key aspect of conditions offered by winemakers in multi-year supply agreements. Changing these terms may result in a significant reduction in the value of the supply agreement to the grower when compared to others that may have been on offer.

On a preliminary basis, the ACCC does not consider quality specifications should be able to be unilaterally varied to the detriment of the grower except for in limited circumstances, such as when there has been a change in government regulations. Such circumstances should be stipulated in supply agreements and/or the ability to change quality specifications should require the grower's agreement.

Price can be varied by the winemaker until the final payment

The ACCC has considered a contractual term which allows a winemaker to vary the final price for grapes up until the time of payment, which may be nine to twelve months after grapes are supplied, subject to a minimum price specified in the contract.

The ACCC considers that such terms may be unfair under the UCT law as growers should not continue to carry the risk of price changes after winemakers have taken possession of the grapes.

5.4.3. Winemakers have broad discretion regarding quality assessment and rejection

Many growers have raised concerns that winemakers use quality assessment processes to unfairly downgrade, and therefore pay less for, grapes. Winemakers rejecting and downgrading grapes is discussed in detail in chapter 3 in the context of quality assessment.

While the ACCC accepts that winemakers require the ability to reject or downgrade produce, we have identified a number of terms in supply agreements that may be unfair. These terms have the potential to cause imbalance in the rights and obligations of the parties and cause potential harm to growers because:

- Winemakers have broad discretion to make quality assessment determinations or reject produce.
- Growers are typically not present at the winery during the quality assessment process.
- Growers frequently lack access to effective dispute resolution mechanisms when their produce is downgraded or rejected (see chapter 3 and chapter 7).

The ACCC has also viewed supply agreements that allow winemakers a significant period after delivery to reject grapes. For instance, one supply agreement provides for rejection within 30 days of title passing to the winemaker if the juice, must or wine is affected by a latent defect that was not reasonably identifiable on delivery. If this clause is exercised, the grower may be required to purchase its grapes for the price the winemaker paid for them.

The right to reject is not limited to defined types of latent defects, and the lengthy rejection period following delivery creates the potential for defects to be incorrectly attributed to the grower when they have had no control over the grapes for some time.

The ACCC also understands that most defects that would become apparent after delivery (such as smoke taint) can be tested for on or shortly after delivery.

5.4.4. Lengthy payment periods are common but may be unfair

The ACCC considers that lengthy payment periods, which are widely used in grape supply agreements, may be unfair under the UCT law.

The SA *Wine Grapes Industry Act 1991* (**WGI Act**) allows the SA Minister for Agriculture, Food and Fisheries to set out timeframes for payment for SA grapes by winemakers. In 2004 the Minister set out the timeframes shown in figure 5.1.[185] The same timeframes have since been inserted into the Code (see chapter 7), which has led some winemakers to adopt them outside of SA.[186]

Figure 5.1 Payment terms under the SA *Wine Grapes Industry Act 1991*

For grapes delivered	First payment	Second payment	Third payment
Before 1 April	⅓ by the end of the month following the month of delivery	⅓ by 30 June	⅓ by 30 September
1 April to 1 May	⅓ by 31 May	⅓ by 30 June	⅓ by 30 September
After 1 May	⅔ by 30 June	⅓ by 30 September	

The WGI Act enables growers to obtain interest from winemakers for late payments.[187] The WGI Act also makes it an offence for a winemaker to accept delivery of grapes without having made full payment for all grapes acquired from SA growers in the previous year.[188]

The above payment terms appear to have been intended to form the absolute minimum requirements for supply agreements. However, oversupply of grapes and the consequent softening of competition has instead allowed winemakers to adopt these payment terms as the industry standard.

Some winemakers have told the ACCC that the rationale for lengthy payment periods is that wine will not be sold for some time after delivery of grapes. However, growers argue that modern winemaking techniques mean many wines do not need to be aged for as long as they previously did. For example, many white wines are ready for consumption within a few months of harvest.

A number of large winemakers maintain that they see very little revenue from products until at least the year after grapes are processed. Growers have argued that regardless, the significant scale of medium to large winemakers means that they are the ones best financially positioned to bear the cost of holding inventory.

Imbalance arises from such terms because the winemaker has the product without being required to make prompt payment, while growers are still required to pay invoices for

185 WGI Act, section 6(1); WGI Ministerial order, 18 March 2004, clause (1)(a)-(c).

186 Code section 2.6.1.

187 WGI Act, section 6(2); WGI Ministerial order, 18 March 2004, clause (1)(d).

188 WGI Act, sections 9 and 10.

agricultural inputs within 30 days. Most growers noted that they were financing their business through overdrafts. Accordingly, growers carry a high degree of financial risk with lengthy or uncertain payment terms well after title in the grapes has passed to the winemaker.

Increased demand for grapes has resulted in a number of winemakers offering improved payment terms. Further, a number of winemakers have indicated that they would change payment terms if required.

Although many growers expressed concern about the lengthy payment terms provided for under the WGI Act and the Code, a number of growers told the ACCC that they have become accustomed to managing their cash flow in line with these payment periods.

The ACCC considers that the widespread nature of lengthy payment periods across the industry is concerning. Many other agricultural commodities have supply chains that include extensive delays before products are sold, yet are subject to shorter payment terms between processors and farmers.

Smaller and less established winemakers may have difficulty paying growers more rapidly, however they may be prepared to offer higher prices in order to secure supply and compensate growers for the delay.

The ACCC is most concerned about potential unfairness arising from terms that provide for lengthy payment periods in supply agreements offered by well-resourced medium to large winemakers. In this instance, winemakers are better financially positioned to bear the cost of holding inventory compared to growers. These terms are particularly concerning when growers do not have the opportunity to negotiate higher prices in exchange for delayed payment.

The ACCC considers that lengthy payment terms should be phased out of most supply agreements between growers and medium to large winemakers. A best practice standard of payment within 30 days of delivery should be adopted for winemakers with processing capacity over 10 000 tonnes. This is consistent with the payment periods in the Australian Supplier Payment Code (see box 5.2).

The ACCC considers that a change to standard payment terms could be introduced through changes to the Code, as well as through amendments to the WGI Act. However, changes within the industry that would address ACCC concerns will only be effective if all large winemakers become signatories to the Code. The ACCC's recommendations regarding increasing the effectiveness of the Code, including by increasing the number of Code signatories are discussed in chapter 7.

Box 5.2 - Best Practice Standards for Payments to Small Business—Australian Supplier Payment Code

The Australian Supplier Payment Code is a voluntary, industry-led initiative that enshrines the importance of prompt and on-time payment for small business suppliers through compliance with a set of best-practice standards.[189]

On 29 May 2017, the Business Council of Australia launched the Australian Supplier Payment Code in order to improve payment times across the economy by paying small businesses within 30 days of receipt of a correct invoice.[190]

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189 http://legacy.bca.com.au/policy-agenda/australian-supplier-payment-code/view-all-related-publications

190 Ibid.

At the time, the Business Council of Australia stated that:

Improving payment times will improve productivity and help ease the stress for small business owners. Healthy cash flows and working capital are crucial to the viability of a business and its ability to expand and create jobs.[191]

Then Minister for Small Business, The Honourable Michael McCormack stated that *'it is clear that most issues relating to payment times and practices occur between businesses',* and welcomed the Code as a '*good first step by industry to acknowledge the seriousness of the problem and the need to improve.'*[192]

The Minister went on to explain that:

The Government's preference is to not add more regulation to address a problem unless it is absolutely necessary. … [and] give industry the first opportunity to address the problem. However, the Government's support is not unconditional and I will be carefully monitoring the effectiveness of the BCA's Code and reserve the right to take stronger action should we see a lack of progress over time.[193]

To date, 46 Business Council members and 37 non-members have adopted the Code. These entities collectively earn revenue of more than $416 billion.[194]

5.4.5. Some winemakers have broad, unilateral rights to terminate agreements

The ACCC considers that some of the termination clauses used in supply agreements may be unfair under the UCT law.

The ACCC has identified clauses that allow winemakers to terminate agreements with growers when grapes become surplus to their requirements for any reason, and at short or immediate notice.

If such a term were relied on, growers would likely suffer significant financial detriment. This would be exacerbated at times when it may be difficult for growers to find an alternative purchaser, such as in years where grapes were in low demand, or if the decision was made close to harvest.

Such clauses benefit only the winemaker, allowing them to push demand risk back to growers. The supply agreements do not provide growers with rights that would allow them to terminate the agreement at their discretion. This negates what most growers consider to be their key priority under supply agreements: having a guaranteed buyer.

While winemakers have an interest in reducing risk, the ACCC considers that winemakers, in particular large winemakers, are in a better strategic position than growers to anticipate and manage demand risks.

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191 Ibid.

192 Ibid.

193 Ibid.

194 Ibid.

5.5. Dispute resolution processes are inadequate in addressing imbalances and detriment arising from supply agreements

Overall, the ACCC did not see examples of dispute resolution processes in written supply agreements that would adequately address imbalances and detriment caused by the potentially unfair terms identified in this chapter, as well as bargaining power imbalances.

Most supply agreements considered by the ACCC specify dispute resolution processes in relation to price and, to a limited extent, quality assessment, but do not address disputes on other matters. The majority of these supply agreements are offered by Code signatories, and therefore wholly or largely reflect the dispute resolution procedures set out in the Code. The ACCC's assessment of dispute resolution under the Code and interim recommendations regarding the Code are discussed in detail in chapter 7.

Growers contracted to winemakers which are not Code signatories consistently told the ACCC that they either did not have any dispute resolution mechanisms available to them or that dispute resolution clauses in written supply agreements were ineffective as these winemakers do not engage with dispute resolution processes.

5.5.1. Growers tend not to use dispute resolution outside of Code processes

Most of the supply agreements between growers and non-signatories to the Code which the ACCC reviewed either give the winemaker the ability make final determinations on disputes or provide for mechanisms for determinations by potentially expensive external service providers. Growers may also escalate disputes through litigation.

Growers have said that winemakers who are not signatories to the Code do not actively engage in dispute resolution processes. Several growers provided examples of processes stalling where the winemaker would not alter their position or consider the grower's case.

Grower representative groups have raised particular concern regarding supply agreements between growers and winemakers who are not signatories to the Code which refer to the dispute resolution under the Code. Such terms have limited effect as the support provided by the Code committee (such as assistance in appointing independent experts) are not available to non-signatories.

5.5.2. Bolstering the Code would improve dispute resolution across the industry

Despite its shortcomings, the ACCC considers that the Code is the most effective avenue currently available for individual growers to resolve disputes. It has provided some growers with avenues for successfully disputing prices in the past. It is also an established entry point to raising disputes, with a support network that can be readily accessed by growers if they wish. However, the Code should be bolstered by increasing the robustness and accessibility of dispute resolution processes, addressing concerns about the independence and cost of experts, and increasing the number of signatories.

The ACCC's recommendations on how the Code could be bolstered to provide more effective dispute resolution for all growers are discussed in chapter 7.

6. Competition for wine grapes

Key points

- A cyclical downturn in the industry since 2006 has resulted in limited competition between winemakers for grapes.
- While there are many winemakers in the warm climate regions, there is a high level of concentration in grape acquisition markets, particularly in the Riverina and Riverland.
- Competition for grapes is substantially affected by transport distances and costs.
- Winemakers compete for grapes on a range of price and non-price terms. However, we have observed limited price competition, and a greater but varying degree of non-price competition, in the warm climate regions.
- Price competition is being restricted by a lack of price transparency. Growers lack reliable price information to inform their switching decisions.
- Growers face high barriers to switching, including because of terms in supply agreements. This restricts growers from taking advantage of superior offers in the market.
- Very few growers have used collective bargaining groups to negotiate supply agreements with winemakers. However, collective bargaining should not be disregarded as a way to reduce bargaining power imbalances.
- A highly concentrated domestic retail market and import competition means winemakers are constrained from increasing wholesale prices of wine.

To assess the extent of competition between buyers of grapes the ACCC analysed the following information:

- where growers are located relative to who they sell to
- the costs of transporting grapes and factors that limit the extent to which they can be transported, such as degradation of quality
- how winemakers compete for suppliers of grapes, including price and non-price factors
- how the wine grape oversupply and price downturn described in chapter 1 continues to influence the nature of competition in the market
- the price information available to and relied upon by growers in choosing who to supply
- the various factors impeding growers switching between different buyers
- the potential for collective bargaining to be a useful mechanism to reduce bargaining power imbalances
- competition between winemakers for supply into export bulk wine markets and to domestic retailers.

6.1. The market for wine grapes

A market includes goods and services that are substitutable for, or otherwise competitive with, the goods or services being considered.[195] Substitution involves switching from one product or service to another in response to a change in relative price or quality.[196]

[195] *Competition and Consumer Act 2010* (Cth), s 4E.

As discussed in the overview of the market study, the ACCC has focused its analysis on competition for wine grapes. This is the first major stage of the wine supply chain and involves buyers (usually winemakers) competing to acquire grapes from growers to process into wines. This takes place within various geographic regions, with the below analysis focusing on warm climate regions.

6.1.1. The ACCC has considered a separate product market for warm climate grapes

The ACCC has considered various possible substitutes for warm climate grapes as a winemaking input. We have found that:

- there is minimal substitutability between warm climate and cool climate grapes
- there is a low degree of substitution between grapes, must and bulk wine
- it has not been necessary to define separate markets for each warm climate grape variety because we have not found competition concerns specific to a variety.

Warm climate grapes are generally not substitutes for cool climate grapes

As discussed in chapter 1, wine from cool climate regions often has premium branding associations. The ACCC heard from growers that even where wine from warm climate regions is of a comparable quality, it will not attract the same price premium. This indicates a distinct market for cool climate grapes.

Warm climate grapes commonly trade at significantly lower prices than cool climate grapes (see figure 2.2). Consequently, it is unlikely that a winemaker would buy cool climate grapes in place of warm climate grapes except where the prices are comparable. However, this only accounts for a small percentage of grapes.

There is limited substitution between grapes, must and bulk wine as winemaking inputs

Although grapes, must and bulk wine are possible inputs into the winemaking process, there is only a limited degree of substitution between them. Compared to wine grapes, the use of bulk wines does not allow the winemaker to take advantage of its processing capacity. As a result, bulk wines are commonly sourced as a secondary input, for example, if a winemaker fails to secure sufficient suitable grapes to fulfil their requirements.

Alternatively, winemakers may source bulk wine if they have insufficient capacity to process the volumes required to meet demand, or if they need volumes of a certain quality for blending.

Winemakers prefer not to source must because it is susceptible to degradation during transport.

There is limited substitution between grape varieties

Industry engagement did not reveal concerns from growers or winemakers that are specific to certain grape varieties. Therefore, we have not found it necessary to identify markets for each variety individually in order to examine concerns relating to the wine grape market.

However, we recognise that grape varieties are often not substitutable for one another. Furthermore, winemakers consider that red and white varieties are only interchangeable in very limited circumstances.

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[196] Australian Competition and Consumer Commission, *Merger Guidelines 2008,* p.16.

Growers told the ACCC that it can cost up to $40 000 per hectare and take at least three years to switch varieties and establish a crop. Consequently, growers are unable to respond in the short term to changes in the relative prices of grape varieties by switching the ones they produce.

6.1.2. Competition is influenced by the distance between growers and wineries

Competition for the purchase of grapes primarily occurs within or close to a given growing region because of:

- grape perishability
- transportation costs relative to the value of the grapes
- wine labelling restrictions
- biosecurity regulations, such as those relating to phylloxera.

Grapes are highly perishable

Grapes begin to degrade hours after harvest, and even more quickly if exposed to heat and sunlight. High temperatures can accelerate the onset of fermentation, which is highly undesirable outside of controlled winery conditions.

Perishability is a key consideration when transporting grapes over long distances. White wines commonly have a lighter and more sensitive flavour profile than red wines, so winemakers are more concerned about the potential of white grapes to degrade. As a result, red varieties can be transported over greater distances than white ones. A major winemaker stated they are typically willing to transport red varieties a maximum of 400 km, as compared to 200 km for white varieties.

Transport costs limit the distances that grapes travel

Where the grower and the winery are situated in the same region, winemakers generally require the grower to bear all costs of transporting the grapes to the winery. Where the grower and the winery are situated in different regions, winemakers generally only require the grower to bear some of the transport costs. As such, winemakers with wineries located further from the grower need to offer higher prices to be competitive with winemakers that are closer.

Winemakers are generally willing to transport higher value grapes or varieties that are locally unavailable over longer distances. Figure 6.1 illustrates estimated transport costs relative to the average Chardonnay and Shiraz prices in 2018.

Figure 6.1 Estimated freight costs per tonne by climate, variety and distance

Transport distance	Estimated freight cost per tonne	Freight cost as a percentage of the 2018 warm climate average grape prices:[197]		Freight cost as a percentage of the 2018 cool climate average grape prices:	
		Chardonnay ($335 per tonne)	Shiraz ($481 per tonne)	Chardonnay ($1217 per tonne)	Shiraz ($1485 per tonne)
100 km	$49	15%	10%	4%	3%
200 km	$70	21%	15%	6%	5%
400 km	$98	29%	20%	8%	7%
800 km	$178	53%	37%	15%	12%

Source: ACCC analysis of data from winemakers and Wine Australia.

Transport costs typically represent a high proportion of the grape price in warm climate regions. One major winemaker with a winery located in the Murray Valley primarily sourced warm climate grapes from the Murray Valley and Riverland regions where transport distances were 200 km or less. This winemaker stated its average transport distance for cool climate grapes was between 200 and 400 km.

Labelling restrictions restrict grape substitution

Winemakers may face some barriers to substitution between grapes from the otherwise largely interchangeable warm climate regions, depending on the geographical indication intended to be attached to the final product.

The *Wine Australia Regulations 2018* require that, if the description and presentation of wine uses a certain registered geographical indication, 85 per cent of the wine volume be produced from grapes grown in the region defined by that indication.[198]

This requirement restricts substitution with grapes sourced from outside the region where the winemaker is seeking to use the branding attributed to that region. This effect is most pronounced for substitution between cool climate and warm climate grapes because of the difference in recognition as premium wine regions (see section 6.1.1).

To illustrate, a winemaker seeking to produce wines labelled as from the Barossa Valley would be restricted to producing only 15 per cent of the volume using Murray Valley grapes. In contrast, a winemaker seeking to produce wines labelled as from South Eastern Australia, which contains the Riverland, Murray Valley and Riverina regions, would be able to use their grapes interchangeably.

There are restrictions on transporting grapes from phylloxera zones

Phylloxera is a pest that attacks the roots of grapevines. It is currently known to be present in several defined quarantine zones in VIC and NSW.

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197 Average prices of grapes are sourced from ACCC analysis of Wine Australia data representing 77 per cent of production in 2018.

198 *Wine Australia Regulations 2018*, reg 26.

State legislation and the National Phylloxera Management Protocol (the Protocol) place restrictions on the movement of ‘risk vectors’ across state borders, quarantine zones and phylloxera exclusion zones. Risk vectors include vines, grapes, must and juice.

Winemakers widely require contracted growers to comply with the Protocol, and at least two winemakers have the discretion to reject grapes from vineyards whose region is declared to be a phylloxera infested zone.

As a result, growers in phylloxera infested zones face both legal and contractual restrictions on transporting grapes and derived products out of the region. This means that grapes grown within such regions are essentially required to be processed in that region.

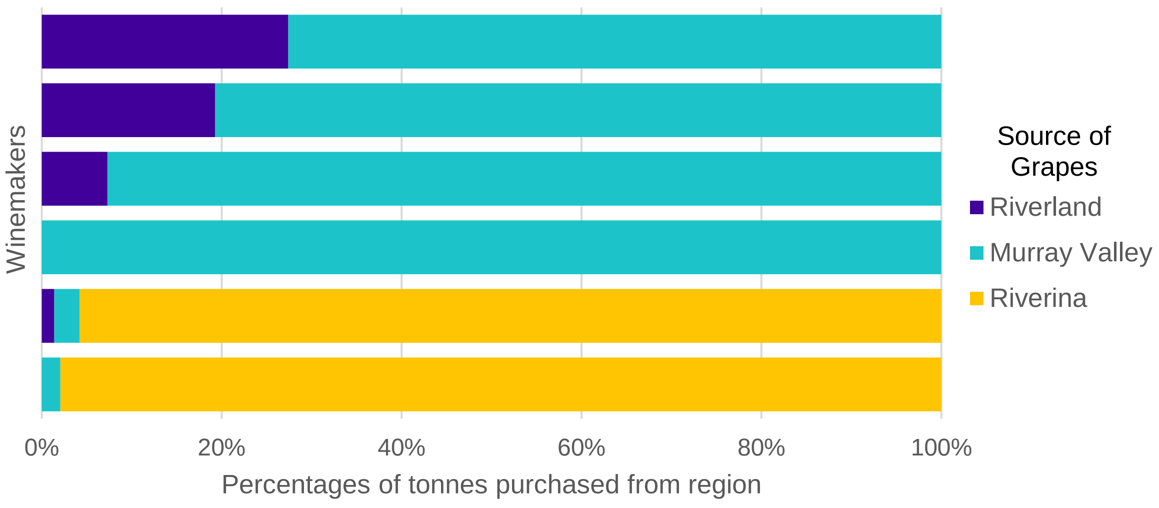
This imposes a clear barrier on substitution between grapes outside and inside phylloxera infested zones that can affect the geographic dimension of the market. These restrictions do not currently apply to any of the warm climate regions.

There is limited competition between warm climate regions

The distance between the Riverland and the Murray Valley is approximately 160 km, while the distance between the Riverina and the Murray Valley is approximately 400 km. The distance between the Riverland and the Riverina is greater still, around 600 km. As such, there is likely to be minimal competition for grapes between Riverina winemakers and those in the other two warm climate regions. However, we expect there to be a minor degree of competition between winemakers with wineries located in the Riverland and Murray Valley.

This is supported by analysis of 2018 grape purchasing data. Figure 6.2 illustrates the percentage of warm climate grapes sourced from each warm climate region by several major winemakers with wineries located in no more than one warm climate region.[199]

Figure 6.2 Percentage of warm climate grapes purchased by some of the largest winemakers in those regions in 2018[200]



Source: ACCC analysis of data from winemakers and Wine Australia.

Figure 6.2 indicates the vast majority of grapes bought by a winemaker are from the region where they have their winery. This is particularly true for grapes purchased by Riverina winemakers, with virtually all grapes coming from their own region. Major winemakers in the

199 We have excluded winemakers with wineries in more than one warm climate region and winemakers which use contract processors to process grapes purchased from the warm climate regions.

200 Owing to a shortage of publishable data, this figure does not include Riverland winemakers.

Murray Valley were more likely to source grapes from another region (the Riverland), albeit most were still acquired from the local region.

This is supported by the results of the ACCC Wine Grape Grower Survey where:

- all of the Riverina growers who responded directly supplied within the region
- around nine per cent of surveyed Murray Valley growers supplied winemakers whose closest wineries were located in or closer to the Riverland region.

As a result, the ACCC considers the geographic markets for warm climate grapes to be predominantly defined as the regions in which they are grown, with a minor degree of overlap between the Riverland and Murray Valley markets.

6.2. Market concentration varies significantly between regions

Market concentration is a measure of the number of firms in a market and the distribution of market share amongst those firms. Generally, higher market concentration is conducive to a lower degree of competition and a greater likelihood of the largest firms having market power. However, if there are effective constraints on market power, such as the threat of new entry or expansion by rivals, then even firms in highly concentrated markets may have little market power.

The following subsections examine the level of market concentration in each of the three warm climate regions by maximum processing capacity. While maximum processing capacity does not directly translate to the volume of grapes purchased in a year, it is a broad indicator of expected winemaking shares over the medium to long term.

6.2.1. Market concentration in the warm climate regions

There is a high concentration of processing capacity in the Riverina, with one to two dominant winemakers (see figure 6.3).

Figure 6.3 Winemakers with the largest processing capacities in the Riverina[201]

Winemaker	Capacity (tonnes pa)
Winemaker A	250 000
Winemaker B	100 000
Winemaker C	48 000
Winemaker D	40 000
Winemaker E	38 000
Winemaker F	21 000
Winemaker G	12 500

Source: various publicly available information, including Winetitles Media[202] and the Australian Financial Review.[203]

[201] The winemakers listed in figures 6.3, 6.4 and 6.5 are restricted to those operating the 20 largest wineries in Australia, of which 16 are located in the warm climate regions.

[202] Winetitles Media, 'The largest wine processing facilities', https://winetitles.com.au/statistics-2/wine-companies/the-largest-wine-processing-facilities.

The ACCC has found that processing capacities do not necessarily reflect the shares of grapes purchased in the Riverina because of varying levels of vertical integration into grape production by winemakers.

Compared to the other warm climate regions, there is a lower degree of market concentration and a more balanced distribution of processing capacity in the Murray Valley (see figure 6.4). Despite this, the ACCC still considers the Murray Valley market to be highly concentrated.

Figure 6.4 Winemakers with the largest processing capacities in the Murray Valley

Winemaker	Capacity (tonnes pa)
Winemaker G	150 000
Winemaker H	110 000
Winemaker I	80 000
Winemaker J	60 000
Winemaker K	52 000
Winemaker L	45 000

Source: Winetitles Media.[204]

There is a particularly high concentration of processing capacity in the Riverland, with one winemaker having around half of the regional processing capacity (see figure 6.5).

Figure 6.5 Winemakers with the largest processing capacities in the Riverland

Winemaker	Capacity (tonnes pa)
Winemaker M	230 000
Winemaker N	100 000
Winemaker O	90 000
Winemaker P	25 000

Source: various publicly available information, including Winetitles Media[205] and The Advertiser.[206]

The high degree of market concentration is likely to have led to reduced competition in each of the three warm climate regions, due to a limited number of buyers competing to acquire grapes from growers.

203 "Rossetto Winery sold to Riverina winemaker Dee Vine Estate", 3/1/16, https://www.afr.com/real-estate/rossetto-winery-sold-to-riverina-winemaker-dee-vine-estate-20151218-glre22.

204 Winetitles Media, 'The largest wine processing facilities', https://winetitles.com.au/statistics-2/wine-companies/the-largest-wine-processing-facilities.

205 Ibid.

206 "Winery sale to revive the Riverland", *The Advertiser*, 13/8/11, https://www.adelaidenow.com.au/news/winery-sale-to-revive-the-riverland/news-story/a731cb9abcaebce0c607a85e2a221961

6.3. Winemakers compete for grapes in a variety of ways

There are price and non-price dimensions to the offers made to growers by winemakers. Many winemakers compete more vigorously on non-price terms.

6.3.1. Winemakers compete for grapes on price and payment terms

Winemakers compete on a range of price and payment terms, including the price offered, price certainty, payment timeframes and certainty of payment.

Winemakers compete on price and price certainty

Growers have told the ACCC that certain winemakers are known for having historically higher or lower prices compared to their competitors. We understand that the reputation of a winemaker to offer high or low prices significantly influences growers' decisions of which winemaker to supply.

In addition to expected prices, price competition also exists in the context of price certainty. As noted in chapter 4, supply agreements are often based on a 'fair market price' which is subject to the winemaker's discretion and communicated to growers close to harvest. This means growers are often unaware of the price they will receive when they enter into a supply agreement.

One winemaker submitted that it would approach uncontracted growers early in the season and offer upfront fixed prices to attract growers. In doing so, this winemaker takes on price risk normally borne by growers in order to secure supply.

Growers prefer certainty of payment

Some growers have complained about late payments and a lack of effective recourse to seek compensation for late payments. As a result, certainty of payment is likely to be a factor in price competition for grapes.

Some winemakers offer shorter payment terms

As discussed in chapter 5, supply agreement terms relating to when growers will be paid vary widely. This suggests that payment terms may be a means of a winemaker differentiating themselves from competitors.

Many winemakers offer payment terms which align with the minimum requirements of the Code (see chapter 7). However, some non-signatory winemakers offer shorter or longer payment timeframes.

6.3.2. Winemakers compete for grapes on non-price terms

Winemakers also compete on a range of non-price terms that utilise their competitive advantages without committing to higher prices.

Winemakers offer varying supply agreement durations

Some winemakers compete by offering growers a range of supply agreements to choose from. Growers have indicated they place significant value on being able to secure a buyer for their grapes. The agreements and terms used in the industry are discussed in detail in chapter 5.

Winemakers generally offer multi-year supply agreements of at least three years, and many supplement these with annual or other short term contracts.

Winemakers seek to secure all vineyard output

The majority of growers produce multiple varieties of grapes. Depending on changing consumer trends, the demand for some varieties may fluctuate and the grower may struggle to find a buyer for these varieties in certain seasons. These growers may find a winemaker that is willing to purchase multiple varieties to be more attractive as a buyer.

Winemakers differentiate themselves by processing capacity

Winemakers and growers agree that timing of harvest is one of the most important factors in determining the quality and volume of grapes that can be harvested. The importance of timing of harvest is considered in detail in chapter 3.

Winemakers with excess processing capacity or multiple wineries have greater flexibility in scheduling harvest and delivery. This translates to greater certainty for growers that their grapes will be harvested at close to the optimal time.

The ACCC understands that winemakers promote their processing capacities to recruit growers.

Winemakers provide viticultural expertise to growers

Some winemakers referred to their level of engagement and strength of relationship with growers as a means of competing for supply. Many winemakers attribute their ability to retain growers to the close relationships they have developed. Engagement with growers may include:

- regular site visits
- viticultural advice
- updates on their product portfolio and demand requirements.

Winemakers offer some degree of supply agreement flexibility

Winemakers may compete for grapes by offering variations to standard form agreements in some circumstances. While most winemakers reported varying their terms for certain growers, the ACCC understands that there is a correlation between the degree of relative bargaining power held by the grower and the likelihood of variation to the supply agreement.

For example, in the grower survey over 60 per cent of warm climate growers reported that their supply agreements were offered on a ‘take-it-or-leave-it’ basis as compared to around 40 per cent of cool climate growers.

Furthermore, a winemaker’s size can influence whether the winemaker will offer variations to their supply agreements. One of the largest winemakers reported that approximately 10 per cent of their supply agreements were varied to some extent. In contrast, a smaller but still major winemaker, demonstrated a wide degree of variation including substantial differences in pricing, delivery and quality assessment terms. This winemaker stated that it was part of its purchasing strategy to offer terms that best appealed to growers of different regions.

6.3.3. Winemakers vertically integrate to reduce risk and secure supply

Winemakers may vertically integrate by acquiring their own vineyards. By doing so they secure access to grapes with particular attributes, reduce the risk of insufficient supply and gain closer control over quality. Winemakers can also maintain a level of viticultural expertise to inform their winemaking business.[207] The extent of vertical integration into grape growing by large winemakers is extremely varied. This will impact on competition for grapes as the more a winemaker grows themselves, the less they need to buy from independent growers.

6.4. Competition for grapes is being impeded by multiple factors

In addition to market concentration (as discussed above), factors which appear to impact the degree of competition between winemakers include the recent prolonged cyclical downturn, lack of price transparency and growers facing significant barriers to switching winemakers.

6.4.1. A prolonged cyclical downturn has reduced competitive behaviour

As discussed in chapter 1, the Australian wine industry is starting to emerge from a prolonged cyclical downturn driven by a decade of grape oversupply, and unfavourable exchange rates and international market conditions. The ongoing and prolonged nature of this event makes it difficult for the ACCC to form precise views as to the underlying extent of competition in the warm climate wine grape markets.

The continuing effects of the oversupply period mean winemakers face low incentives to compete for warm climate grapes. Growers in the Riverland and Murray Valley told the ACCC that they value securing a long term buyer more highly than receiving a better price. This has caused significant inertia in growers responding to improved market conditions. We have not observed large numbers of growers seeking shorter term supply agreements to use the threat of switching as a tool to negotiate higher prices.

6.4.2. Lack of transparency stifles price competition

As discussed in chapter 4, there is a lack of price transparency in grape markets. This lack of price transparency significantly impedes competition for grapes. Growers are less able to make informed switching decisions if they do not know what prices specific winemakers are willing to pay for their grapes. The lack of price information available to growers means that winemakers face reduced pressure to offer higher prices, and this may reduce competition for grapes.

6.4.3. Growers face barriers to switching winemaker

The extent of effective competition for grapes is influenced by whether growers can credibly threaten to switch winemaker. If growers are able to switch with relative ease and frequency, winemakers will need to offer competitive prices and terms in order to maintain their share of grape supply.

Many growers have raised various concerns with the ACCC about the difficulties of switching winemaker, including:

- high market concentration of winemakers (as discussed above)
- multi-year agreement terms
- roll over clauses with long termination notice periods
- fear of retribution
- exclusivity clauses and restrictions on growers dealing with excess tonnages.

[207] For example, winemakers with their own vineyards may better understand what types of grapes and/or viticultural parameters they require to fulfil their wine portfolio.

Growers may be locked into multi-year supply agreements

As detailed in chapter 5, supply agreements in warm climate regions are generally multi-year agreements with three to five year terms.

Multi-year supply agreements are a direct barrier to switching because growers have fewer opportunities to switch winemaker. However, multi-year supply agreements also provide growers with a higher degree of certainty, and ensures winemakers incur some risk for processing particular volumes into the future.

Even if most growers are already contractually committed in a given year, winemaker's price offers may be competitively constrained if:

- a substantial segment of growers are out of contract and are free to switch
- the winemaker does not price discriminate between growers who are free to switch and growers who are not.

It is our understanding that winemakers do not commonly price discriminate between growers in a given warm climate region, except on colour and other quality factors.

Roll over clauses are often accompanied by long termination notice periods

Roll over clauses remove the need for the parties to a supply agreement to renegotiate the agreement on its expiry. When accompanied by long termination notice periods, they can be a significant barrier to switching, and directly reduce the pressure for winemakers to provide competitive offers.

The following are examples from two of the largest winemakers' supply agreements:

- The supply agreement is extended by the original term and requires 30 days' notice to terminate.
- The supply agreement is extended by one year and requires a deed varying the contract to be signed by both parties.

The above examples restrict the grower and winemaker from switching to other buyers and suppliers respectively.

Fear of retribution

During consultation, the ACCC commonly heard that growers are reluctant to switch winemakers because of concerns they would face adverse treatment in future.

The threat of losing a potential buyer is especially persuasive for growers in the highly concentrated warm climate regions. Only small a percentage of respondents to the grower survey in warm climate regions agreed they could choose to sell to different buyers from year to year without suffering adverse treatment.

The ACCC finds this culture particularly concerning, as fear of losing a potential buyer for future harvests can be a significant deterrent to switching. This undermines competition between grape buyers.

6.5. Collective bargaining may result in public benefits

The *Competition and Consumer Act 2010* (Cth) (CCA) generally requires businesses to act independently of their competitors when making decisions about pricing, who they do business with, and the terms and conditions of doing business. Competitors who act collectively in these areas are at risk of breaching the competition provisions of the CCA.

6.5.1. The ACCC can grant legal protection for parties to engage in conduct in certain circumstances

The CCA allows for the ACCC to grant legal protection for parties to engage in practices like voluntary collective bargaining, or collective boycotts, if there are public benefits that would outweigh the public detriments.[208] Currently, there are two ways that businesses can obtain an exemption from the competition provisions of the CCA for collective arrangements: authorisation and notification (see box 6.1). The ACCC is currently developing a class exemption for collective bargaining which will provide a ‘safe harbour’, allowing eligible businesses, including farmers, to form collective bargaining groups without risk of breaching the specified provisions of the CCA. Once a class exemption is in place, businesses that fall within the criteria of the class exemption won’t need to separately lodge a notification or authorisation, and will be able to rely on the exemption without delay or additional cost.

Box 6.1 - Collective bargaining authorisations and notifications

Authorisation and notification are public processes. Applications are placed on the ACCC’s website with any public submissions that are received.

There are some differences between the authorisation and notification processes.

Notification is often a simpler, quicker process than authorisation, coming into effect after just 14 days where the ACCC doesn’t object, but it can only be used where members of the collective bargaining group (CBG) reasonably expect the value of their transactions with the target business will be less than $5 million per annum per member (for primary producers[209]).

Authorisation can take longer to come into effect than notification, but an advantage is that it does not have a transaction threshold.

Once the proposed collective bargaining class exemption comes into effect later in 2019, it is intended that businesses would not need to seek ACCC approval to collectively bargain provided each business in the group had less than $10 million aggregated turnover in the previous year. The class exemption would operate alongside the existing authorisation and notification processes, which could still be used by a business that falls outside the class exemption to seek legal protection on a case-by-case basis.

6.5.2. The public benefits of a collective bargaining arrangement must outweigh the detriments

Most major winemakers offer standard form supply agreements. While some winemakers allow for minor variations, the majority of growers are unable to significantly influence contract terms. As explained in chapter 5, this flows from the imbalance of bargaining power between winemakers and growers.

Collective bargaining can enable growers to mitigate the impact of bargaining power imbalances, allowing them to negotiate more balanced terms. It has been used successfully by some farmers in other agricultural industries.

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208 The term ‘public benefit’ is not defined in the CCA, but the ACCC has generally given it a broad meaning. As noted by the Australian Competition Tribunal, public benefits are ‘anything of value to the community generally, any contribution to the aims of society including as one of its principle elements…the achievement of economic goals of efficiency and progress.’

209 The limit for most other types of businesses is $3 million.

Collective bargaining could involve a number of growers joining together to negotiate with a winemaker on prices or supply arrangements, or to facilitate the efficient sequencing of the delivery of grapes to a winemaker.

In order for collective bargaining to qualify for legal protection via an authorisation or notification, there must be likely public benefits that would outweigh the likely public detriments.

The terms ‘public benefit’ and ‘public detriment’ are not defined in the CCA and they are interpreted broadly. The public benefit and detriment must result from the CBG rather than other effects that would occur in any event.[210]

Public benefits can include:

- reducing transaction costs through sharing the time and expense of negotiation
- creating opportunities for growers to have more effective input into contracts to negotiate supply agreement terms that better reflect growers’ needs
- improving the information available to growers, including about key supply agreement terms
- creating new marketing opportunities by combining volume.

Collective bargaining can also create mutually beneficial outcomes for both the group and winemakers, by guaranteeing a substantial volume of supply or providing access to a unique product.

On the other hand, public detriments may arise as a result of:

- increasing the potential for coordination between CBG members beyond what is necessary to improve the efficiency of contracting
- providing for negotiated supply agreements that have the effect of shielding inefficient members and distorting investment decisions.

Increasing the bargaining power of the group is not in itself a public benefit if it simply results in the transfer of benefit from the target business to the group. However, improvements in bargaining power can generate public benefits if it would be likely to result in contracts that enable more of the gains from trade to be realised.

For example, a growers’ CBG might be able to negotiate higher grape prices than is possible without collective bargaining. If higher prices to growers enabled them to make investments to improve the quality of their grapes, this may provide benefits to both growers and winemakers, and be considered a public benefit.

6.5.3. Collective bargaining has rarely been used by growers

Collective bargaining has rarely been used in the wine grape industry.

One example of a CBG is Rivawine Collaboration Pty Ltd (Rivawine), which represents 11 growers in the Riverland region.[211] While Rivawine is responsible for significantly less volume than CCW, it is not tied to a specific purchaser.

In its notification to the ACCC in November 2018, Rivawine raised the possibility of consolidating production for contract processing as a public benefit arising from the

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210 Australian Competition and Consumer Commission, Small business collective bargaining notification and authorisation guidelines, ACCC, Canberra, 2018, p. 6.

211 https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/collective-bargaining-notifications-register/rivawine-collaboration-pty-ltd

collective bargaining arrangement. It was claimed that consolidating production would ‘improve the management of harvest intake through greater flexibility of harvest across a large group’. In its decision to allow the notification to stand, the ACCC considered that Rivawine could allow its growers to have better input into supply agreement negotiations and may enable its growers to be better informed of relevant market conditions.

6.5.4. Collective bargaining has broad potential in the grapes industry

The ACCC recognises the challenges for growers in using collective bargaining in the wine grape industry. Winemakers lack incentives to negotiate with a CBG where there are sufficient alternative suppliers in a particular region who are not part of the CBG. Despite this, collective bargaining should not be disregarded as there are many potential benefits, as noted in subsection 6.5.2.

6.5.5. Collective boycotts may be a less viable option due to the perishability of grapes

A collective boycott is a mechanism that can be included as part of a CBG authorisation or notification, and can be used to encourage a party to enter negotiations with a CBG. It involves CBG participants agreeing not to supply a party whom the group is negotiating with, until the group is satisfied with the offer received.

Historically, there have been very few applications for authorisation for collective boycotts, and some of these have been denied authorisation by the ACCC, or by the Australian Competition Tribunal overturning the ACCC’s decision to grant authorisation. This has been due to concerns about the harm that some boycotts can do to those in the industry. Despite this, the ACCC remains open to authorising collective bargaining arrangements that include the possibility of boycotting a processor if negotiations don’t succeed. A collective boycott can be a useful negotiating tool to bring the target business to the table or restart stalled negotiations. The effectiveness and appropriateness of a collective boycott will depend on the particular circumstances.

However, for collective boycott conduct to be an effective negotiation tool for growers, it must be possible for the group to credibly threaten to withhold grapes if their requirements are not met. This presents a challenge for growers, given the perishability of grapes and the fact that grapes must be delivered to a winery at a specific time, the use of exclusive agreements and concerns about the industry returning to an oversupply situation.

6.6. Winemakers are constrained at the wholesale level

Major Australian winemakers have two primary options for the wholesaling of their wine: they can sell into the export market or to domestic retailers. Many do both, though in each of these markets, Australian winemakers are largely price takers.

6.6.1. Bulk wine is predominantly sold into competitive export markets

Exported wines can vary significantly in terms of price, variety, region, quality and flavour profile. Figure 6.6 shows the value of wines exported in 2018 by price segment. The majority of bulk wine exports is captured in the lowest price segment, namely $2.49 per litre and under. The average price of bulk wine exports was $1.17 per litre in 2018.[212] This reflects the fact that the majority of bulk wine exports consist of commercial wines.

These wines are often commoditised and highly substitutable with commercial wine produced in other winemaking countries, many of which export far greater volumes than

[212] Wine Australia, ‘Figures show continuing strong international demand for fine Australian wine’, 22 January 2019, https://www.wineaustralia.com/news/media-releases/export-report-december-2018.

Australia. As a result, Australian winemakers are unable to significantly influence bulk wine export prices, which are instead primarily determined by international market conditions and foreign exchange rates (see chapter 4). Australian wholesalers are price takers in bulk wine export markets, unable to significantly influence the prices they receive.

Figure 6.6 Exports by price segment 2018 (AUD million FOB)[213]

Price segment (A$/litre)	MAT December 2018	Value change	Growth rate
$2.49 and under	$556	$44	8.7%
$2.50 to $4.99	$828	-$1.4	-0.2%
$5.00 to $7.49	$376	$44	13%
$7.50 to $9.99	$166	$16	10%
$10.00 to $14.99	$234	$33	16%
$15.00 to $19.99	$77	$0.2	0.3%
$20.00 to $29.99	$218	$86	65%
$30.00 to $49.99	$99	$5.1	5%
$50.00 to $99.99	$187	$23	14%
$100.00 to $199.99	$33	$16	92%
$200.00 +	$48	-$3.9	-7%
Total value	$2,821	$262	10%

Source: Wine Australia.

6.6.2. Winemakers wholesale into highly concentrated domestic retail markets

While most bulk wine is exported, some winemakers sell all or part of their production in the domestic wholesale market. Domestic wholesale prices for wine are constrained by competition between winemakers, imports, and the bargaining power of major supermarkets.

While the warm climate grape markets are highly concentrated, the domestic wholesale wine market is far less concentrated. This is because the geographic dimension of the domestic wholesale market is effectively nationwide, whereas the geographic dimensions of the warm climate grape markets are generally the region of the winemaker's winery.

In contrast to the domestic wholesale wine market, the domestic retail wine market is highly concentrated. The largest four retailers comprise around 80 per cent of the market[214], and the two major players, Woolworths and Coles, accounted for over 60 per cent of industry revenue in 2017−18.

Additionally, retailers can import wine, which is another source of competition for Australian winemakers. As stated in chapter 1, New Zealand Sauvignon Blanc has been the highest selling white wine in Australia since 2009. Actual or potential competition from imported goods constrains the prices that can be achieved by domestic winemakers to some extent, as retailers can credibly threaten to substitute local with imported products if domestic prices are not competitive.

The degree to which retailers can make this threat depends on the extent to which consumers consider imports to be a substitute for Australian products, and may be impacted

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213 Note: FOB refers to 'free on board' and MAT refers to 'moving annual total'.

214 IBISWorld Industry Report G4123, "Liquor Retailing in Australia", December 2018.

by customer preferences for particular brands or local produce. Imports have risen in recent years, from 86.2 million litres in 2012−13 to 96.7 million litres in 2016−17.[215]

This high level of retail market concentration has been accompanied by the two major retailers as well as Aldi developing private label wines. The retailers contract wine production, predominantly to large winemakers, and focus on producing low to middle priced wine. These wines compete directly with the winemakers' equivalent wines. Woolworths has more than 200 private label wines and Coles more than 75.[216]

6.6.3. Winemakers have limited ability to pass on higher costs

Being largely price takers in the export and domestic retail markets means that winemakers cannot simply pass higher grape prices and other costs along the supply chain. The highly competitive wholesale market combined with the concentrated retail market significantly reduces winemakers' power in their negotiations with retailers.

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[215] Winetitles, *The Australian and New Zealand Wine Industry Directory 2018*, p. 7.

[216] For a list of private label wines see: https://www.therealreview.com/who-makes-my-wine/.

7. Australian Wine Industry Code of Conduct

Key points

- The voluntary Australian Wine Industry Code of Conduct (Code) sets out minimum standards for supply agreements, and procedures for the resolution of disputes over price and quality assessments conducted in the vineyard.
- The Code has not been widely adopted by wine grape purchasers. Signatories to the Code account for less than half of all wine grapes purchased from both warm and cool climate regions in Australia. Since 2014, there have been only four new signatories.
- Coverage of the Code varies significantly between regions. For instance, none of the major buyers of wine grapes from the Riverina are signatories to the Code.
- Requirements around indicative pricing are the main reason given by non-signatories in refusing to sign the Code. Winemakers have also expressed concerns about third party dispute resolution, and the minimum requirements for grape supply agreements under the Code.
- There was a significant increase in the number of disputes raised with the Code Management Committee (Code Committee) during the 2017 and 2018 harvests. This may indicate that the Code's dispute resolution procedures are gaining traction with growers.
- The dispute resolution mechanisms set out in the Code are providing a net benefit to the industry. However, these mechanisms can be improved and expanded to cover a greater range of disputes, particularly contractual disputes not related to price or quality assessments.
- If large winemakers continue to refrain from signing the Code, a mandatory code may be required to ensure most growers have the benefit of the Code's additional protections.

The ACCC considers that there is benefit to having an industry-led code of conduct to govern contractual relations between grape growers and winemakers. However, growers, grower representatives, winemakers and the Code Committee have all expressed concerns over shortcomings of the current Code as an effective regulatory instrument in the wine industry.

The ACCC's analysis of the current Code has centred on criticisms raised by industry stakeholders regarding the lack of signatories to the Code, concerns about indicative pricing notifications and the efficacy of dispute resolution mechanisms under the Code.

Despite the fact that some growers and winemakers have been able to successfully resolve disputes under the Code, the ACCC's overall view is that the current Code is currently not working as intended to balance the interests of growers and winemakers. The ACCC considers that the Code has the potential to provide greater benefits to the industry if certain amendments are adopted, and uptake by winemakers increases.

This chapter discusses:

- the contractual framework provided by the Code
- dispute resolution mechanisms under the Code
- the effectiveness of the Code as an industry-led regulatory instrument
- recommendations to improve access to, and outcomes from, dispute resolution under the Code.

7.1. There are three models for industry codes in Australia

Industry codes of conduct set out minimum standards of commercial conduct for industry participants. Broadly speaking, industry codes come in three forms:

- Non-prescribed voluntary industry codes – these are codes developed and administered by industry participants. They are only enforceable to the extent that the industry includes an enforcement mechanism in the code.
- Prescribed voluntary codes – these are voluntary codes that industry participants have the option of signing up to, with signatories subject to enforcement action by the ACCC in the event of a breach of the code. The *Food & Grocery Code* is an example of a prescribed voluntary code.[217]
- Mandatory codes – these codes are binding on all industry participants and are subject to enforcement by the ACCC. The ACCC can take action against parties that breach a mandatory code, including in the form of financial penalties or infringement notices. The *Horticulture Code of Conduct* is an example of a mandatory code.[218]

Industry codes can address specific market failures that cannot be addressed by individual industry participants or regulation.

7.2. The Code is intended to balance the interests of growers and winemakers

The Code was established in December 2008 by the Wine Industry Relations Committee (WIRC) as a joint committee of the then Winemakers' Federation of Australia (WFA) and Wine Grape Growers Association (WGGA). The WGGA became Australian Vignerons (AV) in 2016. In February 2019, AV and the WFA merged to become Australian Grape and Wine Incorporated (AGWI).

At the time of writing this interim report, AGWI and the Code Committee have not amended the Code to reflect these organisational changes.

The Code is a non-prescribed voluntary industry code.[219] Wine grape purchasers throughout Australia have the option of becoming signatories to the Code on an opt-in basis. There are no joining fees or ongoing annual costs associated with signing the Code.

A list of current signatories is published on the Code website.[220]

7.2.1. The Code is administered by the Code Committee

The Code Committee is responsible for administering the Code. Its functions include:

- monitoring and assessing the operation of the Code
- publishing an annual report on the Code's performance
- recommending improvements to the Code
- promoting further adoption of the Code among industry participants
- facilitating the resolution of disputes between growers and signatories to the Code.[221]

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217 Australian Competition and Consumer Commission, *Food and Grocery Code of Conduct*, https://www.accc.gov.au/business/industry-codes/food-and-grocery-code-of-conduct.

218 Australian Competition and Consumer Commission, *Horticulture Code of Conduct*, https://www.accc.gov.au/business/industry-codes/horticulture-code-of-conduct.

219 Code, http://www.wineindustrycode.org/.

220 http://www.wineindustrycode.org/Signatories.html

The number of members sitting on the Code Committee has varied slightly since 2011, when the Code Committee replaced the Code Administration Committee. Currently, the Code Committee is comprised of an Independent Chair, and six members representing a variety of industry participants.

The Code Committee is supported by a Code Secretariat and a Committee Secretariat. The Code Committee may delegate any of its powers and duties under the Code to the Code Secretariat, which is funded by AGWI.[222] Since 2009, The Accord Group has acted as the Code Secretariat.

7.2.2. AGWI's organisational structure is skewed towards winemakers

The Board of AGWI is responsible for appointing members to the Code Committee and approving recommendations from the Code Committee to amend the Code.[223] Decisions by the Board of AGWI require approval from 80 per cent of those voting on the motion.[224]

AGWI's Board consists of 16 Directors and the President. Each of AGWI's four Membership Committees appoints four Directors to the Board of AGWI. The following committees are responsible for appointing members to the Board:

- the Small Winemakers' Membership Committee
- the Medium Winemakers' Membership Committee
- the Large Winemakers' Membership Committee
- the Vigneron's Membership Committee.

Grower representation with regard to the Code should be improved

Given the organisational structure of AGWI, which has three membership committees for winemakers and only one membership committee representing growers, the composition of the Code Committee may become entrenched in favour of winemakers. This has the potential to undermine the Code's effectiveness and reduce grower confidence.

The ACCC's interim recommendation is that the Code be amended to guarantee equal representation of growers (including grower representative bodies) and winemakers on the Code Committee. Equal grower and winemaker representation is likely to:

- lead to increased interaction between grower representatives and winemakers to improve the dispute resolution procedures under the Code
- allow grower representatives to increase grower awareness of the Code and promote access to Code processes
- lead to balanced administration of the Code, including having increased consideration of grower interests when amendments to the Code are considered
- increase grower confidence in the Code.

The ACCC also recommends that AGWI appoint a sub-committee equally representing growers and winemakers to decide on proposed amendments to the Code.

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221 Code, Part 5 – Administration of the Code.

222 Code, cl. 5.1.3.

223 Code, cl. 5.1.2 and 5.1.6.

224 Australian Grape and Wine Incorporated, *Constitution*, 1 February 2019, article 15.10(b), https://www.agw.org.au/assets/role-and-mission/FINAL-Constitution-Australian-Grape-and-Wine-Incorporated-66792778.pdf, viewed 9 April 2019.

7.2.3. The Code regulates a number of industry practices

The Code sets out minimum standards for supply agreements and provides for dispute resolution mechanisms between growers and purchasers.[225] Under the Code, agreements must be in writing and specify:

- the term of the agreement
- the pricing method used between the parties
- any terms relating to price adjustments
- any quality standards
- when title in the grapes passes to the winemaker
- any terms relating to force majeure
- any restrictions on the assignment and sale of vineyards
- dispute resolution mechanisms consistent with those set out in the Code.

Where the agreement does not set a fixed or base price for the grapes, purchasers buying grapes from the warm climate and Hunter Valley regions must communicate an indicative price by 15 December (preceding harvest), before making a final pricing offer closer to harvest. A detailed discussion of indicative pricing under the Code is in chapter 4.

The Code also sets out minimum payment terms for supply agreements. Broadly consistent with SA legislation, the Code requires growers be paid one third of the purchase price at the end of the month following the month of delivery, one third at the end of June, and the balance at the end of September that year. Parties may also agree to different payment terms than those set out in the Code.[226]

Dispute resolution processes under the Code are intended to assist growers and winemakers to resolve certain types of disputes impartially and in a cost effective manner, without resorting to litigation or traditional alternative dispute resolution methods.[227]

7.2.4. The Code creates contractual obligations

Signatories to the Code agree to be bound by the provisions of the Code in their commercial dealings with growers.[228]

Clause 2.1.1 of the Code provides that each supply agreement must contain a statement that it is governed by the Code and that, in the event of any inconsistency between the Code and the agreement, the Code will prevail. The ACCC considers that inclusion of a statement complying with clause 2.1.1 in the parties' supply agreement is sufficient to give the provisions of the Code contractual force. In these circumstances, a breach of the Code could also constitute a breach of contract.

Separately from any action for breach of contract, the Code Committee is responsible for determining alleged breaches of the Code. Part 4 of the Code sets out the procedures for dealing with complaints that a signatory has breached the Code. If the Code Committee determines that a breach has occurred, it may instruct the signatory of the steps required to remedy the breach, or remove the winemaker from the list of signatories to the Code.[229]

[225] Code, Part 1 – Intention.
[226] Ibid, Part 2, cl. 2.6.1 to 2.6.3.
[227] Ibid, Part 1 – Intention.
[228] Ibid, Part 1 – Industry Endorsement.
[229] Ibid, Part 4, cl. 4.1.10.

7.3. The Code has had some positive impact but could be improved

In the ACCC's consultation with growers, a significant number acknowledged that they had benefitted from using the Code's price dispute mechanisms to obtain a better price than that initially offered by their winemaker. However, industry participants have also reported a number of shortcomings. For example:

- The low number of signatories undermines the effectiveness of the Code for the whole industry.
- Dispute resolution processes are limited to disputes over price and quality assessments in the vineyard.
- Dispute resolution processes are perceived as costly.
- There is a lack of industry experts available to be appointed to determine disputes and many growers question the impartiality of these experts.
- While indicative pricing and price offer mechanisms provide some process for negotiating price, the timing of release is problematic.
- Minimum requirements under the Code have served to further entrench lengthy payment terms across the industry.

Indicative pricing and payment terms are discussed further in chapters 4 and 5 respectively. The remainder of this chapter considers other concerns with the Code and recommends avenues for improving its effectiveness.

7.3.1. There is a need for dispute resolution in the wine industry

Access to effective and efficient dispute resolution is important for a well-functioning market. For dispute resolution mechanisms to be effective, they should be fair to all parties, simple to follow, and seek to achieve an outcome in a cost effective and timely manner. Effective dispute resolution can reduce imbalances in bargaining power, improve transparency and lead to fairer contract terms.

The Code provides limited access to dispute resolution procedures for certain types of disputes. However, most growers dealing with non-signatories to the Code do not currently have access to effective dispute resolution procedures (see chapter 5).

7.3.2. The Code provides dispute resolution mechanisms to resolve price and quality disputes in the vineyard

The Code provides mechanisms for disputing final price offers from winemakers and quality assessments conducted by winemakers in the vineyard. These processes are virtually identical, the only difference being that the timeframes for the resolution of quality assessment disputes are significantly shorter. The processes are summarised in figure 7.1.

The Code's processes encourage parties to reach a mutual resolution to a dispute. Disputes that cannot be resolved in the first instance may require the appointment of an independent expert, under the processes set out under the Code. An independent expert must be either a qualified winemaker or viticulturist with a minimum five years' experience in assessing and grading wine grapes, and in grape contracting arrangements.[230]

Independent experts make a determination by applying the Code, the terms of the parties' contract and, where necessary, the independent expert's own procedures. Their decision is

[230] Code Committee, *Dispute Resolution*, http://www.wineindustrycode.org/Dispute_Resolution.html, viewed 10 April 2019.

final and binding on the parties, except in the case of a manifest error or proven misconduct.[231]

The Code Committee has taken a strict view on the enforcement of time limits under the Code. The Secretariat will not assist parties if a dispute is raised out of time, unless both parties agree to waive the time limits under the Code.[232]

Figure 7.1: Processes for the resolution of price disputes and quality assessments conducted in the vineyard under the Code.

Stage	Timeframe
Pricing disputes	
The grower issues a Notice of Dispute (the Notice) to the purchaser and forwards a summary of the dispute to the Code Committee.	**Within seven business days of receiving a final price offer from the purchaser.**
The purchaser must respond to the Notice in writing and inform the Code Committee that it has responded to the Notice.	**Within seven business days of receiving the Notice.**
The parties are given time to negotiate a resolution to the dispute. During this time, the Secretariat may contact the parties to facilitate a resolution to the dispute.	**The relevant period for negotiation is:** • **Sixty business days from the date the Notice was issued, if the Notice was issued *before* 30 April.** • **Fourteen business days from the date the Notice was issued, if the Notice was issued *after* 30 April.**
If the parties fail to resolve the dispute, they may jointly appoint an independent expert to determine the dispute.	**The parties have seven business days from the expiry of the relevant period to appoint an expert.**
If the parties cannot agree on the appointment of an expert, either party can apply to the Code Committee to appoint an expert on their behalf.	**A party must apply to the Code Secretariat within 14 business days of the expiry of the relevant period.**
The independent expert considers the matter and delivers their determination.	**The expert has 14 business days from the date of their appointment to deliver a determination. If the matter requires extensive research or investigation, this is extended to 'a reasonable timeframe'.**
Vineyard quality assessment disputes	
The grower issues a Notice of Dispute to the purchaser and forwards a summary of the dispute to the Code Committee.	**As soon as practicable after being notified of the downgrade or rejection.**
The purchaser must respond to the Notice in writing and inform the Code Committee of this.	**Within 48 hours from the time the Notice was issued.**
The parties have a short period for negotiation. During this time, the Code Secretariat may contact the parties to facilitate a resolution to the dispute.	**The parties have 72 hours from the time the Notice was issued to negotiate.**

[231] Code, Part 3, Powers of Independent Expert.

[232] Code Committee, *Annual Report 2009-10*, September 2010, p 10, http://www.wineindustrycode.org/AWICAC%20Annual%20Report%2009-10.pdf, viewed 10 April 2019.

If the parties cannot resolve the dispute, they may jointly appoint an independent expert.	**The parties have 96 hours from the time the Notice was issued to jointly appoint an expert.**
If the parties cannot agree on the appointment of an expert, either party can apply to the Code Committee to appoint an expert on their behalf.	**Such application must be made within 120 hours of the time the Notice was issued.**
The independent expert delivers their determination.	**The expert has 48 hours from the time of their appointment to make a determination. If the matter requires extensive research or investigation, this is extended to 'a reasonable timeframe'.**

Source: Code.[233]

7.3.3. Use of the Code's dispute resolution mechanisms has increased

Since 2009, the Code Secretariat has received 99 requests from growers seeking assistance with dispute resolution under the Code. Of these enquiries, 85 requests fell within the Code's dispute resolution provisions. Four of these matters related to quality assessments in the vineyard, while 81 related to pricing disputes. The vast majority of these pricing disputes related to prices offered by three signatories to the Code for the 2017 and 2018 harvests.[234]

The ACCC understands the increase in growers seeking to access dispute resolution under the Code has largely been driven by grower representative groups. These groups have increased efforts to educate growers about the processes under the Code. They are also advocating that growers use these processes to pursue price increases in the context of improved demand for grapes.

The Code Committee's annual reports and the ACCC's consultation with industry indicate that disputes are usually resolved before an independent expert is appointed to determine the dispute. Independent experts were only appointed in four of the complaints received by the Secretariat.

Disputes are resolved on a confidential basis.[235] However, submissions received by the ACCC have indicated that in resolving disputes, winemakers have offered price increases, waived the need for compliance with certain quality specifications, or released the grower from the supply agreement.

Figure 7.2: Complaints received by the Code Committee, 2009−2018.

	Enquiries	No jurisdiction	Disputes outside Code	Disputes within Code	Price disputes	Vineyard assessment disputes	Informally settled	Expert appointed
2009	1	0	0	1	1	0	0	1
2009−10	0	0	0	0	0	0	0	0
2010−11	5	3	2	0	0	0	0	0
2011−12	3	0	0	3	2	1	2	1
2012−13	0	0	0	0	0	0	0	0

233 Clauses 3.1 and 3.2.

234 Code Committee, *Annual Report 2016-17*, September 2017, p. 7; Code Committee, *Annual Report 2017-18*, September 2018, p. 7.

235 Code Committee, *Annual Report 2011-12*, September 2012, p. 8.

2013–14	5	0	0	5	3	2	3	2
2014–15	3	1	2	0	0	0	0	0
2015–16	3	1	2	0	0	0	0	0
2016–17	29	0	2	27	27	0	27	0
2017–18	50	0	1	49	48	1	49	0
Total	99	5	9	85	81	4	81	4

Source: Code Committee, Annual Reports 2009 to 2018.

7.3.4. Dispute resolution procedures under the Code should be expanded

Clause 3.3. of the Code does not seem to adequately assist the parties to resolve disputes arising out of quality assessments conducted at the weighbridge. Further, the ACCC considers it would be beneficial for the Code to provide a mechanism to assist the parties to resolve other kinds of contractual disputes.

The Code does not provide a process for the resolution of quality assessment disputes at the winery

In almost all standard form contracts reviewed by the ACCC, the purchaser has the right to perform additional quality assessments at the winery where it may downgrade or reject grapes, including upon delivery at the weighbridge. See chapter 3 for detailed discussion of quality assessment processes.

If a purchaser seeks to impose financial penalties or reject the grapes at the weighbridge, clause 3.3 of the Code provides that the purchaser should notify the grower of that decision 'as soon as practicable'. The Code states that growers should be given an opportunity, where practical, to inspect the grapes. It encourages growers to try and reach agreement with the purchaser on the nature and extent of the downgrade and any resulting price adjustment. This is intended to allow the continued processing of the grapes, or rejection of the grapes.[236]

The Code states disputes over quality assessments at the weighbridge need to be resolved quickly, ideally within 12 hours of the delivery of the grapes. However, the Code does not provide a mechanism for independent assessment or arbitration of the dispute. The Code specifically states:[237]

> *For the avoidance of any doubt but without limiting the other obligations set out in this clause, the Code does not require an independent expert to resolve disputes over downgrades and rejections at the weighbridge.*

The ACCC recognises the need to ensure grapes are processed efficiently during busy harvest schedules by avoiding drawn-out disputes at the winery. However, the ACCC has concerns about winemakers having broad or ultimate discretion under contracts to make unilateral quality assessment determinations, without providing any recourse to growers (see chapters 3 and 5). The issue is particularly problematic where growers have little visibility, and potentially limited understanding, over how quality assessments are conducted.

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236 Code, cl. 3.3.

237 Ibid.

The ACCC considers that the dispute resolution mechanisms under the Code should be expanded. They should provide a clear, structured process for the resolution of disputes over quality assessment decisions made at the winery (including at the weighbridge).

On a preliminary basis, the ACCC considers the Code should be amended to require that winemakers hold a random retention sample for each delivery in respect of which they decide to downgrade or reject the grapes. The ACCC understands that most winemakers already collect samples from grape deliveries, and that the introduction of this requirement would not be unduly burdensome.

The Code should also provide a process for growers to elect to have the retention sample tested by an independent third party to determine whether the grapes met the relevant quality standards. The Code Committee, in consultation with industry participants, should develop procedures for the holding and testing of retention samples and managing disputes.

The ACCC seeks feedback on:

- The feasibility of taking, holding and testing retention samples if a winemaker downgrades or rejects a delivery of grapes.
- The likely costs of having these samples tested by an independent third party.

Expansion of dispute resolution procedures to include contractual disputes

Since 2009, the Code Secretariat has received a number of requests from growers seeking assistance with disputes that fell outside the Code's procedures (see figure 7.2 above). These enquiries generally related to contractual disputes between the parties, indicating that there is demand for structured dispute resolution processes beyond the subject matter currently covered by the Code. Demand for more comprehensive dispute resolution processes has also been expressed by growers during the consultation process.

The ACCC considers that the Code should be amended to provide broader dispute resolution processes for contractual disputes not related to price or quality assessments. For example, an arbitration process may be useful in situations where growers seek to challenge termination notices or negotiate an early exit from a supply agreement.

The ACCC seeks industry feedback regarding an appropriate arbitration model that ensures disputes are resolved fairly, efficiently and without imposing significant costs on the parties.

7.3.5. Independent experts are difficult to find

Most disputes raised under the Code have been resolved by mutual agreement between the parties, without resorting to the appointment of an independent expert. Winemakers have expressed that both growers and winemakers are generally not inclined to involve third parties, such as experts, in their disputes. They state that winemakers and growers prefer to negotiate to a compromised "win-win" outcome rather than to engage a third party whose determination may favour one of the parties.

That notwithstanding, the potential that an unresolved dispute could be dealt with by a third party whose decision may be binding on both parties undoubtedly provides an incentive for parties in dispute to reach an agreement, which may not be the case in the absence of this arbitration process.

A number of growers and grower representative bodies have indicated that growers are not confident that experts can act impartially, as most of them also work with winemakers and are likely to be reliant on continued engagement by winemakers for ongoing income.

Some grower representative bodies have also highlighted that there are few or no independent experts in their region to resolve disputes, which could cause delays and increase costs in the resolution of the dispute.

The Code requires that parties bear the costs of appointing an independent expert equally.[238] This is likely to impose a more significant burden on growers and discourage them from pursuing more formal dispute resolution. Growers generally do not have a clear understanding of the costs of appointing an independent expert, including the number of hours of work the expert would need to undertake to deliver a determination. Further, because of concerns about the impartiality of experts, growers consider that they would also need to engage lawyers. The potentially high costs of engaging industry experts and lawyers are barriers to progressing to the formal stages of the Code's dispute resolution procedures.

Issues around the unknown and potentially high costs of dispute resolution are compounded by the lack of transparency over market prices and quality assessment processes. There is significant potential for growers to incur substantial costs, without any real understanding of the merits of their dispute and consequent likelihood of success.

Unless the Code Committee is able to identify a larger pool of independent experts with an appropriate degree of geographical coverage, and consider ways to reduce the costs of engaging experts to resolve disputes, it is likely the independent expert provisions will continue to go unused.

The ACCC seeks feedback on:

- Strategies to reduce the costs associated with appointing an independent expert.
- Strategies to increase the availability of qualified experts in all winemaking regions to resolve disputes.

7.3.6. Timeframes for the resolution of disputes should be improved

Some growers have raised concerns about the timeframes for dispute resolution under the Code. For price disputes, growers are concerned that their busy workload during harvest prevents them from disputing prices until after harvest, when they no longer have control over their produce. The Code Committee partially addressed these issues in December 2014 by extending the time available for parties to negotiate a resolution to the dispute to 60 days, if the complainant issues a Notice before 30 April.[239]

Nevertheless, the timeframes under the Code require price disputes to be resolved before regional average price data is available. This data is published by Wine Australia around August of the harvest year. It is not until after this data is published that growers would have a better understanding of the merits of their price dispute. See chapter 4 for detailed discussion of the lack of price transparency in the industry and the consequences of this.

While the Code's focus on facilitating the informal resolution of disputes has likely assisted in preserving commercial relationships between growers and winemakers, it does not adequately address the power imbalances between the parties. Because of the perishable nature of grapes, growers bear significant agricultural risks up until the time the purchaser accepts their grapes. Any delays to harvest or delivery of the grapes may result in significant financial losses for the grower, placing them in a weak bargaining position. Therefore, growers cannot risk delaying harvest to negotiate a better price.

AV's submission to the ACCC stated that the Code should aim to ensure that any issues relating to grape intake are settled prior to harvest. This is so that any disputes can be

238 Code, cl. 3.1.6. and 3.2.6.

239 Code Committee, Annual Report 2014-15, p. 6, viewed 15 April 2019.

managed in a timely fashion, and to ensure that growers are not made to incur excessive costs.[240]

The ACCC seeks feedback from the Code Committee and industry participants regarding potential changes to the processes and timeframes for dispute resolution under the Code.

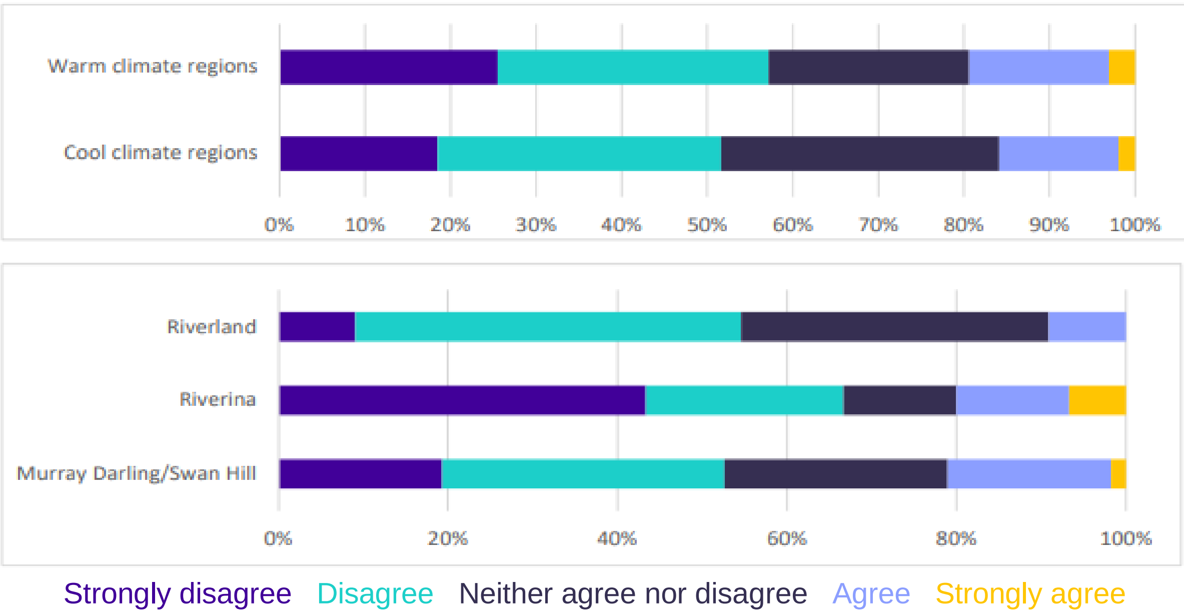
7.3.7. Some growers do not use dispute resolution mechanisms for fear of retribution

Growers in warm and cool climate regions expressed concern to the ACCC that they risk damaging their relationship with the purchaser of their grapes if they raise a dispute. Grower representative bodies have indicated that growers are afraid that if they lodge dispute resolution notices they will be branded 'troublemakers', and that their contracts may not be renewed in the future.

The Code Committee has noted that reports of intimidation of growers, whether real or perceived, are likely to lead to the dispute resolution provisions not being utilised.[241] In this regard, the Code Committee has acknowledged that it must take an educative role and promote dispute resolution under the Code.[242]

The majority of respondents to the ACCC's grower survey indicated they believed that engaging in dispute resolution procedures could harm their future business dealings with purchasers.

Figure 7.3: Engaging in a dispute resolution process would not harm my business' future dealings with wine grape buyers



Source: ACCC grower survey, results report, September 2018.

Data from the Code Committee's 2016−17 and 2017−18 Annual Reports indicates growers are mounting more frequent challenges to price offers from winemakers. Between 2017 and 2018, the Code Committee received 75 price complaints under the Code (see figure 7.2).

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[240] Australian Vignerons, *Submission 'Wine grapes – a market study by the ACCC Issues Paper'*, September 2018, p. 8.

[241] Code Committee, *Annual Report 2013-14*, September 2014, http://www.wineindustrycode.org/AWICoC%20Annual%20Report%202013-14%20(SEP%202014)%20v4.pdf, viewed 10 April 2019.

[242] Ibid.

The increase in the number of disputes in 2017 and 2018 may indicate that growers are gaining the confidence to raise disputes with purchasers. However, it must be borne in mind that the vast majority of these disputes related to only three winemakers, and may not reflect an industry-wide change.

Information received by the ACCC also indicates that signatories to the Code are developing practices to better handle disputes falling under the Code. For instance, Accolade has indicated that disputes are handled by its Chief Viticulturist so that growers can continue to deal with their local viticulturist and not be concerned about damaging their working relationships. This also allows Accolade to obtain a better overall picture of the common causes for disputes. This may indicate a growing acceptance in the industry that disputes are part of the ordinary course of business.

It is likely that fears of retribution are currently more prevalent in light of the recent cyclical downturn in the industry. While demand is strong, it is likely that more growers will be less concerned about potential retaliatory action from winemakers, and feel that they are in a better bargaining position to negotiate and raise disputes concerning contracts. Indeed, the recent and marked increase in disputes under the Code indicates that this shift may already be occurring.

The ACCC considers that the Code Committee should continue to advocate for adherence to the Code and provide education on the Code to growers and winemakers. This will help promote access to, and the effectiveness of, the Code's processes.

7.3.8. The low number of signatories undermines the efficacy of the Code

Of Australia's approximately 2500 winemakers, 43 have signed up to the Code, including six of Australia 20 largest winemakers (by grape intake).[243] While these winemakers represent a significant proportion of the total market for the purchase of grapes, they ultimately represent less than half of all grapes purchased in Australia. Since 2014, there have been only four new signatories to the Code.

The low number of signatories undermines grower confidence in dealings with winemakers and has the potential to exacerbate bargaining power imbalances between growers and winemakers because:

- Growers do not have consistent and ready access to structured dispute resolution.
- Winemakers may announce indicative prices or final prices later than the timeframes provided by the Code, further reducing price transparency and certainty.
- Winemakers may enter into contracts on terms less favourable than the minimum terms set out in the Code.
- Winemakers may continue trading with growers, on a long-term basis, without written contracts.

In its 2012−13 Annual Report, the Code Committee reported on the reasons given by non-signatories for electing not to sign the Code. Winemakers have expressed:

- concerns over having to comply with indicative pricing requirements
- concerns over adhering to minimum requirements for payment terms
- that they are not comfortable with third party dispute resolution
- that they do not have or want written contracts
- that other wineries in their region are not signatories

[243] Winetitles Media, *Wine Industry Directory 2018*, p. 9.

- that being a signatory is unnecessary because they are already complying with the Code's requirements.[244]

These concerns generally reflect those raised with the ACCC in the course of this market study. In addition to the above, some non-signatories to the Code have expressed concern that becoming a signatory would constrain their capacity to negotiate commercially appropriate agreements with specific growers on a case-by-case basis. One winemaker also indicated concern that the Code imposes significant obligations on winemakers in their dealings with growers without providing a commercial benefit.

Coverage of the Code varies across the warm climate growing regions

Data received by the ACCC indicates that the quantity of grapes purchased by signatories to the Code from independent growers varies significantly between the three warm climate regions. These differences are set out in figure 7.4 below.

Figure 7.4: Grapes purchased from independent growers by signatories in warm climate regions

	Total grapes purchased from region (tonnes)	Percentage of grapes purchased by signatories (%)
Riverland	355 078	around 66
Murray Valley	242 276	around 39
Riverina	201 296	< 1

Source: Wine Australia[245] and data supplied by industry.[246]

Signatories to the Code purchase significant quantities of grapes from growers in the Riverland and Murray Valley regions. In contrast, in the Riverina region, signatories to the Code purchase a negligible quantity of grapes from third party growers. It is likely that the problems associated with low numbers of signatories to the Code are felt most acutely by growers in the Riverina region.

More winemakers should sign up to the Code

The ACCC considers that an industry code is an appropriate mechanism for addressing many of the market failures identified in this Report, including by:

- improving minimum standards for payment periods
- improving and expanding dispute resolution mechanisms
- improving access to dispute resolution mechanisms.

However, given the diverse and complex nature of the Australian wine industry, the ACCC is seeking feedback on whether the Code should remain a voluntary, industry-led instrument, or whether a mandatory code is required to address the issues identified in this Report.

The ACCC considers that a voluntary code will not effectively address issues in the wine grapes market without all large winemakers becoming signatories. Unless more large winemakers sign on, many industry issues are likely to become further engrained. For example, without winemakers in the Riverina region signing the Code, the ACCC considers

[244] Code Committee, *Annual Report 2012-13*, September 2013, p 8, http://www.wineindustrycode.org/AWICAC%20Annual%20Report%2012-13.pdf, viewed 10 April 2019.

[245] The total amount of grapes purchased is based on the Wine Australia, 2018 National Vintage Report.

[246] The percentage of grapes purchased by signatories to the Code is based on data provided to the ACCC by winemakers.

that many growers are likely to continue trading without written contracts and will not have meaningful access to dispute resolution mechanisms.

The ACCC will review the progress of the industry in adopting the final recommendations approximately 12−18 months after the release of the final report, and if winemakers do not sign up to the Code, the ACCC may recommend to Government that the code be made mandatory.

After signing up to the Code, the ACCC encourages new signatories to offer to amend existing supply agreements in line with the Code's requirements.