ESG Research

ESG Materiality Map
Midstream Energy

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This report does not constitute a rating action

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ESG Materiality Map Midstream Energy

In line with the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, S&P Global Ratings is publishing research on the ESG materiality map for the midstream energy sector. We provide an illustration, at a point in time, of our findings on the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. The materiality map research does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis.

Midstream Energy Sector

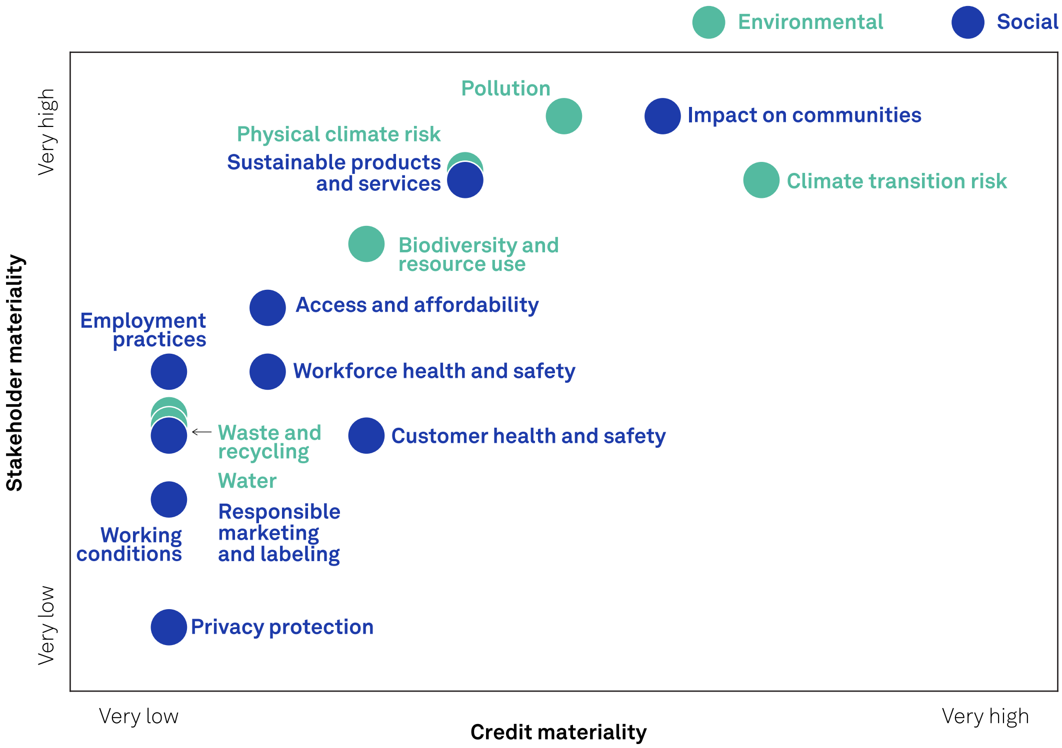
The global midstream energy sector includes companies that primarily gather, process, transport, and store commodities, including crude oil, natural gas, natural gas liquids (NGLs), and refined products (e.g., gasoline and diesel) through a vast network of pipelines and storage assets. The sector serves oil and gas producers, refiners, industrial oil and gas users, utilities, and liquified natural gas (LNG) companies.

Key Takeaways

- Given the sector's role as a logistics provider for the carbon-intensive oil and gas industry to the ultimate end users of hydrocarbons, environmental factors such as climate transition risks and pollution are among the most material to both stakeholders and credit.
- Other environmental factors, such as climate physical risk and biodiversity and resource use, are material considerations to stakeholders but will have limited impact on credit.
- Social factors are more material to stakeholders than credit. However, community pushback on certain projects will continue to affect issuers' investment plans and expected returns.

See materiality map on the following page.

ESG Materiality Map For The Midstream Energy Sector



The materiality map provides an illustration at a point in time, of our findings on the relative materiality of certain environmental and social (E&S) factors, from both the stakeholder and credit perspectives, for the sector. It does not represent any new analytical approach to the treatment of E&S factors in our credit ratings. See our ESG Criteria for more information on how we incorporate the impact of ESG credit factors into our credit ratings analysis. Source: S&P Global Ratings.

How To Read The ESG Materiality Map

The stakeholder materiality (Y axis) reflects our assessment of the relative level of impacts and dependencies of the sector on the environment, society, and economy.

The credit materiality (X axis) reflects our assessment of the relative level of potential and actual credit impact for the sector. The credit implications for the factors positioned on the left side to the middle of the X-axis would be more limited and absorbable. On the right side, there is higher potential for these implications to be more disruptive. We assess credit implications for an entity based on its individual characteristics.

Assessing E&S factors' materiality: We consider both the likelihood of the impact from a given factor, as well as the magnitude of the impact. The materiality of the factors varies depending on the perspective (stakeholder or credit) as well as the evolving and dynamic interactions between these two dimensions.

The main areas of the map:

- The upper-right quadrant displays the most material, on a relative basis, E&S factors identified for the sector from both a stakeholder and credit perspective.
- The upper-left quadrant presents factors that are more material from a stakeholder than credit perspective. These factors have the potential to become more material from a credit perspective.
- The bottom-left quadrant shows factors that are less material for both stakeholders and credit. Their materiality may evolve over time and this dynamic may not be linear.

Examples Of Material Factors

Below we provide the rationale of some of the material factors to illustrate the above findings.

Climate transition risk

We currently view the transition to a low-carbon economy as highly material for stakeholders and the most material environmental factor for credit. Because midstream companies provide logistics for the carbon-intensive oil and gas sector, they and their stakeholders (including businesses and populations that depend on the transport of products) directly contribute to greenhouse gas emissions. We believe the sector can transition to handle lower-carbon energy sources, such as a green gas, renewable motor and aviation fuels, and carbon capture and sequestration. However, we view this transition strategy as nascent and dependent on the substitution of hydrocarbons with lower-carbon and renewable fuel production, which is also still new and not currently a significant credit driver. However, increased regulation and other government oversight promoting low-carbon alternatives could accelerate the move away from traditional hydrocarbons and significantly affect future demand and cash flow for the midstream industry.

Impact on communities

Impact on communities is a material factor for stakeholders given pipeline networks--both natural gas and crude oil--require significant land use, at times crossing through rural communities and conflict areas. The construction and placement of pipelines can disrupt areas unaccustomed to industrial development and indigenous territories. Moreover, pipeline attacks, leaks, and explosions pose severe and sometimes irreversible community health and safety hazards. Community backlash has had the greatest credit impact on midstream companies thus far, although the effect on credit has been somewhat muted. As social factors and “not-in-my backyard” issues have become larger potential credit drivers, companies have looked to share or eliminate much of the risk from large growth projects, which has helped limit the credit impact. Going forward, the sector seems to be willing to continue to manage these risks.

Pollution

Air, land, or water pollution resulting from gas pipeline leaks or oil spills makes it as one of the most material environmental factors for stakeholders. Large-scale pollution incidents have been infrequent for the midstream industry. However, smaller events such as spills, leaks, and explosions have occurred, leading to severe and long-lasting consequences for ecosystems, and sometimes resulting in employee or contractor fatalities. From a credit perspective, companies with ongoing pollution issues could face litigation and substantial remediation costs.

Physical climate risk

The physical risks of climate change for midstream assets are highly material for stakeholders but generally not credit. Issuers have typically maintained resilient operations through extreme weather events. However, the sector is not immune to disruptions given its long-distance, asset-heavy nature, and thus compared to other sectors, exposure to physical climate risks is higher than average. In addition, the sector is exposed to disruptions that occur on its value chain and affect its service offerings and pricing, which is more material for stakeholders than credit. For example, during the recent Texas ice storm in the U.S., freeze-offs did not affect gas pipeline operations but did shut off gas production, affecting its price and availability, as well as stakeholders like companies and municipalities that needed it.

Sustainable products and services

A push from many stakeholders to replace fossil fuels with sustainable products continues to gain momentum and may lead to more stringent regulations and community opposition to existing and new assets for the service and handling of hydrocarbons. Greater awareness and concern from stakeholders around the externalities of hydrocarbon combustion is gradually creating credit pressure. The reduced demand for fossil-based fuels could become more acute as electric vehicles proliferate and battery storage technology offsets the intermittency of renewable energy assets like solar and wind technology. While the credit impact on the midstream industry may be gradual as economies transition to low-carbon energy sources, we do view the demand for more sustainable products and services as a long-term credit risk.

What is our approach to research on the ESG materiality map?

Referring to the research report "Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors," published on May 18, 2022, this research is built on the ESG materiality concept that considers ESG issues as material when they could affect stakeholders, potentially leading to material direct or indirect credit impact on entities. It considers that all businesses, through their activities and interactions, impact and depend, directly or indirectly, on stakeholders such as the environment (natural capital), society (human and social capital), and economy (financial capital). Using this ESG materiality concept, S&P Global Ratings has worked toward identifying a common, global, cross-sector set of E&S factors that we believe are material to stakeholders, and either are already, or have the potential to become, credit material for entities. The materiality map we propose provides an illustration at a point in time, of our findings on the relative materiality of those factors, from both the stakeholder and credit perspectives.

How does the sector ESG materiality map relate to credit ratings or ESG evaluations?

The sector materiality map is a visual representation of the factors that we consider impactful to the sector from a stakeholder and credit perspective for the purposes of this research. It does not represent any new analytical approach to the E&S factors in our credit ratings.

The relative materiality of the factors indicated on the materiality maps may inform the E&S Risk Atlas scores and the weights of the E&S factors used in ESG evaluations.

They may also inform our discussions with issuers on those factors' existing or potential credit materiality.

Related Research

- Materiality Mapping: Providing Insights Into The Relative Materiality Of ESG Factors, May 18, 2022
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- ESG Evaluation Analytical Approach, Dec. 15, 2020