

THE RAILROAD WEEK IN REVIEW

February 28, 2014

"The railroads are back in the oil business and they aren't going away — ever." - - Fred Frailey, Trains magazine, March, 2014.

Crude oil shipments on short lines and regional railroads can be big business. Fred Frailey's March, 2014 feature article in *Trains* names 21 properties with line-haul or origin terminal operations in this sector. Of these, 14 connect with BNSF, 11 with UP, two with CN and one with CP. Genesee & Wyoming owns three, Watco and Iowa Pacific each own two, while Rio Grande Pacific and OmniTrax own one apiece. The rest are non-affiliated.

The Dakota, Missouri Valley & Western is the biggest property in terms of route-miles at 534; Watco's newly-minted Swan Ranch Railroad near Cheyenne is the smallest at three miles. You can count the number of short lines in the Bakken Shale area on the fingers one hand; the Eagle Ford, Barnett and Permian Basin formations in Texas see at least six shortlines, from the 278-mile Fort Worth & Western to the 12-mile Texas, Gonzales & Northern in — where else? — Gonzales.

Regardless of size or location, however, all these carriers share one trait: they are in a bet-the-farm business. Bloomberg recently listed ten crude-by-rail incidents in 2013, ranging in scope from the five cars of light crude CP derailed in Calgary to the Montreal Maine & Atlantic disaster in Lac Megantic. As investigators drill down into root causes and effects, they're finding that all crude oil is not created equal.

This really doesn't come as a surprise. My friend Bob Andrews, himself a veteran oil field fire-fighter and first-responder, told me - while the Lac Megantic fires were still burning - that all crude oil is a mixture of oil, gasoline, ethane, propane and other gaseous liquids, and how it reacts to heat in a closed space depends on how much of what is in it. As Bob expected, it turns out that Bakken crude is more "gassy" than others, which explains why Bakken oil acts like gasoline or equivalent materials in accidents.

Wednesday's *Wall Street Journal* tells us the Feds have decreed that oil shippers must "test each batch of crude for an array of characteristics, from the temperature at which it boils to the percentage of flammable gases trapped in the oil and the vapor pressure, which is created when crude emits gases that can build up inside railcars." Moreover, the new regs will effectively take the popular DOT-111s (the car type is stenciled just above the build-date box on the car side) out of crude-oil service. The AAR says some 1,100 cars - three percent of the fleet - are 111s.

In a related note, UBS advises clients the oil-testing rules are hitting home. The Pipeline and Hazardous Materials Safety Administration (PHMSA) issued three "Notices of Probable

Violations” to shippers on Feb 4, issuing fines of \$93,000 in all. USB continues to say the order is not a “game changer” inasmuch as “the industry has been taking action ahead of regulatory changes, motivated to keep crude-by-rail rolling. Examples include newer tank cars built to an industry-led standard, and last week’s BNSF announcement that it will seek to establish a new fleet of 5,000 tank cars in order to reduce risk of crude by rail.”

To be sure, testing the oil before loading and having the right cars on hand isn’t going to be the originating short line’s responsibility. But protecting the load (and coping with an incident) surely is, starting with the AAR’s recommended practices for handling crude-oil trains. These guidelines will affect non-Class I roads in a number of ways.

First, track. Starting March 25, routes handling trains of 20 or more crude-oil loads must get at least one more internal-rail inspection per year than the FRA requires, plus two annual geometry car runs. Second, brakes. Starting April 1, you have to run trains of 20 or more crude-oil cars with either distributed-power units or two-way telemetry end-of-train devices. A red flag stuck in the rear knuckle is no longer enough. Third, lower speeds. Starting July 1, trains with 20 or more crude-oil loads and even *one* older DOT-111 car may not exceed 40 mph on any of the 46 federally designated 46 high-threat-urban areas. (Most short lines avoid these, but check the list anyway.)

Lastly, it’s quite possible the Rail Corridor Risk Management System will dictate Class I re-routes over shortlines to avoid metro centers. Short lines so affected get to abide by all the other rules, as well as the requirement to install wayside wheel bearing detectors every 40 miles along tracks with trains carrying 20 or more crude-oil cars.

The AAR says railroads have committed to have in place by July 1 a \$5 million fund “to develop specialized crude-by-rail training and tuition assistance program for local first responders.” As for implementing such a plan, railroads are to develop an inventory of emergency response resources along routes used by trains of 20 or more crude-oil cars. “This inventory will include locations for the staging of emergency response equipment and, where appropriate, contacts for the notification of communities.”

Class I support for short lines in the emergency training and resources varies by Class I, however we know as a fact that Class Is have sent shortline crews to Pueblo for emergency training and their 10-Ks typically mention support of this nature. And in the Philadelphia area, Bob Andrews (the oil fire guy named above) is setting up a fully-staffed and equipped emergency support base specifically to do what the AAR is laying out.

The AAR Weekly Rail Traffic Summary charts key in on year-over-year changes, but when you’re trying to guess where the trends are now, consecutive week-over-week changes are helpful. The way I see it, there’s a powerful correlation between weekly car counts and the share price trends traders watch. Nobody really cares where prices were a year ago; where they were 50 or 20 days ago is of much more import. Thus the chart below.

Starting with the AAR Weekly Rail Traffic Summary for North American carloads, I backed out the commodity groups that most short lines don't see: intermodal, auto, coal. I'm including grain and ethanol. Crude oil's in there too because AAR lumps together the STCC 28 chems from plastics to ferters, STCC 29 petroleum products like LPG and asphalt, and STCC 13 crude oil.

Week	1	2	3	4	5	6	7
Date	1/4	1/11	1/18	1/25	2/1	2/8	2/15
Units	554,595	632,376	557,253	680,737	662,201	650,849	660,850
Intermodal	233,959	294,092	267,428	309,249	303,955	305,121	303,191
Auto	8,979	11,276	16,144	24,490	24,626	23,614	25,292
Coal	110,861	111,865	112,405	119,251	115,096	107,770	118,272
Merch	200,796	215,143	161,276	227,747	218,524	214,344	214,095
Wkly chg		7.1%	-25.0%	41.2%	-4.0%	-1.9%	-0.1%
YTD Cume		7.1%	-19.7%	13.4%	8.8%	6.7%	6.6%
Source: AAR North American Rail Traffic							

What you get is a weekly trend line for the merch traffic that's the bread-and-butter for the largest number of non-Class I railroads. Weekly change is the percentage change of each week from the preceding week; YTD cume is each week's change with respect to Week One. The outliers are Weeks 3 and 4, and though the AAR commentary doesn't say as much, I suspect it's weather-related, where cars that got stuck in yards Week 3 (CN's Winnipeg dwell was 50+ hours at one point) were forwarded in Week 4.

The point is, merch carload commodities are on a run-rate of plus six percent over seven weeks, and I find that encouraging words for carload short lines everywhere.

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