Swiss, Watch

In the last *ECRG Intelligence* I discussed the serious crude oil export contamination crisis that prompted a closure of the Druzhba pipeline oil flow west (refer to that issue for specifics on the pipeline and the initial reactions to the export curtailment).

Well, additional ripple effects have since come to light, striking an increasingly serious blow to the Russian budget. Five points emerge today.

First, as the flow remains closed, over 5 million tons (more than 35 million barrels) of Urals Export Blend (UEB) crude remain stuck in the pipeline network.

Second, the stoppage translates into more than $600 million of lost revenue per day to Moscow. To date, the estimated revenue losses have topped $9 billion (and counting). To that must also be added the payments for equipment damage downstream, starting with at least a $100 million bill for corrosion at the Mozyr Refinery in Belarus, jointly owned by the Russian oil company Slavneft and Belarusian state oil and chemical company Belneftekhim. Other charges are pending and will increase the liabilities of Transneft, the Russian state oil pipeline monopoly, and a series of other Russian state, quasi-state, and private companies.

Third, during our conversation on Sunday, a European oil trading contact contended that the problem is bigger than who in Russia may have contributed to the fiasco. It involves the positioning of global trading major Glencore. The argument discussed has emerged in several quarters over the last week.

Glencore is the Baar, Switzerland-based giant in global mining, metals, and commodity trading. It has long had a rumored connection with Russian oligarchs (and Russian President Vladimir Putin) and acquired a position in Russian state oil company Rosneft several years ago, subsequently selling virtually all of it to its consortium partner the Qatar Investment Authority in 2018.

But Glencore's intimacy with Russian oil exports has existed for some time. This relationship has factored into several of the company's legal and PR difficulties, as I recounted here last March in a two-part series on the "Glencore Scandals."

In the last edition of ECRG Intelligence I indicated that the contamination of Druzhba export with organic chloride may well have resulted from attempts to enhance flow rates to Europe, thereby increasing export volumes through the pipeline system.

This, in turn, had resulted from the imposition of US sanctions against Iranian exports and the need for European end users to source crude elsewhere. The immediate result had been to reduce significantly the usual discount paid for UEB against Brent. That provided an opportunity for Russia to increase exports west and, thereby, revenue.

But the apparent move backfired.

Introducing organic chloride to pipeline flow does combat viscosity, thereby allowing fluids like crude oil to move faster and increasing the overall amount that can be transmitted. That is especially the case with heavier oil like that contributing the bulk of UEB crude.

But it also runs the risk of corroding equipment in the process. Additionally, there are levels of natural organic chloride in the Urals blend itself, one of the ingredients causing the crude grade to be discounted to Brent (along with a higher sulfur content).

Word is now circulating that Glencore wrote futures contracts on UEB which anticipated higher flow rates. Given that the primary arteries in the Druzhba were already contracted for maximum flow earlier in April, this only made sense if the trading company has prior knowledge of the chloride usage to increase the flow rate. The Glencore contracts anticipated more aggregate pass through volume of UEB than the Druzhba was capable of handling. Further, these contracts would have comprised a combination of effective European end ownership of the crude and provide for contract swaps with other parties to improve Glencore profitability and reduction of risk.

In any event, somebody was under severe pressure to move as much crude as possible and the chloride levels were miscalculated, leading to the contamination levels that prompted a halt to western exports. Both elements of the export apparatus within Russia and Glencore's contract network in the West appear complicit.

Big Names, Bigger Shenanigans

Fourth, both Transneft and the Russian Energy Ministry (Minenergo) have identified who they call the culprits. Depending on which of these versions you accept, the source is either or both.

The former I discussed in the most recent ECRG Intelligence, writing then that:

> The pipeline monopoly has stated that its initial investigation reveals a possible intentional action led to the shutdown. Further, according to a contact at the company, Transneft now believes the injection was of “various organic chloride compounds” at a pipeline monitoring station belonging to Samaratransneft-Terminal. According to my information, Transneft has been investigating several companies in Samara since Friday to determine the extent of involvement.
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> Samaratransneft-Terminal is part of Samaratransneft (STN), a private Russian company billed as the world’s largest vertically integrated oil storage and logistics company. STN has facilities in Russia, Houston, Rotterdam, and the Qingdao Commercial Port.
>
> STN’s assets at Ust-Luga are a main element in moving transited oil from railway cars and feeder lines into Druzhba volume moving out of Russia, while the Rotterdam location figures prominently in European distribution. STN is a minor shareholder in LukoilSamaranaftatankfarm which, in turn, is controlled by Russian oil major Lukoil and comprises a major partner in the Botlek network of oil terminals at Rotterdam, Vopak, and Maasvlakte.
>
> Back in Russia, Transneft is apparently claiming that the chloride was introduced at a STN-Terminal metering location (used to record pipeline crude flow and properties).

The latter was named last week by Russian Energy Minister Alexander Novak. This is the Nikolayeva Refinery, also in the Samara region. Much of the transport of crude on pipelines to outside parties involves passthrough volume from refineries unable to process it into products fulfilling market needs or at margins justifying processing.

Four suspects from both alleged sources were arrested on May 7, according to Minenergo information. Novak noted on the same date that the companies “transferred standard oil using organochlorine compounds in volumes exceeding the norm.”

Transnegligent

The Nikolayeva facility also brings into play a further wrinkle. After a curious (and hasty) building plan in 2017, the plant was owned by a dual Russian-Maltese citizen, and subsequently transferred under curious circumstances to two individuals residing outside Russia.

The mantra, it seems, has moved from a positive inference of sabotage to incompetence, although the blame is now likely to be placed on “foreigners.”

Nonetheless, no treated oil could have been introduced to the Druzhba system without at least the tacit approval of Transneft. Neither Nikolayeva nor any part of Samaratransneft-Terminal has any authority over access to the pipeline system.

The likely charge I expect from Russian officials is to claim that the private companies injected organochlorides to increase the amount they could export to Europe. Yet, neither makes that determination. Transneft does.

Fifth, Transneft has now redirected some European export consignments to be filled via tanker from its Pacific Coast terminal at Primorsk. This is the terminus for the East Siberia-Pacific Ocean (ESPO) pipeline servicing China (by means of a spur midway), elsewhere in Asia, and to other foreign customers.

This pipeline has its own export blend –characteristically called ESPO Blend – that does not have the domestic heavier sulfur flows from Tatarstan and Bashkiria (both part of UEB) and is also a lighter oil less subject to the viscosity requiring treatment.

This move may allow some sales to Europe, but given the circuitous route, will cut into Transneft margins as well.

About the Author

Dr. Kent Moors is an internationally recognized expert in oil and natural gas policy, risk management, emerging market economic development, and market risk assessment.

He serves as an advisor to the highest levels of 27 countries, including the U.S., Russian, Kazakh, Chinese, Iraqi, and Kurdish governments, to the governors of several U.S. states, and to the premiers of two Canadian provinces. He's served as a consultant to private companies, financial institutions and law firms in 29 countries, and has appeared more than 2,300 times as a featured radio-and-television commentator. He appears regularly on ABC, BBC, Bloomberg TV, CBS, CNBC, CNN, NBC, Russian RTV, and the Fox Business Network.

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