

# CENTER FOR RURAL PROSPERITY AND INNOVATION

## Peanut Forfeitures: A Revisit Peanut Update

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## ADDITIONAL INFORMATION

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Questions have arisen about peanut forfeitures. Historically, peanut forfeitures have usually been less than half a percent (<0.5%), Table 1. The last all-time high peanut production occurred in 2012 when a record yield was reported. For that crop, only 1.66% of the crop was forfeited. One could say, based on history, any significant peanut forfeitures are an anomaly. When an anomaly occurred, a unique event created the environment for significant forfeitures.

The last major anomaly occurred during the 2014 crop year. The Clint Williams Company (peanut sheller) filed for bankruptcy. Their inventory was treated as forfeitures and sold as a fire sale where the posted price for those peanuts was set \$100 per ton below the loan rate. This created a major disruption in the peanut sector. The second potential anomaly that has created the environment for a potential significant forfeiture of the 2017 peanut crop was the major inaccuracy in the 2015 ending inventory of the magnitude of over 800,000 tons. Once USDA-NASS discovered that the major error was due to incorrect data reporting by the industry, they immediately corrected the ending inventory number. The U.S. House Agriculture Committee discussed the issue with USDA-NASS. In addition, peanut growers included this issue in 2017 testimony before the U.S. House and Senate Agriculture Committees.

Why would this event lead to potential forfeitures of the 2017 crop? It created a roller coaster environment. During the 2016 crop planting decision time, contract prices were very low (\$355 to \$380) due to the expected significantly large ending inventory which implied limited storage capacity for the 2016 crop in the Southeast. Southeast farmers reduced acreage by 11%.

Once USDA corrected the mistake during the 2016 crop growing season, contract prices for the uncontracted 2016 crop and any unsold 2015 crop in the loan increased significantly to the \$450/ton range. Later, any uncontracted 2016 crop peanuts saw contracts increase even more. As one major sheller stated in their newsletter "This will continue to support 2016 crop values as the market is forced to ration supply of quality tons." At that point in time, demand exceeded supply. Given this economic situation, early contract prices for the 2017 crop were reported in the \$475-\$550/ton.

What does a contract look like between a peanut sheller and the peanut farmer? The contracts are classified as an option contract. The sheller has the option to purchase that farmer's peanuts at the lesser of either the loan rate or the posted price. The sheller pays the farmer, typically at delivery when the peanuts are graded, the option money. When one hears reported in the peanut industry that the contracts are \$400/ton, it really means the farmer will receive the \$355/ton loan value plus an option of \$45/ton. This option contract would be for a limited yield/acre (e.g., 1 ton per acre) and for a given number of acres. The limited yield has historically been significantly below the farmer's normal yield. For example, if a farmer normally produces 2 tons per acre, the option contract may be for 1 ton. The option contract may specify a significantly lower price for the additional yield or may state that those peanuts may be purchased at market price at harvest time. If a farmer signs the option contract, the farmer also signs a power of attorney document giving the sheller the ability to redeem the peanuts at their discretion or forfeit the peanuts. All option contract peanuts go into the loan. The option contracts also reimburse the farmer for the shrinkage (3.5%) taken by USDA when a loan is made. Since loan peanuts are placed in the loan on the first of the month, a farmer may owe storage between the time of harvest and the first of the next month. Again, the sheller will cover this expense for a farmer with an option contract. This puts pressure on the farmer to have an option contract otherwise the farmer is looking at receiving significantly below the loan value of \$355/ton at harvest time when he/she places their peanuts in the loan.

Besides the significantly higher 2017 contract price, the contracts were significantly different from prior years and even the 2018 contracts as described previously. What was the difference? At least one sheller did not



restrict the contract price to a certain production level, e.g., for the first ton produced. Any yield per acre above the ton level would have a lower price, or a price later or no price. Thus, for at least one sheller the contract price was for all production by the farmer, i.e., no production limit. The implication is that at least one sheller thought the market demand was growing faster than it really did.

Given the significantly depressed net farm cash income plus cotton prices were very low at planting and had no farm bill safety net, farmers responded to the price signal and planted peanuts in 2017 to the tune of 1.87 million acres which was a 12% increase over 2016. Coupled with favorable weather, 2017 peanut yield exceeded 4,000 lbs/acre which was only second to the historical high average in 2012. The increased yield and acreage lead to a record production of over 7.2 billion lbs. This was 7% higher than the previous record in 2012 and 30% higher than the prior year's crop of 2016.

However, manufacturers seemed to have reduced the demand for shelled peanuts significantly from earlier anticipated levels. While manufacturers may have contracts for a given production level, they are spreading out the delivery longer than usual.

Given the imbalance in supply relative to demand, economic theory suggests that manufacturers are delaying their contract deliveries and future purchases with the concept of obtaining lower shelled prices. Current shelled prices are significantly lower than the prior year.

Finally, the trade rhetoric has created a cloud over the peanut sector. Domestic manufacturers may believe with reduced exports and the level of ending inventory that domestic prices accepted by shellers will drop further. Thus, they have put off purchases. However, shellers may not feel they can offer lower prices given the price they paid for the 2017 crop.

Any potential forfeitures of the 2017 crop started with the incorrect reporting of the 2015 crop ending inventory due to incorrect data reporting by the industry which lead to a reduced supply of the 2016 crop. This created an imbalanced supply and demand where demand exceeded supply. The industry responded to this imbalanced by offering significantly higher prices to increase supply of the 2017 crop. Farmers responded appropriately and Mother Nature ensured an excellent yield. Demand declined due to external factors. This has created a situation where supply exceeds demand for the 2017 crop. Compounding the situation is that USDA-NASS is forecasting another year of excellent yields for the 2018 crop which is starting to be harvested. This leads to "new" crop versus "old" crop competition.

Despite this environment, two of the three major peanut shellers have committed to redeeming all of the loan peanuts in their warehouses. Plus, two of the three grower-owned shelling organizations in the Southeast have committed to not forfeit any 2017 peanuts. In fact, they have stated that they will be totally shelled out of the 2017 crop by the end of September. Yet word has come from Alabama that farmer(s) peanuts that had an option contract with one sheller have been forfeited by the sheller. Why would a sheller forfeit an option contract peanut since they are responsible for paying the option money and any upfront storage fees before they were placed in the loan except for the possibility of repurchasing the peanuts on the Seam at a lower price and not being responsible to reimburse USDA for the storage and handling fees?



*Table 1. Peanut loan forfeitures and percentage of crop, 2002-2017*

crop year	Acquired by CCC		NASS production	
	million lbs.	million lbs.	million lbs.	% Forfeited
2002	5.8	3,321.04		0.17%
2003	0.9	4,144.15		0.02%
2004	211.7	4,288.20		4.94%
2005	83.9	4,869.86		1.72%
2006	0.9	3,464.25		0.03%
2007	0.9	3,672.25		0.02%
2008	11.8	5,162.40		0.23%
2009	5.9	3,691.65		0.16%
2010	0.0	4,156.84		0.00%
2011	0.0	3,658.59		0.00%
2012	111.9	6,753.88		1.66%
2013	12.1	4,173.17		0.29%
2014*	346.3	5,188.67		6.67%
2015	0.1	6,001.36		.0017%
2016	78.3	5,684.61		1.38%
2017**	14.2	7,233.60		0.20%

\* Clint Williams bankruptcy

\*\* August 27, 2018 USDA-FSA Commodity Loan Activity Report

