Article rank | *2 Feb 2019* | *Toronto Star* | *REBECCA ELLIOTT AND PAUL ZIOBRO* | *THE WALL STREET JOURNAL*

Oil trains make comeback as pipeline bottlenecks worsen

Crude-by-rail has rebounded across U.S. as production has outstripped pipeline capacity

The use of trains to carry crude is surging after dropping in recent years amid concerns about safety, as drillers in parts of North America produce more oil than area pipelines can accommodate.

MATTHEW BROWN THE ASSOCIATED PRESS FILE PHOTO

Much of the recent oil train growth is due to record shipments from Canada, where pipeline expansion projects have stalled.

An average of 718,000 barrels of crude a day traversed America's railways as of October, the latest data available, an 88% increase from a year earlier, according to the U.S. Energy Information Administration. That compares with a peak average of about 1.1 million barrels in October 2014.

Much of the recent oil train growth is due to record shipments from Canada, where pipeline expansion projects, including Keystone XL and Trans Mountain, have stalled amid environmental opposition and legal delays. Crude-by-rail shipments also have ticked up from North Dakota's Bakken region and the Permian Basin of West Texas and New Mexico, according to energy-monitoring firm Genscape Inc.

The crude-by-rail comeback is expected to last through late this year in the Permian, and longer in North Dakota and Canada, as companies struggle to lay new pipe as quickly as drillers are getting oil out of the ground.

Shipping oil by train is more expensive than sending it through a pipeline, so producers often avoid making longterm commitments to rail companies. It costs about $20 a barrel to send oil by rail from Canada to the U.S. Gulf Coast, compared with about $12.50 by pipeline, according to energy investment bank Tudor Pickering Holt & Co.

But pipeline projects typically lag behind growth in oil and gas production, and the gap has lengthened in many parts of the country in recent years as local activism has made it increasingly difficult to complete projects. Meantime, North American oil production topped 15.6 million barrels daily in August, a 17% annual increase, according to the EIA.

Bottlenecks have grown particularly severe in Canada. Heavy crude there was selling locally for more than $50 a barrel below U.S. benchmark prices last fall, reflecting producers' inability to get it to market due to pipeline problems. U.S. oil prices have since fallen about 24%, closing at $54.23 a barrel on Wednesday.

The congestion in Canada spurred companies including Houston-based ConocoPhillips and Calgary-based Cenovus Energy Inc. to ink rail deals.

"The intention is to bridge us over to the next major pipeline expansion, so a few years," ConocoPhillips finance chief Don Wallette, Jr. said last fall.

Cenovus's three-year agreements will allow it to transport about 100,000 barrels of oil daily to the U.S. Gulf Coast, where refiners mix it with lighter crudes to produce fuel.

In October, about half of the oil the U.S. imported by rail from its northern neighbor went to the Gulf Coast, EIA data show, helping to offset a 30% decline in crude purchases from Venezuela over the past two years. Roughly a quarter went to the Midwest, while smaller amounts went to the East and West coasts.

Derailments, notably one in Lac-Mégantic, Quebec, that killed 47 people in 2013, have raised concerns about the safety of transporting oil by trains on a large scale. That prompted federal regulators to impose tougher safety requirements for railcars, though opposition remains in some communities.

The heightened demand for oil train transportation has benefited railroads including Union Pacific Corp., whose petroleum shipments rose 30% last year to 228,470 carloads as the company handled more crude oil. But Chief Executive Lance Fritz said the Omaha, Neb.-based railroad isn't investing heavily to support crudeby-rail shipping because the demand could evaporate once major pipeline projects come online. "We're careful to make these commitments because it's a short-lived phenomenon," Mr. Fritz said in a recent interview. "It's just not going to be around for long-term returns."

Since shipping oil by rail is generally more expensive, pipelines remain a more attractive option when available, analysts say. "People would love to have the optionality to move onto crude by rail whenever they want to, but nobody wants to be signing a check for it," RBN Energy analyst John Zanner said.

Mr. Zanner said because of limited supply of railcars and other infrastructure he doesn't expect oil train shipments from Canada to increase significantly as a result of U.S. sanctions on Venezuela's state-owned oil company.

Oil companies often use trains on an ad hoc basis, and rail provides geographic and financial alternatives for producers wary of committing to new pipes. Pipeline companies typically won't proceed with a project unless drillers sign multiyear contracts guaranteeing payment regardless of whether they have oil to ship.

Whiting Petroleum Corp. is weighing those trade-offs in North Dakota, where it is evaluating whether to support an additional pipeline or rely on costlier, but more flexible, crudeby-rail transportation. Crude production in the state, once the heart of oil-train transportation, has swelled about 38% since the Dakota Access Pipeline opened in 2017, federal data show, testing the limits of existing pipelines.

In November, oil sold in Minnesota fetched as much as $19 a barrel less than it would have at the main U.S. trading hub in Cushing, Okla., reflecting the bottleneck, according to pricereporting agency S&P Global Platts. "You're always balancing between getting the infrastructure in place versus flexibility," said Peter Hagist, a senior vice president for Whiting.

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