

MAGELLAN MIDSTREAM PARTNERS LP
Form 10-K
February 27, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K
(Mark One)

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

For the fiscal year ended December 31, 2011

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 1-16335

Magellan Midstream Partners, L.P.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

73-1599053
(I.R.S. Employer
Identification No.)

Magellan GP, LLC
P.O. Box 22186, Tulsa, Oklahoma
(Address of principal executive offices)

74121-2186
(Zip Code)

Registrant's telephone number, including area code: (918) 574-7000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
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Common Units representing limited partnership interests	New York Stock Exchange
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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 ☒ No ☐

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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

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The aggregate market value of the registrant's voting and non-voting limited partner units held by non-affiliates computed by reference to the price at which the limited partner units were last sold as of June 30, 2011 was \$6,720,057,505.

As of February 23, 2012, there were 113,100,436 limited partner units outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement prepared for the solicitation of proxies in connection with the 2012 Annual Meeting of Limited Partners are incorporated by reference in Part III of this Form 10-K.

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MAGELLAN MIDSTREAM PARTNERS, L.P.

FORM 10-K

PART I

Item 1. Business

(a) General Development of Business

We are a Delaware limited partnership formed in August 2000 and our limited partner units are traded on the New York Stock Exchange under the ticker symbol "MMP." Magellan GP, LLC ("MMP GP"), a wholly-owned Delaware limited liability company, serves as our general partner. Unless indicated otherwise, the terms "our," "we," "us" and similar language refer to Magellan Midstream Partners, L.P. together with its subsidiaries.

Crude Oil and Condensate Development

During 2011, we took significant steps to expand our crude oil transportation and storage assets. We completed the construction of more than 4 million barrels of crude oil storage in Cushing, Oklahoma during the year, bringing our total crude oil storage in Cushing to 12 million barrels, solidifying our position as one of the largest owners of crude oil storage in the strategic Cushing crude oil hub.

We also decided to reverse and convert a portion of our Houston-to-El Paso, Texas pipeline from refined products to crude oil service in order to provide crude oil deliveries from its origin point in Crane, Texas to our East Houston, Texas terminal for further delivery to refineries or third-party pipelines along the Houston ship channel and Texas City, Texas through our existing crude oil distribution system. This reversed pipeline system is expected to have an initial capacity of 135,000 barrels per day, cost approximately \$245 million to reverse and convert and be operational by early 2013. We have received long-term committed volumes for a portion of the initial capacity of this pipeline. Capacity could be expanded to up to 225,000 barrels per day if warranted by additional commitments.

In addition, in December 2011, we announced the formation of a joint venture to deliver Eagle Ford shale condensate to our Corpus Christi, Texas terminal. We have a 50% ownership interest in this joint venture, with Copano Energy, L.L.C. ("Copano") owning the other 50% interest. The joint venture, known as Double Eagle Pipeline LLC, will construct and own approximately 140 miles of pipeline to connect to an existing 50-mile pipeline segment owned by Copano, enabling delivery of approximately 100,000 barrels per day of condensate from the Eagle Ford shale formation to our Corpus Christi terminal. Copano will oversee the construction of the pipeline and will serve as operator once pipeline operations commence. This project is supported by long-term customer commitments and is expected to be fully operational by early 2013. In conjunction with this project (but separate from the joint venture with Copano), we are making enhancements to our Corpus Christi terminal, including the construction of 500,000 barrels of dedicated condensate storage and a dedicated dock delivery pipeline. This project will cost approximately \$100 million, which includes \$75.0 million for our portion of the pipeline construction and \$25.0 million for tankage and other infrastructure changes at our Corpus Christi terminal.

(b) Financial Information About Segments

See Part II—Item 8. Financial Statements and Supplementary Data.

(c) Narrative Description of Business

We are principally engaged in the transportation, storage and distribution of petroleum products. As of December 31, 2011, our asset portfolio consists of:

• petroleum pipeline system, comprised of approximately 9,600 miles of pipeline and 50 terminals;

• petroleum terminals, which includes storage terminal facilities (consisting of six marine terminals located along coastal waterways and crude oil storage in Cushing, Oklahoma) and 27 inland terminals; and

• ammonia pipeline system, representing our 1,100-mile ammonia pipeline and six terminals.

Petroleum products transported, stored and distributed through our petroleum pipeline system and petroleum terminals include:

• refined petroleum products, which are the output from refineries and are primarily used as fuels by consumers.

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Refined petroleum products include gasoline, diesel fuel, aviation fuel, kerosene and heating oil. Collectively, diesel fuel and heating oil are referred to as distillates;

liquefied petroleum gases, or LPGs, which are produced as by-products of the crude oil refining process and in connection with natural gas production. LPGs include butane and propane;

blendstocks, which are blended with petroleum products to change or enhance their characteristics such as increasing a gasoline's octane or oxygen content. Blendstocks include alkylates and oxygenates;

heavy oils and feedstocks, which are used as burner fuels or feedstocks for further processing by refineries and petrochemical facilities. Heavy oils and feedstocks include No. 6 fuel oil and vacuum gas oil;

crude oil and condensate, which are used as feedstocks by refineries; and

biofuels, such as ethanol and biodiesel, which are increasingly required by government mandates.

Refined Petroleum Products Logistics Industry Background

The U.S. petroleum products transportation and distribution system links oil refineries to end-users of gasoline and other petroleum products. This system is comprised of a network of pipelines, terminals, storage facilities, tankers, barges, railcars and trucks. For transportation of petroleum products, pipelines are generally the lowest-cost alternative for intermediate and long-haul movements between different markets. Throughout the distribution system, terminals play a key role in moving products to the end-user markets by providing storage, distribution, blending and other ancillary services.

The Gulf Coast region is a significant supply source for our facilities and is a major hub for petroleum refining. According to the "Annual Refinery Report for 2011" published by the Energy Information Administration ("EIA"), the Gulf Coast region accounted for approximately 45% of total U.S. daily refining capacity and 85% of U.S. refining capacity expansion from 2001 to 2011. The growth in Gulf Coast refining capacity has resulted in part from consolidation in the petroleum industry to take advantage of economies of scale from operating larger refineries. The role of Gulf Coast refiners as well as imports should become even more significant going forward given the recent shutdown of refining capacity in the Northeast U.S.

Crude Oil Logistics Industry Background

The crude oil available to U.S. and world-wide refineries consists of a substantial number of different grades and varieties. This is due to crude oil produced from different producing regions, whether from within or outside the U.S., that may have unique qualities, each with varying economic attributes. Consequently, different refineries have developed a distinct configuration of process units designed to handle particular grades of crude oil. This creates transportation, terminalling and storage challenges associated with regional volumetric supply and demand imbalances. In many cases, these factors result in the need for certain grades to be batched or segregated in the transportation and storage processes or blended to precise specifications. One of the largest storage hubs for crude oil is in Cushing, Oklahoma, the delivery point for crude oil futures contracts traded on the New York Mercantile Exchange ("NYMEX"). From Cushing the crude oil is shipped to various refineries throughout the U.S. With higher crude prices and improved drilling technology, new domestic fields are being developed and previously existing fields are being redeveloped, increasing the need for new or expanded transportation and storage infrastructure.

Description of Our Businesses

PETROLEUM PIPELINE SYSTEM

Our common carrier petroleum pipeline system extends approximately 9,600 miles and covers a 13-state area, extending from the Gulf Coast refining region across Texas and through the Midwest to Colorado, North Dakota, Minnesota, Wisconsin and Illinois. Our pipeline system transports petroleum products and includes 50 terminals. The

products transported on our pipeline system are largely transportation fuels and in 2011 were comprised of 50% gasoline, 33% distillates, 10% crude oil and 7% aviation fuel and LPGs. Refined product and LPG shipments originate on our pipeline system from direct connections to refineries, at our terminals and through interconnections with other interstate pipelines for transportation and ultimate distribution to retail gasoline stations, truck stops, railroads, airports and other end-users. Crude oil shipments originate on our pipeline system from connections to refineries, crude oil terminals and through interconnections with other interstate pipelines

for transportation and distribution to refineries or terminals.

Our petroleum pipeline system segment accounted for the following percentages of our consolidated revenues, operating margin and total assets:

	Year Ended December 31,		
	2009	2010	2011
Percent of consolidated revenues	80%	85%	84%
Percent of consolidated operating margin	75%	79%	77%
Percent of consolidated total assets	73%	71%	67%

See Note 15—Segment Disclosures in the accompanying consolidated financial statements for additional financial information about our petroleum pipeline system segment.

The portion of our petroleum pipeline system that ships refined products and LPGs is dependent on the ability of refiners and marketers to meet the demand for those products in the markets they serve through their shipments on our pipeline system. According to January 2012 projections provided by the EIA, the demand for refined petroleum products in the primary market areas served by our petroleum pipeline system, known as West North Central and West South Central census districts, is expected to remain relatively stable over the next 10 years. The total production of refined petroleum products from refineries located in the West North Central district has historically been insufficient to meet the demand for refined petroleum products in that region. Any excess West North Central demand has been and is expected to be met largely by imports of refined petroleum products via pipelines from Gulf Coast refineries that are located in the West South Central census district.

Our petroleum pipeline system is well-connected to Gulf Coast refineries. In addition to our own pipeline that originates in the Gulf Coast region, we also have interconnections with third-party pipelines that originate in the Gulf Coast region. These connections to Gulf Coast refineries, together with our pipeline's extensive network throughout the West North Central district, should aid us in accommodating any demand growth or supply shifts that may occur. The portion of our petroleum pipeline system that ships crude oil is dependent in part on the production levels and related crude oil demand by Houston-area refineries. Additional connections for this pipeline are being developed that will provide access to a broader group of origins and refineries in the Houston refining region.

The operating statistics below reflect our petroleum pipeline system's operations for the periods indicated:

	Year Ended December 31,		
	2009	2010	2011
Shipments (thousand barrels):			
Refined products			
Gasoline	169,873	194,338	208,852
Distillates	100,214	122,929	136,003
Aviation fuel	19,843	22,612	25,245
LPGs	5,770	4,949	4,927
Crude oil	—	14,658	43,239
Total shipments	295,700	359,486	418,266
Capacity leases	29,821	27,084	30,672
Total shipments, including capacity leases	325,521	386,570	448,938
Daily average (thousand barrels)	892	1,059	1,230

The increase in total shipments for 2010 and 2011 was primarily due to acquisitions and growth projects completed during the last two fiscal years.

The maximum number of barrels our petroleum pipeline system can transport per day depends upon the operating balance achieved at a given time between various segments of our pipeline system. This balance is dependent upon the mix of petroleum products to be shipped and the demand levels at the various delivery points. We believe that we will be able to accommodate demand increases in the markets we serve through expansions or modifications of our

petroleum pipeline system,

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if necessary.

Operations. Our petroleum pipeline system is the longest common carrier pipeline for refined petroleum products and LPGs in the U.S. Through direct refinery connections and interconnections with other interstate pipelines, our system can access more than 44% of the refinery capacity in the continental U.S. Most of the shipments on our pipeline system are for third parties, and we do not take title to those products. We do take title to products related to our petroleum products blending and fractionation activities, and until we reverse and convert a portion of our Houston-to-El Paso pipeline segment (See Pipeline Conversion to Crude Service in Item 7), we take title to the linefill related to this pipeline section and a portion of the petroleum products we currently transport on this pipeline for sale in El Paso, Texas. Furthermore, under our tariffs, we are allowed to deduct from our shipper's inventory a prescribed quantity of the products our shippers transport on our pipeline to compensate us for metering inaccuracies, evaporation or other events that result in volume losses during the shipment process. To the extent we can manage our volume loss below the deducted amount, we take title to those products, which we can sell and thereby reduce our operating expenses.

In 2011, our petroleum pipeline system generated 72% of its revenues, excluding product sales revenues, from transportation tariffs on volumes shipped. These transportation tariffs vary depending upon where the product originates, where ultimate delivery occurs and any applicable discounts. All interstate transportation rates and discounts are in published tariffs filed with the Federal Energy Regulatory Commission ("FERC"). Included as part of these tariffs are charges for terminalling and storage of products at 34 of our pipeline system's 50 terminals. Revenues from terminalling and storage at our other 16 terminals are at privately-negotiated rates.

In 2011, our petroleum pipeline system generated the remaining 28% of its revenues, excluding product sales revenues, from leasing pipeline and storage tank capacity to shippers and from providing product and other services such as ethanol and biodiesel unloading and loading, additive injection, custom blending, terminalling, laboratory testing and data services to shippers, which are performed under a mix of "as needed" monthly and long-term agreements. We also receive a fee for operating a 135-mile pipeline (in which we have a 50% interest) that transports crude oil from Cushing, Oklahoma to El Dorado, Kansas and has connections to National Cooperative Refining Association's refinery in McPherson, Kansas and HollyFrontier's refinery in El Dorado, Kansas.

Product revenues for the petroleum pipeline system primarily result from our petroleum products blending and transmix fractionation activities and from linefill management and product marketing associated with our Houston-to-El Paso pipeline section. Our petroleum products blending activity involves purchasing LPGs and blending them into gasoline, which creates additional gasoline available for us to sell. This activity is limited by seasonal gasoline vapor pressure specification requirements and by the varying quality of the product delivered to us at our pipeline origins. We typically lock in most of the margin from this blending activity by entering into either forward physical or NYMEX gasoline futures contracts at the time we purchase the related LPGs. These blending activities accounted for approximately 75% of the total product margin for the petroleum pipeline system during 2011. If the differential between the cost of butane and the price of gasoline were to narrow, which generally occurs when crude prices decrease, the product margin we earn from these activities would be negatively impacted. We also operate two fractionators along our pipeline system that separate transmix, which is an unusable mixture of various petroleum products, back into its original components. We purchase transmix from third parties and sell the resulting separated petroleum products. We also purchase petroleum products for shipment on the Houston-to-El Paso pipeline section to facilitate product shipments on the pipeline. We sell these products in the El Paso, Texas wholesale market. Product margin from all of these activities was \$44.2 million, \$81.3 million and \$126.8 million for the years ended December 31, 2009, 2010 and 2011, respectively. The amount of margin we earn from these activities fluctuates with changes in petroleum prices. Product margin is not a generally accepted accounting principle ("GAAP") financial measure, but its components are determined in accordance with generally accepted accounting principles. Product margin, which is calculated as product sales revenues less product purchases, is used by management to evaluate the

profitability of our commodity-related activities. A reconciliation of the components of product margin to operating profit, the nearest GAAP measurement, is provided in Note 15—Segment Disclosures to the consolidated financial statements included in this Annual Report on Form 10-K.

Commodity Risk Management. Our policy is generally to purchase only those products necessary to conduct our normal business activities. We do not acquire and hold physical inventory, futures contracts or other derivative instruments for the purpose of speculating on commodity price changes as these activities could expose us to significant losses. Our blending, fractionation and pipeline linefill management activities require us to carry significant levels of inventories. We use derivative instruments to hedge against commodity price changes and manage risks associated with our various commodity purchase and sale obligations. Our risk management policies and procedures are designed to monitor our derivative instrument positions, as well as physical volumes, grades, locations, delivery schedules and storage capacity to help ensure that our hedging activities address our risks. Our strategies are primarily intended to mitigate and manage price risks that are inherent in our blending, fractionation and pipeline linefill activities.

Facilities. Our petroleum pipeline system consists of an approximate 9,600-mile pipeline and 50 terminals and includes approximately 39 million barrels of aggregate usable storage capacity. The terminals on our pipeline system deliver petroleum products primarily into tank trucks.

Petroleum Products Supply. Petroleum products originate from refineries, pipeline interconnection points and terminals along our pipeline system. In 2011, approximately 59% of the petroleum products transported on our petroleum pipeline system originated from 13 direct refinery connections and 41% originated from interconnections with other pipelines or terminals.

The portion of our system that transports refined petroleum products and LPGs is directly connected to and receives product from the 13 refineries shown below:

Major Origins—Refineries (Listed Alphabetically)

Company	Refinery Location
BP	Texas City, TX
Calumet Specialty Products	Superior, WI
CVR Energy	Coffeyville, KS
CVR Energy	Wynnewood, OK
ConocoPhillips	Ponca City, OK
Flint Hills Resources (Koch)	Pine Bend, MN
HollyFrontier	El Dorado, KS
HollyFrontier	Tulsa, OK
National Cooperative Refining Association	McPherson, KS
St. Paul Park Refining	St. Paul, MN
Valero	