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When Markets Diverge: Pricing Chicago road fuels

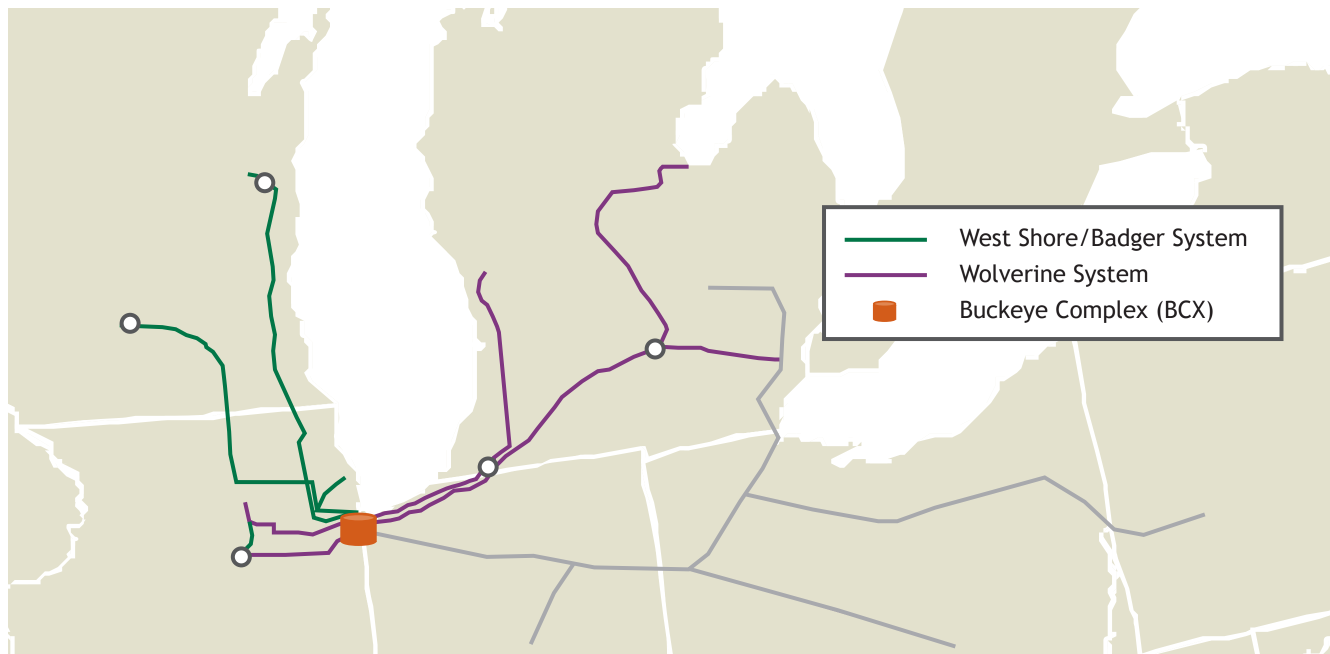
When you think of Chicago, you may think of a tightly-defined geography in northern Illinois - a windy city with a rich history of deep dish pizza and winning sports teams. But Chicago spot markets have a much wider reach, making them some of the most important in North America. Fuel supply contracts from Wisconsin to Missouri, Kentucky to Michigan, and Illinois to Ohio all frequently cite a "Chicago" spot price, and many of them will be fulfilled with fuel from one of Chicago's three major refineries.

The problem with talking about a "Chicago" spot price is that it can mean many things. The price of fuel on the West Shore pipeline? The Badger pipeline? The Wolverine pipeline? Or off the Explorer pipeline? Maybe it means the price of fuel at a particular terminal – the Buckeye storage complex (BCX)? Or perhaps East Chicago? All these pieces of infrastructure move fuel between different markets, and work in very different ways.

If this seems familiar, it's because you've seen it before. The prequel to Chicago? New York! Spot trade in the harbor has for years been split between several distinct sub-markets. There are market prices for cargoes, for barges, for Buckeye pipeline clips … even for fuel coming off the Colonial pipeline. Index providers like Argus publish daily prices for each one of these submarkets, giving you a clear picture of what different fuels cost at different locations.

In Chicago, the distinctions between these markets haven't always been so clear-cut. Price index providers have tended to ignore the difference between locations, bundling all Chicago trade into a single "generic" or "Chicago area" price assessment. These Chicago prices – used in contracts all across the Midwest – incorporate plenty of trade, and cover a lot of ground, but lack specificity.

KEY CHICAGO FUEL INFRASTRUCTURE



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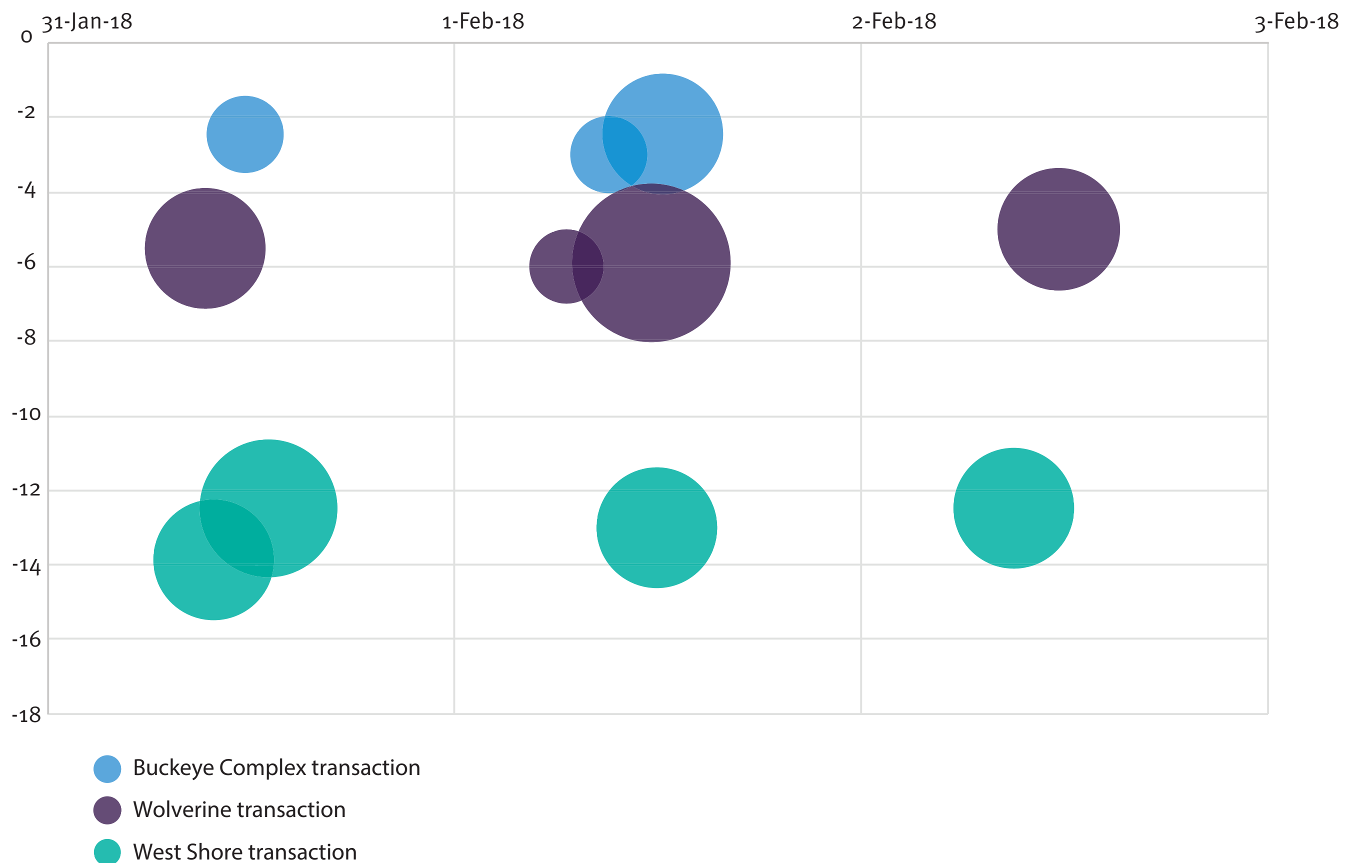
So what's changed? Do "generic" Chicago prices no longer work? Simply put, yes, and that's because "generic" Chicago spot trades no longer exist. When it did exist, a Chicago "generic" trade meant the fuel would be delivered to any Chicago location at seller's option. If you went into the spot market to buy 25,000bl of generic diesel, you accepted that the product might not be delivered to your location of choice, but the risk was small (each location was around the same price) and delivery terms could be negotiated.

Several years ago, these Chicago "sub-markets" began to diverge from one another, largely because of increased refinery output and changes to local infrastructure. Some rose in price, and others fell. As some sub-markets grew more expensive than others, sellers of the "generic" chose to deliver fuel at the cheapest location. Buyers became unwilling to accept the risk of getting fuel where they didn't need it, and started insisting on location-specific deals. Rather than bidding for 25,000bl of "generic," they went into the market for 25,000bl of Wolverine or 25,000bl of West Shore.

Even though "generic" Chicago is no longer a traded contract, it is still possible to craft a "generic" Chicago assessment that looks and feels like the old version. Some might do that by defining it as the cheapest of the three Chicago locations, whatever that happens to be on a given day. This approach mirrors the economics of a seller-driven, delivered-anywhere generic contract. Others might take a less scientific view to generating a "generic" assessment, looking at all Chicago locations and then seeking consensus from a group of traders on where "generic" should be priced.

THREE DAYS IN THE CHICAGO SPOT MARKET FOR CBOB GASOLINE (CPG VS TO NYMEX FUTURES)



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But neither of those approaches deals with the crux of the problem: that generic Chicago no longer exists as a spot market, a geography, a concept, or a price. Instead, there are three distinct Chicago markets, each at a different price, each subject to different supply-demand factors, and each serving a different geography.

When spot markets change, price indexes have to either change with them, or become irrelevant. So in March of 2016, Argus broke the mold and split its coverage, first launching assessments for the Buckeye Complex, and in May 2018, for the Wolverine pipeline. It has become imperative to assess all three fungible locations in Chicago: the West Shore / Badger pipelines market; the Buckeye Complex storage terminal; and the Wolverine pipeline. The aim? To throw light on every corner of the market and provide complete transparency to buyers, sellers, and the people in between, enabling all of us to make smarter business decisions.

With a full array of prices, buyers in Milwaukee can sign contracts against a West Shore/Badger index that moves with their market. Jobbers in Michigan or even eastern Canada can use a Wolverine-specific quote. Those buying fuel on Explorer or looking for optionality can use a BCX quote. This new price visibility, with market specificity, gives participants confidence and certainty – the knowledge that their contract will settle against the price that genuinely reflects their market.

This is significant to the downstream road fuel markets. A Michigan marketer shouldn't have to see his or her price hit by an outage that only affects Wisconsin. But if our marketer has a contract indexed to a generic Chicago price, that's exactly what will happen. Likewise, a Wisconsin buyer shouldn't have to pay Michigan prices for fuel that is available off West Shore at a 7 cent discount.

And it isn't just the gasoline market that sees these risks. Chicago diesel markets bifurcate throughout the year, with Buckeye Complex (BCX) diesel often commanding a large premium over West Shore/Badger and Wolverine. A wholesaler exposed to the BCX-West Shore spread could have been losing as much as 3-4 cents from their margin early this spring, enough to cause serious financial hardship at best.

The obvious lesson to take from the last three years of Chicago's fuel price evolution is that markets change. Even before Chicago, we saw New York evolve from cargo to barge, from Buckeye to Colonial offline, and even for a time to a USGC basis. Change happens.

As retailers, wholesalers, jobbers, or refiners, we have to pay attention to the nuances that affect prices in the markets we participate in. It's important to constantly question the status quo in order to maintain a reasonable margin. Vigilantly watch for advances in market coverage as they emerge. They can have a huge impact on your enterprise.

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