

WINE GRAPES INDUSTRY ACT, 1991

REPORT ON A LEGISLATIVE REVIEW

FEBRUARY 2001

1.0 BACKGROUND

On 8 December 1997 the South Australian Government approved that a National Competition Policy review of the *Wine Grapes Industry Act 1991* be conducted jointly with reviews of similar legislation in Victoria and New South Wales.

KPMG Management Consulting was engaged to conduct the review. KPMG concluded that the indicative price arrangements that the *Wine Grapes Industry Act 1991* provides for do not have the effect of fixing, controlling or maintaining prices, are unlikely to give rise to a breach of the Trade Practices Act and are not presently operating to restrict competition in the market for the supply of wine grapes. Nevertheless, KPMG recommended that the Act be repealed because it is not achieving its apparent objectives. Such a recommendation was beyond the scope of the terms of reference for the review.

Rather than implement the recommendation to repeal the Act in isolation, the Government's preferred path was to work with industry stakeholders, particularly wine grape producers and processors, to explore alternative mechanisms for achieving desired outcomes. Primary Industries and Resources SA (PIRSA) established a departmental Review Team to manage the process.

The Review Team prepared a Green Paper to facilitate informed and objective input from industry stakeholders. The Green Paper drew extensively from the KPMG Issues Paper and Report, focusing on key issues that will assist the Government determine its position on the *Wine Grapes Industry Act* in order to conclude the NCP review.

2.0 INTRODUCTION

The *Wine Grapes Industry Act 1991* (the Act) enables the Minister for Primary Industries to recommend an indicative price for the sale to processors of wine grapes grown in defined areas. Indicative prices can be recommended according to the variety of wine grapes.

The Minister is also authorised to fix terms and conditions relating to payments made by processors to producers for wine grapes sold. In doing so, the Minister must not differentiate between processors.

The Minister must consult with wine grape producers and processors before recommending indicative prices or fixing terms and conditions. The Minister may also consult with such other persons as he or she thinks fit.

Both the indicative prices and the terms and conditions of payment are published as Ministerial Notices in the South Australian Government Gazette.

The substantive provisions of the Act are summarised as Appendix 1.

The Green Paper posed a series of questions and invited industry stakeholders to respond. Nine responses to the Green Paper were received by the Review Team.

In essence, it was the view of producer respondents that the Act should be retained, that processors should be compelled to negotiate indicative prices and that the penalties for processors who fail to comply with the terms and conditions of payment should be strengthened. Conversely, it was the view of processor respondents that the act of setting indicative prices has outlived its usefulness and should be discontinued.

The Australian Competition and Consumer Commission accepted an invitation to respond to the Green Paper. The Commission was cautious about any scheme that recommends or indicates prices. It also expressed concern that the apparent arms length distance between growers and processors and the indicative prices – as implied in the Act – does not exist.

The Commission advised that, in the absence of statutory exemption under section 51 or through the authorisation process, provisions which set terms and conditions of payment may breach the Trade Practices Act. In any event, it was the Commission's view that legislated terms of payment result in rigidity in the market.

3. DISCUSSION

3.1. Indicative Prices

There is widespread agreement, among grape growers and wine makers alike, that there has been substantial industry benefit from the information sharing process that commenced in 1992 following the then Trade Practices Commission's approval of the "Three State Agreement." The information sharing process does not rely on the Act.

Like the information sharing process, the wine grape market has become much more sophisticated, to the point where an indicator price for a variety has very little relevance. This is evidenced by:

- Southcorp scoring grapes on a scale of 1 to 30. The score then aligns with a specific product in the Southcorp range.
- BRL Hardy pioneering the use of Near Infra Red Spectroscopy to measure grape quality objectively.
- PIRSA partnering with the Vic and NSW departments, CSIRO and the MIA Wine Grapes Marketing Board in a CRCV project which aims to specify, define and document the key quality attributes for the main red and white wine grapes grown in south east Australia

More precise specification of grapes by winemakers will render an indicative price even more meaningless, even in the Riverland where large variations are emerging between prices paid for fruit suitable for premium wines and fruit suitable only for the cask market, even varietal fruit.

For these reasons, indicator prices have not been published for either the 2000 or 2001 wine grape harvests. There was a clear message from the Minister for Primary Industries and Resources at a meeting with the SA Farmers Federation Winegrape Section leadership group in October 2000 that indicator prices have passed their use-by date.

Given that the publication of indicative prices is a matter over which you have discretion and that you have chosen not to exercise that discretion for the past two harvests, the issue of whether the Act is achieving its objectives or not, which was the rationale for KPMG to recommend its repeal, is no longer worth pursuing. If the Act was subject to amendment, the Indicative Price provisions should be repealed.

3.2. Terms and Conditions of Payment

There is general support for retention of the payment provisions of the Act. This was reflected in the responses to the Green Paper. However, in view of the KPMG recommendation that the provisions be repealed, the former Microeconomic Reform Unit of Premier & Cabinet advised that retention of the payment provisions would require further analysis, in accordance with the Competition Principles Agreement.

It is important to recognise that, pursuant to the Act, the Minister **may**, by order, fix terms and conditions relating to the time of payment for wine grapes and the penalties for late payment. In determining terms and conditions, the Minister **must not** differentiate between processors.

The terms and conditions currently in force require payment of the first 33.3% of the amount payable essentially within one month of receiving the grapes. A further 33.3% is to be paid by 30 June and the balance by 30 September.

The Act also states that the processor must not accept delivery of wine grapes unless all amounts that have fallen due for payment in the previous season have been paid in full or **unless** the processor has been granted an exemption by the Minister, subject to such terms and conditions (if any) as the Minister specifies.

Therefore, the only aspect of the provisions where the Minister has no discretion and, as a consequence, cannot accommodate alternative arrangements is the requirement that the Minister not differentiate between processors when terms and conditions are fixed. This means that individual grape growers and wine makers cannot negotiate alternative payment arrangements which might be advantageous to both parties.

At present, many growers are making good profits and, if they are not expanding their vineyards, they may have cash on deposit at relatively low interest rates. In this environment, it is likely that delayed wine grape payments could be mutually beneficial. Moreover, risk-sharing agreements involving payment of a percentage of the price based on the eventual sale of the wine may also be mutually beneficial.

Further, as the demand for red wines increases and consumers move further up-market, stocks-to-sales ratios will increase, and with them, the cash-flow demands on wineries. Thus the potential benefits from alternative payment schedules are likely to be greater in the future. If similar legislation does not exist in other wine grape-producing States, the restriction may place South Australian growers at a competitive disadvantage.

The concerns of the ACCC that legislated terms of payment result in rigidity in the market could, therefore, be overcome if the Act allowed individual grape growers and wine makers to negotiate an alternative payment arrangement which might be advantageous to both parties when the Minister fixes terms and conditions of payment.

Nevertheless, with more fruit produced for red wine which winemakers hold for at least eighteen months, the temptation to defer payment of grapes until wine is sold might become too great for some winemakers, particularly those with cash flow problems. In these circumstances, the Ministerial Order would serve as a safety net for wine grape growers and wine makers who are either unwilling or unable to negotiate alternative arrangements.

As far as the community is concerned, there is no anti-competitive effect of any consequence of the safety net payment provisions as payment for the fruit is inevitable.

3.3. The Nature of the Grape Grower / Wine Maker Relationship

The buoyant wine grape market for the past five or so vintages has masked the fact that an adversarial relationship still persists between grape growers and winemakers, as evidenced by the SA Farmers Federation response to the Green Paper which records that “the Act needs to recognise that there are two industries, not one: one sells grapes and the other sells wine”.

Seeing other participants in the demand chain as their partners is a cultural shift that many grape growers and wine makers have yet to make. The result is that most grape growers and wine makers still retain a spot market mentality to pricing, rather than seeking to establish strategic alliances, which have the potential to address many of the problems inherent in the wine grape market.

4. CONCLUSIONS

There are no compelling reasons to retain the Indicative Price provisions of the Wine Grapes Industry Act.

The lack of industry opposition to the Terms and Conditions of Payment provisions suggest that the provisions are not currently having a significant impact on competition.

In order to address concerns that the Terms and Conditions of Payment provisions result in rigidity in the market, the Act should be amended to allow individual grape growers and wine makers to negotiate an alternative payment arrangement which might be advantageous to both parties when the Minister fixes terms and conditions of payment.

5. RECOMMENDATION

That Cabinet approval be sought to amend the *Wine Grapes Industry Act, 1991* to:

- remove the Indicative Price provisions of the Act;
- allow individual grape growers and wine makers to negotiate an alternative payment arrangement which might be advantageous to both parties when the Minister fixes terms and conditions of payment.

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MAIN PROVISIONS OF THE *WINE GRAPES INDUSTRY ACT 1991*

The Wine Grapes Industry Act essentially enables the Minister for Primary Industries to 'recommend' a price for the sale of wine grapes grown in defined areas to wine processors. Prices can be recommended according to the variety of wine grape. The Minister is also authorised to fix terms and conditions relating to the payments for wine grapes made by processors to producers. Both recommended prices and payment terms are published as Ministerial Orders in the South Australian Government gazette.

As the substantive provisions of the Act are quite short, they are reproduced in their entirety below.

Indicative price (Section 5)

- (1) The Minister may, by order, recommend a price (expressed as an amount per tonne) for wine grapes grown in the production area and sold to a processor.
- (2) The price may vary according to the variety of wine grapes.

Terms and conditions of payment (Section 6)

- (1) The Minister may, by order, fix terms and conditions relating to:
 - (a) the time within which payment for wine grapes must be made by processors; and
 - (b) payments (which are to be regarded as payments in the nature of liquidated damages) to be made by processors in default of payment within that time.
- (2) In determining terms and conditions, the Minister must not differentiate between processors.
- (3) Any terms and conditions fixed under this section are implied in every contract for the sale of wine grapes to a processor and any provision of a contract or other instrument is void to the extent of any inconsistency with those terms and conditions.

Consultation (Section 7)

- (1) The Minister must, before recommending prices or fixing terms and conditions under this Act, consult representatives of both producers and processors and may consult such other persons as he or she thinks fit.
- (2) A person may, at the request of the Minister or otherwise:
 - (a) make a submission to the Minister on the exercise of powers under this Act; and
 - (b) engage in discussions or negotiations incidental to making or considering such a submission.

Conditions for acceptance of delivery (Section 9)

- (1) A processor must not accept delivery of wine grapes for processing unless:
 - (a) all amounts that have previously fallen due for payment by the processor for wine grapes received by the processor, or any person acting on the processor's behalf, in a previous season have been paid in full; or
 - (b) the processor has been granted an exemption under this section. Penalty: Division 5 fine.
- (2) If a processor enters into a contract for the sale of wine grapes and is prohibited by this section from accepting delivery of the grapes, the processor will be regarded as being in breach of a fundamental condition of the contract.
- (3) The Minister may, by written notice, exempt a processor from this section subject to such conditions (if any) as the Minister specifies in the notice.
- (4) The Minister may, by written notice, revoke an exemption or vary or revoke any conditions to which an exemption is subject.
- (5) A processor who contravenes or fails to comply with a condition of an exemption is guilty of an offence. Penalty: Division 5 fine.

Application of the Act (Section 4)

This Act does not apply in relation to the sale of wine grapes by a member of a registered cooperative to the cooperative.