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BY FACSIMILE

AND BY EMAIL: rrat.sen@aph.gov.au

The Senate Rural and Regional Affairs and Transport References Committee
Australian Senate
Parliament House
CANBERRA
ACT 2600

Dear Senators

**Re: Australian winemaking industry inquiry - reply to submission of
Globe Wines Pty Ltd**

We refer to your letter to Mr Laurent Lacassagne, CEO of Orlando Wyndham Group Pty Ltd (**OWG**) received by OWG on 15 June 2005. Thank you for forwarding this letter and the submission made by Globe Wines Pty Ltd (**Globe**) to us and for providing us with the opportunity to reply.

We consider that OWG has been given limited opportunity within which to respond to Globe's extensive submission prior to the Senate Committee authorising the publication of Globe's submission. In particular, we note that Globe's submission was dated 4 April 2005 and was only forwarded to OWG on 15 June 2005. Initially OWG was informed that it had until 24 June 2005 to respond in order that its response be considered together with Globe's submission. However, our solicitors were informed late on 21 June 2005 that the Committee had already decided to publish Globe's submission on 23 June 2005. It is disappointing that OWG has not been provided with an opportunity to have its response published at the same time as the Globe submission. OWG does not seek to interfere in any way with the Committee's process, however, we are concerned that the failure to publish Globe's submission simultaneously with OWG's response to the adverse comment contained in it will result in Globe's submission being interpreted outside of its proper context.

We refer to our solicitor's previous correspondence dated 20 June 2005 and confirm that OWG is concerned that Globe's submission is a blatant breach of the confidentiality constraints contained in Globe's Grape Supply Agreement of June 2001 (**Globe Agreement**). In addition, Globe's submission may, in OWG's view, damage the reputation of OWG, thereby causing it actual economic loss, if the representations made by Globe are released into the public domain in their current unqualified and unverified form.

OWG considers the allegations made by Globe to be entirely without basis and given:

- (a) our concern to have our response published simultaneously or as soon thereafter with Globe's submission;
- (b) the timeframes; and
- (c) the previous involvement in this matter of both independent experts and the ACCC,

we have not replied to each of Globe's "adverse comments" about OWG in detail. Instead, the following is a high level and general response to Globe's claims. We are also providing you with a brief background to the relationship between Globe and OWG as it is our view that Globe's views are being driven by a protracted dispute between the parties as to the assessment of the quality of Globe's grapes and do not reflect any general behaviour by OWG towards its growers.

Our comments are as follows:

1. Accuracy of assertions:

The various assertions made by Globe concerning the conduct and motives of both OWG and its various employees and directors are, in our opinion, inaccurate and unfair.

OWG is renowned for having strong, long term relationships with its approximately 650 growers. We further note that Globe is the only grower in the last 10 years that has exercised the right to the independent determination of pricing (explained in more detail in point 2 below) which is a right available to all growers with a long term supply contract with OWG. OWG submits that this is a very strong indication that OWG's pricing process is fair and equitable for its growers. OWG considers that Globe's views of OWG and its conduct are a result of a long standing dispute between the parties relating to Globe's perception that its Chardonnay grapes are of a quality which differs from OWG's assessment.

Given the timeframe within which we are to respond if publication of these comments is to occur in line with the publication of Globe's

comments, we are only in a position to make general statements about Globe's various assertions. Globe's complaints appear to fall within the following categories:

- Globe's issues with the mechanism used by OWG for "wine quality classification";
- Globe's claims that OWG is devaluing the actual quality of Globe's Chardonnay grapes; and
- Globe's issues with OWG's reduction of the price payable to Globe by the maximum allowable reduction of 15%.

We will address these in turn:

a. Wine Quality Classification

Before summarising OWG's approach to grape pricing, it is important to describe a pricing bonus system that was used in the past by OWG as it appears that Globe may be confusing the bonus system with OWG's general pricing process. OWG used to offer growers a pricing bonus if the wine produced from their grapes was of a higher quality than the quality level used to assess the grape prices. OWG's aim was to ensure that growers were fairly remunerated for their grapes. This system operated purely as a bonus and pricing deductions were not applied (other than as set out in the grape supply agreements) if the wine quality was lower than the quality used to assess the grape price. In this case, there was a direct link between the quality of the wine produced from the grapes in each vintage and the price paid for the grapes. However, Globe declined to participate in this system and OWG has never sought to impose it on Globe. There is no direct link between wine quality classifications and grape pricing outside this bonus system but there are still some indirect links which are explained below.

There are 2 separate elements which are relevant to determining grape quality:

- There are vintage specific quality issues which can be measured definitively when the grapes are harvested, for example, baume, the level of disease and other damage or contamination etc. These vintage specific issues are dealt with as deductions from the price in each vintage and, in the Globe Agreement, are reflected in Appendix 2.

- There is also a component of inherent quality in the grapes which cannot be scientifically measured. This inherent quality is not taken into account in the Appendix 2 price adjustments and is reflected in more subjective judgements such as “taste”. This inherent quality derives from longer term environmental issues such as the vineyard soil, climate and vineyard management. These criteria will limit the quality of the grapes produced from a vineyard, for example, a vineyard with poor soil and an adverse climate will never produce high quality grapes even if the vintage specific quality issues are all carefully managed and optimised. The Globe Agreement makes it clear that these inherent quality issues are also to be taken into account when setting the fair market price for the grapes.

Both quality elements will determine which wine product the grapes are likely to end up in. It is impossible to make a high quality wine from low quality grapes.

The quality of the grapes in each vintage is predominantly assessed through pre-vintage vineyard inspections undertaken by OWG’s viticulture and winemaking staff. However, it is correct to state that OWG also takes into account vineyard history when assessing the quality of the grapes. The quality of the wine produced from a vineyard is a relevant factor, especially when a trend has built up over time – for example, if grapes from a vineyard has consistently produced commercial quality wine then it is reasonable to assume that this trend reflects the inherent limits of the vineyard. However, as we have stated above, the grapes are physically inspected and assessed every year.

b. Product Quality and Pricing

OWG denies any assertion that it has misrepresented the quality of the Chardonnay grapes grown and supplied by Globe, to Globe itself, the ACCC or the independent experts.

OWG acknowledges that it initially paid prices to Globe for its Chardonnay grapes (during the maturation period for the vineyard) which were significantly in excess of the market price for those grapes. This reflected OWG’s expectations as to the quality of the grapes that the mature vineyard would produce and OWG did not classify the grapes as “premium” at that stage (in fact, prior to 1997, OWG did not use a grape

quality classification system at all and this system was not formally linked to OWG's pricing offers until the 2000 vintage). These expectations as to inherent quality were not met and the real inherent quality of the grapes is reflected in the assessments made for the 1997-2002 vintages. At no time did OWG represent to Globe that it would continue to pay excessive prices to it for its grapes and OWG has simply adjusted its pricing to the contractual requirements ie fair market price.

We note that Globe is protected, in relation to pricing, under the terms of the Globe Agreement. Globe has the option of either selling some or all of its crop to a third party or having an independent expert set the price for the grapes. Globe has exercised both of these rights since the contract was entered into in 2001. We note that Globe accepted the outcome of the first expert determination undertaken by Mr McGrath-Kerr which was in Globe's favour (including a clear mathematical error in favour of Globe) but now disputes the pricing process when the second determination, undertaken by Mr Charles Drew, an independent expert, found in OWG's favour.

Additionally, in relation to quality, OWG notes that it uses its best endeavours to minimise the time between crushing and processing all of its growers' grapes, including Globe's, to ensure that the quality of the grapes remain.

OWG's conduct in relation to its pricing process and the expert determinations was considered at length by the ACCC and it found that there were no grounds for suspecting a breach of the Trade Practices Act by OWG.

c. 15% Price Reduction

As explained above, OWG initially offered higher prices to Globe for its grapes to reflect quality expectations for the vineyard which were not fulfilled. In effect, OWG was paying more than it was legally required to under the agreement. When OWG recognised that the vineyard would not fulfil its quality expectations, it sought to reduce the payments to the fair market price for the grapes (which is the amount required to be paid under the Globe Agreement). During this period, OWG formed a genuine and reasonable belief that the fair market price for Globe's grapes was less than the 15% allowable deduction and therefore OWG limited the reduction to 15% to comply with the terms of the Globe Agreement. OWG never represented to Globe that it would

continue to pay more for Globe's grapes than what the Globe Agreement required and Globe has never alleged such a misrepresentation against OWG. OWG's intentions with respect to paying fair market price for the grapes was made clear to Globe during the settlement discussions in 2001 and Globe was represented by legal advisers during those discussions.

OWG's position is that it has always acted in good faith in formulating its pricing offers for Globe and within the terms of the Globe Agreement and OWG strongly denies any assertions that its conduct has been misleading or deceptive or unconscionable in any way.

OWG acknowledges that there have been and continue to be disagreements between OWG and Globe with respect to the value of Globe's grapes. However, OWG has always acted in good faith in all of its dealings with Globe and has fully respected Globe's right to seek an independent price determination. The Globe Agreement between OWG and Globe was entered into following extensive negotiations between the parties with input from their respective legal advisers. As indicated in Globe's submissions, Globe has previously enlisted the services of leading law firms, and a Queen's Counsel. OWG believes that this agreement is fair to both parties and therefore OWG's reliance on the Globe Agreement is also fair. OWG does not agree that it has acted outside the terms of the Globe Agreement at any time. There have been instances where Globe has insisted on strict performance of the contract to OWG's detriment in circumstances which may be regarded as unfair but this has never been challenged by OWG.

2. Prior Conduct:

In its submission, Globe has raised numerous issues in relation to prior conduct which have been previously been dealt with in proceedings involving Globe and OWG. In particular we note that Globe's allegations relate to conduct prior to a settlement reached between Globe and OWG in 2001. Since that time OWG and Globe have been operating under pricing arrangements negotiated on Globe's behalf by its lawyers. A brief history of the relationship between OWG and Globe is as follows:

- a. OWG has purchased grapes (Chardonnay and Sauvignon Blanc) from Globe since the 1993 vintage under

contractual grape supply arrangements. The majority of the Globe vineyard was a new development when the contractual arrangements were first entered into. At that time, OWG expected the vineyard to develop into a vineyard capable of consistently producing high quality Chardonnay grapes and the initial pricing offered to Globe prior to 1999 reflected this expectation (and not the actual quality of the grapes being produced at the time). In essence, these were incentive payments to Globe and no guarantee was ever given that OWG would continue to pay prices which exceeded the market rate for equivalent grapes. The 15% rise and fall clause in the contract was the only protection offered to Globe in relation to future pricing.

- b. As the vineyard reached maturity, it became clear to OWG that its quality expectations for the vineyard would not be met and the prices offered to Globe from that point were adjusted (within the terms of the contract) to reflect the market price for the grapes (taking into account the actual quality of the grapes). Globe has never accepted that its vineyard has failed to meet quality expectations.
- c. Disputes relating to a number of matters arose between OWG and Globe between 1997 and 2000 and, as a result, Globe commenced legal proceedings against OWG in the NSW Supreme Court in 2001. As a result of these disputes, prices for the Chardonnay grapes delivered by Globe to OWG for the 1999, 2000 and 2001 vintages had not been agreed between the parties.
- d. Those proceedings were settled in 2001 and OWG and Globe entered into a new grape supply agreement - the Globe Agreement - which was deemed to have taken effect in 1997 (to cover the entire period in dispute). The new agreement was negotiated by Globe with the assistance of its legal advisers and the entire document was discussed at length between the parties during those negotiations. The majority of concessions granted during those negotiations were in favour of Globe.
- e. Although many of the misunderstandings between parties were resolved through the settlement process, the underlying disagreement as to the quality of the grapes produced at the Globe vineyard has never been fully resolved. However, both parties were aware during the settlement discussions that this would continue to be an

issue and various protections for Globe were built into the new grape supply agreement.

- f. As Globe and OWG had been unable to agree the prices for the Chardonnay grapes for the 1999-2001 vintages, an independent expert, Mr Stuart McGrath-Kerr, was appointed by the parties to set the price. Although OWG did not agree with the methodology applied by Mr McGrath-Kerr, as it completely ignored the quality of the grapes supplied in the relevant vintages, OWG accepted his determination as being final and binding in accordance with the terms of the agreement.
- g. A disagreement as to pricing arose again in relation to the Chardonnay grapes from the 2002 vintage. Globe exercised its rights to sell some of these grapes to a third party and the parties appointed Mr Charles Drew as an independent expert to determine the fair market price for the Chardonnay grape crop. Mr Drew sought independent legal advice in relation to the correct construction of the Globe Agreement and his determination was based on the advice that he received. Of particular importance was the acceptance that fair market price involved an examination of the quality of the grapes themselves as well as movements in market prices generally. Detailed reasons for his determination were provided and Mr Drew agreed that the fair market price for the Chardonnay grapes was actually below the 15% "floor" price applied by the Globe Agreement. Globe has not accepted this determination and has sought to challenge it, despite the fact that the Globe Agreement clearly states that the determination is intended to be final and binding (something that Globe accepted and enforced when faced with the favourable determination issued by Mr McGrath-Kerr).
- h. In late 2001 Globe made a complaint against OWG to the ACCC on the basis that, since 1999, OWG:
 - determined the price for the Chardonnay grapes using a "wine quality classification";
 - devalued the actual quality of the Chardonnay grapes; and
 - reduced the price paid to Globe by the maximum allowable reduction of 15%.

OWG provided lengthy submissions to the ACCC and the ACCC has determined that there was no breach by OWG of the *Trade Practices Act* and therefore no basis to Globe's various claims.

3. Summary

In summary, OWG strongly refutes the claims made by Globe in its submission to the Committee. OWG acknowledges that there have been and continue to be disagreements between OWG and Globe with respect to the quality and value of Globe's grapes. However, OWG has always acted in good faith in all of its dealings with Globe and has fully respected Globe's right to seek an independent price determination, pursuant to the grape supply agreement in place between the parties.

The allegations made by Globe in its submissions have previously been dealt with and settled in 2001, as outlined above. The ACCC has also previously investigated allegations made by Globe, with the full cooperation of OWG, and has determined that there was no basis to Globe's various claims.

We trust that the information provided above will assist you in your inquiry. In particular, we trust that the information provided by OWG will place the materials provided by Globe in their proper context. We note that some of these issues are extremely complex and are not explained in sufficient detail in this letter. OWG would be pleased to provide you with any further information as required.

Please do not hesitate to contact me on (08) 8208 2448 to discuss.

Yours sincerely,
ORLANDO WYNDHAM
GROUP PTY LTD

HELEN STRACHAN
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