

Contract Use in the California Winegrape Economy

Rachael Goodhue, Dale Heien and Hyunok Lee*

The California winegrape industry is one of the most dynamic in all of agriculture. It has a long history, but has been growing rapidly for several years. Among the industry practices that have gained attention has been the increasing use of grower/winery contracts. It is perhaps surprising that there has been no systematic data available on the pattern of contract usage in the winegrape economy. This issues brief reports on our efforts to fill this void.

In agriculture as a whole, the extent of contract usage varies by commodity. Nationally, almost all broiler chickens, processed vegetables, and turkeys are marketed under contract, as are about half of fresh vegetables, but almost no feed grains. Contract usage in other fruits is not uncommon but the extent is not known.

Winegrapes are an important crop nationally, and especially in California where 96 percent of the U.S. output is grown. Grapes are the largest U.S. fruit crop in terms of cash receipts and over three-fourths of those receipts come from winegrapes. California winegrapes accounted for about \$1.5 billion or about 6 percent of California agricultural production value in 1998.

In the winegrape market, contracts are thought to mitigate the effects of uncertainty and imperfect informa-

tion. Initial investment, including land, can exceed \$40,000 or more per acre. After planting, there is virtually no crop for three years. Year to year fluctuations in yield and quality are considerable, causing substantial price variation. Since time is required to recoup the large initial investments, price variation and future price levels are major concerns.

Contracts deal with marketing uncertainty in several ways. Besides covering future price variations, planting contracts help growers secure financing for vineyard developments. Contracts often confirm the price to be paid upon delivery and avoid later conflicts. Also, a grower's bargaining position for an unsold crop becomes weaker as harvest time approaches and the contract helps assure a home for the grapes. Conversely, contracts assure a supply of grapes to wineries at a known cost. Contracts also provide a vehicle for wineries to implement and monitor viticultural practices, bonuses or penalties for attributes such as sugar and acid content or disease control.

The AIC Survey on Winegrape Contracts

In June 1999, the Agricultural Issues Center conducted a survey of contract usage in the California winegrape

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Table 1 – Regional Distribution of California Grape Growers

Region		All	North Coast	Central Coast	San Joaquin Central	San Joaquin South/Other
Acreage (acres)	CASS*	752,000	96,000	65,000	103,000	488,000
Number of Growers	CASS	11,726	3430	1018	1834	5444
% of Growers	CASS	100	29%	9%	16%	46%
% of Respondents	Survey	100	26%	12%	25%	37%
Acres/grower	CASS	64	28	64	56	90
Acres/grower	Survey	120	64	99	104	165

* *California Agricultural Statistics Service*

North Coast	Napa, Sonoma, Mendocino, Lake, and Solano
Central Coast	Monterey, San Luis Obispo, Santa Barbara, San Benito, Santa Clara, Santa Cruz, San Mateo, Contra Costa, and Alameda
San Joaquin Central	Sacramento, San Joaquin, Yolo (south of I-80), Stanislaus, Merced, and foothills
San Joaquin South/Other	Fresno, Tulare, Kings, Madera, and all other

industry. The survey was based on a questionnaire mailed to about 12,000 growers statewide (see the Appendix insert for a copy of the questionnaire). The CASS (California Agricultural Statistics Service) grape acreage database was used for this mailing. This database included all known grape growers and wineries. About 10 percent of the total are engaged in wine-making, either as a winery-grower or as a winery alone. The Center received over 2,000 responses, a nearly 20 percent response rate. Since a grower's time is valuable, we kept the questionnaire simple and short—one page, asking mostly yes or no answers.

Table 1 compares our survey coverage to the overall CASS data. The percentage response from each region closely matches the grower population percentage (CASS) in that region. This is one indication that the survey is representative of the population of grow-

ers. Survey respondents were generally operators of larger vineyards. However, the relative sizes of CASS acres per grower versus survey acres per grower in each region are similar. This is important since there are difficulties in ascribing average size to intervals (see survey question 15) making the survey average size computation somewhat problematical.

Survey Results

Table 2 gives the percentage of respondents (growers and wineries) who use contracts at all and whether the contracts are written or oral. Clearly, contract usage is widespread in the winegrape industry.

Table 3 shows that overall about 10 percent of all contracts were made before vines were planted (planting contracts). This percentage is highest in the Central

Valley where the share of new winegrape acreage is high. Table 3 also indicates that contracts with evergreen (renewal) clauses are common, accounting for 30 percent of all contracts and as much as 45 percent on the North Coast.

Survey responses showed that 50 percent of respondents had contracts of more than one year with an average length of 3.5 years (not shown in tables). The most frequent contract lengths were 3, 5 and 10 years; 10-year contracts were generally planting contracts.

Note that one-year contracts are nearly equivalent to spot market sales since few growers wait until harvest to obtain a buyer, even if they do not have a prior contract.

Price Determination

The manner in which prices are determined is an area of major interest. Table 4 gives the percentages of contracts using various methods for price determination.

The column totals in Table 4 can sum to more than 100 percent since some contracts have more than one price determination method. For example, the base price could be stated in the contract and also could be adjusted year-to-year with the county average (reference price) for that variety, or could be negotiated yearly within a set minimum and maximum. In Table 4, the term “Stated in contract” means that the buyer and seller agree to a price or a price schedule over time and incorporate it in the contract.

The term “Reference price” means that the contract price is based on some widely available price, such as the crush district average, which is published annually by CASS. The “Maximum” and “Minimum” entries in Table 4 refer to stated maximum or minimum price limits. The most popular form of contract is a reference price but the methods varied significantly across regions.

Our survey also asked if the contract specified quantities. We found that 22 percent of contracts stipulated maximum tonnage although nearly half did note some expected level of tonnage or specified grapes from a certain acreage.

Table 2 **Contract Usage**

	All	North Coast	Central Coast	Central	South & Other
	%				
No contract	10	4	11	6	18
Written Only	70	71	56	68	74
Oral only	11	13	20	15	4
Both	9	12	13	11	4

Table 3 **Planting Contract and Evergreen Clause**

	All	North Coast	Central Coast	Central	South & Other
	%				
Planting contract	10	9	13	21	8
Evergreen clause	30	45	34	31	9

Table 4 **Price Determination Provisions**

	All	North Coast	Central Coast	Central	South & Other
	%				
Stated in contract	31	27	30	29	36
Negotiated yearly	27	28	25	27	24
Reference price	35	50	41	34	11
Per Acre price	2	3	3	1	1
Maximum	8	8	13	9	7
Minimum	15	13	14	24	14
Other	5	4	3	3	3

Bonuses and Penalties

The survey also asked about the extent of bonuses and penalties for sugar, acids, MOG (material other than grapes), and defects (rot, mildew, etc.). As shown in Table 5, penalties are more prevalent than bonuses, although 33 percent of contracts in the San Joaquin South/Other region does provide for a sugar bonus. Overall, only about 10 percent of contracts have bonus provisions, while over 35 percent of contracts have penalty provisions.

Other survey responses

- Most sellers have been in the grape growing business for many years — the average was 19 years, with little variation by region. The average time with the same buyer was 9 years, again with little regional variation.
- Only 7 percent of contracts were brokered by a third party.
- Almost half of the contracts for the North and Central coasts contained conflict resolution clauses such as arbitration. The share was less than one-third in the other regions.

Table 5 **Bonuses and Penalties**

	All	North Coast	Central Coast	Central	South and other
	%				
Bonus					
Sugar	18	11	7	17	33
Acids	4	3	3	3	6
MOG*	9	7	5	10	13
Defects	10	8	10	10	15
Penalty					
Sugar	42	13	40	57	34
Acids	10	11	9	12	7
MOG*	43	39	37	59	48
Defects	47	45	41	60	48

*Material other than grapes

Summary

The primary finding of the AIC survey is that contract usage is widespread in the winegrape industry: 90 percent of growers surveyed have contracts. Of this 90 percent, 80 percent are written and 10 percent are oral contracts. The majority of the respondents had multi-year contracts. Many contracts contained an evergreen (renewal) clause.

The survey showed that price determination, the most important aspect of a contract, was roughly divided among: (a) a negotiated price stated in the contract, (b) a price to be negotiated yearly, and (c) a contract price based on some reference price such as the crush district average. The referenced price method was most favored in all regions except in the San Joaquin South/Other region. Bonuses were not widespread with the exception of sugar for the San Joaquin Central and South/Other regions, while penalties were common in all regions. ■

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The UC Agricultural Issues Center is interested in contractual relations between growers and wineries. We would appreciate cooperation of growers and wineries in filling out this questionnaire. We do not ask for your name or for prices and all responses will be kept confidential. Please use the enclosed business reply envelope and mail as soon as possible. The preliminary results of this survey will be presented at our Winegrape Outlook Workshop on July 7. To obtain a copy of the results, telephone 530-752-2320 or email: agissues@ucdavis.edu. Thank you for your participation.

If you do not use a winegrape contract, please answer questions 1-3 and return. If you have more than one contract, choose the most representative. If you are both a grape grower and a winery, answer as most appropriate for you, or return two surveys (one for each operation).

- 1 Are you a grower or a winery? Grower (Seller) Winery (Buyer)
- 2 Do you use a written contract? Yes No
- 3 Do you use an oral contract? Yes No
- 4 Is your contract for one year? Yes No, how many years? _____
- 5 Is it a planting contract? Yes No
- 6 Does your contract have an evergreen clause? Yes No
- 7 How is price determined? *Check more than one if needed.*
- Fixed price stated in contract Fair market price, e.g. negotiated yearly
- Price based on some reference price (Crush district average, etc.) Per acre price
- Specified max and/or min price (circle one) Other, please describe (use back)
- 8 Does your contract specify tonnage? Yes No
- Acreage? Yes No
- Maximum tonnage? Yes No
- 9 Bonuses/Penalties
- | | | |
|----------------------------------|--|--|
| | Bonuses | Penalties |
| For sugar? | <input type="checkbox"/> Yes <input type="checkbox"/> No | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| For acids? | <input type="checkbox"/> Yes <input type="checkbox"/> No | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| Material Other Than Grapes (MOG) | <input type="checkbox"/> Yes <input type="checkbox"/> No | <input type="checkbox"/> Yes <input type="checkbox"/> No |
| Defects (mold, rot, mildew)? | <input type="checkbox"/> Yes <input type="checkbox"/> No | <input type="checkbox"/> Yes <input type="checkbox"/> No |
- 10 Was your contract brokered by a third party? Yes No
- 11 Is there a clause for disagreement resolution? Yes No
- 12 Contract requires/suggests specific viticultural practices? Requires Suggests Neither
- 13 Contract includes a best viticultural practices clause? Yes No
- 14 Contract requires winery be informed of chemicals used? **Before use** Yes No **After use** Yes No
- 15 What varieties do you market/buy? [up to 3]
- 16 Total Acres (circle): 0-10 11-25 26-49 50-99 100-199 200-499 500+
- 17 How many years have you dealt with your current buyer/seller?
- 18 How many years have you been in the grape/wine business?