

WORKING SMARTER TO INNOVATE MIDSTREAM COMPLIANCE MANAGEMENT

By Paul Moran

Oil prices swing and regulations evolve, but the need for effective compliance is constant for midstream energy organizations. As a result, midstream operators—which live in the jurisdiction of myriad regulatory bodies from the Department of Energy to the Pipeline and Hazardous Materials Safety Administration (PHMSA)—have embraced safety as a corporate objective, not simply a box to be checked.

This industrywide philosophy has led many midstream leaders to believe in a false correlation between compliance efficacy and spending (i.e., that shrinking budgets will detract from safety and increase risk).

In the volatile energy realm, compliance management deserves the same treatment as any other business process: strong financial oversight and ongoing identification of opportunities to improve. Risk and compliance effectiveness and cost optimization are not tradeoffs; they are complementary aspects of operational performance to be proactively managed together to yield shareholder value and deliver a competitive advantage.

Why There's Room to Improve Midstream Compliance Management

While most midstream companies focus extensively on the effectiveness of their risk and compliance management efforts, few understand their end-to-end risk profile. Even fewer grasp the full extent of their compliance costs or have pursued enterprise wide efforts to optimize them.

Recent conversations with C-level executives and senior leadership reveal that while many believe their organization has a good sense of where the greatest risks of noncompliance are, few feel they have:

- Full visibility into the compliance risk profile across all aspects of their business.
- A comprehensive understanding of the current costs of compliance management across the business.
- A plan for optimizing risk mitigation and compliance management efforts.

Now is the time for midstream operators to get a firm handle on their compliance effectiveness and costs, for multiple reasons:

- **Transparency:** Since the 2014 oil downturn, the entire energy industry has renewed its emphasis on shareholder transparency and communication. Because the cost of compliance is frequently embedded in different functions and departmental budgets, many midstream organizations lack full insight into their total

cost of compliance. Regardless, management teams owe it to shareholders to figure out their current level of spend and then work to optimize these costs

- **Scalability:** The energy sector has dominated the deal-making space over the last two years, surpassing 380 mergers and acquisitions in 2016 and 340 in 2017 (up from 264 in 2015)¹. As midstream competitor lines are redrawn and newly combined entities integrate operations, it's critical that management teams eliminate duplicate resources and streamline compliance costs.
- **Regulatory resilience:** The expansion of PHMSA regulations governing pipeline and natural gas storage safety, originally proposed in 2016, and the development of the American Petroleum Institute's recommended practice 1173 (which provides a framework for comprehensive pipeline safety) are two examples illustrating the trend toward uncompromising incident prevention and compliance. For better or for worse, midstream regulations will always be a moving target. Organizations that strategically manage their compliance spend and processes now will more easily adapt to future rule changes.

How to Transform Midstream Compliance Capabilities

Existing compliance management flaws will magnify as regulations, transactions and shareholder expectations add complexity to the industry. To succeed in the future, midstream leaders can't afford to leave compliance costs unchecked. Haphazard spending on compliance efforts does not guarantee risk reduction.

Future-proofing midstream compliance starts by creating unprecedented visibility into all risks and risk management costs.

Midstream companies are subject to overlapping regulatory jurisdictions that govern everything from commercial operations to financial reporting and investor communications. Corporate back-office staff, technical teams and field workers alike play a role in organizational compliance. Not

surprisingly, flagging key risk areas and sources of wasteful spending (e.g., delays or non-value add activities) is a tall order.

Taking a fact-based approach to compliance improvement—as management teams would with any other business process—is the first step toward generating value. This means facilitating an objective, independent assessment of each part of your operating model that touches compliance, including risk mitigation capabilities, human capital and corporate governance pillars.

By critically analyzing these factors, leadership can identify spending patterns that impact compliance, and begin to understand where each part of the business falls on the spectrum between reactive and proactive performance. This exercise helps management uncover process gaps, sources of wasteful spending and other variabilities that contribute to inefficient compliance operations.

INDICATIVE MIDSTREAM COMPLIANCE FACTORS TO EVALUATE

Risk Mitigation

- Operations monitoring and control systems
- Asset integrity manuals
- Maintenance protocol

Human Capital

- Employee and contractor skills
- Training and certifications
- Cross-team communication

Governance and Culture

- Corporate values linked to compliance
- Corporate objectives linked to compliance
- Decision-making authority

¹ Mergermarket data

Identifying and prioritizing areas to optimize compliance efforts is the first leg in a long journey. Once the prework is complete, midstream leaders need a plan for meaningfully transforming the way they monitor risks, and manage compliance efforts across their ranks. Inevitably, technology will be an essential component of this evolution.

Highly regulated industries from financial services to healthcare are applying sophisticated automation and analytics to run leaner, more profitable operations. The energy sector is no stranger to technology, but there is growing opportunity for midstream organizations to apply a digital mindset to compliance through:

- **Artificial intelligence:** Data is integral to maintaining effective compliance. In fact, one of PHMSA's recently proposed regulations outlines an expansion of pipeline operators' data collection requirements. Advanced analytics tools and dashboards aren't midstream organizations' only options for better reporting. Robotics processing automation (RPA), for instance, can eliminate much of the tedious data entry that fuels compliance reporting, serving as a conduit between field operation, asset management and ERP systems. Researchers are even exploring new ways of applying [machine learning](#) (a derivative of artificial intelligence) to improve the accuracy of pipeline sensors, not only to flag potential leaks but also minimize false alarms.

- **Blockchain:** Experts point to blockchain, the distributed ledger technology behind bitcoin and other cryptocurrencies, as a gamechanger for B2C transactions in retail, banking and higher education, but its use cases can extend to internal B2B functions. A significant step in effective compliance reporting involves "showing your work" to regulators and preserving the integrity of environmental, health and safety information. Blockchain's ability to record and verify activity would add a necessary layer of trust to midstream compliance. More importantly, its centralized nature could be an efficiency boon for organizations with multiple subsidiaries, creating a single source of truth for important compliance-related data.

To be a leader in midstream energy is to be committed to the safe, reliable transportation and storage of oil and gas. A dedication to compliance, however, does not need to come at the expense of high-performing, cost efficient operations. Organizations that continuously stress test their current compliance approach, and search for opportunities to innovate it, will be best positioned to compete. Investments made in aligning people, processes and advanced technology today will pay dividends to midstream operators long into the future.



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