NuStar Energy L.P.
Form 10-Q
November 08, 2012

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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, 2012

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, 2012 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, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$107,456	$17,497
Accounts receivable, net of allowance for doubtful accounts of $2,248 and $2,147 as of September 30, 2012 and December 31, 2011, respectively	453,137	547,808
Receivable from related party	2,358	—
Inventories	240,694	587,785
Income tax receivable	995	4,148
Other current assets	59,600	43,685
Total current assets	864,240	1,200,923
Property, plant and equipment, at cost	4,171,269	4,413,305
Accumulated depreciation and amortization	(1,016,179)	(982,837)
Property, plant and equipment, net	3,155,090	3,430,468
Intangible assets, net	26,518	38,923
Goodwill	822,911	846,717
Investment in joint ventures	116,139	66,687
Deferred income tax asset	2,080	9,141
Note receivable from related party	170,711	—
Other long-term assets, net	206,195	288,331
Total assets	$5,363,884	$5,881,190
Liabilities and Partners' Equity		
Current liabilities:		
Current portion of long-term debt	$517,863	$364,959
Accounts payable	439,622	454,326
Payable to related party	13,717	6,735
Accrued interest payable	23,966	29,833
Accrued liabilities	97,441	71,270
Taxes other than income tax	15,020	13,455
Income tax payable	2,771	3,222
Total current liabilities	1,110,400	943,800
Long-term debt, less current portion	1,518,543	1,928,071
Long-term payable to related party	16,004	14,502
Deferred income tax liability	30,851	35,437
Other long-term liabilities	15,987	95,045
Commitments and contingencies (Note 6)		
Partners' equity:		
Limited partners (77,886,078 and 70,756,078 common units outstanding as of September 30, 2012 and December 31, 2011, respectively)	2,679,791	2,817,069
General partner	60,375	62,539

Accumulated other comprehensive loss	(80,981)	(27,407)
Total NuStar Energy L.P. partners' equity	2,659,185	2,852,201
Noncontrolling interest	12,914	12,134
Total partners' equity	2,672,099	2,864,335
Total liabilities and partners' equity	$5,363,884	$5,881,190

See Condensed Notes to Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
Service revenues:				
Third parties	$221,108	$210,395	$634,350	$607,866
Related party	713	286	2,198	823
Total service revenues	221,821	210,681	636,548	608,689
Product sales	1,522,945	1,613,669	4,745,815	4,039,461
Total revenues	1,744,766	1,824,350	5,382,363	4,648,150
Costs and expenses:				
Cost of product sales	1,486,985	1,535,609	4,638,011	3,797,424
Operating expenses:				
Third parties	103,387	98,464	288,283	281,419
Related party	39,032	37,151	115,065	109,061
Total operating expenses	142,419	135,615	403,348	390,480
General and administrative expenses:				
Third parties	8,773	8,746	26,566	27,865
Related party	16,181	8,985	48,710	41,968
Total general and administrative expenses	24,954	17,731	75,276	69,833
Depreciation and amortization expense	39,686	42,418	129,943	124,354
Asset impairment loss	—	—	249,646	—
Goodwill impairment loss	—	—	22,132	—
Gain on legal settlement	—	—	(28,738)	—
Total costs and expenses	1,694,044	1,731,373	5,489,618	4,382,091
Operating income (loss)	50,722	92,977	(107,255)	266,059
Equity in (loss) earnings of joint ventures	(951)	2,599	3,816	6,997
Interest expense, net	(24,867)	(21,565)	(71,037)	(62,644)
Other (expense) income, net	(19,940)	767	(21,384)	(5,699)
Income (loss) before income tax expense	4,964	74,778	(195,860)	204,713
Income tax expense	622	4,497	20,354	13,311
Net income (loss)	4,342	70,281	(216,214)	191,402
Less net (loss) income attributable to noncontrolling interest	(47)	123	(217)	143
Net income (loss) attributable to NuStar Energy L.P.	$4,389	$70,158	$(215,997)	$191,259
Net (loss) income per unit applicable to limited partners (Note 12)	$(0.09)	$0.92	$(3.40)	$2.49
Weighted-average limited partner units outstanding	72,383,578	64,612,423	71,302,538	64,611,181
Comprehensive (loss) income	$(4,018)	$(55,969)	$(268,791)	$44,529
Less comprehensive income (loss) attributable to noncontrolling interest	66	(2,063)	780	(2,318)
Comprehensive (loss) income attributable to NuStar Energy L.P.	$(4,084)	$(53,906)	$(269,571)	$46,847

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,	
	2012	2011
Cash Flows from Operating Activities:		
Net (loss) income	$(216,214)	$191,402
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization expense	129,943	124,354
Amortization of debt related items	(5,718)	(8,328)
Loss (gain) from sale or disposition of assets	19,828	(117)
Asset and goodwill impairment loss	271,778	—
Gain on legal settlement	(28,738)	—
Deferred income tax expense	1,403	4,130
Equity in earnings of joint ventures	(3,816)	(6,997)
Distributions of equity in earnings of joint venture	6,364	9,397
Changes in current assets and current liabilities (Note 13)	108,750	(216,427)
Other, net	(11,701)	4,457
Net cash provided by operating activities	271,879	101,871
Cash Flows from Investing Activities:		
Reliability capital expenditures	(21,420)	(32,808)
Strategic capital expenditures	(299,358)	(211,150)
Acquisitions	—	(100,693)
Investment in other long-term assets	(2,364)	(8,449)
Proceeds from sale or disposition of assets	35,547	445
Proceeds from sale of Asphalt Operations	436,276	—
Increase in note receivable from related party	(170,711)	—
Net cash used in investing activities	(22,030)	(352,655)
Cash Flows from Financing Activities:		
Proceeds from long-term debt borrowings	1,805,168	707,102
Proceeds from short-term debt borrowings	71,880	31,600
Proceeds from senior note offering, net of issuance costs	247,408	—
Long-term debt repayments	(2,287,178)	(348,153)
Short-term debt repayments	(71,880)	(31,600)
Proceeds from issuance of common units, net of issuance costs	336,662	1,583
Contributions from general partner	7,121	70
Distributions to unitholders and general partner	(267,228)	(240,571)
(Payments for) proceeds from termination of interest rate swaps	(5,678)	12,632
Other, net	363	(785)
Net cash (used in) provided by financing activities	(163,362)	131,878
Effect of foreign exchange rate changes on cash	3,472	(3,001)
Net increase (decrease) in cash and cash equivalents	89,959	(121,907)
Cash and cash equivalents as of the beginning of the period	17,497	181,121
Cash and cash equivalents as of the end of the period	$107,456	$59,214

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 petroleum refining and 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 one 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 15.1% total interest in us as of September 30, 2012.

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, transportation, and asphalt 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 United States 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, 2012 and 2011 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, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The consolidated balance sheet as of December 31, 2011 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, 2011.

2. DISPOSITIONS

Asphalt Operations

On September 28, 2012, we sold a 50% voting interest (the Asphalt Sale) in NuStar Asphalt LLC (Asphalt JV), previously a wholly owned subsidiary, to an affiliate of Lindsay Goldberg LLC (Lindsay Goldberg), a private investment firm. Asphalt JV owns and operates asphalt refining assets that were previously wholly owned by NuStar Energy, including the asphalt refineries located in Paulsboro, New Jersey and Savannah, Georgia (collectively, the Asphalt Operations). Lindsay Goldberg paid $175.0 million for the Class A equity interests (Class A Interests) of Asphalt JV, while we retained the Class B equity interests with a fair value of $52.0 million (Class B Interests). The Class A Interests have a distribution preference over the Class B Interests, as well as a liquidation preference.

NuStar Asphalt Refining, LLC and NuStar Marketing LLC are wholly owned subsidiaries of NuStar Asphalt LLC. Unless otherwise indicated, the term "Asphalt JV" is used in this report to refer to Asphalt JV, to one or more of its consolidated subsidiaries or to all of them taken as a whole.

At closing, we received $261.3 million from Asphalt JV for inventory related to the Asphalt Operations, pending a final inventory valuation. Asphalt JV funded the purchase of those inventories with proceeds from borrowings under a third-party asset-based revolving credit facility (the Third-Party Financing) and a $250.0 million unsecured revolving credit facility provided by NuStar Energy (the NuStar JV Facility). In addition to the NuStar JV Facility, we entered into various other agreements with Asphalt JV. See Note 9. Related Party Transactions for additional discussion of our agreements with Asphalt JV.

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Deconsolidation. We determined the equity of Asphalt JV is not sufficient to finance its activities without additional subordinated support, including support provided by us as described in Note 9. Related Party Transactions. Therefore, we determined the Asphalt JV is a variable interest entity (VIE). An entity is required to consolidate a VIE if the entity is considered the primary beneficiary of the VIE. We analyzed our relationship with Asphalt JV, including our representation on the board of members, our equity interests and our rights under the various agreements with Asphalt JV and determined that NuStar Energy does not have the power to direct the activities most significant to the economic performance of Asphalt JV. As a result, NuStar Energy is not the primary beneficiary of Asphalt JV. Upon closing, we deconsolidated Asphalt JV and started reporting our remaining investment in Asphalt JV using the equity method of accounting. Since the fair value of the consideration we received was less than the carrying amount of the assets of the Asphalt Operations, we recognized a loss of $21.6 million in “Other (expense) income, net” in the condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2012.

As of September 30, 2012, we included our 50% interest in Asphalt JV within “Investment in joint ventures” on the consolidated balance sheet. The condensed consolidated statements of comprehensive income include the results of operations for Asphalt JV in “Equity in earnings of joint ventures” commencing on September 28, 2012. Because of our continued involvement with Asphalt JV, we have not presented the results of operations for the Asphalt Operations prior to closing as discontinued operations. Beginning on September 28, 2012, we have presented transactions between us and the Asphalt JV as related party transactions in the consolidated financial statements.

Our maximum exposure to loss as a result of our involvement with Asphalt JV is approximately $448.7 million, which consists of (i) our investment in Asphalt JV of $48.7 million as of September 30, 2012, (ii) up to $250.0 million under the NuStar JV Facility and (iii) up to $150.0 million for credit support, including guarantees.

Other
On April 16, 2012, we sold five terminals in Georgia and Alabama with an aggregate storage capacity of 1.8 million barrels for total proceeds of $30.8 million.

3. ASSET IMPAIRMENTS

In anticipation of the Asphalt Sale, we evaluated the goodwill and other long-lived assets associated with the Asphalt Operations for potential impairment. As of June 30, 2012, we estimated the fair value of the Asphalt Operations reporting unit as the sum of (i) the purchase price to be paid by Lindsay Goldberg for the Class A Interests of Asphalt JV, (ii) the fair value of the Class B Interests of Asphalt JV that we would retain and (iii) the fair value of the working capital, primarily inventory. We determined the fair value of the Class B Interests using a combination of estimated discounted future cash flows and a pricing model. The fair value of the working capital was based on estimated current market prices. The estimated fair value of the Asphalt Operations reporting unit was less than its carrying value, which resulted in the recognition of a goodwill impairment loss of $22.1 million in the second quarter of 2012. In addition, in the second quarter of 2012, we recorded an asset impairment loss of $244.3 million in order to write-down the carrying value of long-lived assets related to the Asphalt Operations, including fixed assets, intangible assets and other long-term assets to their estimated fair value. The goodwill impairment loss and the asset impairment loss related to the Asphalt Operations are reported in the asphalt and fuels marketing segment.

In the second quarter of 2012, we reduced the carrying value of the fixed assets of one of our refined product terminals to its estimated fair value and recorded an asset impairment loss of $2.1 million. The impairment loss resulted from changing market conditions that reduced the estimated cash flows for that terminal. The impairment loss associated with this refined product terminal was reported in the storage segment. In addition, we recorded an asset impairment loss of $3.3 million in the second quarter of 2012 in order to reduce the carrying value of certain corporate assets we intend to sell to their estimated sales price of $2.8 million. These corporate assets that are held for sale are included in “Other current assets” on the consolidated balance sheet as of September 30, 2012.

The total asset impairment loss consisted of the following:

	Nine Months Ended September 30, 2012
	(Thousands of Dollars)
Asphalt Operations:	
Property, plant and equipment, net	$ 232,759
Intangible assets, net	6,564
Other long-term assets, net	4,902
Asset impairment loss	244,225
Other:	
Property, plant and equipment, net	5,421
Total asset impairment loss	$ 249,646

4. INVENTORIES

Inventories consisted of the following:

	September 30, 2012	December 31, 2011
	(Thousands of Dollars)	
Crude oil	$ 11,267	$ 157,297
Finished products	221,113	421,288
Materials and supplies	8,314	9,200
Total	$ 240,694	$ 587,785

5. DEBT

Revolving Credit Agreement
On May 2, 2012, NuStar Logistics replaced its $1.2 billion five-year revolving credit agreement (the 2007 Revolving Credit Agreement) with a new $1.5 billion five-year revolving credit agreement (the 2012 Revolving Credit Agreement), which includes the ability to borrow up to the equivalent of $250.0 million in Euros. NuStar Logistics used borrowings of $588.6 million under the 2012 Revolving Credit Agreement and cash on hand to repay in full the balance on the 2007 Revolving Credit Agreement. Obligations under the 2012 Revolving Credit Agreement are guaranteed by NuStar Energy and NuPOP. NuPOP will be released from its guarantee of the 2012 Revolving Credit Agreement when it no longer guarantees NuStar Logistics public debt instruments.

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; provided, for the rolling period ending June 30th of each year, the maximum consolidated debt coverage ratio will increase to 5.50-to-1.00. Moreover, if we consummate an acquisition for an aggregate net consideration of at least $50.0 million, the maximum consolidated debt coverage ratio will increase to

5.50-to-1.00 for two rolling periods.

On June 29, 2012, we amended the 2012 Revolving Credit Agreement to permit unlimited investments in joint ventures and unconsolidated subsidiaries, provided that no default exists, and to limit the amount of cash distributions for such joint ventures and unconsolidated subsidiaries included in the calculation of the consolidated debt coverage ratio to 20% of consolidated EBITDA (the Amendment). In addition, the Amendment provides that we will be in compliance with the consolidated debt coverage ratio as long as it does not exceed 6.50-to-1.00 for the rolling period ended June 30, 2012 or 6.00-to-1.00 for the rolling period ending September 30, 2012. The Amendment further stipulates that if the Asphalt Operations were owned by an unconsolidated joint venture, the maximum allowed consolidated debt coverage would revert to 5.00-to-1.00. Therefore, as of September 30, 2012, our consolidated debt coverage ratio could not 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, 2012, our consolidated debt coverage ratio was 4.3x, and we had $1,152.9 million available for borrowing.

During the nine months ended September 30, 2012, we borrowed an aggregate $1,772.0 million under our revolving credit agreements to fund working capital requirements, our capital expenditures and distributions. Additionally, we repaid $1,937.2 million during the nine months ended September 30, 2012 under our revolving credit agreements. These borrowings and repayments include borrowings under the 2012 Revolving Credit Agreement to pay down the 2007 Revolving Credit Agreement and the $100.0 million of 6.875% senior notes due July 15, 2012.

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, 2012, our weighted average interest rate was 1.7%.

UK Term Loan
On June 29, 2012, our UK subsidiary, NuStar Terminals Limited, amended the £21.0 million amended and restated term loan agreement (the UK Term Loan) to be consistent with the covenant terms of the 2012 Revolving Credit Agreement. As a result of this amendment to the UK Term Loan, the covenants and ratios of the UK Term Loan are substantially the same as the 2012 Revolving Credit Agreement, as amended.

NuStar Logistics' 6.875% Senior Notes
In July 2012, we repaid the $100.0 million of 6.875% senior notes due July 15, 2012 with borrowings under our 2012 Revolving Credit Agreement.

NuStar Logistics' 4.75% Senior Notes
On February 2, 2012, NuStar Logistics issued $250.0 million of 4.75% senior notes under our May 13, 2010 shelf registration statement. The net proceeds of $247.4 million were used to repay the outstanding principal amount of NuPOP's 7.75% senior notes due February 15, 2012. The interest on the 4.75% senior notes is payable semi-annually in arrears on February 1 and August 1 of each year beginning on August 1, 2012. The notes will mature on February 1, 2022. The 4.75% senior notes do not have sinking fund requirements. These notes rank equally with existing senior unsecured indebtedness of NuStar Logistics and contain restrictions on NuStar Logistics' ability to incur secured indebtedness unless the same security is also provided for the benefit of holders of the senior notes. In addition, the senior notes limit NuStar Logistics' ability to incur indebtedness secured by certain liens and to engage in certain sale-leaseback transactions. At the option of NuStar Logistics, the 4.75% senior notes may be redeemed in whole or in part at any time at a redemption price, which includes a make-whole premium, plus accrued and unpaid interest to the redemption date. The 4.75% senior notes are fully and unconditionally guaranteed by NuStar Energy and NuPOP.

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 (GoZone Bonds) associated with our St. James 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 0.2% as of September 30, 2012. The proceeds are deposited with a trustee and disbursed to us upon our request for reimbursement of expenditures related to our St. James terminal expansions. We include the amount remaining in trust related to the GoZone Bonds in "Other long-term assets, net," and the amount of bonds issued in

"Long-term debt, less current portion" on the consolidated balance sheets. For the nine months ended September 30, 2012, we received $38.8 million from the trustee. As of September 30, 2012, the amount remaining in trust totaled $134.6 million.

Line of Credit

On July 2, 2012, our short-term line of credit that had an uncommitted borrowing capacity of up to $20.0 million was terminated. During the nine months ended September 30, 2012, we borrowed and repaid $71.9 million related to this line of credit.

Credit Ratings

The interest rates on the 2012 Revolving Credit Agreement and NuStar Logistics' $350.0 million of 7.65% senior notes are subject to adjustment if our debt rating is downgraded (or subsequently upgraded) by certain credit rating agencies. In July 2012, Standard & Poor's lowered our credit rating to BB+ from BBB- and revised the outlook to Stable. In August 2012, Fitch Ratings also lowered our credit rating to BB+ from BBB- and revised the outlook to Stable. The interest rates applicable to the

2012 Revolving Credit Agreement do not adjust unless both Moody's and Standard & Poor's change their ratings. However, the downgrade by Standard & Poor's caused the interest rate on NuStar Logistics' $350.0 million of 7.65% senior notes to increase by 0.25%. These downgrades may also require us to provide additional credit support for certain contracts.

6. COMMITMENTS AND CONTINGENCIES

Contingencies

We have contingent liabilities resulting from various litigation, claims and commitments, as discussed below. 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, 2012, we have accrued $0.3 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.

Grace Energy Corporation Matter. In 1997, Grace Energy Corporation (Grace Energy) sued subsidiaries of Kaneb Pipeline Partners, L.P. (KPP) and Kaneb Services LLC (KSL and collectively with KPP and their respective subsidiaries, Kaneb) in Texas state court. We acquired Kaneb on July 1, 2005. The complaint sought recovery of the cost of remediation of fuel leaks in the 1970s from a pipeline that had once connected a former Grace Energy terminal with Otis Air Force Base in Massachusetts (Otis AFB). Grace Energy alleges the Otis AFB pipeline and related environmental liabilities had been transferred in 1978 to an entity that was part of Kaneb's acquisition of Support Terminal Services, Inc. and its subsidiaries from Grace Energy in 1993. Kaneb contends that it did not acquire the Otis AFB pipeline and never assumed any responsibility for any associated environmental damage.

In 2000, the court entered final judgment that: (i) Grace Energy could not recover its own remediation costs of $3.5 million, (ii) Kaneb owned the Otis AFB pipeline and its related environmental liabilities and (iii) Grace Energy was awarded $1.8 million in attorney costs. Both Kaneb and Grace Energy appealed the final judgment of the trial court to the Texas Court of Appeals in Dallas. In 2001, Grace Energy filed a petition in bankruptcy, which created an automatic stay of actions against Grace Energy. In September 2008, Grace Energy filed its Joint Plan of Reorganization and Disclosure Statement.

The Otis AFB is a part of a Superfund Site pursuant to the Comprehensive Environmental Response Compensation and Liability Act (CERCLA). The site contains a number of groundwater contamination plumes, two of which are allegedly associated with the Otis AFB pipeline. Relying on the final judgment of the Texas state court assigning ownership of the Otis AFB pipeline to Kaneb, the United States Department of Justice (the DOJ) advised Kaneb in 2001 that it intends to seek reimbursement from Kaneb for the remediation costs associated with the two plumes. In November 2008, the DOJ forwarded information to us indicating that the past and estimated future remediation expenses associated with one plume are $71.9 million. We reached an agreement to settle the claims of the United States government with respect to the Otis AFB pipeline and to resolve the underlying dispute between Kaneb and Grace. The settlement was approved by the United States Bankruptcy Court for the District of Delaware and a consent decree was entered by the United States District Court for the District of Massachusetts. Pursuant to the terms of the settlement, we paid approximately $13.1 million to the United States government in July 2012 and received releases of claims from various private parties and a covenant not to sue from the United States government. In connection with the settlement, we recognized a gain of $28.7 million during the second quarter of 2012.

Other

We are a party to additional claims and legal proceedings arising in the ordinary course of business. 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 17, 2010, we entered into a crude purchase commitment with Statoil Brasil Oleo E Gas Limitada (Statoil) to purchase an average of 10,000 barrels per day of crude oil over a three-year period, which began in December 2011. Pending receipt of and payment for one final shipment from Statoil in the fourth quarter of 2012, this agreement will be terminated.

In connection with the deconsolidation of the Asphalt Operations, our future minimum rental payments applicable to noncancellable operating leases were reduced by certain storage and railcar lease obligations.

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7. 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 in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; 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.

Recurring Fair Value Measurements

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 use 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 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. We have consistently applied these valuation techniques in all periods presented. See Note 8. Derivatives and Risk Management Activities for a discussion of our derivative instruments.

The following assets and liabilities are measured at fair value:

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
	(Thousands of Dollars)			
Other current assets:				
Product imbalances	$898	$—	$—	$898
Commodity derivatives	19,013	2,365	—	21,378
Other long-term assets, net:				
Commodity derivatives	—	6,675	—	6,675
Accrued liabilities:				
Product imbalances	(577)	—	—	(577)
Commodity derivatives	(5,929)	(20,861)	—	(26,790)
Interest rate swaps	—	(41,117)	—	(41,117)
Other long-term liabilities:				
Commodity derivatives	—	(1,265)	—	(1,265)
Total	$13,405	$(54,203)	$—	$(40,798)

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	December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(Thousands of Dollars)			
Other current assets:				
Product imbalances	$2,117	$—	$—	$2,117
Commodity derivatives	10,282	1,830	—	12,112
Other long-term assets, net:				
Commodity derivatives	—	27,084	—	27,084
Interest rate swaps	—	2,335	—	2,335
Accrued liabilities:				
Product imbalances	(1,469)	—	—	(1,469)
Commodity derivatives	(5,424)	—	—	(5,424)
Interest rate swaps	—	(22,009)	—	(22,009)
Other long-term liabilities:				
Interest rate swaps	—	(27,190)	—	(27,190)
Total	$5,506	$(17,950)	$—	$(12,444)

Fair Value of Financial Instruments

We recognize cash equivalents, receivables, payables and debt in our consolidated balance sheets at their carrying amount.

The fair values of these financial instruments, except for debt, approximate their carrying amounts. The estimated fair value and carrying amount of our debt was as follows:

	September 30, 2012	December 31, 2011
	(Thousands of Dollars)	
Fair value	$2,018,993	$2,377,565
Carrying amount	$2,036,406	$2,293,030

We estimated the fair value of our publicly-traded senior notes based upon quoted prices in active markets; therefore, we determined 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 the fair value falls in Level 2 of the fair value hierarchy.

As of September 30, 2012, we also had a note receivable from related party of $170.7 million under the NuStar JV Facility. The note receivable related to the NuStar JV Facility was recorded at face value, and the fair value of the note receivable approximates its carrying amount as of September 30, 2012. See Note 9. Related Party Transactions for additional information on the NuStar JV Facility.

8. DERIVATIVES AND RISK MANAGEMENT ACTIVITIES

We utilize various derivative instruments to: (i) manage our exposure to commodity price risk; (ii) manage our exposure to interest rate risk; and (iii) attempt to profit from market fluctuations. 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 our 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, which was approved by our board of directors.

Interest Rate Risk

We are a party to certain interest rate swap agreements that we use to manage our exposure to changes in interest rates. We entered into fixed-to-floating interest rate swap agreements associated with a portion of our fixed-rate senior notes. During the six months ended June 30, 2012, we entered into and terminated fixed-to-floating interest rate swap agreements with an aggregate notional amount of $200.0 million related to the 4.75% senior notes issued on February 2, 2012. Under the terms of these interest rate swap agreements, we received a fixed rate of 4.75% and paid a variable rate based on one month USD LIBOR plus a percentage that varied with each agreement. We also terminated fixed-to-floating interest rate swap agreements with an aggregate notional amount of $270.0 million associated with our 4.80% senior notes. We received $19.7 million in connection with the terminations, which we are amortizing into "Interest expense, net" over the remaining lives of the 4.80% and 4.75% senior notes. The termination payments are included in cash flows from financing activities on the consolidated statements of cash flows. We had no fixed-to-floating interest rate swaps as of September 30, 2012, and the total aggregate notional amount of the fixed-to-floating interest rate swaps was $270.0 million as of December 31, 2011.

We are also a party to forward-starting interest rate swap agreements related to forecasted probable debt issuances. 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 are designated and qualify as cash flow hedges. In connection with the issuance of the 4.75% senior notes on February 2, 2012, we terminated forward-starting interest rate swap agreements with an aggregate notional amount of $225.0 million. We paid $25.4 million in connection with the terminations, which is being amortized into "Interest expense, net" over the life of the 4.75% senior notes. The termination payment is included in cash flows from financing activities on the consolidated statements of cash flows. As of September 30, 2012 and December 31, 2011, the total aggregate notional amount of the forward-starting interest rate swaps was $275.0 million and $500.0 million, respectively.

Commodity Price Risk

We are exposed to market risks related to the volatility of crude oil and refined product prices. In order to attempt 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 them as, fair value hedges.

We also enter into commodity swap contracts to attempt to hedge the price risk associated with the San Antonio refinery. These contracts fix the purchase price of crude oil and sales prices of refined products for a portion of the expected production of the San Antonio refinery, thereby attempting to mitigate the risk of volatility of future cash flows associated with hedged volumes. These contracts qualify, and we designate them, as cash flow hedges. During the second quarter of 2012, we reduced the hedged volumes of the expected production of the San Antonio refinery, thereby exposing us to additional price risk.

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 from such derivatives in net income. We also entered into commodity derivatives in order to attempt to profit from market fluctuations. These derivative instruments were financial positions entered into without underlying physical inventory and were not considered hedges. Changes in the fair values were recorded in net income.

The volume of commodity contracts is based on open derivative positions and represents the combined volume of our long and short positions on an absolute basis, which totaled 23.0 million barrels and 27.8 million barrels as of September 30, 2012 and December 31, 2011, respectively.

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

	Balance Sheet Location	Asset Derivatives		Liability Derivatives	
		September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
		(Thousands of Dollars)			
Derivatives Designated as Hedging Instruments:					
Commodity contracts	Other current assets	$4,182	$36,116	$(783)	$(33,616)
Commodity contracts	Other long-term assets, net	22,943	86,052	(20,761)	(66,175)
Interest rate swaps	Other long-term assets, net	—	2,335	—	—
Commodity contracts	Accrued liabilities	15,132	—	(40,708)	—
Interest rate swaps	Accrued liabilities	—	—	(41,117)	(22,009)
Commodity contracts	Other long-term liabilities	9,861	—	(9,171)	—
Interest rate swaps	Other long-term liabilities	—	—	—	(27,190)
Total		52,118	124,503	(112,540)	(148,990)
Derivatives Not Designated as Hedging Instruments:					
Commodity contracts	Other current assets	26,484	15,568	(8,505)	(5,956)
Commodity contracts	Other long-term assets, net	13,726	7,207	(9,233)	—
Commodity contracts	Accrued liabilities	21,035	519	(22,249)	(5,943)
Commodity contracts	Other long-term liabilities	—	—	(1,955)	—
Total		61,245	23,294	(41,942)	(11,899)
Total Derivatives		$113,363	$147,797	$(154,482)	$(160,889)

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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, 2012:				
Interest rate swaps	Interest expense, net	$—	$—	$ —
Commodity contracts	Cost of product sales	(23,131)	22,505	(626)
Total		$(23,131)	$22,505	$ (626)
Three months ended September 30, 2011:				
Interest rate swaps	Interest expense, net	$45,963	$(46,320)	$ (357)
Commodity contracts	Cost of product sales	3,772	(4,508)	(736)
Total		$49,735	$(50,828)	$ (1,093)
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)
Nine months ended September 30, 2011:				
Interest rate swaps	Interest expense, net	$54,577	$(55,172)	$ (595)
Commodity contracts	Cost of product sales	(7,292)	6,212	(1,080)
Total		$47,285	$(48,960)	$ (1,675)

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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, 2012:				
Interest rate swaps	$ (3,825)	Interest expense, net	$ (645)	$ —
Commodity contracts	(20,629)	Cost of product sales	(8,728)	277
Total	$ (24,454)		$ (9,373)	$ 277
Three months ended September 30, 2011:				
Interest rate swaps	$ (63,100)	Interest expense, net	$ —	$ —
Commodity contracts	(46,532)	Cost of product sales	(7,733)	3,594
Total	$ (109,632)		$ (7,733)	$ 3,594
Nine months ended September 30, 2012:				
Interest rate swaps	$ (17,276)	Interest expense, net	$ (1,697)	$ —
Commodity contracts	(73,289)	Cost of product sales	(24,590)	4,287
Total	$ (90,565)		$ (26,287)	$ 4,287
Nine months ended September 30, 2011:				
Interest rate swaps	$ (75,930)	Interest expense, net	$ —	$ —
Commodity contracts	(62,986)	Cost of product sales	(8,958)	3,594
Total	$ (138,916)		$ (8,958)	$ 3,594

(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).

Derivatives Not Designated as Hedging Instruments	Income Statement Location	Amount of Gain (Loss) Recognized in Income
		(Thousands of Dollars)
Three months ended September 30, 2012:		
Commodity contracts	Cost of product sales	$ (846)
Three months ended September 30, 2011:		
Commodity contracts	Cost of product sales	$ 5,482
Nine months ended September 30, 2012:		
Commodity contracts	Revenues	$ (7,654)
Commodity contracts	Cost of product sales	23,091

		$15,437	
Nine months ended September 30, 2011:			
Commodity contracts	Revenues	$235	
Commodity contracts	Cost of product sales	(5,685	)
Commodity contracts	Operating expenses	46	
		$(5,404	)

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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, 2012, we expect to reclassify a loss of $25.6 million to "Cost of product sales" and a loss of $4.2 million to "Interest expense, net" within the next twelve months. The maximum length of time over which we are hedging our exposure to the variability in future cash flows is approximately three years for our commodity contracts and less than one year for our forward-starting interest rate swaps.

9. RELATED PARTY TRANSACTIONS

The following table summarizes information pertaining to related party transactions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Thousands of Dollars)			
Revenues	$713	$286	$2,198	$823
Operating expenses	$39,032	$37,151	$115,065	$109,061
General and administrative expenses	$16,181	$8,985	$48,710	$41,968

NuStar GP, LLC
Our operations are managed by NuStar GP, LLC, the general partner of our general partner. Under a services agreement between NuStar Energy and NuStar GP, LLC, employees of NuStar GP, LLC perform services for our United States operations. Certain of our wholly owned subsidiaries employ persons who perform services for our international operations. Employees of NuStar GP, LLC provide services to both NuStar Energy and NuStar GP Holdings; therefore, we reimburse NuStar GP, LLC for all costs related to its employees, other than costs associated with NuStar GP Holdings.

We had a payable to NuStar GP, LLC of $13.7 million and $6.7 million as of September 30, 2012 and December 31, 2011, respectively, with both amounts representing payroll, employee benefit plan expenses and unit-based compensation. We also had a long-term payable to NuStar GP, LLC as of September 30, 2012 and December 31, 2011 of $16.0 million and $14.5 million, respectively, related to amounts payable for retiree medical benefits and other post-employment benefits.

Asphalt JV
As of September 30, 2012, we had a receivable from Asphalt JV of $2.1 million associated with the Asphalt Sale.

Financing Agreements and Credit Support. The NuStar JV Facility is an unsecured revolving credit facility provided by NuStar Energy that will be available to fund working capital needs and for general purposes of Asphalt JV in an aggregate principal amount not to exceed $250.0 million for a term of seven years. The NuStar JV Facility matures on September 28, 2019 and bears interest based on either an alternative base rate or a LIBOR-based rate. We recognize interest income over the term of the facility in "Interest expense, net" on the consolidated statements of comprehensive income. As of September 30, 2012, the interest rate was 4.875%. In the event NuStar Energy no longer owns an equity interest in Asphalt JV, the interest rate increases and the availability under the NuStar JV Facility is reduced to a maximum of $167.0 million after two years and $83.0 million after three years. On September 28, 2012, Asphalt JV borrowed $170.7 million from us under the NuStar JV Facility.

In addition, during the term of the NuStar JV Facility, NuStar Energy will provide credit support, such as guarantees, letters of credit and cash collateral, as applicable, of up to $150.0 million. As of September 30, 2012, NuStar Energy has provided guarantees for commodity purchases, lease obligations and certain utilities for Asphalt JV with a maximum potential exposure of $141.8 million. In addition, NuStar has provided three guarantees to suppliers that do not specify a maximum amount. All guarantees were in existence prior to the Asphalt Sale, and the majority of these guarantees have no expiration date. In the event NuStar Energy must fund its obligation under these guarantees, that amount will be added to borrowings under the NuStar JV Facility.

Terminal Service Agreements. Simultaneously with the Asphalt Sale, we entered into four terminal service agreements with Asphalt JV for our terminals in Wilmington, NC, Rosario, NM, Catoosa, OK and Houston, TX. Pursuant to the terms of the agreements, we will provide aggregate storage capacity of 0.8 million barrels and blending services to Asphalt JV for a service charge of $1.5 million per year. The storage charge will be adjusted annually based on the percentage increase in the consumer price index. The terminal service agreements each have a term of ten years, with Asphalt JV's option to extend for an additional five years. Asphalt JV also has the option to terminate any terminal service agreement with 90 days written notice. If any of the terminal service agreements are extended, the storage charge will be based on the then-current fair market storage rates for

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comparable storage services charged by us to third parties.

Crude Oil Supply Agreements. In connection with the Asphalt Sale, NuStar Marketing LLC assigned the crude oil supply agreement (the PDVSA Crude Oil Supply Agreement) with an affiliate of Petróleos de Venezuela S. A. (PDVSA) to NuStar Logistics.

Simultaneously with the Asphalt Sale, we entered into a crude oil supply agreement with Asphalt JV (the Asphalt JV Crude Oil Supply Agreement) that commits Asphalt JV to purchase from us in a given year the lesser of (i) the number of barrels of crude oil required to be purchased by us from PDVSA under the PDVSA Crude Oil Supply Agreement for such year or (ii) 35,000 barrels per day of crude oil multiplied by the number of days in such year. The price for the crude oil under this agreement will be the actual price paid by us to PDVSA under the PDVSA Crude Oil Supply Agreement and will include any credits received or adjustments made. The Asphalt JV Crude Oil Supply Agreement is effective for the term of the PDVSA Crude Oil Supply Agreement.

Services Agreements Between Asphalt JV and NuStar GP,LLC. In conjunction with the Asphalt Sale, NuStar GP, LLC entered into a services agreement with Asphalt JV, effective September 28, 2012 (the Asphalt JV Services Agreement). The Asphalt JV Services Agreement provides that NuStar GP, LLC will furnish certain administrative and other operating services necessary to conduct the business of Asphalt JV. Asphalt JV will compensate NuStar GP, LLC for these services through an annual fee totaling $10.0 million, subject to adjustment based on the annual merit increase percentage applicable to NuStar GP, LLC employees for the most recently completed contract year. The Asphalt JV Services Agreement will terminate on December 31, 2017 and will automatically renew for successive two-year terms. Asphalt JV may terminate the Asphalt JV Services Agreement at any time, with 180 days prior written notice or reduce the level of service with 45 days prior written notice.

In addition, NuStar GP, LLC entered into an employee services agreement with Asphalt JV, effective September 28, 2012 (the Asphalt JV Employee Services Agreement). The Asphalt JV Employee Services Agreement provides that certain of NuStar GP, LLC employees will provide employee-services to Asphalt JV. In exchange, Asphalt JV will reimburse NuStar GP, LLC for the compensation expense of those employees at the same rates that were in effect at the effective date of the Asphalt JV Employee Services Agreement, including an annual bonus amount that does not exceed NuStar GP, LLC's target bonus plan. The employees covered under the Asphalt JV Employee Services Agreement will not be entitled to any new unit-based compensation grants from NuStar GP, LLC, and Asphalt JV will not be responsible for unit-based compensation costs prior to the effective date. The Asphalt JV Employee Services Agreement will terminate on December 31, 2012.

Other

For the three and nine months ended September 30, 2012, the majority of related party revenues resulted from storage agreements between our Turkey subsidiary and the noncontrolling shareholder. We had a receivable of $0.3 million as of September 30, 2012 related to these revenues.

10. OTHER (EXPENSE) INCOME

Other (expense) income, net consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Thousands of Dollars)			

(Loss) gain from sale or disposition of assets	$(19,880)	$(119)	$(19,828)	$117
Contingent loss adjustment	—	(3,250)	—	(3,250)
Storage agreement early termination costs	—	—	—	(5,000)
Foreign exchange (losses) gains	(1,069)	3,059	(3,568)	2,483
Other, net	1,009	1,077	2,012	(49)
Other (expense) income, net	$(19,940)	$767	$(21,384)	$(5,699)

For the three and nine months ended September 30, 2012, the (loss) gain on sale or disposition of assets included a $21.6 million loss in connection with the deconsolidation of Asphalt JV. See Note 2. Dispositions for additional discussion on the Asphalt Sale.

For the nine months ended September 30, 2011, “Other (expense) income, net” included $5.0 million in costs associated with the early termination of a third-party storage agreement at our Paulsboro, New Jersey asphalt refinery.

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11. PARTNERS' EQUITY

Issuance of Common Units

On September 10, 2012, we issued 7,130,000 common units representing limited partner interests at a price of $48.94 per unit. We used the net proceeds from this offering of $344.1 million, including a contribution of $7.1 million from our general partner to maintain its 2% general partner interest, for general partnership purposes, including repayments of outstanding borrowings under our 2012 Revolving Credit Agreement and working capital purposes.

Partners' Equity Activity

The following table summarizes changes in the carrying amount of equity attributable to NuStar Energy L.P. partners and noncontrolling interest:

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	NuStar Energy L.P. Partners' Equity	Noncontrolling Interest	Total Partners' Equity	NuStar Energy L.P. Partners' Equity	Noncontrolling Interest	Total Partners' Equity
	(Thousands of Dollars)					
Beginning balance	$2,408,269	$ 12,848	$2,421,117	$2,644,221	$ 14,745	$2,658,966
Net (loss) income	4,389	(47)	4,342	70,158	123	70,281
Other comprehensive (loss) income:						
Foreign currency translation adjustment	6,608	113	6,721	(22,165)	(2,186)	(24,351)
Net unrealized loss on cash flow hedges	(24,454)	—	(24,454)	(109,632)	—	(109,632)
Net loss reclassified into income on cash flow hedges	9,373	—	9,373	7,733	—	7,733
Total other comprehensive (loss) income	(8,473)	113	(8,360)	(124,064)	(2,186)	(126,250)
Cash distributions to partners	(89,076)	—	(89,076)	(81,339)	—	(81,339)
Issuance of common units, including contribution from general partner	344,076	—	344,076	3,391	—	3,391
Ending balance	$2,659,185	$ 12,914	$2,672,099	$2,512,367	$ 12,682	$2,525,049

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	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	NuStar Energy L.P. Partners' Equity	Noncontrolling Interest	Total Partners' Equity	NuStar Energy L.P. Partners' Equity	Noncontrolling Interest	Total Partners' Equity
	(Thousands of Dollars)					
Beginning balance	$2,852,201	$ 12,134	$2,864,335	$2,702,700	$ —	$2,702,700
Acquisition	—	—	—	—	15,000	15,000
Net (loss) income	(215,997)	(217)	(216,214)	191,259	143	191,402
Other comprehensive (loss) income:						
Foreign currency translation adjustment	10,704	997	11,701	(14,454)	(2,461)	(16,915)
Net unrealized loss on cash flow hedges	(90,565)	—	(90,565)	(138,916)	—	(138,916)
Net loss reclassified into income on cash flow hedges	26,287	—	26,287	8,958	—	8,958
Total other comprehensive (loss) income	(53,574)	997	(52,577)	(144,412)	(2,461)	(146,873)
Cash distributions to partners	(267,228)	—	(267,228)	(240,571)	—	(240,571)
Issuance of common units, including contribution from general partner	344,076	—	344,076	3,391	—	3,391
Other	(293)	—	(293)	—	—	—
Ending balance	$2,659,185	$ 12,914	$2,672,099	$2,512,367	$ 12,682	$2,525,049

Allocations of Net Income

Our partnership agreement, as amended, sets forth the calculation to be used to determine the amount and priority of cash distributions that the common unitholders and the general partner will receive. The partnership agreement also contains provisions for the allocation of net income and loss to the unitholders and the general partner. For purposes of maintaining partner capital accounts, the partnership agreement specifies that items of income and loss shall be allocated among the partners in accordance with their respective percentage interests. Normal allocations according to percentage interests are made after giving effect to priority income allocations, if any, in an amount equal to incentive cash distributions allocated 100% to the general partner. The following table details the calculation of net income applicable to the general partner:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Thousands of Dollars)			
Net (loss) income attributable to NuStar Energy L.P.	$4,389	$70,158	$(215,997)	$191,259

Less general partner incentive distribution	10,805	8,972	30,437	26,503
Net (loss) income after general partner incentive distribution	(6,416)	61,186	(246,434)	164,756
General partner interest	2 %	2 %	2 %	2 %
General partner allocation of net (loss) income after general partner incentive distribution	(128)	1,223	(4,928)	3,294
General partner incentive distribution	10,805	8,972	30,437	26,503
Net income applicable to general partner	$10,677	$10,195	$25,509	$29,797

Cash Distributions

On August 10, 2012, we paid a quarterly cash distribution totaling $89.1 million, or $1.095 per unit, related to the second quarter of 2012. On October 25, 2012, we announced a quarterly cash distribution of $1.095 per unit related to the third quarter of 2012. This distribution will be paid on November 14, 2012 to unitholders of record on November 9, 2012 and will total $98.1 million.

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The following table reflects the allocation of total cash distributions to the general and limited partners applicable to the period in which the distributions were earned:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Thousands of Dollars, Except Per Unit Data)			
General partner interest	$1,961	$1,628	$5,525	$4,847
General partner incentive distribution	10,805	8,972	30,437	26,503
Total general partner distribution	12,766	10,600	35,962	31,350
Limited partners' distribution	85,285	70,814	240,241	211,019
Total cash distributions	$98,051	$81,414	$276,203	$242,369
Cash distributions per unit applicable to limited partners	$1.095	$1.095	$3.285	$3.265

12. NET INCOME PER UNIT

We have identified the general partner interest and incentive distribution rights (IDR) as participating securities and use the two-class method when calculating the net income per unit applicable to limited partners, which is based on the weighted-average number of common units outstanding during the period. Basic and diluted net income per unit applicable to limited partners are the same because we have no potentially dilutive securities outstanding.

The following table details the calculation of earnings per unit:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Thousands of Dollars, Except Unit and Per Unit Data)			
Net (loss) income attributable to NuStar Energy L.P.	$4,389	$70,158	$(215,997)	$191,259
Less general partner distribution (including IDR)	12,766	10,600	35,962	31,350
Less limited partner distribution	85,285	70,814	240,241	211,019
Distributions (greater than) less than earnings	$(93,662)	$(11,256)	$(492,200)	$(51,110)
General partner earnings:				
Distributions	$12,766	$10,600	$35,962	$31,350
Allocation of distributions (greater than) less than earnings (2%)	(1,874)	(225)	(9,846)	(1,023)
Total	$10,892	$10,375	$26,116	$30,327
Limited partner earnings:				
Distributions	$85,285	$70,814	$240,241	$211,019
Allocation of distributions (greater than) less than earnings (98%)	(91,788)	(11,031)	(482,354)	(50,087)
Total	$(6,503)	$59,783	$(242,113)	$160,932
Weighted-average limited partner units outstanding	72,383,578	64,612,423	71,302,538	64,611,181

Net (loss) income per unit applicable to limited partners	$(0.09)	$0.92	$(3.40)	$2.49

13. STATEMENTS OF CASH FLOWS

Changes in current assets and current liabilities were as follows:

	Nine Months Ended September 30,	
	2012	2011
	(Thousands of Dollars)	
Decrease (increase) in current assets:		
Accounts receivable	$95,213	$(148,814)
Receivable from related party	(3,149)	—
Inventories	60,878	(176,936)
Income tax receivable	3,190	—
Other current assets	(17,571)	(25,838)
Increase (decrease) in current liabilities:		
Accounts payable	(11,854)	153,626
Payable to related party	6,976	2,023
Accrued interest payable	(5,867)	(6,092)
Accrued liabilities	(21,253)	(21,471)
Taxes other than income tax	2,662	5,607
Income tax payable	(475)	1,468
Changes in current assets and current liabilities	$108,750	$(216,427)

The above changes in current assets and current liabilities differ from changes between amounts reflected in the applicable balance sheets due to our deconsolidation of the Asphalt Operations in connection with the Asphalt Sale and the effect of foreign currency translation.

Cash flows related to interest and income taxes were as follows:

	Nine Months Ended September 30,	
	2012	2011
	(Thousands of Dollars)	
Cash paid for interest, net of amount capitalized	$85,583	$87,576
Cash paid for income taxes, net of tax refunds received	$18,308	$11,974

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14. INCOME TAXES

The tax effects of significant temporary differences representing deferred income tax assets and liabilities were as follows:

	September 30, 2012	December 31, 2011
	(Thousands of Dollars)	
Deferred income tax assets:		
Net operating losses	$24,552	$17,089
Environmental and legal reserves	216	14,822
Capital loss	1,712	1,044
Valuation allowance	(71)	(1,161)
Total deferred income tax assets	26,409	31,794
Deferred income tax liabilities:		
Property, plant and equipment	(54,184)	(57,392)
Other	(996)	(698)
Total deferred income tax liabilities	(55,180)	(58,090)
Net deferred income tax liability	$(28,771)	$(26,296)
Reported on the Consolidated Balance Sheets as:		
Deferred income tax asset	$2,080	$9,141
Deferred income tax liability	(30,851)	(35,437)
Net deferred income tax liability	$(28,771)	$(26,296)

Grace Energy Corporation Matter
In connection with the settlement of the Grace Energy Corporation matter, we recognized a pre-tax gain of $28.7 million within one of our taxable subsidiaries. As a result, we recorded related income tax expense of $10.1 million, resulting from the reduction of the related deferred income tax asset. See Note 6. Commitments and Contingencies for a discussion on the Grace Energy Corporation matter.

Canadian Income Tax Audit
During the second quarter of 2012, we recorded $1.0 million of additional income tax liability and $2.2 million of interest and penalties associated with an ongoing Canadian income tax audit for the years 2006 through 2011. We also recorded $1.3 million of Canadian withholding tax and $0.7 million of interest and penalties associated with the withholding tax liability related to interest payments made from our Canadian subsidiaries to a United States entity from 2003 to 2009. We believe that adequate provisions for uncertainties related to the Canadian audits have been reflected in the financial statements.

15. SEGMENT INFORMATION

Our reportable business segments consist of storage, transportation, and asphalt and fuels marketing. Our segments represent strategic business units that offer different services and products. We evaluate the performance of each segment based on its respective operating income, before general and administrative expenses and certain non-segmental depreciation and amortization expense. General and administrative expenses are not allocated to the operating segments since those expenses relate primarily to the overall management at the entity level. Our principal operations include terminalling and storage of petroleum products, the transportation of petroleum products and anhydrous ammonia, and petroleum refining and marketing. Intersegment revenues result from storage and throughput agreements with related parties at lease rates consistent with rates charged to third parties for storage and at pipeline tariff rates based upon the applicable published tariff.

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Results of operations for the reportable segments were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Thousands of Dollars)			
Revenues:				
Storage:				
Third parties	$128,538	$128,561	$389,412	$381,460
Intersegment	19,679	13,042	55,542	35,925
Related party	713	286	2,198	823
Total storage	148,930	141,889	447,152	418,208
Transportation:				
Third parties	92,570	81,834	244,938	226,406
Intersegment	1,160	65	2,171	65
Total transportation	93,730	81,899	247,109	226,471
Asphalt and fuels marketing:				
Third parties	1,522,945	1,613,669	4,745,815	4,039,461
Intersegment	99	5,024	406	9,618
Total asphalt and fuels marketing	1,523,044	1,618,693	4,746,221	4,049,079
Consolidation and intersegment eliminations	(20,938)	(18,131)	(58,119)	(45,608)
Total revenues	$1,744,766	$1,824,350	$5,382,363	$4,648,150
Operating income:				
Storage	$50,422	$48,778	$160,696	$140,322
Transportation	42,597	38,248	111,418	102,808
Asphalt and fuels marketing	(15,682)	25,418	(323,996)	97,689
Consolidation and intersegment eliminations	(22)	29	(48)	(16)
Total segment operating (loss) income	77,315	112,473	(51,930)	340,803
General and administrative expenses	(24,954)	(17,731)	(75,276)	(69,833)
Other depreciation and amortization expense	(1,639)	(1,765)	(5,492)	(4,911)
Other asset impairment loss	—	—	(3,295)	—
Gain on legal settlement	—	—	28,738	—
Total operating (loss) income	$50,722	$92,977	$(107,255)	$266,059

Total assets by reportable segment were as follows:

	September 30, 2012	December 31, 2011
	(Thousands of Dollars)	
Storage	$2,609,293	$2,597,904
Transportation	1,355,492	1,251,474
Asphalt and fuels marketing	996,154	1,717,960
Total segment assets	4,960,939	5,567,338
Other partnership assets	402,945	313,852
Total consolidated assets	$5,363,884	$5,881,190

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

16. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

NuStar Energy has no operations and its assets consist mainly of its investments in NuStar Logistics and NuPOP, both wholly owned subsidiaries. The senior notes issued by NuStar Logistics and NuPOP are fully and unconditionally guaranteed by NuStar Energy, and each of NuStar Logistics and NuPOP fully and unconditionally guarantee the outstanding senior notes of the other. As a result, the following condensed consolidating financial statements are presented as an alternative to providing separate financial statements for NuStar Logistics and NuPOP.

Condensed Consolidating Balance Sheets
September 30, 2012
(Thousands of Dollars)

	NuStar Energy	NuStar Logistics	NuPOP	Non-Guarantor Subsidiaries (a)	Eliminations	Consolidated
Assets						
Cash and cash equivalents	$7,281	$12	$—	$ 100,163	$—	$107,456
Receivables, net	—	38,215	10,350	410,091	(3,161)	455,495
Inventories	—	2,585	8,050	230,079	(20)	240,694
Income tax receivable	—	—	—	995	—	995
Other current assets	—	18,367	1,311	39,922	—	59,600
Intercompany receivable	—	383,534	568,526	—	(952,060)	—
Total current assets	7,281	442,713	588,237	781,250	(955,241)	864,240
Property, plant and equipment, net	—	1,353,763	584,868	1,216,459	—	3,155,090
Intangible assets, net	—	1,929	—	24,589	—	26,518
Goodwill	—	18,094	170,652	634,165	—	822,911
Investment in wholly owned subsidiaries	3,248,470	67,390	1,228,601	2,322,860	(6,867,321)	—
Investment in joint ventures	—	48,696	—	67,443	—	116,139
Deferred income tax asset	—	—	—	2,080	—	2,080
Note receivable from related party	—	170,711	—	—	—	170,711
Other long-term assets, net	498	157,006	26,328	22,363	—	206,195
Total assets	$3,256,249	$2,260,302	$2,598,686	$ 5,071,209	$(7,822,562)	$5,363,884
Liabilities and Partners' Equity						
Current portion of long-term debt	$—	$232,428	$251,535	$ 33,900	$—	$517,863
Payables	100	54,642	9,502	392,256	(3,161)	453,339
Accrued interest payable	—	19,049	4,896	21	—	23,966
Accrued liabilities	750	54,972	6,165	35,554	—	97,441
Taxes other than income tax	63	6,339	3,566	5,052	—	15,020
Income tax payable	—	230	2	2,539	—	2,771
Intercompany payable	515,170	—	—	436,891	(952,061)	—
Total current liabilities	516,083	367,660	275,666	906,213	(955,222)	1,110,400
Long-term debt, less current portion	—	1,518,543	—	—	—	1,518,543

Long-term payable to related party	—	10,562	—	5,442	—	16,004
Deferred income tax liability	—	—	—	30,851	—	30,851
Other long-term liabilities	—	2,821	165	13,001	—	15,987
Total partners' equity	2,740,166	360,716	2,322,855	4,115,702	(6,867,340)	2,672,099
Total liabilities and partners' equity	$3,256,249	$2,260,302	$2,598,686	$ 5,071,209	$(7,822,562)	$5,363,884

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy, NuStar Logistics or NuPOP.

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

Condensed Consolidating Balance Sheets
December 31, 2011
(Thousands of Dollars)

	NuStar Energy	NuStar Logistics	NuPOP	Non-Guarantor Subsidiaries (a)	Eliminations	Consolidated
Assets						
Cash and cash equivalents	$139	$14	$—	$ 17,344	$—	$17,497
Receivables, net	—	27,533	6,877	514,477	(1,079)	547,808
Inventories	—	2,311	6,370	579,152	(48)	587,785
Income tax receivable	—	—	—	4,148	—	4,148
Other current assets	—	9,796	2,423	31,466	—	43,685
Intercompany receivable	—	893,268	780,066	—	(1,673,334)	—
Total current assets	139	932,922	795,736	1,146,587	(1,674,461)	1,200,923
Property, plant and equipment, net	—	1,150,318	596,229	1,683,921	—	3,430,468
Intangible assets, net	—	1,966	—	36,957	—	38,923
Goodwill	—	18,094	170,652	657,971	—	846,717
Investment in wholly owned subsidiaries	3,386,170	220,513	1,159,620	2,216,792	(6,983,095)	—
Investment in joint venture	—	—	—	66,687	—	66,687
Deferred income tax asset	—	—	—	9,141	—	9,141
Other long-term assets, net	364	192,007	26,329	69,631	—	288,331
Total assets	$3,386,673	$2,515,820	$2,748,566	$ 5,887,687	$(8,657,556)	$5,881,190
Liabilities and Partners' Equity						
Current portion of long-term debt	$—	$331,317	$1,060	$ 32,582	$—	$364,959
Payables	—	32,590	11,512			