Shale plays are driving rail usage by oil companies

Sanford Nowlin
Reporter- *San Antonio Business Journal*

The domestic oil boom has South Texas companies — from refining giant **Valero Energy Corp.** to wildcatter Rod Lewis' Lewis Energy Group — riding the rails.

Railroads shipped a record 97,135 carloads of crude oil in the United States during the first quarter, up 166 percent from the same period last year. The expansion comes as production from shale plays, like the nearby Eagle Ford, outstrip pipeline capacity and environmental debate holds up completion of the Keystone XL pipeline.

Rail's new significance came into sharp focus last week when energy giant Kinder Morgan shelved a $2 billion pipeline plan because refiners, including San Antonio's Valero Energy and **Tesoro Corp.**, are moving more crude via rail.

"If you have a pipeline, for the most part, you have one place where you input and one where you output," Valero spokesman Bill Day says. "With rail you can bring in crude from a variety of places. It makes a lot of economic sense."

And while rail is pricier than pipe, it also has a speed advantage, Day adds. Cars can whisk along crude shipments at speeds of up to 60 miles per hour, while transferring crude cross-country via pipeline can take a week or more.

Valero, arguably the most active refiner in rail, hopes to build a fleet of 12,000 rail cars by 2015. The company will spend up to $190 million to build a rail off-loading facility at its Jean Gaulin refinery in Quebec and another $30 million on rail infrastructure to bring inexpensive mid-continent crude to its Benicia, Calif., plant.

San Antonio-based midstream firm NuStar Energy LP in 2011 formed a joint venture to run a train-offloading facility at its crude terminal in St. James, La. It's now doubling the size of that operation, increasing the company's rail capacity to 140,000 barrels per day.

"We got into rail early on, and we continue to see a value in it," NuStar Chief Executive Officer and President Curt Anastasio says.

Rail growth around North Dakota's Bakken Shale is easy to understand, given the remote area's lack of midstream infrastructure. But even in the Eagle Ford — zig-zagged by miles of existing pipeline — rail development is exploding.

Lewis Energy's LaSalle Railway affiliate began developing an $11 million rail park in Encinal, 40 miles north of Laredo, as a way to bring in its own supplies. It's now fielding inquiries from businesses interested in moving everything from crude to frac sand.

Given the interest, Lewis Energy Vice President Rick Smart says he expects the facility to support up to 150 jobs by the middle of next year.

"We already have at least four different opportunities developing right now," he says. "It's almost turned out to be a 'Field of Dreams' thing: If you build it, they will come."

The newly developed Live Oak Railroad near Three Rivers will begin switching rail traffic in the next 30 to 45 days.

The 250-acre development — backed by San Antonio's Howard Midstream Energy Partners LLP — will benefit both from the export of shale crude and the importation of supplies like sand, pipe and chemicals into the shale, says managing partner Bart Simpson.

"The bottom line is rail is more versatile when it comes to moving a commodity," Simpson adds. "A pipeline goes one place, but rail can go a number of places. You can go wherever the market is."

An hour away, Cotulla's Gardendale Railroad Inc., once nearly abandoned, now is selling its third development phase of a rail park adjoining its 28 miles of track. The facility is expected to handle 20,000 railcars a year as it expands.

No quick fix

While rail is thriving, analysts caution that it's not likely to be the ideal solution for every petroleum player.

"Rail provides tremendous speed, but I don't know that it necessarily provides tremendous savings," says Gregg Laskowski, senior petroleum analyst for **GasBuddy.com**. "The best situation for a refiner probably involves both. I don't know that we're looking at an either-or scenario."

Plus, Laskowski says, rail is likely not a realistic proposition for refineries without rail access in close proximity. Those in remote areas may find pipelines or barges the only feasible solution.

While Kinder Morgan pulled the plug on its Freedom pipeline in part because of its potential customers' interest in rail, experts say the trend is unlikely to significantly disrupt pipeline construction.

"I don't think you'll see these shipments derail — if I can use a bad pun — more major pipeline projects, because there's still such a great need," says Bill Waldrip, managing partner in EnCap Flatrock Midstream, whose investments include both pipelines and rail. "I think you'll see conventional pipeline projects continuing along with rail."

Still, industry officials maintain that rail isn't just a quick fix while pipeline infrastructure catches up with demand. Many point to the size and scope of their rail investments as proof that it will be a viable way of shipping for years to come.

"Even after all these pipeline projects are built, there still won't be enough to move all the crude that needs to be moved," Valero's Day says. "Rail is going to be around for a while."