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Argus White Paper:

When markets diverge — Pricing Chicago road fuels

The key Chicago road fuels market has seen significant change over the past three years, as developments in local infrastructure and refinery output have eroded the notion of a generic "Chicago" spot price, creating the need for price assessments that more accurately reflect specific market conditions

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 frequently cite a "Chicago" spot price, and many of them will be fulfilled with fuel from one of Chicago's major refineries.

The problem with talking about a "Chicago" spot price is that this 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? Or perhaps East Chicago? All these pieces of infrastructure move fuel between different markets, and work in different ways.

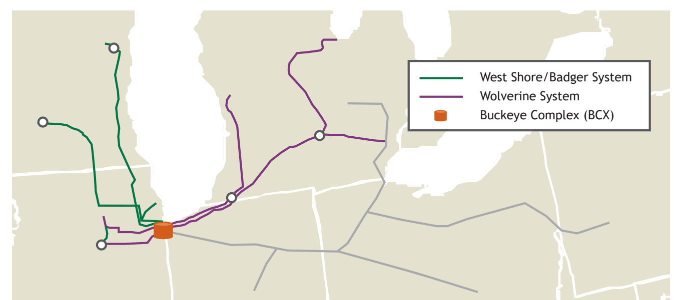
If this seems familiar, it is because you have seen it before. The prequel to Chicago? New York! Spot trade in the harbor has for years been split between several distinct sub-markets. There are market prices for cargoes, for barges, for Buckeye pipeline clips… even for fuel coming off the Colonial pipeline. Price reporting agencies (PRAs) such as *Argus* publish daily prices for each of these sub-markets, providing a clear picture of what different fuels cost at different locations.

In Chicago, the distinctions between these markets have not always been clear-cut. PRAs have tended to ignore the differences between locations, bundling all Chicago trade into a single "generic" or "Chicago area" price assessment. These Chicago prices – which are used in contracts across the Midwest – incorporate plenty of trade, and cover a lot of ground, but they lack specificity.

So, what has changed? Do "generic" Chicago prices no longer work? Simply put, yes, and that is 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 25,000 bl of generic diesel, you accepted that the product might not be delivered to your location of choice, but the risk was small — the price at each location was around the same — 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 became 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 did not need it and started insisting on location-specific deals. Rather than bidding for 25,000 bl of "generic" Chicago fuel, they went into the market for 25,000 bl of Wolverine or 25,000 bl of West Shore.

Key Chicago fuel infrastructure



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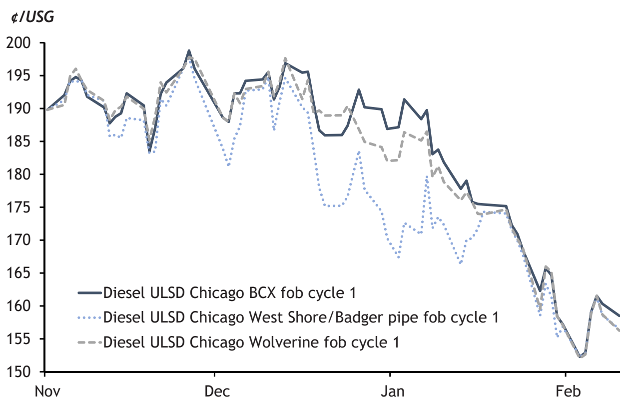
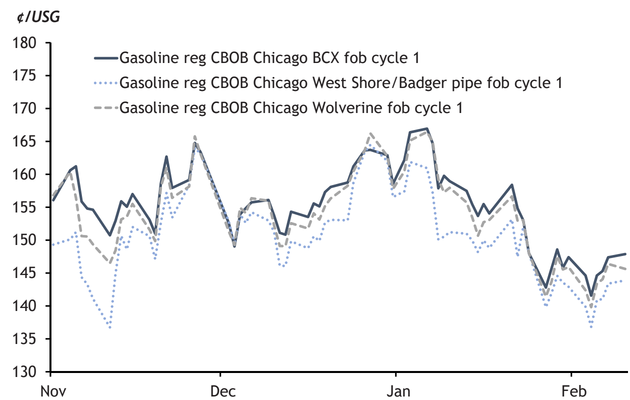
Argus historical prices - Chicago diesel



Argus historical prices - Chicago gasoline



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.

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, subject to different supply-demand factors, and serving a different geography.

When spot markets change, price indexes have to either change with them, or become irrelevant. So, in March 2016, *Argus* broke the mold and split its coverage, launching assessments for the Buckeye Complex, followed by prices for the Wolverine pipeline in May 2018. 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 everyone 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 assessment. Those buying fuel on Explorer or looking for optionality can use a Buckeye Complex price. 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 should not have to see his or her price hit by an outage that only affects Wisconsin. But if our marketer had a contract indexed to a generic Chicago price, that is exactly what would happen. Likewise, a Wisconsin buyer should not have to pay Michigan prices for fuel that is available off West Shore at a 7¢ discount.

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

The obvious lesson to take from the past 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 US Gulf coast basis. Change happens.

Retailers, wholesalers, jobbers and refiners all have to pay attention to the nuances that affect prices in the markets that they participate in. It is important to constantly question the status quo in order to maintain a reasonable margin, and to watch for advances in market coverage as they emerge — they can have a huge impact on your enterprise.

Argus has been at the forefront of the Chicago market evolution, launching the industry's first Buckeye Complex prices in 2016. Since then, Argus has carved out Wolverine and West Shore Badger assessments, added new cycles, and — most recently — launched premium gasoline prices for the Buckeye Complex and the Wolverine pipeline. All of *Argus*' premium gasoline prices are now assessed directly against Nymex Rbob, simplifying the way you see Chicago cash differentials. All prices for West Shore Badger, Buckeye Complex, and Wolverine are published daily the Argus US Products report.

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