

BELARUS' OIL SUPPLY DIVERSIFICATION

Towards cooperation with
the U.S. and Poland



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BELARUS OIL DIVERSIFICATION VIA POLAND: STATE OF PLAY

Belarus has been struggling with its dependency on Russian crude supplies for many years already. The continuous spats between the two countries have hit the Belarusian economy for several times, when duty-free oil imports from Russia have been limited or halted by Moscow.

During the times of crises, Belarus sought many different options to provide sufficient crude volumes to its refineries, including swap deliveries, rail transit and reverse pipeline shipments from Ukraine. Through all that time, the question of reverse supplies via Druzhba pipeline from Poland has been discussed as well. However, it was only the last several months that the pace of developments has substantially increased.

Since the second half of 2019, the issue of crude oil supplies from direction of Poland has been brought up several times by both Belarusian and Polish side. Moreover, particular investment decisions have been made too.

Last year Belarusian president Alexander Lukashenka stated that according to internal analyses and studies, the reverse flow on Druzhba pipeline seemed to be the most feasible option for possible alternative crude oil deliveries to Belarus. Since that time also other Belarusian officials have confirmed that they would like to see first test supplies from direction of Poland as early as before the end of 2020 and the Belarusian government has set transportation tariff from the boundary with Poland to Mazyr refinery. Moreover, in late April Lukashenka announced the decision to build brand-new Gomel-Gorki pipeline to allow future possible deliveries from direction of Poland (and Ukraine) to reach Naftan refinery.

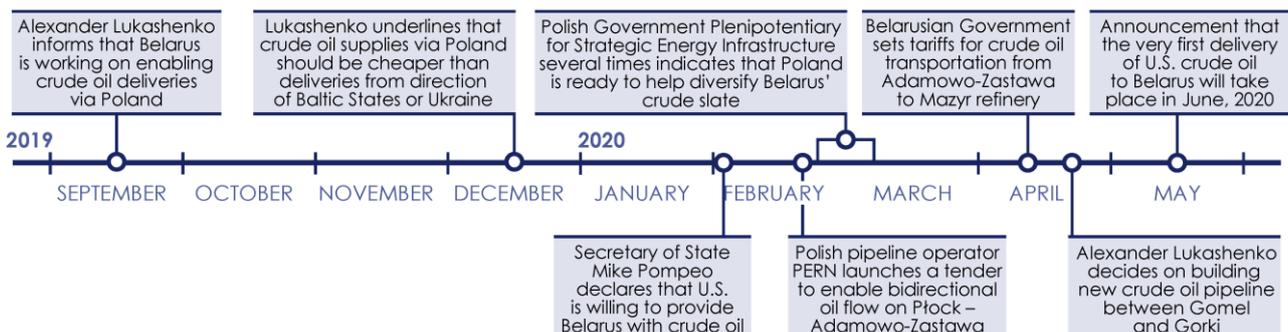
At the same time the Poles did not let the grass grow under their feet too. The Polish government have numerously confirmed its interest in oil cooperation with Belarus and have significantly advanced the talks with Belarusian partners.

In February Polish pipeline system operator, PERN, launched a tender to enable bidirectional crude flow on the Polish part of Druzhba pipeline (Plock-Adamowo Zastawa section). Works are supposed to take 35 weeks since contract award and will make possible crude supplies in direction of Belarus amounting to as much as 15,8 mtpa.

Last but not least, it seems that the cooperation between Warsaw and Minsk is now facilitated due to the U.S. interest in Belarus' oil&gas diversification (the issue seems to be actively discussed on Polish-American and Lithuanian-American level). The most tangible sign of that remains the Secretary of State Mike Pompeo's visit to Minsk on February 1, 2020, when he assured his Belarusian counterpart that the U.S. companies "stand ready to deliver 100 percent of the oil Belarus needs at competitive prices". Of course such huge supplies are not realistic as for the nearest future, but it does not change the fact the Belarus may import some smaller volumes of the U.S. crude.

The very first cargo of 90,000 tonnes of U.S. Bakken crude oil will be delivered to Novopolotsk refinery via Klaipeda, Lithuania seaport in June, 2020. At the same time, Belarus officials state that they are willing to import U.S. crude via Poland in the future.

TIMELINE OF MAIN EVENTS REGARDING CRUDE DELIVERIES TO BELARUS VIA POLAND



BELARUS' REFINING SECTOR: UNDER RUSSIA'S THUMB?

CRUDE OIL PIPELINES IN BELARUS AND ITS SURROUNDINGS



There are two oil refineries in Belarus, located in Novopolotsk ("Naftan") and Mazyr, with total capacity amounting to as much as 24 mtpa (~480,000 bpd). Oil products are partially oriented for exports to the CEE countries and to the Western Europe via transshipment terminals in the Baltic States.

Refining assets remain crucial for Belarusian economy as they cover full domestic fuel consumption (imports from Russia is not possible due to the ban imposed) and oil products exports equaled to more than 8% of Belarus' GDP in 2019.

Both of the refineries are actually controlled by Belarus, but in case of Mazyr refinery 42,58% of shares are in possession of Russian oil companies. There are also no doubts that the Russians would be willing to take over at least one of the Belarusian refineries if the opportunity arises in the future.

Despite lack of majority interest, Russia can now control Belarus' refinery sector due to its current dependency on duty-free crude oil deliveries.

Insofar as Belarusian refineries are vulnerable to Russian pressure was well demonstrated in 1Q2020, when the latest spat between the two countries

took place. Russian companies dramatically slashed their deliveries back then (-77% y/y), and the only supplies from Russia were performed by Mikhail Gutseriev – oligarch involved in numerous businesses in Belarus. The situation forced Minsk to halt its own oil exports, use strategic reserves, process some of the technological oil in the pipelines and purchase much more expensive oil via Ukraine and Lithuania. Despite all of this, Belarusian refineries were barely functioning, stopping most of their exports, as they were not able to contract sufficient crude volumes.

That is, however, an open question how the situation is going to develop in the coming years. Russia is currently advancing so-called "tax maneuver" reform, gradually replacing the excise duty for crude exports with extraction tax. Therefore, if no new oil subsidies will be offered by Russia (and it also might be a case), Belarus will be forced to import Russian crude on the fully market basis starting from 2024.

To survive in the "post-tax maneuver" realities, Belarus will have to complete upgrade of the refineries (might happen already in 2021) and to stop subsidizing fuel sales on domestic market. Anyway, diversification of the crude slate will still be needed too, as it will favor rise of margins and give Minsk new leverage over the Russian crude sellers.

WHAT MIGHT POLAND (AND THE U.S.) OFFER?

Regular crude oil supplies from direction of Poland to Belarus in the future will require PERN (Polish pipeline operator) to complete works on enabling bidirectional flow on Płock – Adamowo Zastawa section of Druzhba pipeline. There is no public information whether the relevant engineering contract has been already awarded by PERN, but it should be assumed that construction works could be ultimately finished only as early as 1st half of 2021.

There are three Druzhba pipeline strings on Płock – Adamowo Zastawa section with total capacity around 50 mtpa. In 2018 (2019 data are not relevant due to the “dirty oil crisis”) the above-mentioned capacity has been used in 75% to supply two Polish and two German refineries.

At the same time there is even more flexibility regarding Gdańsk oil transshipment terminal (“Naftoport”) and Gdańsk-Płock crude oil pipeline (“Pomeranian Pipeline”). The capacity of both assets is used in less than a half, leaving space for the possible additional crude imports to the region amounting to as much as 20 mtpa. Moreover, PERN is also further expanding Pomeranian Pipeline by adding brand-new branch with a capacity of 25 mtpa. Construction works on the project are scheduled to begin in 2021 and the commissioning should take place by the end of 2023.

While technical capacities in Poland should not pose any problems in terms of allowing crude deliveries to Belarus, it seems that the concept fits well Polish energy strategy too. Poland's government actively pursues its goal to become a transit hub regarding oil and gas deliveries to the region.

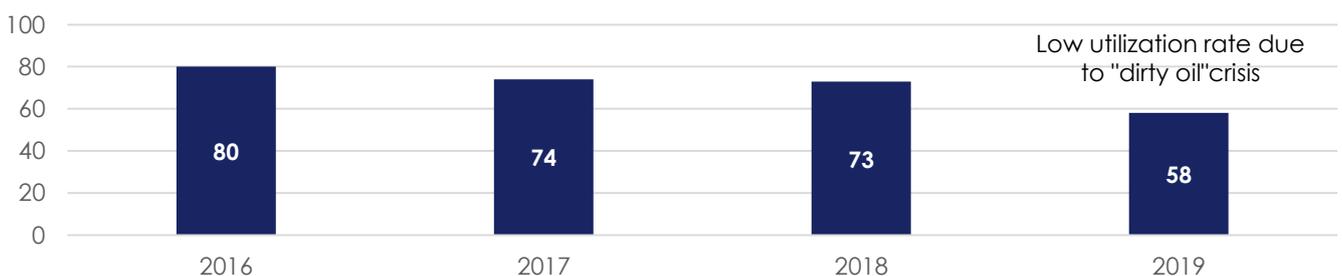
Poland bets on energy cooperation with the United States perceived both as a key global oil&gas exporter and as an ally interested in reducing CEE region dependence on Russian energy resources.

It is worth to note that also the U.S. administration stays determined to help deliver non-Russian crude to the Belarusian refineries, actively cooperating on that very issue with Lithuanian and Polish governments. In that spirit, the American State Department declares that U.S. companies are ready to provide Belarusian refineries with any crude oil volumes they might need and urges officially Minsk to “increase the access for American businesses”.

However, leaving aside the political statements it remains unclear, which particular U.S. producers could be interested in selling their crude oil to Belarus, as none of them has revealed its interest on that matter. As for now, the only information available is that the very first delivery of the U.S. Bakken crude to Belarus which has just departed from Beaumont, Texas comes from the U.S. energy trader United Energy Trading, assisted by the U.S. firm Getka and Polish company Unimot.

It is worth mentioning that Getka is headed by a U.S. citizen of Polish origin, Dariusz Cichocki and it aims to enter the European crude oil market in the coming years, possibly also by delivering American crude to Poland and/or Belarus. It might possibly cooperate on that very issue with the already-mentioned Unimot as the latter has developed extensive relationship with the Belarusian oil companies. In August, 2019 that was Unimot CEO, Adam Sikorski, who coordinated an agreement between Belarus' oil company BNK and the U.S. lobbyist, David F. Gencarelli.

NORTHERN DRUZHBA PIPELINE (MAZYR-PŁOCK SECTION) UTILIZATION RATE



WHAT ARE THE ALTERNATIVES?

In the past few months Belarus has imported numerous cargoes via Pivdennyi port in Ukraine (with subsequent pipeline transport to Mazyr) and Lithuanian port of Klaipėda (with rail transport to Naftan). Therefore, the competitiveness of supplies via Poland against already used options remains a prerequisite to ultimately launch reverse flow on Druzhba pipeline.

Belarus takes advantage of Ukrainian crude oil pipeline system operated by Ukrtransnafta, which allows to import up to 14,5 mtpa of crude oil via Pivdennyi Sea Port. In March-May Belarusians have already bought 4 tankers with total volume amounting to 350,000 t.

Currently Belarusians cooperate with Ukrainians basing on the agreement concluded on March 2, 2019 between BNK Ltd. (subsidiary of Belarusian Oil Company) and Ukrtransnafta for crude oil transportation to Mazyr refinery. The total value of the contract (including annexes) is 6,8 million USD, and the estimated combined cost of transshipment and pipeline transport of crude to Mazyr is 10 USD/t (~1,36 USD/bbl).

At the same time Belarus receives crude oil via Klaipėdos nafta (KN) terminal in Lithuania, with further rail deliveries to Naftan refinery. The current capacity of the KN terminal regarding oil imports is 3 mtpa and in January-May Belarus has taken 7 tankers with more than 600,000 t of crude in total.

It is worth to note that Belarusian Oil Company already concluded 3-year long agreement for transportation of both crude oil and oil products with Lithuanian Railways as early as in November, 2017. The contract probably will be renegotiated and prolonged in the coming months. Estimated combined cost of transshipment and rail transport of crude from Klaipėda to Novopolotsk is 45 USD/t (~6,1 USD/bbl).

Potentially it may also be possible to realize crude oil deliveries to Naftan via other Baltic States. Belarusian officials are also in talks with Latvian counterparts on that very issue, however no cargo has been delivered via Latvia so far.

The easiest way for crude oil imports to Belarus via Latvian ports would be to transport it to Naftan in rail wagons. The issue is being discussed by Minsk and Riga officials, but it seems that Latvian transshipment terminals are not interested at all in handling of crude for Belarusian refineries. That was indicated by Latvian MFA back in January, 2020, when it expressed disappointment that the Norwegian crude oil for Belarus had been handled in Lithuania, not Latvia.

Another option could be to restore oil pipeline from Ventspils to Novopolotsk. This, however, seems improbable. The asset has not been used for more than decade and it might be in bad condition. Moreover, the 34% interest is being held by Russia, which could block proposals to restore non-Russian crude flow.

SEABORNE CRUDE OIL DELIVERIES TO BELARUS IN 2020

	DATE OF DELIVERY	VOLUME	GRADE	SELLER
PIVDENNYI SEA PORT (UKRAINE)	March 12	~90,000 t	BTC Blend	SOCAR Trading
	March 16	~80,000 t	Urals	SOCAR Trading
	March 24	~90,000 t	Azeri Light	SOCAR Trading
	April 12	~85,000 t	Azeri Light	SOCAR Trading
KLAIPĖDA SEA PORT (LITHUANIA)	January 22	~86,000 t	Johan Sverdrup	Total/Equinor
	March 4	~100,000 t	Urals	Rosneft/Glencore
	March 17	~100,000 t	Urals	Lukoil
	March 20	~100,000 t	Urals	Gazpromneft/Shell/Petraco
	March 29	~100,000 t	Urals	Rosneft/Glencore
	April 13	~85,000 t	Johan Sverdrup	Equinor
	May 12	~87,000 t	Arab Light	Saudi Aramco

MAIN CONCLUSIONS

Limited chances for diversification?

Despite the fact that Polish oil infrastructure (Naftoport transshipment terminal, Pomeranian Pipeline, Druzhba Pipeline) will be sufficient to provide as much as 15 mtpa of crude oil for Belarus refineries, **large-scale deliveries in the nearest future remain unlikely**. Until 2024 the Russian crude supplies for Belarus should be cheaper than those from any other direction due to their duty-free character. Moreover, **deliveries from Russia will probably remain highly competitive also after completion of the so-called “tax maneuver”** because of the logistics advantages (direct pipeline connection, no need for transit or seaborne transport).

Therefore, if nothing unexpected happens, the supplies from direction of Poland are not to fully replace Russian crude but rather supplement them. However, still **in the periods of crises in relations with Moscow, Minsk should be willing to significantly increase shipments from the alternative sources**, including reverse supplies on Druzhba pipeline.

Supplies via Poland will have to be competitive

Possible future **crude oil supplies from direction of Poland will have to be competitive** against the pipeline deliveries via Ukraine. Leaving aside the very variable factor of crude prices in NW Europe and the Black Sea region, the key question is where the transshipment and pipeline transport will be cheaper. As for now it seems that the **Poles should be more competitive, as crude handling costs in the Ukrainian ports remain to be one of the highest in the world**. Moreover, the pipeline route Gdańsk-Płock-Mazyr is significantly shorter than the Pivdennyi-Brody-Mazyr one.

U.S. seeks political and business benefits

The U.S. statements regarding crude oil supplies to Belarus seem to be politically motivated first. The **American support to Minsk, even if verbal only, is intended to help decrease Belarus' dependence on Russia, ultimately reducing the leverage that the Russians have over their neighbor**. Even if that seems improbable to launch full-scale U.S. crude deliveries to Belarus, the discussions on that will still fuel the conflict between Minsk and Moscow, which seems favorable from the American perspective.

At the same time, the **oil cooperation with Belarus is being actively developed to bring benefits for American (and Polish) companies too**. Further intensification of contacts might pose chances for the U.S. crude producers and U.S. and Polish traders. Moreover, it should also ultimately push forward cooperation in other sectors too, possibly resulting even in investment opportunities.

PL-U.S.-BY cooperation: risk for the Polish companies?

Belarus' crude oil supplies diversification seems to be actively pursued by both American and Polish politicians. However, it might ultimately pose a **risk to Polish companies which are competing with Belarus' refineries in the region**. It seems reasonable for the Polish government to coordinate further steps with both Polish refiners: PKN ORLEN and LOTOS to secure their interests. **Negotiations with the Belarusian counterparts should include some possible benefits for Poland's oil companies too**. While any acquisition of the Belarusian assets by Polish companies remain unlikely and would create big business risks, at the same time there might be some other ways to cooperate in the future. One of such options could be that Poles would enter into tolling agreement with Belarus' refineries, taking advantage e.g. from Mazyr refinery location near Ukraine.

Reverse flow on Druzhba will strengthen Lukashenka in talks with Putin

Enabling bidirectional crude oil flow on the Polish section of Druzhba pipeline will strengthen Minsk's position in the talks with Moscow, providing Belarusians with additional option for alternative, non-Russian deliveries. Therefore, **the possible supplies from direction of Poland can play the role of "bargaining card" too**, helping Belarus to get better terms of further oil imports with Russian companies. This, however, may ultimately mean that the deliveries via Poland might remain small-scale only.

No chances for restoring old oil pipelines to Novopolotsk?

As for now it does not seem possible that any of the old crude oil pipelines from the Naftan refinery to Mažeikiai and Ventspils could be restored to help diversify Belarusian crude slate. **The pipeline to the Latvian port of Ventspils is in 34% owned by the Russian pipeline operator Transneft** and it will definitely block any attempts to start reverse crude oil deliveries to Novopolotsk.

At the same time the **deliveries via Mažeikiai-Novopolotsk oil pipeline remain unlikely too**. Despite that there is no Russian interest in that case, it has to be noted that the asset (and Butinge oil terminal) is owned by the Polish PKN ORLEN – direct competitor to the Belarusian refineries.