NuStar Energy L.P.
Form 10-Q
November 12, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to _______

Commission File Number 1-16417

NUSTAR ENERGY L.P.
(Exact name of registrant as specified in its charter)

Delaware	74-2956831
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
19003 IH-10 West San Antonio, Texas	78257
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (210) 918-2000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule12b-2 of the Exchange Act:

Large accelerated filer	x	Accelerated filer	£
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	£

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of common units outstanding as of October 31, 2013 was 77,886,078.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements
NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Thousands of Dollars, Except Unit Data)

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$24,519	$83,602
Accounts receivable, net of allowance for doubtful accounts of $959 and $808 as of September 30, 2013 and December 31, 2012, respectively	242,203	387,943
Receivable from related parties	26,529	109,833
Inventories	122,998	173,228
Income tax receivable	25	1,265
Other current assets	41,188	65,238
Assets held for sale	2,847	118,334
Total current assets	460,309	939,443
Property, plant and equipment, at cost	4,528,950	4,287,859
Accumulated depreciation and amortization	(1,167,100)	(1,049,399)
Property, plant and equipment, net	3,361,850	3,238,460
Intangible assets, net	81,710	92,435
Goodwill	950,963	951,024
Investment in joint ventures	70,812	102,945
Deferred income tax asset	5,088	3,108
Note receivable from related party	146,472	95,711
Other long-term assets, net	165,456	189,963
Total assets	$5,242,660	$5,613,089
Liabilities and Partners' Equity		
Current liabilities:		
Current portion of long-term debt	$33,982	$286,422
Accounts payable	222,360	397,633
Payable to related party	19,589	1,408
Accrued interest payable	26,384	23,741
Accrued liabilities	37,444	124,203
Taxes other than income tax	13,066	9,893
Income tax payable	3,878	2,671
Total current liabilities	356,703	845,971
Long-term debt, less current portion	2,439,696	2,124,582
Long-term payable to related party	29,637	18,071
Deferred income tax liability	29,455	32,114
Other long-term liabilities	6,190	7,356
Commitments and contingencies (Note 5)		
Partners' equity:		
Limited partners (77,886,078 common units outstanding as of September 30, 2013 and December 31, 2012)	2,374,962	2,573,263

General partner	53,277	57,986
Accumulated other comprehensive loss	(57,665)	(58,865)
Total NuStar Energy L.P. partners’ equity	2,370,574	2,572,384
Noncontrolling interest	10,405	12,611
Total partners’ equity	2,380,979	2,584,995
Total liabilities and partners’ equity	$5,242,660	$5,613,089

See Condensed Notes to Consolidated Financial Statements.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, Thousands of Dollars, Except Unit and Per Unit Data)

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Revenues:				
Service revenues	$245,577	$225,068	$706,493	$646,444
Product sales	534,433	1,368,688	1,977,423	4,324,465
Total revenues	780,010	1,593,756	2,683,916	4,970,909
Costs and expenses:				
Cost of product sales	527,217	1,329,377	1,928,237	4,211,966
Operating expenses:				
Third parties	88,974	105,165	255,490	293,012
Related party	31,517	36,872	97,647	108,636
Total operating expenses	120,491	142,037	353,137	401,648
General and administrative expenses:				
Third parties	8,336	8,773	24,171	26,566
Related party	10,495	16,180	41,807	48,688
Total general and administrative expenses	18,831	24,953	65,978	75,254
Depreciation and amortization expense	47,597	38,037	137,185	125,538
Asset impairment loss	—	—	—	249,646
Goodwill impairment loss	—	—	—	22,132
Gain on legal settlement	—	—	—	(28,738)
Total costs and expenses	714,136	1,534,404	2,484,537	5,057,446
Operating income (loss)	65,874	59,352	199,379	(86,537)
Equity in (loss) earnings of joint ventures	(5,358)	(951)	(26,629)	3,816
Interest expense, net	(31,078)	(23,894)	(93,601)	(68,118)
Interest income from related party	1,828	—	4,560	—
Other income (expense), net	1,407	(19,943)	3,978	(21,392)
Income (loss) from continuing operations before income tax (benefit) expense	32,673	14,564	87,687	(172,231)
Income tax (benefit) expense	(563)	599	6,147	20,318
Income (loss) from continuing operations	33,236	13,965	81,540	(192,549)
(Loss) income from discontinued operations, net of tax	—	(9,623)	9,069	(23,665)
Net income (loss)	33,236	4,342	90,609	(216,214)
Less net loss attributable to noncontrolling interest	(161)	(47)	(439)	(217)
Net income (loss) attributable to NuStar Energy L.P.	$33,397	$4,389	$91,048	$(215,997)
Net income (loss) per unit applicable to limited partners:				
Continuing operations	$0.28	$0.04	$0.61	$(3.07)
Discontinued operations	—	(0.13)	0.12	(0.33)
Total (Note 10)	$0.28	$(0.09)	$0.73	$(3.40)
Weighted-average limited partner units outstanding	77,886,078	72,383,578	77,886,078	71,302,538
Comprehensive income (loss)	$38,790	$(4,018)	$90,042	$(268,791)
Less comprehensive (loss) income attributable to noncontrolling interest	(729)	66	(2,206)	780
Comprehensive income (loss) attributable to	$39,519	$(4,084)	$92,248	$(269,571)

NuStar Energy L.P.
See Condensed Notes to Consolidated Financial Statements.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, Thousands of Dollars)

	Nine Months Ended September 30,	
	2013	2012
Cash Flows from Operating Activities:		
Net income (loss)	$90,609	$(216,214)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization expense	137,185	129,943
Amortization of debt related items	1,721	(5,718)
(Gain) loss from sale or disposition of assets	(8,739)	19,828
Asset and goodwill impairment loss	—	271,778
Gain on legal settlement	—	(28,738)
Deferred income tax (benefit) expense	(3,815)	1,403
Equity in loss (earnings) of joint ventures	26,629	(3,816)
Distributions of equity in earnings of joint ventures	5,787	6,364
Changes in current assets and current liabilities (Note 11)	116,838	108,750
Other, net	12,325	(11,701)
Net cash provided by operating activities	378,540	271,879
Cash Flows from Investing Activities:		
Capital expenditures	(260,701)	(320,778)
Change in accounts payable related to capital expenditures	(2,879)	—
Investment in other long-term assets	—	(2,364)
Proceeds from sale or disposition of assets	116,467	471,823
Increase in note receivable from related party	(50,761)	(170,711)
Other, net	156	—
Net cash used in investing activities	(197,718)	(22,030)
Cash Flows from Financing Activities:		
Proceeds from long-term debt borrowings	1,299,220	1,805,168
Proceeds from short-term debt borrowings	—	71,880
Proceeds from note offering, net of issuance costs	687,151	247,408
Long-term debt repayments	(1,897,182)	(2,287,178)
Short-term debt repayments	—	(71,880)
Proceeds from issuance of common units, net of issuance costs	—	336,662
Contributions from general partner	—	7,121
Distributions to unitholders and general partner	(294,153)	(267,228)
Payments for termination of interest rate swaps	(33,697)	(5,678)
Other, net	3,168	363
Net cash used in financing activities	(235,493)	(163,362)
Effect of foreign exchange rate changes on cash	(4,412)	3,472
Net (decrease) increase in cash and cash equivalents	(59,083)	89,959
Cash and cash equivalents as of the beginning of the period	83,602	17,497
Cash and cash equivalents as of the end of the period	$24,519	$107,456

See Condensed Notes to Consolidated Financial Statements.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization and Operations
NuStar Energy L.P. (NuStar Energy) (NYSE: NS) is engaged in the terminalling and storage of petroleum products, the transportation of petroleum products and anhydrous ammonia, and fuels marketing. Unless otherwise indicated, the terms “NuStar Energy,” “the Partnership,” “we,” “our” and “us” are used in this report to refer to NuStar Energy L.P., to on or more of our consolidated subsidiaries or to all of them taken as a whole. NuStar GP Holdings, LLC (NuStar GP Holdings) (NYSE: NSH) owns our general partner, Riverwalk Logistics, L.P., and owns a 15.0% total interest in us as of September 30, 2013.

We conduct our operations through our subsidiaries, primarily NuStar Logistics, L.P. (NuStar Logistics) and NuStar Pipeline Operating Partnership L.P. (NuPOP). We have three business segments: storage, pipeline and fuels marketing.

Basis of Presentation
These unaudited condensed consolidated financial statements include the accounts of the Partnership and subsidiaries in which the Partnership has a controlling interest. Noncontrolling interests are separately disclosed on the financial statements. Inter-partnership balances and transactions have been eliminated in consolidation. We account for investments in 50% or less-owned entities using the equity method.

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to the Quarterly Report on Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and notes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included, and all disclosures are adequate. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three and nine months ended September 30, 2013 and 2012 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited condensed consolidated financial statements. Operating results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The consolidated balance sheet as of December 31, 2012 has been derived from the audited consolidated financial statements as of that date. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012.

New Accounting Pronouncements
Balance Sheet Offsetting. In December 2011, the Financial Accounting Standards Board (FASB) amended the disclosure requirements with respect to offsetting assets and liabilities. The amended guidance requires new disclosures to enable users of financial statements to reconcile differences in the offsetting requirements under U.S. GAAP and International Financial Reporting Standards. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In January 2013, the FASB further amended and clarified the scope of balance sheet offsetting disclosure requirements. The amended guidance limits the scope of the new balance sheet offsetting disclosures to derivatives, repurchase agreements, and securities lending transactions to the extent that they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement. The disclosures are required irrespective of whether the transactions

are offset in the consolidated balance sheets. The amended guidance is effective for annual and interim reporting periods beginning on or after January 1, 2013, and retrospective application is required. Accordingly, we adopted the amended guidance January 1, 2013, and it did not have a material impact on our disclosures.

Other Comprehensive Income. In February 2013, the FASB further amended the disclosure requirements for the presentation of comprehensive income. The amended guidance requires that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification. The amended guidance is effective prospectively for annual and interim reporting periods beginning after December 15, 2012. Accordingly, we adopted the amended guidance January 1, 2013, and it did not have a material impact on our disclosures.

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2. DISPOSITIONS

San Antonio Refinery
On January 1, 2013, we sold our fuels refinery in San Antonio, Texas (the San Antonio Refinery) and related assets, which included inventory, a terminal in Elmendorf, Texas and a pipeline connecting the terminal and refinery for approximately $117.0 million (the San Antonio Refinery Sale), and the purchaser assumed certain related liabilities. We have presented the results of operations for the San Antonio Refinery and related assets, previously reported in the fuels marketing and pipeline segments, as discontinued operations for all periods presented. For the three and nine months ended September 30, 2012, we allocated interest expense of $1.0 million and $2.9 million, respectively, to discontinued operations based on the ratio of net assets sold to consolidated net assets. We recognized a gain of $9.3 million on the sale, which is included in discontinued operations for the nine months ended September 30, 2013.

The following table summarizes the results from discontinued operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Thousands of Dollars)			
Revenues	$—	$151,010	$185	$411,454
Income (loss) before income tax expense	$—	$(9,600)	$9,069	$(23,629)

As of December 31, 2012, we reclassified the assets related to the San Antonio Refinery as “Assets held for sale” on the consolidated balance sheet. The liabilities held for sale related to the San Antonio Refinery are included within “Accrued liabilities” on the consolidated balance sheet. The total assets and liabilities held for sale consisted of the following:

	December 31, 2012
	(Thousands of Dollars)
Inventories	$15,939
Property, plant and equipment, net	93,899
Other long-term assets, net	5,650
Assets held for sale	$115,488
Accrued liabilities (environmental reserve)	$289
Other long-term liabilities (environmental reserve)	7,621
Liabilities held for sale	$7,910

3. INVENTORIES

Inventories consisted of the following:

	September 30, 2013	December 31, 2012
	(Thousands of Dollars)	
Crude oil	$8,112	$447
Finished products	106,997	164,894
Materials and supplies	7,889	7,887
Total	$122,998	$173,228

4. DEBT

Revolving Credit Agreement

During the nine months ended September 30, 2013, our $1.5 billion five-year revolving credit agreement (the 2012 Revolving Credit Agreement) was reduced by $154.3 million, primarily as a result of applying a portion of the proceeds from the issuance of NuStar Logistics' 6.75% senior notes in August 2013. The 2012 Revolving Credit Agreement bears interest, at our option, based on either an alternative base rate or a LIBOR-based rate. The interest rate on the 2012 Revolving Credit Agreement is subject to adjustment if our debt rating is downgraded (or subsequently upgraded) by certain credit rating agencies. As of September 30, 2013, our weighted average interest rate was 2.4%.

The 2012 Revolving Credit Agreement contains customary restrictive covenants, including requiring us to maintain, as of the end of each rolling period, which consists of any period of four consecutive fiscal quarters, a consolidated debt coverage ratio (consolidated indebtedness to consolidated EBITDA, as defined in the 2012 Revolving Credit Agreement) not to exceed 5.00-to-1.00. The requirement not to exceed a maximum consolidated debt coverage ratio may limit the amount we can borrow under the 2012 Revolving Credit Agreement to an amount less than the total amount available for borrowing. As of September 30, 2013, our consolidated debt coverage ratio was 4.3x, and we had $1,055.5 million available for borrowing.

6.75% Senior Notes
On August 19, 2013, NuStar Logistics issued $300.0 million of 6.75% senior notes due February 1, 2021 (the 6.75% Senior Notes). We received proceeds of approximately $296.3 million, net of the underwriters' discount and deferred issuance costs of $3.7 million, which we used for general partnership purposes, including repayment of outstanding borrowings under our 2012 Revolving Credit Agreement. The interest on the 6.75% Senior Notes is payable semi-annually in arrears on February 1 and August 1 of each year beginning on February 1, 2014.

The 6.75% Senior Notes rank equally with existing senior unsecured indebtedness of NuStar Logistics and do not have sinking fund requirements. The 6.75% Senior Notes issued by NuStar Logistics are fully and unconditionally guaranteed by NuStar Energy and NuPOP. NuPOP will be released from its guarantee when it no longer guarantees any obligations of NuStar Energy, or any of its subsidiaries, including NuStar Logistics, under any bank facility or public debt instrument. The 6.75% Senior Notes contain restrictions on NuStar Logistics' ability to incur secured indebtedness unless the same security is also provided for the benefit of holders of the notes. In addition, the 6.75% Senior Notes limit NuStar Logistics' ability to incur indebtedness secured by certain liens, to engage in certain sale-leaseback transactions and to engage in certain consolidations, mergers or asset sales. At the option of NuStar Logistics, the 6.75% Senior Notes may be redeemed in whole or in part at any time at a redemption price, which may include a make-whole premium, plus accrued and unpaid interest to the redemption date.

7.625% Fixed-to-Floating Rate Subordinated Notes
On January 22, 2013, NuStar Logistics issued $402.5 million of 7.625% fixed-to-floating rate subordinated notes due January 15, 2043 (the Subordinated Notes), including the underwriters' option to purchase up to an additional $52.5 million principal amount of the notes, which was exercised in full. We received proceeds of approximately $390.9 million, net of $11.6 million of deferred issuance costs, which we used for general partnership purposes, including repayment of outstanding borrowings under our 2012 Revolving Credit Agreement. The Subordinated Notes are fully and unconditionally guaranteed on an unsecured and subordinated basis by NuStar Energy and NuPOP.
The Subordinated Notes bear interest at a fixed annual rate of 7.625%, payable quarterly in arrears on January 15, April 15, July 15 and October 15 of each year beginning on April 15, 2013 and ending on January 15, 2018. Thereafter, the Subordinated Notes will bear interest at an annual rate equal to the sum of the three-month LIBOR rate for the related quarterly interest period, plus 6.734% payable quarterly on January 15, April 15, July 15 and October 15 of each year, commencing April 15, 2018, unless payment is deferred in accordance with the terms of the notes. NuStar Logistics may elect to defer interest payments on the Subordinated Notes on one or more occasions for up to five consecutive years. Deferred interest will accumulate additional interest at a rate equal to the interest rate then applicable to the Subordinated Notes until paid. If NuStar Logistics elects to defer interest payments, NuStar Energy cannot declare or make cash distributions to its unitholders during the period interest is deferred.

The Subordinated Notes do not have sinking fund requirements and are subordinated to existing senior unsecured indebtedness of NuStar Logistics and NuPOP. The Subordinated Notes do not contain restrictions on NuStar Logistics' ability to incur additional indebtedness, including debt that ranks senior in priority of payment to the notes. In addition, the Subordinated Notes do not limit NuStar Logistics' ability to incur indebtedness secured by certain liens or to engage in certain sale-leaseback transactions. At the option of NuStar Logistics, the Subordinated Notes may be redeemed in whole or in part at any time at a redemption price, which may include a make-whole premium, plus accrued and unpaid interest to the redemption date.

Gulf Opportunity Zone Revenue Bonds

In 2008, 2010 and 2011, the Parish of St. James, Louisiana issued, pursuant to the Gulf Opportunity Zone Act of 2005, tax-exempt revenue bonds (the GoZone Bonds) associated with our St. James, Louisiana terminal expansions. The GoZone Bonds bear interest based on a weekly tax-exempt bond market interest rate, and we pay interest monthly. The interest rate was 0.1% as of September 30, 2013. Following the issuance, the proceeds were deposited with a trustee and are disbursed to us upon our request for reimbursement of expenditures related to our St. James terminal expansions. We include the amount remaining in trust in "Other long-term assets, net," and we include the amount of bonds issued in "Long-term debt, less current portion" on the consolidated balance sheets. For the nine months ended September 30, 2013, we received $38.5 million from the trustee. As of September 30, 2013, the amount remaining in trust totaled $88.1 million.

Other
In February 2013, we repaid the remaining principal balance of $0.6 million on our $12.0 million note payable due to the Port of Corpus Christi Authority of Nueces County, Texas. During the nine months ended September 30, 2013, we repaid NuStar Logistics' $229.9 million of 6.05% senior notes due March 15, 2013 and NuPOP's $250.0 million of 5.875% senior notes due June 1, 2013 with borrowings under our 2012 Revolving Credit Agreement.

In January 2013, Moody's Investor Service lowered our credit rating to Ba1 from Baa3. This downgrade caused the interest rates on the 2012 Revolving Credit Agreement, NuStar Terminals Limited's £21 million amended and restated term loan agreement and NuStar Logistics' $350.0 million of 7.65% senior notes due 2018 to increase by 0.375%, 0.375% and 0.25%, respectively, effective January 2013. This downgrade may also require us to provide additional credit support for certain contracts, although as of September 30, 2013, we have not been required to provide any additional credit support.

5. COMMITMENTS AND CONTINGENCIES

Contingencies
We have contingent liabilities resulting from various litigation, claims and commitments. We record accruals for loss contingencies when losses are considered probable and can be reasonably estimated. Legal fees associated with defending the Partnership in legal matters are expensed as incurred. As of September 30, 2013, we have accrued $0.6 million for contingent losses. The amount that will ultimately be paid related to these matters may differ from the recorded accruals, and the timing of such payments is uncertain. In addition, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on our results of operations, financial position or liquidity.

Commitments
On November 6, 2013, we came to a mutual agreement with PDVSA-Petróleo S.A. (PDVSA) to terminate that certain Crude Oil Sales Agreement dated effective as of March 1, 2008 (the CSA). We previously amended the CSA to reduce the crude oil purchase obligations from 75,000 barrels per day to 30,000 barrels per day, which remains in effect for the remainder the year. The termination is effective January 1, 2014, and will also terminate our crude oil supply agreement with NuStar Asphalt LLC (Asphalt JV) effective January 1, 2014. See Note 8. Related Party Transactions for a discussion of our crude oil supply agreement with Asphalt JV.

6. FAIR VALUE MEASUREMENTS

We segregate the inputs used in measuring fair value into three levels: Level 1, defined as observable inputs such as quoted prices for identical assets or liabilities in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in markets that are not active; and Level 3, defined as unobservable inputs in which little or no market data exists. We consider counterparty credit risk and our own credit risk in the determination of all estimated fair values.

Product Imbalances. We value our assets and liabilities related to product imbalances using quoted market prices in active markets as of the reporting date.

Interest Rate Swaps. We estimate the fair value of both our fixed-to-floating and forward-starting interest rate swaps using discounted cash flows, which used observable inputs such as time to maturity and market interest rates.

Commodity Derivatives. We base the fair value of certain of our commodity derivative instruments on quoted prices on an exchange; accordingly, we include these items in Level 1 of the fair value hierarchy. We also have derivative instruments for which we determine fair value using industry pricing services and other observable inputs, such as quoted prices on an exchange for similar derivative instruments. Therefore, we include these derivative instruments in Level 2 of the fair value hierarchy. See Note 7. Derivatives and Risk Management Activities for a discussion of our derivative instruments.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following assets and liabilities are measured at fair value:

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
	(Thousands of Dollars)			
Other current assets:				
Product imbalances	$970	$—	$—	$970
Commodity derivatives	202	4,200	—	4,402
Other long-term assets, net:				
Commodity derivatives	—	6,575	—	6,575
Accrued liabilities:				
Product imbalances	(1,476)	—	—	(1,476)
Commodity derivatives	—	(5,006)	—	(5,006)
Contingent consideration	—	—	(2,818)	(2,818)
Other long-term liabilities:				
Commodity derivatives	—	(208)	—	(208)
Total	$(304)	$5,561	$(2,818)	$2,439

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
	(Thousands of Dollars)			
Other current assets:				
Product imbalances	$1,232	$—	$—	$1,232
Commodity derivatives	1,001	8,357	—	9,358
Other long-term assets, net:				
Commodity derivatives	—	9,206	—	9,206
Accrued liabilities:				
Product imbalances	(1,686)	—	—	(1,686)
Commodity derivatives	—	(19,210)	—	(19,210)
Interest rate swaps	—	(40,911)	—	(40,911)
Contingent consideration	—	—	(9,600)	(9,600)
Total	$547	$(42,558)	$(9,600)	$(51,611)

Contingent Consideration

On December 13, 2012, NuStar Logistics acquired certain assets, including 100% of the partnership interest in TexStar Crude Oil Pipeline, LP, from TexStar Midstream Services, LP and certain of its affiliates (collectively, TexStar) for approximately $325.0 million (the TexStar Asset Acquisition), including contingent consideration.

In connection with the TexStar Asset Acquisition, we could be obligated to pay additional consideration to TexStar. Such obligations are dependent upon the cost of work required to complete certain assets and obtain outstanding real estate rights (collectively, the Contingent Consideration). We estimated the fair value of the Contingent Consideration using a probability-weighted discounted cash flow model, which reflects possible outcomes and our estimates of the probabilities of those outcomes. Our estimate of the fair value is based on significant inputs not observable in the market and thus falls within Level 3 of the fair value hierarchy. The probability-weighted cash flows were discounted using a discount rate of 11%.

Based on our assessment of the costs necessary to complete the assets in accordance with our agreement with TexStar, and considering the probability of possible outcomes, we determined that it is unlikely we would be obligated to pay a portion of the Contingent Consideration. The undiscounted amount of potential future payments that we could be required to make under the applicable agreements is between $0 and $9.3 million.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table summarizes the activity in our Level 3 liabilities for contingent consideration:

	Nine Months Ended September 30, 2013
	(Thousands of Dollars)
Beginning balance	$9,600
Amounts settled	(1,114)
Changes in fair value recorded in earnings:	
Operating expenses	(6,500)
Interest expense, net	832
Ending balance	$2,818

Fair Value of Financial Instruments

We recognize cash equivalents, receivables, note receivables from related parties, payables and debt in our consolidated balance sheets at their carrying amount. The fair values of these financial instruments, except for a note receivable from related party and debt, approximate their carrying amounts. The estimated fair value and carrying amounts of the note receivable from related party and debt were as follows:

	September 30, 2013		December 31, 2012	
	Fair Value	Carrying Amount	Fair Value	Carrying Amount
	(Thousands of Dollars)			
Debt	$2,429,001	$2,473,678	$2,377,120	$2,411,004
Note receivable from related party	$109,505	$146,472	$91,705	$95,711

We estimated the fair value of our publicly-traded senior notes based upon quoted prices in active markets; therefore, we determined that the fair value of our publicly traded senior notes falls in Level 1 of the fair value hierarchy. For our other debt, for which a quoted market price is not available, we estimated the fair value using a discounted cash flow analysis using current incremental borrowing rates for similar types of borrowing arrangements and determined that the fair value falls in Level 2 of the fair value hierarchy.

We estimated the fair value of the note receivable from related party using discounted cash flows, which use inputs such as time to maturity and estimated market interest rates, and determined the fair value falls in Level 3 of the fair value hierarchy. See Note 8. Related Party Transactions for additional information on the note receivable from Asphalt JV.

7. DERIVATIVES AND RISK MANAGEMENT ACTIVITIES

We utilize various derivative instruments to manage our exposure to commodity price risk and interest rate risk. Our risk management policies and procedures are designed to monitor interest rates, futures and swap positions and over-the-counter positions, as well as physical volumes, grades, locations and delivery schedules, to help ensure that our hedging activities address our market risks. Our risk management committee oversees our trading controls and procedures and certain aspects of commodity and trading risk management. Our risk management committee also reviews all new commodity and trading risk management strategies in accordance with our risk management policy, as approved by our board of directors.

Interest Rate Risk

We were a party to certain interest rate swap agreements to manage our exposure to changes in interest rates, which included forward-starting interest rate swap agreements related to the interest payments associated with forecasted probable debt issuances in 2013. We entered into these swaps in order to hedge the risk of changes in the interest payments attributable to changes in the benchmark interest rate during the period from the effective date of the swap to the issuance of the forecasted debt. These swaps qualified, and we designated them, as cash flow hedges of future interest payments associated with forecasted debt issuances. In connection with the maturity of the 6.05% senior notes due March 15, 2013 and 5.875% senior notes due June 1, 2013, we terminated forward-starting interest rate swap agreements with an aggregate notional amount of $275.0 million. We paid $33.7 million in connection with the terminations, which we reclassify out of “Accumulated other comprehensive loss” and into “Interest expense, net” as the interest payments occur or if the interest payments are probable not to occur. During the second quarter of 2013, we determined that one forecasted interest payment was probable not to occur, and we reclassified $2.0 million out of “Accumulated other comprehensive loss” to “Interest expense, net.” As of September 30, 2013, we had no forward-starting interest rate swaps.

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We were also a party to fixed-to-floating interest rate swap agreements associated with a portion of our fixed-rate senior notes, which we accounted for as fair value hedges. We terminated all remaining fixed-to-floating interest rate swap agreements during the year ended December 31, 2012.

Commodity Price Risk
We are exposed to market risks related to the volatility of crude oil and refined product prices. In order to reduce the risk of commodity price fluctuations with respect to our crude oil and finished product inventories and related firm commitments to purchase and/or sell such inventories, we utilize commodity futures and swap contracts, which qualify, and we designate as, fair value hedges. Derivatives that are intended to hedge our commodity price risk, but fail to qualify as fair value or cash flow hedges, are considered economic hedges, and we record associated gains and losses in net income.

To determine the volume represented by commodity contracts, we combined the volume of our long and short open positions on an absolute basis, which totaled 20.9 million barrels and 22.7 million barrels as of September 30, 2013 and December 31, 2012, respectively.

As of September 30, 2013 and December 31, 2012, we had $4.5 million and $6.2 million, respectively, of margin deposits related to our derivative instruments.

The fair values of our derivative instruments included in our consolidated balance sheets were as follows:

	Balance Sheet Location	Asset Derivatives September 30, 2013	Asset Derivatives December 31, 2012	Liability Derivatives September 30, 2013	Liability Derivatives December 31, 2012
		(Thousands of Dollars)			
Derivatives Designated as Hedging Instruments:					
Commodity contracts	Other current assets	$412	$1,471	$—	$(811)
Interest rate swaps	Accrued liabilities	—	—	—	(40,911)
Total		412	1,471	—	(41,722)
Derivatives Not Designated as Hedging Instruments:					
Commodity contracts	Other current assets	19,120	22,269	(15,130)	(13,571)
Commodity contracts	Other long-term assets, net	18,034	39,322	(11,459)	(30,116)
Commodity contracts	Accrued liabilities	7,199	17,406	(12,205)	(36,616)
Commodity contracts	Other long-term liabilities	7,165	—	(7,373)	—
Total		51,518	78,997	(46,167)	(80,303)
Total Derivatives		$51,930	$80,468	$(46,167)	$(122,025)

Certain of our derivative instruments are eligible for offset in the consolidated balance sheets and subject to master netting arrangements. Under our master netting arrangements, there is a legally enforceable right to offset amounts, and we intend to settle such amounts on a net basis. The following are the net amounts presented on the consolidated balance sheets:

Commodity Contracts	September 30, 2013	December 31, 2012
	(Thousands of Dollars)	
Net amounts of assets presented in the consolidated balance sheets	$10,977	$18,564
Net amounts of liabilities presented in the consolidated balance sheets	$(5,214)	$(19,210)

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The earnings impact of our derivative activity was as follows:

Derivatives Designated as Fair Value Hedging Instruments	Income Statement Location	Amount of Gain (Loss) Recognized in Income on Derivative (Effective Portion)	Amount of Gain (Loss) Recognized in Income on Hedged Item	Amount of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)
		(Thousands of Dollars)		
Three months ended September 30, 2013:				
Commodity contracts	Cost of product sales	$(3,853)	$4,184	$ 331
Three months ended September 30, 2012:				
Commodity contracts	Cost of product sales	$(23,131)	$22,505	$ (626)
Nine months ended September 30, 2013:				
Commodity contracts	Cost of product sales	$4,059	$(6,298)	$ (2,239)
Nine months ended September 30, 2012:				
Interest rate swaps	Interest expense, net	$(17,345)	$17,345	$ —
Commodity contracts	Cost of product sales	(20,496)	19,058	(1,438)
Total		$(37,841)	$36,403	$ (1,438)

Derivatives Designated as Cash Flow Hedging Instruments	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Income Statement Location (a)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)
	(Thousands of Dollars)		(Thousands of Dollars)	
Three months ended September 30, 2013:				
Interest rate swaps	$ —	Interest expense, net	$(1,653)	$ —
Three months ended September 30, 2012:				
Interest rate swaps	$ (3,825)	Interest expense, net	$(645)	$ —
Commodity contracts	(20,629)	Income (loss) from discontinued operations	(8,728)	277
Total	$ (24,454)		$(9,373)	$ 277

Nine months ended September 30, 2013:				
Interest rate swaps	$ 7,213	Interest expense, net	$(4,615)	$ —
Nine months ended September 30, 2012:				
Interest rate swaps	$ (17,276)	Interest expense, net	$(1,697)	$ —
Commodity contracts	(73,289)	Income (loss) from discontinued operations	(24,590)	4,287
Total	$ (90,565)		$(26,287)	$ 4,287

(a) Amounts are included in specified location for both the gain (loss) reclassified from accumulated other comprehensive income (OCI) into income (effective portion) and the gain (loss) recognized in income on derivative (ineffective portion).

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Derivatives Not Designated as Hedging Instruments	Income Statement Location	Amount of Gain (Loss) Recognized in Income (Thousands of Dollars)
Three months ended September 30, 2013:		
Commodity contracts	Cost of product sales	$ (4,941)
Three months ended September 30, 2012:		
Commodity contracts	Cost of product sales	$ (710)
Commodity contracts	Income (loss) from discontinued operations	(136)
Total		$ (846)
Nine months ended September 30, 2013:		
Commodity contracts	Cost of product sales	$ (4,492)
Commodity contracts	Income (loss) from discontinued operations	(218)
Total		$ (4,710)
Nine months ended September 30, 2012:		
Commodity contracts	Revenues	$ (7,654)
Commodity contracts	Cost of product sales	20,679
Commodity contracts	Income (loss) from discontinued operations	2,412
Total		$ 15,437

For derivatives designated as cash flow hedging instruments, once a hedged transaction occurs, we reclassify the effective portion from accumulated OCI to “Cost of product sales” or “Interest expense, net.” As of September 30, 2013, we expect to reclassify a loss of $11.0 million to “Interest expense, net” within the next twelve months.

8. RELATED PARTY TRANSACTIONS

The following table summarizes information pertaining to related party transactions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Thousands of Dollars)			
Revenues	$2,376	$713	$16,183	$2,198
Operating expenses	$31,517	$36,872	$97,647	$108,636
General and administrative expenses	$10,495	$16,180	$41,807	$48,688
Interest income	$1,828	$—	$4,560	$—
Expenses included in discontinued operations, net of tax	$—	$2,161	$196	