

SUNOCO LOGISTICS PARTNERS LP  
Form 10-K  
March 01, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-K**

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(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, 2005

OR

**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 1-31219

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**SUNOCO LOGISTICS PARTNERS L.P.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

Mellon Bank Center

23-3096839  
(I.R.S. Employer  
Identification No.)

19103-7583

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1735 Market Street, Suite LL, Philadelphia, PA  
(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (866) 248-4344

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Units representing limited partnership interests	New York Stock Exchange
Senior Notes 7.25%, due February 15, 2012	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Exchange 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 Securities Exchange 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 of this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.: Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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The aggregate value of the Common Units held by non-affiliates of the registrant (treating all executive officers and directors of the registrant and holders of 10 percent or more of the Common Units outstanding (including the General Partner of the registrant, Sunoco Partners LLC, as if they may be affiliates of the registrant)) was approximately \$457.6 million as of June 30, 2005, based on \$37.88 per unit, the closing price of the Common Units as reported on the New York Stock Exchange on that date.

At February 28, 2006, the number of the registrant's Common Units outstanding was 20,164,051, and its Subordinated Units outstanding was 5,691,819.

**DOCUMENTS INCORPORATED BY REFERENCE: NONE**

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### **Forward-Looking Statements**

*Certain matters discussed in this report, excluding historical information, include forward-looking statements. Forward-looking statements discuss Sunoco Logistics Partners L.P.'s (the Partnership) goals, intentions and expectations as to future trends, plans, events, results of operations or financial condition, or state other information relating to it, based on the current beliefs of its management as well as assumptions made by, and information currently available to, management. Words such as may, will, anticipate, believe, expect, estimate, intend, project, and other similar phrases or expressions identify forward-looking statements. When considering forward-looking statements, investors should keep in mind the risk factors and other cautionary statements in this Annual Report.*

*Although management believes these forward-looking statements to be reasonable, they are based upon a number of assumptions, any or all of which ultimately may prove to be inaccurate. These statements are subject to numerous assumptions, uncertainties and risks that could cause actual results to differ materially from any results projected, forecasted, estimated or budgeted, including, but not limited to, the following:*

*changes in demand for, or supply of, crude oil, refined petroleum products and natural gas liquids that impact demand for our pipeline, terminalling and storage services;*

*changes in the demand for crude oil we both buy and sell;*

*the loss of Sunoco R&M or another large customer or a significant reduction in its current level of throughput and storage with us;*

*an increase in the competition encountered by our crude oil and refined products terminals, pipelines and crude oil acquisition and marketing operations;*

*changes in the financial condition or operating results of joint ventures or other holdings in which we have an equity ownership interest;*

*changes in the general economic conditions in the United States;*

*changes in laws and regulations to which we are subject, including federal, state, and local tax, safety, environmental and employment laws;*

*changes in regulations concerning required composition of refined petroleum products, that result in changes in throughput volumes, pipeline tariffs and/or terminalling and storage fees;*

*improvements in energy efficiency and technology resulting in reduced demand for crude oil and refined products;*

*our ability to manage growth and control costs;*

*the effect of changes in accounting principles and tax laws and interpretations of both;*

*global and domestic economic repercussions, including disruptions in the crude oil and petroleum products markets, from terrorist activities, international hostilities and other events, and the government's response thereto;*

*changes in the level of operating expenses and hazards related to operating facilities (including equipment malfunction, explosions, fires, spills and the effects of severe weather conditions);*

*the occurrence of operational hazards or unforeseen interruptions for which the Partnership may not be adequately insured;*

*the age of, and changes in the reliability and efficiency of our operating facilities;*

*changes in the expected level of capital, operating, or remediation spending related to environmental matters;*

*delays related to construction of, or work on, new or existing facilities and issuance of applicable permits;*

*changes in insurance markets resulting in increased costs and reductions in the level and types of coverage available;*

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*our ability to identify acquisitions under favorable terms, successfully consummate announced acquisitions or expansions and integrate them into existing business operations;*

*risks related to labor relations and workplace safety;*

*non-performance by or disputes with major customers, suppliers or other business partners;*

*changes in our tariff rates implemented by federal and/or state government regulators;*

*the amount of our indebtedness, which could make us vulnerable to adverse general economic and industry conditions, limit our ability to borrow additional funds, place us at a competitive disadvantage as compared to our competitors that have less debt, or have other adverse consequences;*

*restrictive covenants in our or Sunoco, Inc.'s credit agreements;*

*changes in our or Sunoco, Inc.'s credit ratings, as assigned by rating agencies;*

*the condition of the debt capital markets and equity capital markets in the United States, and our ability to raise capital in a cost-effective way;*

*changes in interest rates on our outstanding debt, which could increase the costs of borrowing;*

*claims of our non-compliance with regulatory and statutory requirements; and*

*the costs and effects of legal and administrative claims and proceedings against us or any entity in which we have an ownership interest, and changes in the status of, or the initiation of new litigation, claims or proceedings, to which we, or any entity in which we have an ownership interest, is a party.*

*These factors are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of the Partnership's forward-looking statements. Other unknown or unpredictable factors could also have material adverse effects on future results. The Partnership undertakes no obligation to update publicly any forward-looking statement whether as a result of new information or future events.*

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**PART I**

**ITEM 1. BUSINESS**

**(a) General Development of Business**

The Partnership is a publicly traded Delaware limited partnership formed by Sunoco, Inc. on October 15, 2001 to own, operate and acquire a geographically diverse portfolio of complementary pipeline, terminalling, and crude oil acquisition and marketing assets. The Partnership completed its initial public offering ( IPO ) on February 8, 2002. The principal executive offices of Sunoco Partners LLC, the Partnership's general partner (the General Partner ), are located at Mellon Bank Center, 1735 Market Street, Suite LL, Philadelphia, Pennsylvania 19103 (telephone (866) 248-4344). The Partnership's website address is [www.sunocologistics.com](http://www.sunocologistics.com).

Sunoco, Inc., through its wholly-owned subsidiaries (collectively, Sunoco ), owns approximately 47.9 percent of the partnership interests at December 31, 2005, including a 2 percent general partner interest.

**(b) Financial Information about Segments**

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

**(c) Narrative Description of Business**

The Partnership is principally engaged in the transport, terminalling and storage of refined products and crude oil and the purchase and sale of crude oil in 12 states located in the Northeast, Midwest and Southwest United States. Sunoco, Inc. (R&M), a wholly-owned refining and marketing subsidiary of Sunoco ( Sunoco R&M ), accounted for approximately 44 percent of the Partnership's total revenues for the year ended December 31, 2005. The business comprises three segments:

*The Eastern Pipeline System* primarily serves the Northeast and Midwest United States operations of Sunoco R&M and includes: approximately 1,647 miles of refined product pipelines, including a two-thirds undivided interest in the 80-mile refined product Harbor pipeline, and 58 miles of interrefinery pipelines between two of Sunoco R&M's refineries; approximately 140 miles of crude oil pipelines; a 9.4 percent interest in Explorer Pipeline Company, a joint venture that owns a 1,413-mile refined product pipeline; a 31.5 percent interest in Wolverine Pipe Line Company, a joint venture that owns a 721-mile refined product pipeline; a 12.3 percent interest in West Shore Pipe Line Company, a joint venture that owns a 652-mile refined product pipeline; and a 14.0 percent interest in Yellowstone Pipe Line Company, a joint venture that owns a 655-mile refined product pipeline.

*The Terminal Facilities* consist of 35 inland refined product terminals with an aggregate storage capacity of 5.9 million barrels, primarily serving the Partnership's Eastern Pipeline System; a 2.0 million barrel refined product terminal serving Sunoco R&M's Marcus Hook refinery near Philadelphia, Pennsylvania; a 12.5 million barrel marine crude oil terminal on the Texas Gulf Coast, the Nederland Terminal; one inland and two marine crude oil terminals with a combined capacity of 3.4 million barrels, and related



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pipelines, which serve Sunoco R&M's Philadelphia refinery; a ship and barge dock which serves Sunoco R&M's Eagle Point refinery; and a 1.0 million barrel liquefied petroleum gas (LPG) terminal near Detroit, Michigan.

The *Western Pipeline System* gathers, purchases, sells, and transports crude oil principally in Oklahoma and Texas and consists of approximately 2,197 miles of crude oil trunk pipelines, including a 37.0 percent undivided interest in the 80-mile Mesa Pipe Line system, and approximately 520 miles of crude oil gathering lines that supply the trunk pipelines; approximately 116 crude oil transport trucks; approximately 130 crude oil truck unloading facilities; and a 43.8 percent interest in West Texas Gulf Pipe Line Company, a joint venture that owns a 579-mile crude oil pipeline.

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Revenues are generated by charging tariffs for transporting refined products, crude oil and other hydrocarbons through the pipelines and by charging fees for storing refined products, crude oil, and other hydrocarbons, and for providing other services at the Partnership's terminals. The Partnership also generates revenue by purchasing domestic crude oil and selling it to Sunoco R&M and other customers. Generally, as crude oil is purchased, corresponding sale transactions are simultaneously entered into involving physical deliveries of crude oil, which enables the Partnership to secure a profit on the transaction at the time of purchase and establish a substantially balanced position, thereby minimizing exposure to price volatility after the initial purchase. The Partnership's practice is to not enter into commodity derivative contracts.

The Partnership's primary business strategies are to generate stable cash flows, increase pipeline and terminal throughput, pursue strategic and accretive acquisitions that complement the Partnership's existing asset base, improve operating efficiencies, and increase distributions to its unitholders.

For the year ended December 31, 2005, Sunoco R&M accounted for approximately 70 percent of the Eastern Pipeline segment's total revenues, approximately 69 percent of the Terminal Facilities segment's total revenues, and approximately 43 percent of the Western Pipeline System segment's total revenues.

**Eastern Pipeline System***Refined Product Pipelines*

The Partnership owns and operates approximately 1,647 miles of refined product pipelines in the Northeast and Midwest United States. The refined product pipelines transport refined products from Sunoco R&M's Philadelphia and Marcus Hook, Pennsylvania, Toledo, Ohio and Eagle Point, New Jersey refineries, as well as from third party locations, to markets in New York, New Jersey, Pennsylvania, Ohio, and Michigan. The refined products transported in these pipelines include multiple grades of gasoline, middle distillates (such as heating oil, diesel and jet fuel), liquefied petroleum gases (LPGs) (such as propane and butane), refining feedstocks, and other hydrocarbons. The Federal Energy Regulatory Commission (FERC) regulates the rates for interstate shipments on the Eastern Pipeline System and the Pennsylvania Public Utility Commission (PA PUC) regulates the rates for intrastate shipments in Pennsylvania. The Partnership also leases to Sunoco R&M three bi-directional, 18-mile interrefinery pipelines and a four-mile pipeline spur extending to the Philadelphia International Airport.

The following table details the total shipments on the refined product pipelines in each of the years presented. Total shipments represent the total average daily pipeline throughput multiplied by the number of miles of pipeline through which each barrel has been shipped. Management of the Partnership believes that total shipments is a better performance indicator for the Eastern Pipeline System than barrels transported as certain refined product pipelines such as transfer pipelines transport large volumes over short distances and generate minimal revenues. The following excludes amounts attributable to the interrefinery pipelines and equity ownership interests in the corporate joint ventures:

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Total shipments (in thousands of barrel miles per day)	44,657	46,284	46,144

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The mix of refined petroleum products delivered varies seasonally, with gasoline demand peaking during the summer months, and demand for heating oil and other distillate fuels being higher in the winter. In addition, weather conditions in the areas served by the Eastern Pipeline System affect both the demand for, and the mix of, the refined petroleum products delivered through the Eastern Pipeline System, although historically any overall impact on the total volume shipped has been short term.

**Table of Contents***Crude Oil Pipelines*

The Eastern Pipeline system includes a 123-mile, 16-inch crude oil pipeline that runs from Marysville, Michigan to Toledo, Ohio. This pipeline receives crude oil from the Enbridge pipeline system for delivery to Sunoco R&M and BP refineries located in Toledo, Ohio and to Marathon's Samaria, Michigan tank farm, which supplies its refinery in Detroit, Michigan. Marysville is also a truck injection point for local production. The Partnership is expanding the Marysville pipeline capacity by approximately 20% to 190,000 barrels per day, which it expects to complete in 2007.

The table below sets forth the average daily number of barrels of crude oil transported through this crude oil pipeline in each of the years presented:

	Year Ended December 31,		
	2003	2004	2005 <sup>(1)</sup>
Crude oil throughput (in barrels per day ( bpd ))	91,951	111,104	92,778

<sup>(1)</sup> During the first three quarters of 2005, production issues at two third-party Canadian synthetic crude oil plants resulted in lower shipments on the Marysville to Toledo crude oil pipeline as compared to 2004.

*Explorer Pipeline*

The Partnership owns a 9.4 percent interest in Explorer Pipeline Company ( Explorer ), a joint venture that owns a 1,413-mile common carrier refined product pipeline. Other owners of Explorer are Shell, Marathon, Chevron, CITGO, and ConocoPhillips. The system, which is operated by Explorer employees, originates from the refining centers of Lake Charles, Louisiana and Beaumont, Port Arthur and Houston, Texas, and extends to Chicago, Illinois, with delivery points in the Houston, Dallas/Fort Worth, Tulsa, St. Louis, and Chicago areas. Explorer has received FERC approval to charge market-based rates for all its tariffs. The Partnership receives a quarterly cash dividend from Explorer that is proportionate with its ownership interest.

During the third quarter of 2003, Explorer completed its \$100 million plus expansion of the system's capacity. The capacity from Port Arthur to Tulsa was expanded by 130,000 bpd to 690,000 bpd and the capacity from Tulsa to Chicago was expanded by 100,000 bpd to 450,000 bpd.

*Wolverine Pipe Line*

The Partnership owns a 31.5 percent interest in Wolverine Pipe Line Company ( Wolverine ), a joint venture that owns a 721-mile common carrier pipeline that transports primarily refined products. Other owners of Wolverine are CITGO, ExxonMobil, Marathon, and Shell. The system, which is operated by Wolverine employees, originates from Chicago, Illinois and extends to Detroit, Grand Haven, and Bay City, Michigan with delivery points along the way. Wolverine has received FERC approval to charge market-based rates for tariffs at the Detroit, Jackson, Niles, Hammond, and Lockport destinations. The Partnership receives a quarterly cash dividend from Wolverine that is proportionate with its ownership interest.

*West Shore Pipe Line*

The Partnership owns a 12.3 percent interest in West Shore Pipe Line Company ( West Shore ), a joint venture that owns a 652-mile common carrier refined product pipeline. On September 30, 2003, the Partnership acquired an additional 3.1 percent interest in West Shore increasing its overall ownership percentage from 9.2 percent to 12.3 percent. Other owners of West Shore are CITGO, ExxonMobil, BP, Buckeye, and Shell. The system, which is operated by CITGO employees, originates from the Chicago, Illinois refining center and extends to Madison and Green Bay, Wisconsin with delivery points along the way. West Shore has received FERC approval to charge market-based tariff rates in the Chicago area. The Partnership receives a quarterly cash dividend from West Shore that is proportionate with its ownership interest.

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*Yellowstone Pipe Line*

The Partnership owns a 14.0 percent interest in Yellowstone Pipe Line Company ( Yellowstone ), a joint venture that owns a 655-mile common carrier refined product pipeline. Other owners of Yellowstone are ExxonMobil and ConocoPhillips. The system, which is operated by ConocoPhillips employees, originates from the Billings, Montana refining center and extends to Moses Lake, Washington with delivery points along the way. Tariff rates are regulated by the FERC for interstate shipments and the Montana Public Service Commission for intrastate shipments in Montana.

In 1997, the Yellowstone board of directors established a dividend policy whereby dividends would not be paid to owners until the debt incurred to finance a multi-year pipeline upgrade program was repaid. No dividends were received by the Partnership from Yellowstone during 2003 or 2004, however quarterly cash dividends from Yellowstone resumed in January 2005 after the debt was repaid.

**Terminal Facilities**

*Refined Product Terminals*

The Partnership's 35 inland refined product terminals receive refined products from pipelines and distribute them to Sunoco R&M and to third parties, who in turn deliver them to end-users and retail outlets. Terminals are facilities where refined products are transferred to or from storage or a transportation system, such as a pipeline, to another transportation system, such as trucks or another pipeline. The operation of these facilities is called terminalling. Terminals play a key role in moving product to the end-user market by providing the following services: storage; distribution; blending to achieve specified grades of gasoline; and other ancillary services that include the injection of additives and the filtering of jet fuel. Typically, the Partnership's terminal facilities consist of multiple storage tanks and are equipped with automated truck loading equipment that is available 24 hours a day. This automated system provides for control of allocations, credit and carrier certification. In 2005, the Partnership began the installation of ethanol blending facilities at 12 of its refined product terminals. The Partnership will have ethanol blending capabilities at all 30 of its refined product terminals that handle gasoline upon the completion of these installations in 2006.

The Partnership's refined product terminals derive most of their revenues from terminalling fees paid by customers. A fee is charged for receiving refined products into the terminal and delivering them to trucks, barges, or pipelines. In addition to terminalling fees, the Partnership generates revenues by charging customers fees for blending, including ethanol blending, injecting additives, and filtering jet fuel. Refined product terminals generate the balance of their revenues from the handling of other hydrocarbons for Sunoco R&M at Toledo, Ohio and from lubricants handled for Sunoco R&M at Cleveland, Ohio. Sunoco R&M accounts for substantially all of the Partnership's refined product terminal revenues. The Eastern Pipeline System supplies the majority of the Partnership's refined product terminals, with third-party pipelines supplying the remainder.

The table below sets forth the total average daily throughput for the inland refined product terminals in each of the years presented:

Year Ended December 31,		
2003	2004	2005

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Refined products throughput (bpd)	283,071	340,675	389,523
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The following table outlines the number of terminals and storage capacity in barrels ( bbls ) by state:

<u>State</u>	<u>Number of Terminals</u>	<u>Storage Capacity</u>
		(bbls)
Indiana	1	207,000
Maryland	1	646,000
Michigan	2	408,000
New Jersey	4	751,200
New York <sup>(1)</sup>	3	623,600
Ohio	7	916,500
Pennsylvania	16	2,043,700
Virginia	1	277,000
<b>Total</b>	<b>35</b>	<b>5,873,000</b>

<sup>(1)</sup> The Partnership has a 45 percent ownership interest in a terminal at Inwood, New York. The storage capacity included in the table represents the proportionate share of capacity attributable to the Partnership's ownership interest.

*Nederland Terminal*

The Nederland Terminal, which is located on the Sabine-Neches waterway between Beaumont and Port Arthur, Texas, is a large marine terminal that provides storage and distribution services for refiners and other large transporters of crude oil. The terminal receives, stores, and distributes crude oil, feedstocks, lubricants, petrochemicals, and bunker oils (used for fueling ships and other marine vessels). In addition, it also blends lubricants and is equipped with petroleum laboratory facilities. The terminal currently has a total shell storage capacity of approximately 12.5 million barrels in 128 aboveground storage tanks with individual capacities of up to 660,000 barrels. During 2003, construction of two new tanks was completed, which added approximately 1.3 million barrels of storage capacity to the terminal. During 2005, construction began on two new tanks, which will add approximately 1.0 million barrels of storage capacity to the terminal in 2006.

The Nederland Terminal can receive crude oil at each of its five ship docks and three barge berths, which can accommodate any vessel capable of navigating the 40-foot freshwater draft of the Sabine-Neches Ship Channel. The five ship docks are capable of receiving over 1.0 million bpd of crude oil. The terminal can also receive crude oil through a number of pipelines, including the Shell pipeline from Louisiana, the Cameron Highway pipeline, the Department of Energy ( DOE ) Big Hill pipeline, the DOE West Hackberry pipeline, and the Partnership's Western Pipeline System. The DOE pipelines connect the terminal to the United States Strategic Petroleum Reserve's West Hackberry caverns at Hackberry, Louisiana and Big Hill caverns near Winnie, Texas, which have an aggregate storage capacity of 370 million barrels. The Nederland Terminal is one of two facilities connected to the Cameron Highway pipeline, a new 390-mile, 24-inch to 30-inch pipeline that has the capacity to deliver up to 500,000 barrels per day of crude oil from off-shore production developments in the Gulf of Mexico. Crude oil deliveries through the Cameron Highway pipeline began in February 2005. In the first quarter of 2006 ExxonMobil reversed the flow of crude oil on its pipeline from Patoka, Illinois to the Nederland Terminal, which will result in the flow of Canadian crude oil to the Nederland Terminal beginning in the first or second quarter of 2006.

The Nederland Terminal can deliver crude oil and other petroleum products via pipeline, barge, ship, rail, or truck. In the aggregate, the terminal is capable of delivering over 1.0 million bpd of crude oil to 12 connecting pipelines. The connecting pipelines include the ExxonMobil pipeline to its Beaumont, Texas refinery; the DOE pipelines to the Big Hill and West Hackberry Strategic Petroleum Reserve caverns; the Valero



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pipeline to its Port Arthur, Texas refinery; the TotalFinaElf pipelines to its Port Arthur, Texas refinery; the Shell pipeline to Houston, Texas refineries; the West Texas Gulf and the Partnership's pipelines to the Mid-Valley pipeline at

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Longview, Texas and to the CITGO pipeline at Sour Lake, Texas; the Partnership's pipeline to Seabreeze, Texas; and the Alon pipeline to its Big Spring, Texas refinery.

The table below sets forth the total average daily throughput for the Nederland Terminal in each of the years presented:

	<u>Year Ended December 31,</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
Crude oil and refined products throughput (bpd)	441,701	487,828	457,655

Revenues are generated at the Nederland Terminal primarily by providing term or spot storage services and throughput capability to a number of customers. Most of the terminal's total revenues in 2005 were from unaffiliated third parties.

*Fort Mifflin Terminal Complex*

The Fort Mifflin Terminal Complex is located on the Delaware River in Philadelphia and supplies Sunoco R&M's Philadelphia refinery with all of its crude oil. These assets include the Fort Mifflin Terminal, the Hog Island Wharf, the Darby Creek Tank Farm and connecting pipelines. Revenues are generated from the Fort Mifflin Terminal Complex by charging fees based on tank capacity and throughput. Substantially all of the revenues from the Fort Mifflin Terminal Complex are derived from Sunoco R&M.

The Fort Mifflin Terminal consists of two ship docks with 38-foot freshwater drafts and nine tanks with a total storage capacity of 570,000 barrels. This terminal also has a connection from the Colonial Pipeline System. Crude oil and some refined products enter the Fort Mifflin Terminal primarily from marine vessels on the Delaware River. One Fort Mifflin dock is designed to handle crude oil from very large crude carrier-class tankers and smaller crude oil vessels. The other dock can accommodate only smaller crude oil vessels.

The Hog Island Wharf is located next to the Fort Mifflin Terminal on the Delaware River and receives crude oil via two ship docks, one of which can accommodate crude oil tankers and smaller crude oil vessels and the other of which can accommodate some smaller crude oil vessels.

The Darby Creek Tank Farm is a primary crude oil storage terminal for Sunoco R&M's Philadelphia refinery. This facility has 26 tanks with a total storage capacity of 2.9 million barrels. Darby Creek receives crude oil from the Fort Mifflin Terminal and Hog Island Wharf via the Partnership's pipelines. The tank farm then stores the crude oil and pumps it to the Philadelphia refinery via the Partnership's pipelines.

The table below sets forth the average daily number of barrels of crude oil and refined products delivered to Sunoco R&M's Philadelphia refinery in each of the years presented:

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	Year Ended December 31,		
	2003	2004	2005
Crude oil throughput (bpd)	311,455	330,022	321,623
Refined products throughput (bpd)	10,934	6,533	5,533
<b>Total (bpd)</b>	<b>322,389</b>	<b>336,555</b>	<b>327,156</b>

*Marcus Hook Tank Farm*

The Marcus Hook Tank Farm stores substantially all of the gasoline and middle distillates that Sunoco R&M ships from its Marcus Hook refinery. This facility has 16 tanks with a total storage capacity of approximately 2.0 million barrels. After receipt of refined products from the Marcus Hook refinery, the tank farm

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either stores or delivers them to the Partnership's Twin Oaks terminal or to the Twin Oaks pump station, which supplies the Eastern Pipeline System.

The table below sets forth the total average daily throughput for the Marcus Hook Tank Farm in each of the years presented:

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Refined products throughput (bpd)	157,233	144,724	149,934

*Eagle Point Dock*

On March 30, 2004, the Partnership acquired the Eagle Point logistics assets from Sunoco R&M, including a ship and barge dock connected to the Sunoco R&M Eagle Point refinery. This dock, located on the Delaware River, can accommodate three ships or barges and supplies the Eagle Point refinery with all of its crude oil. The dock can also receive and deliver intermediate products and refined products to outbound ships and barges.

The table below sets forth the total average daily throughput for the Eagle Point Dock in each of the years presented:

	<b>Year Ended December 31,</b>	
	<b>2004<sup>(1)</sup></b>	<b>2005</b>
Crude oil throughput (bpd)	136,888	146,720
Refined products throughput (bpd)	67,217	78,439
<b>Total (bpd)</b>	<b>204,105</b>	<b>225,159</b>

<sup>(1)</sup> For the period from March 30, 2004, the date of acquisition, to December 31, 2004.

*Inkster Terminal*

The Inkster Terminal, located near Detroit, Michigan, consists of eight salt caverns with a total storage capacity of 975,000 barrels. The Partnership uses the Inkster Terminal's storage in connection with its Toledo, Ohio to Sarnia, Canada pipeline system and for the storage of LPGs from Sunoco R&M's Toledo refinery and from Canada. The terminal can receive and ship LPGs in both directions at the same time and has a propane truck loading rack.

## **Western Pipeline System**

### Crude Oil Pipelines

The Partnership owns and operates approximately 2,197 miles of crude oil trunk pipelines and approximately 520 miles of crude oil gathering pipelines in Texas and Oklahoma. The Partnership is the primary shipper on the Western Pipeline System. The Partnership also delivers crude oil and other feedstocks for Sunoco R&M and other third parties from points in Texas and Oklahoma.

The Partnership's pipelines also access several trading hubs, including the largest and most significant trading hub for crude oil in the United States located in Cushing, Oklahoma ( Cushing ), as well as other trading hubs located in Colorado City and Longview, Texas. The Partnership's crude oil pipelines also connect with other pipelines that deliver crude oil to a number of third-party refineries.

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The table below sets forth the average daily number of barrels of crude oil and other feedstocks transported on the Partnership's crude oil pipelines in each of the years presented:

	Year Ended December 31,		
	2003	2004	2005 <sup>(1)</sup>
Crude oil and other feedstocks throughput (bpd)	304,471	298,797	356,129

<sup>(1)</sup> Includes results from the Partnership's Texas crude oil pipeline system from the date of acquisition, August 1, 2005, through December 31, 2005.

*Texas*

The Partnership owns and operates approximately 1,397 miles of crude oil trunk pipelines and approximately 340 miles of crude oil gathering pipelines in Texas. The Texas system is connected to the West Texas Gulf pipeline which is 43.8 percent owned by the Partnership, the Mid-Valley pipeline in Longview, Texas which is 55.3 percent owned by Sunoco, other third-party pipelines, and the Partnership's Nederland Terminal.

Revenues are generated from tariffs paid by shippers utilizing the Partnership's transportation services. These tariffs are filed with the Texas Railroad Commission and the FERC.

The Partnership's Texas crude oil pipeline system also includes the following assets acquired since December 31, 2004:

*Corsicana to Wichita Falls Pipeline Acquisition.* On August 1, 2005, the Partnership purchased, from an affiliate of Exxon Mobil Corporation, a crude oil pipeline system and storage facilities located in Texas for \$100.0 million. The pipeline system consists primarily of a 187-mile, 16-inch pipeline with an operating capacity of 125,000 barrels per day. It originates at a crude oil terminal in Corsicana, Texas and terminates at Wichita Falls, Texas. The storage facilities include the Corsicana terminal, which has 2.9 million barrels of shell capacity for crude oil, and the Ringgold, Texas terminal, which consists of 0.5 million barrels of shell capacity for crude oil. In addition, the Partnership invested approximately \$16.0 million to construct a new 20-mile pipeline to connect the Corsicana to Wichita Falls pipeline to the West Texas Gulf pipeline, in which the Partnership has a 43.8% ownership interest. Construction of the new 20-mile pipeline was completed in December 2005, and it is currently operational.

*Mesa Pipe Line Undivided Interest Acquisition.* On December 5, 2005, the Partnership purchased a subsidiary of Sunoco which owned a 7.2 percent undivided interest in the Mesa Pipe Line system for approximately \$1.3 million. The Mesa Pipe Line system consists of an 80-mile, 24-inch crude oil pipeline from Midland, Texas to Colorado City, Texas, with an operating capacity of 316,000 barrels per day, and approximately 800,000 barrels of tankage at Midland. The Mesa pipeline connects to the West Texas Gulf pipeline, which supplies crude oil to the Mid-Valley pipeline. On December 29, 2005, the Partnership purchased an additional 29.8 percent interest in Mesa from Chevron for \$5.3 million, increasing the Partnership's ownership to 37.0 percent. Other owners of the undivided interest in Mesa are Plains All American Pipeline and BP. On December 16, 2005, the owners of Mesa agreed to extend the operating agreement for the Mesa Pipe Line System until June 30, 2006. The operating agreement provides that upon expiration of the term, the pipeline is to be sold or salvaged. The owners are in discussions to extend the operating agreement beyond June 30, 2006 and are in disagreement as to the disposition of the pipeline if the agreement is not extended. Although the Partnership is in favor of extending the agreement,

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there can be no assurance that the agreement will be extended or that the pipeline system will remain operational.

*Millenium and Kilgore Pipeline Acquisition.* On March 1, 2006, the Partnership purchased a Texas crude oil pipeline system from affiliates of Black Hills Energy, Inc. for approximately \$40.9 million. The system consists of (a) the Millennium Pipeline, a 200-mile, 12-inch crude oil pipeline with 65,000

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barrels per day operating capacity, originating near the Partnership's Nederland Terminal, and terminating at Longview Texas; (b) the Kilgore Pipeline, a 190-mile, 10-inch crude oil pipeline with 35,000 barrel per day capacity originating in Kilgore, Texas and terminating at refineries in the Houston, Texas region; (c) approximately 340,000 shell barrels of active storage capacity at Kilgore, and Longview, Texas; (d) a lease acquisition marketing business; and (e) crude oil line fill and working inventory.

*Amdel and White Oil Pipeline Acquisition.* On March 1, 2006, the Partnership acquired a Texas crude oil pipeline system from Alon USA Energy, Inc. for approximately \$68.0 million. The system consists of (a) the Amdel Pipeline, a 503-mile, 10-inch common carrier crude oil pipeline with 27,000 barrels per day operating capacity, originating at the Nederland Terminal, and terminating at Midland, Texas, and (b) the White Oil Pipeline, a 25-mile, 10-inch crude oil pipeline with 40,000 barrels per day operating capacity, originating at the Amdel Pipeline and terminating at Alon's Big Spring, Texas refinery. Alon has also agreed to ship a minimum of 15,000 barrels per day under a 10-year, throughput and deficiency agreement on the pipelines. These pipelines are currently idled and are scheduled to be returned to service on June 1, 2006. The Partnership also expects to complete a \$12 million program to expand capacity on the Amdel Pipeline from 27,000 to 40,000 barrels per day, and to construct new tankage at the Nederland Terminal to service these new volumes by the end of 2006.

### *Oklahoma*

The Partnership owns and operates a crude oil pipeline and gathering system in Oklahoma. This system contains approximately 800 miles of crude oil trunk pipelines and approximately 180 miles of crude oil gathering pipelines. The Partnership has the ability to deliver substantially all of the crude oil gathered on its Oklahoma system to Cushing. Additionally, deliveries are made on the Oklahoma system to Sunoco R&M and other third-party refineries.

Revenues are generated on the Partnership's Oklahoma system from tariffs paid by shippers utilizing the Partnership's transportation services. The Partnership files these tariffs with the Oklahoma Corporation Commission and the FERC. The Partnership is one of the largest purchasers of crude oil from producers in the state, and is the primary shipper on its Oklahoma system.

### *West Texas Gulf Pipe Line*

The Partnership owns a 43.8 percent interest in, and operates the West Texas Gulf Pipe Line Company ( West Texas Gulf ), a joint venture that owns a 579-mile common carrier crude oil pipeline. Other owners of West Texas Gulf are Chevron, BP, and CITGO. The system originates from the West Texas oil fields at Colorado City and the Nederland crude oil import terminals and extends to Longview, Texas where deliveries are made to several pipelines, including the Mid-Valley pipeline. On January 1, 2005, the Partnership became the operator of this system. The Partnership receives a quarterly cash dividend from West Texas Gulf that is proportionate with its ownership interest.

### *Crude Oil Acquisition and Marketing*

In addition to receiving tariff revenues for transporting crude oil on the Western Pipeline System, the Partnership generates most of its revenues through its crude oil acquisition and marketing activities. These activities are primarily in Oklahoma and Texas and include: purchasing crude oil at the wellhead from producers and in bulk from aggregators at major pipeline interconnections and trading locations; transporting crude oil on the Partnership's pipelines and trucks or, when necessary or cost effective, pipelines or trucks owned and operated by third parties; and marketing crude oil to major integrated oil companies, independent refiners, including Sunoco R&M for its Tulsa and Toledo refineries, and resellers in various types of sale and exchange transactions.





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The crude oil acquisition and marketing operations generate substantial revenue and cost of products sold because they reflect the sales price and cost of the significant volume of crude oil bought and sold. However, the absolute price levels for crude oil normally do not bear a relationship to gross margin, although these price levels significantly impact revenue and cost of products sold. As a result, period-to-period variations in revenue and cost of products sold are not generally meaningful in analyzing the variation in gross margin for the crude oil acquisition and marketing operations. The operating results of the crude oil acquisition and marketing operations are dependent on its ability to sell crude oil at a price in excess of the aggregate cost. Management of the Partnership believes gross margin, which is equal to sales and other operating revenue less cost of products sold and operating expenses and depreciation and amortization, is a key measure of financial performance for the Western Pipeline System.

The Partnership mitigates most of its pricing risk on purchase contracts by selling crude oil for an equal term on a similar pricing basis. The Partnership also mitigates most of its volume risk by entering into sales agreements, generally at the same time that purchase agreements are executed, at similar volumes. As a result, volumes sold are generally equal to volumes purchased. The Partnership does not acquire and hold crude oil futures contracts or enter into other commodity derivative contracts.

### *Crude Oil Purchases and Exchanges*

In a typical producer's operation, crude oil flows from the wellhead to a separator where the petroleum gases are removed. After separation, the producer treats the crude oil to remove water, sand, and other contaminants and then moves it to an on-site storage tank. When the tank is full, the producer contacts the Partnership's field personnel to purchase and transport the crude oil to market. The crude oil in producers' tanks is then either delivered directly or transported via truck to the Partnership's pipeline or to a third party's pipeline. The trucking services are performed either by the Partnership's truck fleet or a third-party trucking operation.

Crude oil purchasers who buy from producers compete on the basis of competitive prices and highly responsive services. Management of the Partnership believes that its ability to offer competitive pricing and high-quality field and administrative services to producers is a key factor in its ability to maintain its volume of lease purchased crude oil and to obtain new volume.

The Partnership also enters into exchange agreements to enhance margins throughout the acquisition and marketing process. When opportunities arise to increase its margin or to acquire a grade of crude oil that more nearly matches its delivery requirement or the preferences of its refinery customers, the Partnership's physical crude oil is exchanged with third parties. Generally, the Partnership enters into exchanges to acquire crude oil of a desired quality in exchange for a common grade crude oil or to acquire crude oil at locations that are closer to the Partnership's end-markets, thereby reducing transportation costs.

The Partnership enters into contracts with producers at market prices generally for a term of one year or less, with a majority of the transactions on a 30-day renewable basis. For the year ended December 31, 2005, the Partnership purchased 186,224 bpd from approximately 3,400 producers and from approximately 34,000 leases, and undertook approximately 237,401 bpd of exchanges and bulk purchases during the same period.

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The following table shows the Partnership's average daily volume for crude oil lease purchases and sales and other exchanges and bulk purchases for the years presented:

	<b>Year Ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	(in thousands of bpd)		
<b>Lease purchases:</b>			
Available for sale	167	164	164
Exchanged	26	23	22
Other exchanges and bulk purchases	300	282	237
<b>Total Purchases</b>	<b>493</b>	<b>469</b>	<b>423</b>
<b>Sales:</b>			
Sunoco R&M refineries:			
Toledo	26	24	27
Tulsa	80	80	62
Third parties	79	85	96
Exchanges:			
Purchased at the lease	26	23	22
Other	282	257	216
<b>Total Sales</b>	<b>493</b>	<b>469</b>	<b>423</b>

*Market Conditions*

Market conditions impact the Partnership's sales and marketing strategies. The Partnership operates the crude oil acquisition and marketing activities differently as market conditions change. During periods when demand for crude oil is weak, the market for crude oil is often in contango, meaning that the price of crude oil in a given month is less than the price of crude oil for delivery in a subsequent month. In a contango market, the Partnership will use its tankage to improve margins by storing crude oil it has purchased at lower current prices for delivery in future months at higher prices. When there is a higher demand than supply of crude oil in the near term, the market is referred to as backwardated, meaning that the price of crude oil in a given month exceeds the price of crude oil for delivery in a subsequent month. A backwardated market generally has a positive impact on marketing margins because crude oil marketers can continue to purchase crude oil at fixed premiums to posted prices while selling crude oil at higher premiums to such prices. The Partnership's storage capacity is less utilized in a backwardated market, however, the increased marketing margins normally reduce the impact of lower storage revenues.

The periods between a backwardated market and a contango market are referred to as transition periods. These transition periods may have either an adverse or beneficial impact on gross margins. A prolonged transition from a backwardated market to a contango market represents the most difficult environment for the Partnership's sales and marketing activities. Management normally seeks to reduce the adverse impact during such transition periods by renegotiating its crude oil contracts.

*Crude Oil Trucking*

The Partnership owns approximately 130 crude oil truck unloading facilities in Oklahoma, Texas, and New Mexico, the majority of which are located on the Partnership's pipeline system. Approximately 270 crude oil truck drivers are employed by the general partner of the Partnership and approximately 116 crude oil transport trucks are owned. The crude oil truck drivers pick up crude oil at production lease sites and transport it to various truck unloading facilities on the Partnership's pipelines and third-party pipelines. Third-party trucking firms are also retained to transport crude oil to certain facilities.

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### **Pipeline and Terminal Control Operations**

Almost all of the Partnership's refined products and crude oil pipelines are operated via satellite, microwave, and frame relay communication systems from central control rooms located in Montello, Pennsylvania and through December 2005, Tulsa, Oklahoma. In January 2006, the Western area control center was moved from Tulsa to Sugar Land, Texas in connection with the Western Pipeline System headquarters move. The Montello control center primarily monitors and controls the Partnership's Eastern Pipeline System, and the Sugar Land control center primarily monitors and controls the Western Pipeline System. The Nederland Terminal has its own control center.

The control centers operate with System Control and Data Acquisition, or SCADA, systems that continuously monitor real time operational data, including refined product and crude oil throughput, flow rates, and pressures. In addition, the control centers monitor alarms and throughput balances. The control centers operate remote pumps, motors and valves associated with the delivery of refined products and crude oil. The computer systems are designed to enhance leak-detection capabilities, sound automatic alarms if operational conditions outside of pre-established parameters occur, and provide for remote-controlled shutdown of pump stations on the Partnership's pipelines. Pump stations and meter-measurement points along the Partnership's pipelines are linked by satellite or telephone communication systems for remote monitoring and control, which reduces the requirement for full-time on-site personnel at most of these locations.

### **Acquisitions**

The Partnership completed the following acquisitions in the three years ended December 31, 2005:

*Mesa Pipe Line Undivided Interest Acquisition.* On December 5, 2005, the Partnership purchased a subsidiary of Sunoco which owned a 7.2 percent undivided interest in the Mesa Pipe Line system for approximately \$1.3 million. On December 29, 2005, the Partnership purchased an additional 29.8 percent interest in Mesa from Chevron for \$5.3 million, increasing its combined interest to 37.0 percent. For further information, see "Western Pipeline System" discussion above.

*Corsicana to Wichita Falls Pipeline Acquisition.* On August 1, 2005, the Partnership purchased, from an affiliate of Exxon Mobil Corporation, a crude oil pipeline system and storage facilities located in Texas for \$100.0 million. For further information, see "Western Pipeline System" discussion above.

*Columbus Terminal Acquisition.* On November 30, 2004, the Partnership acquired a refined products terminal located in Columbus, Ohio for approximately \$8.0 million. The terminal is connected to a third-party, refined product, common carrier pipeline and includes 6 refined product tanks with approximately 160,000 barrels of working storage capacity, located on 13 acres; two truck racks for shipping gasoline, distillate fuels, and ethanol via tanker truck; and rail siding access for 4 rail cars for ethanol handling.

*Harbor Pipeline Interest Acquisition.* On June 28, 2004, the Partnership purchased an additional 33.3 percent undivided interest in the Harbor pipeline for \$7.3 million. The Harbor pipeline is an 80-mile, 180,000 bpd refined product, common carrier pipeline originating near Woodbury, New Jersey and terminating in Linden, New Jersey. As a result of this transaction, the Partnership increased its undivided ownership interest to 66.7 percent and continues to operate the pipeline.

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*Baltimore and Manassas Terminals Acquisition.* On April 28, 2004, the Partnership purchased two refined product terminals located in Baltimore, Maryland and Manassas, Virginia for \$12.0 million. The Baltimore terminal is connected to a third-party, refined product, common carrier pipeline and includes 13 refined product tanks with approximately 646,000 barrels of working storage capacity, located on 35 acres; one truck rack for shipping gasoline and distillate fuels via tanker truck; and one marine dock with two berths for receiving refined products. The Manassas terminal is connected to a third-party, refined product, common carrier pipeline and

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includes 7 refined product tanks with approximately 277,000 barrels of working storage capacity, located on 11 acres, and one truck rack for shipping gasoline and distillate fuels via tanker truck.

*Eagle Point Logistics Assets Acquisition.* On March 30, 2004, the Partnership acquired the Eagle Point refinery logistics assets from Sunoco R&M for \$20 million. The Eagle Point logistics assets consist of a crude oil and refined product ship and barge dock, a refined product truck rack, and a 4.5 mile, refined product pipeline from the Eagle Point refinery to the origin of the Harbor pipeline. In connection with the acquisition, the Partnership entered into a throughput agreement with Sunoco R&M whereby they have agreed to minimum volumes on the truck rack upon completion of certain capital improvements, which were completed during the fourth quarter of 2004.

*West Shore Pipe Line Company Interest Acquisition.* On September 30, 2003, the Partnership acquired an additional 3.1 percent interest in West Shore for \$3.7 million, increasing its overall ownership percentage to 12.3 percent.

Although the Partnership does not currently engage in business unrelated to the transportation or storage of crude oil and refined products and the other businesses discussed above, management of the Partnership may, in the future, consider and make acquisitions in other business areas.

## **Competition**

As a result of the physical integration with Sunoco R&M's refineries and the contractual relationship with Sunoco pursuant to the Omnibus Agreement and Sunoco R&M pursuant to agreements such as the pipelines and terminals storage and throughput agreement, management of the Partnership believes that it will not face significant competition for crude oil transported to the Philadelphia, Toledo, Tulsa, and Eagle Point refineries, or refined products transported from the Philadelphia, Marcus Hook, Toledo, and Eagle Point refineries, particularly during the term of the pipelines and terminals storage and throughput agreement with Sunoco R&M. For further information on this agreement, see Item 7.

Management's Discussion and Analysis of Financial Condition and Results of Operations Agreements with Sunoco R&M and Sunoco, Inc. For the year ended December 31, 2005, Sunoco R&M accounted for approximately 44 percent of the Partnership's total revenues.

### *Eastern Pipeline System*

Nearly all of the Eastern Pipeline System is directly linked to Sunoco R&M's refineries. Sunoco R&M constructed or acquired these assets as the most cost-effective means to access raw materials and distribute refined products. Generally, pipelines are the lowest cost method for long-haul, overland movement of refined products. Therefore, the most significant competitors for large volume shipments in the area served by the Eastern Pipeline System are other pipelines. Management of the Partnership believes that high capital requirements, environmental considerations, and the difficulty in acquiring rights-of-way and related permits make it difficult for other companies to build competing pipelines in areas served by the Partnership's pipelines. As a result, competing pipelines are likely to be built only in those cases in which strong market demand and attractive tariff rates support additional capacity in an area.

Although it is unlikely that a pipeline system comparable in size and scope to the Eastern Pipeline System will be built in the foreseeable future, new pipelines (including pipeline segments that connect with existing pipeline systems) could be built to effectively compete with it in particular locations.

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In addition, the Partnership, including its interests in corporate joint ventures, faces competition from trucks that deliver refined products in a number of areas that it serves. While their costs may not be competitive for longer hauls or large volume shipments, trucks compete effectively for incremental and marginal volume in many areas that are served. The availability of truck transportation places a significant competitive constraint on the Partnership's ability to increase tariff rates.



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### *Terminal Facilities*

Historically, except for the Nederland Terminal, essentially all of the throughput at the Terminal Facilities segment has come from Sunoco R&M. Under the terms of the pipelines and terminals storage and throughput agreement and other agreements, the Partnership will continue to receive a significant portion of the throughput at these facilities from Sunoco R&M.

The 35 inland refined product terminals compete with other independent terminals regarding price, versatility, and services provided. The competition primarily comes from integrated petroleum companies, refining and marketing companies, independent terminal companies, and distribution companies with marketing and trading activities.

The primary competitors for the Nederland Terminal are its refinery customers' docks and other terminal facilities, located in the Beaumont, Texas area.

The Inkster Terminal's primary competition comes from other nearby facilities located in Michigan and Windsor, Canada.

### *Western Pipeline System*

The Western Pipeline System faces competition from a number of major oil companies and smaller entities. Competition among common carrier pipelines is based primarily on transportation charges and access to crude oil supply and demand. Management of the Partnership believes that high capital costs make it unlikely that other companies will build new competing crude oil pipeline systems in the pipeline corridors served by the Western Pipeline System, however changes in refiners' supply sources may negatively impact existing throughput on the Western Pipeline System. Crude oil purchasing and marketing competitive factors include price and contract flexibility, quantity and quality of services, and accessibility to end markets.

### **Partnership's Option to Purchase Pipelines from Sunoco**

The Partnership owns most of the pipeline, terminalling, storage, and related assets that support Sunoco R&M's refinery operations. Sunoco has retained the assets discussed below:

*Mid-Valley Pipeline.* A subsidiary of Sunoco owns a 55.3 percent interest in the Mid-Valley Pipeline Company (a 50 percent voting interest), which owns and operates a 1,087-mile crude oil pipeline from Longview, Texas to Samaria, Michigan. The Mid-Valley pipeline serves a number of refineries in the Midwest United States.

*Inland Pipeline.* A subsidiary of Sunoco owns a 10.0 percent interest in Inland Corporation, which owns and operates a 611-mile refined products pipeline from Lima and Toledo, Ohio to Canton, Cleveland, Columbus, and Dayton, Ohio. This pipeline transports refined products for Sunoco R&M from its Toledo, Ohio refinery and for the other owners.

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Sunoco has granted the Partnership a ten-year option, which expires in 2012, to purchase its interest in either of the preceding assets for fair market value at the date of purchase. Sunoco's interests in these assets are subject to agreements with the other interest owners that include, among other things, consent requirements and rights of first refusal that may be triggered upon certain transfers. The exercise of the option with respect to any of these assets is subject to the terms and conditions of those agreements.

Sunoco has also granted the Partnership a ten-year option, which expires in 2012, to purchase an idled 370-mile 6-inch refined product pipeline from Icedale, Pennsylvania to Cleveland, Ohio for fair market value at the date of purchase.

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Both of the ten-year option agreements discussed above are contained in the Omnibus Agreement that was entered into with Sunoco, Sunoco R&M and the general partner. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Agreements with Sunoco R&M and Sunoco, Inc. In accordance with this agreement, if the Partnership decides to exercise the option to purchase any of the assets discussed above, written notice must be provided to Sunoco setting forth the fair market value the Partnership proposes to pay for the asset. If Sunoco does not agree with the proposed fair market value, the Partnership and Sunoco will appoint a mutually agreed-upon, nationally recognized investment banking firm to determine the fair market value of the asset. Once the investment bank submits its valuation of the asset, the Partnership will have the right, but not the obligation, to purchase the asset at the price determined by the investment banking firm.

## **Safety Regulation**

A majority of the Partnership's pipelines are subject to United States Department of Transportation ( DOT ) regulations under the Hazardous Liquid Pipeline Safety Act of 1979 ( HLPESA ), and to regulation under comparable state statutes relating to the design, installation, testing, construction, operation, replacement and management of pipeline facilities. In addition, the Partnership must permit access to and copying of records and must prepare certain reports and provide information required by the Secretary of Transportation.

New DOT regulations, adopted in December 2000, require operators of hazardous liquid interstate pipelines to develop and follow a program to assess the integrity of all pipeline segments that could affect designated high consequence areas, including high population areas, drinking water and ecological resource areas that are unusually sensitive to environmental damage from a pipeline release, and commercially navigable waterways. The Partnership has prepared its own written Risk Based Integrity Management Program, identified the line segments that could impact high consequence areas and developed Baseline Assessment Plans. Management has completed the assessment of more than the minimum required 50 percent highest risk line segments as of December 31, 2005, and expects that it will complete the full assessment of the remaining segments by March 31, 2008, the timeframe prescribed by the regulations.

Management of the Partnership believes that its pipeline operations are in substantial compliance with applicable DOT regulations and comparable state requirements. However, an increase in expenditures may be needed in the future to comply with higher industry and regulatory safety standards. Such expenditures cannot be estimated accurately at this time, but management of the Partnership does not believe they would likely have a material adverse effect relative to its financial position.

### *Employee Safety*

The Partnership is subject to the requirements of the United States Federal Occupational Safety and Health Act ( OSHA ) and comparable state statutes that regulate worker health and safety. Management believes the Partnership is in substantial compliance with Federal OSHA requirements and comparable state statutes, including general industry standards, recordkeeping requirements and monitoring of occupational exposure to hazardous substances.

## **Environmental Regulation**

### *General*

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The Partnership's operations are subject to complex federal, state, and local laws and regulations relating to the protection of health and the environment, including laws and regulations which govern the handling and release of crude oil and other liquid hydrocarbon materials, some of which are discussed below. Violations of environmental laws or regulations can result in the imposition of significant administrative, civil and criminal fines and penalties and, in some instances, injunctions banning or delaying certain activities. Management of the Partnership believes it is in substantial compliance with applicable environmental laws and regulations.

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However, these laws and regulations are subject to frequent change at the federal, state and local levels, and the clear trend is to place increasingly stringent limitations on activities that may affect the environment.

There are also risks of accidental releases into the environment associated with the Partnership's operations, such as releases of crude oil or hazardous substances from its pipelines or storage facilities. To the extent not insured, such accidental releases could subject the Partnership to substantial liabilities arising from environmental cleanup and restoration costs, claims made by neighboring landowners and other third parties for personal injury and property damage, and fines or penalties for any related violations of environmental laws or regulations.

In connection with the February 2002 IPO, and the contribution of pipeline and terminalling assets to the Partnership by affiliates of Sunoco, Inc., Sunoco agreed to indemnify the Partnership for 100 percent of all losses from environmental liabilities related to the transferred assets arising prior to, and asserted within 21 years of, February 8, 2002. There is no monetary cap on this indemnification from Sunoco. Sunoco's share of liability for claims asserted thereafter will decrease by 10 percent each year through the thirtieth year following the February 8, 2002 date. Any remediation liabilities not covered by this indemnity will be the Partnership's responsibility. The Partnership has agreed to indemnify Sunoco, Inc. and its affiliates for events and conditions associated with the operation of the transferred assets occurring after February 8, 2002, and for environmental and toxic tort liabilities related to these assets to the extent Sunoco, Inc. is not required to indemnify the Partnership. Total future costs for environmental remediation activities will depend upon, among other things, the extent of impact at each site, the timing and nature of required remedial actions, the technology available, and the determination of the Partnership's liability at multi-party sites. As of December 31, 2005, all material environmental liabilities incurred by, and known to, the Partnership are either covered by the environmental indemnification or reserved for by the Partnership within its financial statements.

### *Air Emissions*

The Partnership's operations are subject to the Clean Air Act, as amended, and comparable state and local statutes. The Partnership will be required to incur certain capital expenditures in the next several years for air pollution control equipment in connection with maintaining or obtaining permits and approvals addressing air emission related issues. Although no assurances can be given, management of the Partnership believes implementation of the 1990 Clean Air Act Amendments will not have a material adverse effect on its financial condition or results of operations.

The Partnership's customers, including Sunoco R&M, are also subject to, and affected by, environmental regulations. As a result of these regulations, Sunoco R&M could be required to make significant capital expenditures, operate these refineries at reduced levels, and pay significant penalties. It is uncertain what Sunoco, Inc.'s or Sunoco R&M's responses to these emerging issues will be. Those responses could reduce Sunoco R&M's obligations under the pipelines and terminals storage and throughput agreement, thereby reducing the Partnership's throughput in its pipelines and terminals, cash flow, and ability to make distributions or satisfy its debt obligations.

### *Hazardous Substances and Waste*

In the course of ordinary operations, the Partnership may generate waste that falls within the Comprehensive Environmental Response, Compensation, and Liability Act's, referred to as CERCLA and also known as Superfund, definition of a hazardous substance and, as a result, may be jointly and severally liable under CERCLA for all or part of the costs required to clean up sites at which these hazardous substances have been released into the environment. Costs for any such remedial actions, as well as any related claims, could have a material adverse effect on the Partnership's maintenance capital expenditures and operating expenses to the extent not all are covered by the indemnity from Sunoco. For more information, please see [Environmental Remediation](#).



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The Partnership also generates solid wastes, including hazardous wastes that are subject to the requirements of the Federal Resource Conservation and Recovery Act, referred to as RCRA, and comparable state statutes. The Partnership is not currently required to comply with a substantial portion of the RCRA requirements because its operations generate minimal quantities of hazardous wastes. However, it is possible that additional wastes, which could include wastes currently generated during the Partnership's operating activities, will in the future be designated as hazardous wastes. Hazardous wastes are subject to more rigorous and costly disposal requirements than are non-hazardous wastes. Any changes in the regulations could have a material adverse effect on the Partnership's maintenance capital expenditures and operating expenses.

The Partnership currently owns or leases, and the Partnership's predecessor has in the past owned or leased, properties where hydrocarbons are being or have been handled for many years. These properties and wastes disposed thereon may be subject to CERCLA, RCRA, and analogous state laws. Under these laws, the Partnership could be required to remove or remediate previously disposed wastes (including wastes disposed of or released by prior owners or operators), to clean up contaminated property (including contaminated groundwater), or to perform remedial operations to prevent future contamination.

The Partnership has not been identified by any state or federal agency as a potentially responsible party in connection with the transport and/or disposal of any waste products to third party disposal sites.

### *Water*

The Partnership's operations can result in the discharge of regulated substances, including crude oil. The Federal Water Pollution Control Act of 1972, also known as the Clean Water Act, and analogous state laws impose restrictions and strict controls regarding the discharge of regulated substances into state waters or waters of the United States.

The Oil Pollution Act subjects owners of covered facilities to strict, joint, and potentially unlimited liability for removal costs and other consequences of a release of oil, where the release is into navigable waters, along shorelines or in the exclusive economic zone of the United States. Spill prevention control and countermeasure requirements of the Clean Water Act and some state laws require diking and similar structures to help prevent the impact on navigable waters in the event of a release. The Office of Pipeline Safety of the DOT, the EPA, or various state regulatory agencies have approved the Partnership's oil spill emergency response plans, and management of the Partnership believes it is in substantial compliance with these laws.

In addition, some states maintain groundwater protection programs that require permits for discharges or operations that may impact groundwater conditions. Management of the Partnership believes that compliance with existing permits and compliance with foreseeable new permit requirements will not have a material adverse effect on its financial condition or results of operations.

### *Environmental Remediation*

Contamination resulting from releases of refined products and crude oil is not unusual within the petroleum pipeline industry. Historic releases along the Partnership's pipelines, gathering systems, and terminals as a result of past operations have resulted in impacts to the environment, including soils and groundwater. Site conditions, including soils and groundwater, are being evaluated at a number of properties where operations may have resulted in releases of hydrocarbons and other wastes. Sunoco has agreed to indemnify the Partnership from environmental

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and toxic tort liabilities related to the assets transferred to the extent such liabilities exist or arise from operation of these assets prior to the closing of the February 2002 IPO and are asserted within 30 years after the closing of the IPO. This indemnity will cover the costs associated with performance of the assessment, monitoring, and remediation programs, as well as any related claims and penalties. See Environmental Regulation General.



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The Partnership has experienced several petroleum releases for which it is not covered by an indemnity from Sunoco, Inc., and for which it is responsible for necessary assessment, remediation, and/or monitoring activities. Management of the Partnership estimates that the total aggregate cost of performing the currently anticipated assessment, monitoring, and remediation activities at these sites is not material in relation to its financial position at December 31, 2005. The Partnership has implemented an extensive inspection program to prevent releases of refined products or crude oil into the environment from its pipelines, gathering systems, and terminals. Any damages and liabilities incurred due to future environmental releases from the Partnership's assets have the potential to substantially affect its business.

### **Rate Regulation**

*General Interstate Regulation.* Interstate common carrier pipeline operations are subject to rate regulation by the FERC under the Interstate Commerce Act, the Energy Policy Act of 1992, and rules and orders promulgated pursuant thereto. The Interstate Commerce Act requires that tariff rates for petroleum pipelines be just and reasonable and not unduly discriminatory. This statute also permits interested persons to challenge proposed new or changed rates and authorizes the FERC to suspend the effectiveness of such rates for up to seven months and to investigate such rates. If, upon completion of an investigation, the FERC finds that the new or changed rate is unlawful, it is authorized to require the carrier to refund revenues in excess of the prior tariff during the term of the investigation. The FERC also may investigate, upon complaint or on its own motion, rates that are already in effect and may order a carrier to change its rates prospectively. Upon an appropriate showing, a shipper may obtain reparations for damages sustained for a period of up to two years prior to the filing of a complaint.

The FERC generally has not investigated interstate rates on its own initiative when those rates, like the Partnership's, have not been the subject of a protest or a complaint by a shipper. However, the FERC could investigate the Partnership's rates at the urging of a third party if the third party is either a current shipper or has a substantial economic interest in the tariff rate level. Although no assurance can be given that the tariffs charged by the Partnership ultimately will be upheld if challenged, management believes that the tariffs now in effect for the Partnership's pipelines are within the maximum rates allowed under current FERC guidelines.

Sunoco R&M and its subsidiaries are the only current shippers on many of the pipelines. Sunoco R&M has agreed not to challenge, cause others to challenge, or assist others in challenging, the tariff rates for the term of the pipelines and terminals storage and throughput agreement. Since most of the pipelines are common carrier pipelines, the Partnership may be required to accept new shippers who wish to transport on the pipelines. It is possible that any new shippers, current shippers, or other interested parties, may decide to challenge the tariff rates. If any rate challenge or challenges were successful, revenues, cash flows, and the cash available for distribution could be materially reduced.

The Partnership has applied to FERC for permission to charge market-based rates in many of the refined products markets it serves. On January 19, 2006, the FERC ruled on the Partnership's application for market-based rates on certain of its pipelines. Market-based rates were approved on the Detroit, MI, Pittsburgh, PA, Rochester, NY and Toledo, OH origin markets and the Detroit, MI, Philadelphia, PA and New York, NY destination markets. FERC ordered hearings on the application for the Philadelphia, PA origin market and the Cleveland, OH, Harrisburg, PA, Scranton, PA and Toledo, OH destination markets. In those markets where market-based rates were approved, the Partnership would be able to establish rates without regard to the index or our cost-of-service. As to the markets where hearings have been ordered, there can be no assurances that market-based rates will be approved, in which case, our rates would continue to be subject to current rate structures.

*Intrastate Regulation.* Some of the Partnership's pipeline operations are subject to regulation by the Texas Railroad Commission, the Pennsylvania Public Utility Commission, the Ohio Public Utility Commission, and the Oklahoma Corporation Commission. The operations of the Partnership's joint venture interests are also subject to regulation in the states in which they operate. The applicable state statutes require that pipeline rates be



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nondiscriminatory and provide no more than a fair return on the aggregate value of the pipeline property used to render services. State commissions generally have not been aggressive in regulating common carrier pipelines or investigating rates or practices of petroleum pipelines in the absence of shipper complaints. Complaints to state agencies have been infrequent and are usually resolved informally. Although management cannot be certain that the Partnership's intrastate rates ultimately would be upheld if challenged, it believes that, given this history, the tariffs now in effect are not likely to be challenged or, if challenged, are not likely to be ordered to be reduced.

## **Title to Properties**

Substantially all of the Partnership's pipelines were constructed on rights-of-way granted by the apparent record owners of the property and in some instances these rights-of-way are revocable at the election of the grantor. Several rights-of-way for the pipelines and other real property assets are shared with other pipelines and other assets owned by affiliates of Sunoco, Inc. and by third parties. In many instances, lands over which rights-of-way have been obtained are subject to prior liens that have not been subordinated to the right-of-way grants. The Partnership has obtained permits from public authorities to cross over or under, or to lay facilities in or along, watercourses, county roads, municipal streets, and state highways and, in some instances, these permits are revocable at the election of the grantor. The Partnership has also obtained permits from railroad companies to cross over or under lands or rights-of-way, many of which are also revocable at the grantor's election. In some cases, property for pipeline purposes was purchased in fee. In some states and under some circumstances, the Partnership has the right of eminent domain to acquire rights-of-way and lands necessary for the common carrier pipelines. The previous owners of the applicable pipelines may not have commenced or concluded eminent domain proceedings for some rights-of-way.

Some of the leases, easements, rights-of-way, permits, and licenses acquired by the Partnership or transferred to it upon the closing of the February 2002 IPO require the consent of the grantor to transfer these rights, which in some instances is a governmental entity. The Partnership has obtained or is in the process of obtaining third-party consents, permits, and authorizations sufficient for the transfer of the assets necessary to operate the business in all material respects. In management's opinion, with respect to any consents, permits, or authorizations that have not been obtained, the failure to obtain them will not have a material adverse effect on the operation of the business.

The Partnership has satisfactory title to all of the assets contributed to it in connection with the February 2002 IPO, or is entitled to indemnification from Sunoco, Inc. under the Omnibus Agreement for title defects to these assets and for failures to obtain certain consents and permits necessary to conduct its business that arise within ten years after the closing of the February 2002 IPO. Record title to some of the assets may continue to be held by affiliates of Sunoco, Inc. until the Partnership has made the appropriate filings in the jurisdictions in which such assets are located and obtained any consents and approvals that were not obtained prior to the closing of the February 2002 IPO. Although title to these properties is subject to encumbrances in some cases, such as customary interests generally retained in connection with acquisition of real property, liens for environmental contamination, taxes and other burdens, easements, or other restrictions, management believes that none of these burdens materially detract from the value of the properties or will materially interfere with their use in the operation of the Partnership's business.

## **Employees**

To carry out the Partnership's operations, the general partner and its affiliates employed approximately 1,125 people at December 31, 2005 who provide direct support to the operations. Labor unions or associations represent approximately 608 of these employees at December 31, 2005. The general partner considers its employee relations to be good. The Partnership has no employees.

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### **(d) Financial Information about Geographical Areas**

The Partnership has no significant amount of revenue or segment profit or loss attributable to international activities.

### **(e) Available Information**

The Partnership makes available, free of charge on its website, *www.sunocologistics.com*, all materials that it files electronically with the Securities Exchange Commission, including its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the SEC.

## **ITEM 1A. RISK FACTORS**

**The risks below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial also may impair our business operations. If any of the following risks actually occur, our business, results of operations, cash flows and financial condition could be affected materially and adversely.**

*We may not be able to generate sufficient cash from operations to allow us to make the required payments to our debt holders or to pay quarterly distributions.*

The amount of cash we can distribute on our common units principally depends upon the cash we generate from our operations. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Because the cash we generate from operations will fluctuate from quarter to quarter, we may not be able to pay all the applicable interest and principal obligations on our debt, or to pay quarterly distributions.

In the future, we may not be able to generate sufficient cash flow from operations, realize currently anticipated operating improvements or borrow amounts under our revolving credit facility sufficient to fund our liquidity needs. We may need to refinance all or a portion of our indebtedness on or before maturity. We may not be able to refinance any of our indebtedness on or before maturity on commercially reasonable terms, or at all.

Our ability to pay quarterly distributions depends primarily on cash flow, including cash flow from financial reserves and working capital borrowings, and not solely on profitability, which is affected by non-cash items. As a result, we may pay cash distributions during periods when we record net losses and may be unable to pay cash distributions during periods when we record net income.

*Our general partner's discretion in determining the level of cash reserves may adversely affect our ability to make cash distributions to our unitholders.*

Our partnership agreement provides that our general partner may reduce operating surplus by establishing cash reserves to provide funds for our future operating expenditures. In addition, the partnership agreement provides that our general partner may reduce available cash by establishing cash reserves for the proper conduct of our business, to comply with applicable law or agreements to which we are a party or to provide funds for future distributions to our unitholders in any one or more of the next four quarters. These cash reserves will affect the amount of cash available for current distribution to our unitholders.

*Cost reimbursements, which will be determined by our general partner in good faith, and fees due our general partner and its affiliates will be substantial and could materially and adversely affect our financial condition, results of operations, or cash flows.*

We currently pay Sunoco, Inc. an annual administrative fee for the provision by Sunoco, Inc. or its affiliates of various general and administrative services for our benefit. This fee is subject to periodic re-negotiation, and

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there can be no assurance that future administrative fees charged by Sunoco, Inc. will be at or below the current level. This fee may increase if an expansion of our operations requires an increased level of general and administrative services from Sunoco, Inc. or its affiliates. If we are unable to obtain such services from Sunoco, Inc. or third parties at or below the current cost, it could materially and adversely affect our financial condition, results of operations, or cash flows. In addition, our general partner is entitled to reimbursement for all other expenses it incurs on our behalf, including the salaries of, and the cost of employee benefits for, our general partner's employees, including senior executives, who provide services to us. Our general partner will determine the amount of these expenses in good faith.

***Our general partner may cause us to borrow funds in order to make cash distributions, even where the purpose or effect of the borrowing benefits the general partner or its affiliates.***

In some instances, our general partner may cause us to borrow funds from affiliates of Sunoco, Inc. or from third parties in order to permit the payment of cash distributions. These borrowings are permitted even if the purpose and effect of the borrowing is to enable us to make a distribution on the subordinated units, to make incentive distributions, or to hasten the expiration of the subordination period.

***Our general partner has a limited call right that may require our unitholders to sell their common units at an undesirable time or price.***

If at any time our general partner and its affiliates own more than 80% of the common units, our general partner will have the right, but not the obligation, which it may assign to any of its affiliates or to us, to acquire all, but not less than all, of the common units held by unaffiliated persons at a price not less than their then-current market price. As a result, unitholders may be required to sell their common units at an undesirable time or price, may not receive a return on the investment, and may incur a tax liability upon the sale.

***Even if unitholders are dissatisfied, they cannot remove our general partner without its consent, which could lower the trading price of the common units.***

Unlike the holders of common stock in a corporation, unitholders have only limited voting rights on matters affecting our business and, therefore, limited ability to influence management's decisions regarding our business. Unitholders did not elect our general partner or its board of directors and will have no right to elect our general partner or its board of directors on an annual or other continuing basis. The board of directors of our general partner is chosen by the members of our general partner, all of which are subsidiaries of Sunoco, Inc. Furthermore, if the unitholders are dissatisfied with the performance of our general partner, they will have little ability to remove our general partner. As a result of these limitations, the price at which the common units trade could be diminished because of the absence or reduction of a control premium in the trading price.

The partnership agreement also contains provisions limiting the ability of unitholders to call meetings or to acquire information about our operations, as well as other provisions limiting the unitholders' ability to influence the manner or direction of management.

***The control of our general partner may be transferred to a third party without unitholder consent.***

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The general partner may transfer its general partner interest to a third party in a merger or in a sale of all or substantially all of its assets without the consent of the unitholders. Furthermore, there is no restriction in the partnership agreement on the ability of the owner of the general partner from transferring its ownership interest in the general partner to a third party. The new owner of the general partner would then be in a position to replace the board of directors and officers of the general partner with its own choices and to control the decisions taken by the board of directors and officers.

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*Sunoco, Inc. and its affiliates have conflicts of interest and limited fiduciary responsibilities, which may permit them to favor their own interests to the detriment of our unitholders.*

Sunoco, Inc. indirectly owns and controls our general partner, which holds the 2 percent general partner interest and holds a 45.9 percent limited partner interest in us. Conflicts of interest may arise between Sunoco, Inc. and its affiliates, including our general partner, on the one hand, and us and our unitholders, on the other hand. As a result of these conflicts, the general partner may favor its own interests and the interests of its affiliates over the interests of our unitholders. These conflicts include, among others, the following situations:

Sunoco R&M, as a shipper on our pipelines, and a customer at our terminals, could seek lower tariff rates or terminalling fees, once the terms of Sunoco R&M's obligations under the pipelines and terminals storage and throughput agreements expire in 2007 through 2009.

neither our partnership agreement nor any other agreement requires Sunoco, Inc. to pursue a business strategy that favors us or utilizes our assets, including whether to increase or decrease refinery production, whether to shut down or reconfigure a refinery, or what markets to pursue or grow. Sunoco, Inc.'s directors and officers have a fiduciary duty to make these decisions in the best interests of the stockholders of Sunoco, Inc.;

our general partner is allowed to take into account the interests of parties other than us, such as Sunoco, Inc., in resolving conflicts of interest;

under our partnership agreement, our general partner has limited liability and restricted fiduciary duties with respect to actions that, without these limitations and restrictions, might constitute breaches of fiduciary duty;

under our partnership agreement, the remedies available to our unitholders with respect to conduct by our general partner that may constitute a breach of fiduciary duty have been limited;

our general partner determines the amount and timing of asset purchases and sales, capital expenditures, borrowings, issuance of additional partnership securities, and reserves, each of which can affect the amount of cash that is distributed to our unitholders;

our general partner determines which costs incurred by Sunoco, Inc. and its affiliates are reimbursable by us;

our partnership agreement does not restrict our general partner from causing us to pay it or its affiliates for any services rendered on terms that are fair and reasonable to us or entering into additional contractual arrangements with any of these entities on our behalf;

our general partner controls the enforcement of obligations owed to us by our general partner and its affiliates, including the pipelines and terminals storage and throughput agreements with Sunoco R&M; and

our general partner decides whether to retain separate counsel, accountants, or others to perform services for us.

*We are a holding company. We conduct our operations through our subsidiaries and depend on cash flow from our subsidiaries to service our debt obligations.*



We are a holding company. We conduct our operations through our subsidiaries. As a result, our cash flow and ability to service our debt is dependent upon the earnings of our subsidiaries. In addition, we are dependent on the distribution of earnings, loans or other payments from our subsidiaries to us. Any payment of dividends, distributions, loans or other payments from our subsidiaries to us could be subject to statutory or contractual restrictions. Payments to us by our subsidiaries also will be contingent upon the profitability of our subsidiaries. If we are unable to obtain funds from our subsidiaries we may not be able to pay interest or principal on our debt securities when due or to obtain the necessary funds from other sources.

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*We depend upon Sunoco R&M for a substantial portion of the crude oil and refined products transported on our pipelines and handled at our terminals, and our crude oil sales.*

For the year ended December 31, 2005, Sunoco R&M accounted for approximately 70 percent of our Eastern Pipeline System total revenues, 69 percent of our Terminal Facilities total revenues, and 43 percent of our Western Pipeline System total revenues. The balance of our revenues was received from third parties, and we will continue to remain dependent on third parties for these additional revenues. Our pipelines and terminals storage and throughput agreements with Sunoco R&M provide for escalation of the fees charged to Sunoco R&M, but the increased fees may be inadequate to cover increased costs in the future. We expect to continue to derive a substantial portion of our revenues from Sunoco R&M for the foreseeable future. If for any reason, Sunoco R&M were to decrease the throughput transported on our pipelines, the volumes of crude oil or refined products handled at our terminals or the amounts of crude oil purchased from us, it could materially and adversely affect our financial condition, results of operations, or cash flows.

*Sunoco R&M's obligations to us under the pipelines and terminals storage and throughput agreements and other arrangements may be reduced or suspended in some circumstances.*

Sunoco R&M's obligations to us under the pipelines and terminals storage and throughput agreements may be permanently reduced in some circumstances. These events, some of which are within the exclusive control of Sunoco R&M, include:

The inability of Sunoco R&M and us to agree on the amount of any surcharge required to be paid by Sunoco R&M to cover substantial and unanticipated costs that may be incurred in complying with new laws or governmental regulations applicable to our Terminal Facilities;

A decision by Sunoco R&M to shut down or reconfigure one or more of its refineries if Sunoco R&M reasonably believes in good faith that such event will jeopardize its ability to satisfy its minimum revenue or throughput obligations; and

Federal or state governmental action that prohibits Sunoco R&M from using MTBE in the gasoline it produces if Sunoco R&M reasonably believes in good faith that this action will jeopardize its ability to satisfy its minimum revenue or throughput obligations.

Depending on the ultimate cost of complying with existing and future environmental regulations or proceedings, Sunoco R&M may determine that it is more economical to reduce production at a refinery or shut down all or a portion of a refinery rather than make these capital expenditures. Sunoco R&M's obligations to us under the pipelines and terminals storage and throughput agreements would be reduced in this event.

Furthermore, Sunoco R&M's obligations to us would be temporarily suspended during the occurrence of an event that is outside the control of the parties, which renders performance impossible with respect to an asset for at least 30 days. The occurrence of any of these events could materially and adversely affect our financial condition, results of operations, or cash flows.

Sunoco, Inc. actively manages its assets and operations, and therefore, changes of some nature, possibly material to our business relationship, may occur at some point in the future.

*If Sunoco R&M satisfies only its minimum obligations to us under, or if we are unable to renew or extend the pipelines and terminals storage and throughput agreements, it could materially and adversely affect our financial condition, results of operations, or cash flows.*

Sunoco R&M may reduce the volume it transports on our pipelines or delivers at our terminals to the minimum amounts it is obligated to transport or deliver under the pipelines and terminals storage and throughput agreements. In addition, the terms of Sunoco R&M's obligations to us under the pipelines and terminals storage and throughput agreements entered into at the time of our initial public offering are of relatively brief duration,

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generally expiring in 2007 through 2009. If Sunoco R&M reduces its use of our facilities after expiration of this agreement or any other storage and throughput agreements between us and Sunoco R&M, or if the terms under a new agreement are materially changed in a way that reduces revenues, and we are unable to generate additional revenues from third parties, it could materially and adversely affect our financial condition, results of operations, or cash flows.

*A sustained decrease in demand for refined products in the markets served by our pipelines and terminals could materially and adversely affect our financial condition, results of operations, or cash flows.*

Factors that could lead to a sustained decrease in market demand for refined products include:

a recession or other adverse economic condition that results in lower purchases of refined petroleum products;

higher refined product prices due to an increase in the market price of crude oil, changes in economic conditions, or other factors;

higher fuel taxes or other governmental or regulatory actions that increase, directly or indirectly, the cost of gasoline or other refined products;

a shift by consumers to more fuel-efficient or alternative fuel vehicles or an increase in fuel economy, whether as a result of technological advances by manufacturers, pending legislation proposing to mandate higher fuel economy, or otherwise; and

a temporary or permanent material increase in the price of refined products as compared to alternative sources of refined products available to our customers.

*When the price of foreign crude oil delivered to the United States is greater than that of domestic crude oil, or the price for the future delivery of crude oil falls below current prices, customers are less likely to store crude oil, thereby reducing storage revenues at our Nederland Terminal.*

Most of the crude oil stored at our Nederland Terminal is foreign crude oil. When the price of foreign crude oil delivered to the United States is greater than that of domestic crude oil, the demand for this storage capacity may decrease. If this market condition occurs, our storage revenues will be lower.

When the price of crude oil in a given month exceeds the price of crude oil for delivery in a subsequent month, the market is backwardated. When the crude oil market is backwardated, the demand for storage capacity at our Nederland Terminal may decrease because crude oil producers can capture a premium for prompt deliveries rather than storing it for sale later. Although a backwardated market generally has a favorable impact on marketing margins because crude oil marketers can continue to purchase crude oil from producers at a fixed premium to posted prices while selling crude oil at a higher premium to such prices, we may be unable to completely offset the lower storage revenues in a backwardated market.

*A material decrease in crude oil available for transport through our Western Pipeline System could materially and adversely affect our financial position, results of operations, or cash flows.*

The volume of crude oil transported in our crude oil pipelines depends on the availability of attractively priced crude oil produced in the areas accessible to our crude oil pipelines and received from other common carrier pipelines. If we do not replace volume lost due to a material temporary or permanent decrease in supply, the volume of crude oil transported through our pipelines would decline. In addition, sustained low crude oil prices could lead to a decline in drilling activity and production levels or the shutting-in or abandonment of marginal wells. Similarly, a temporary or permanent material increase in the price of crude oil supplied from any of these sources, as compared to alternative sources of crude oil available to our customers, could cause the volume of crude oil transported in our pipelines to decline.

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*Any reduction in the capability of, or the allocations to, our shippers in interconnecting, third-party pipelines would cause a reduction of volumes transported in our pipelines and through our terminals.*

Sunoco R&M and the other users of our pipelines and terminals are dependent upon connections to third-party pipelines to receive and deliver crude oil and refined products. Any reduction of capabilities of these interconnecting pipelines due to testing, line repair, reduced operating pressures, or other causes would result in reduced volumes transported in our pipelines or through our terminals. Similarly, if additional shippers begin transporting volume over interconnecting pipelines, the allocations to our existing shippers could be reduced, which also would reduce volumes transported in our pipelines or through our terminals.

*If we are unable to complete capital projects at their expected costs and/or in a timely manner, or if the market conditions assumed in our project economics deteriorate, our financial condition, results of operations, or cash flows could be affected materially and adversely.*

Delays or cost increases related to capital spending programs involving construction of new facilities (or improvements and repairs to our existing facilities) could adversely affect our ability to achieve forecasted internal rates of return and operating results. Delays in making required changes or upgrades to our facilities could subject us to fines or penalties as well as affect our ability to supply certain products we make. Such delays or cost increases may arise as a result of unpredictable factors in the marketplace, many of which are beyond our control, including:

denial or delay in issuing requisite regulatory approvals and/or permits;

unplanned increases in the cost of construction materials or labor;

disruptions in transportation of modular components and/or construction materials;

severe adverse weather conditions, natural disasters, or other events (such as equipment malfunctions explosions, fires, spills) affecting our facilities, or those of vendors and suppliers;

shortages of sufficiently skilled labor, or labor disagreements resulting in unplanned work stoppages;

market-related increases in a project's debt or equity financing costs; and/or

nonperformance by, or disputes with, vendors, suppliers, contractors, or sub-contractors involved with a project.

Our forecasted internal rates of return also are based upon our projections of future market fundamentals which are not within our control, including changes in general economic conditions, available alternative supply and customer demand.

*Potential future acquisitions and expansions, if any, may increase substantially the level of our indebtedness and contingent liabilities, and we may be unable to integrate them effectively into our existing operations.*

From time to time, we evaluate and acquire assets and businesses that we believe complement or diversify our existing assets and businesses. Acquisitions may require substantial capital or the incurrence of substantial indebtedness. If we consummate any future acquisitions, our capitalization and results of operations may change significantly.

Acquisitions and business expansions involve numerous risks, including difficulties in the assimilation of the assets and operations of the acquired businesses, inefficiencies and difficulties that arise because of unfamiliarity with new assets and the businesses associated with them and new geographic areas. Further, unexpected costs and challenges may arise whenever businesses with different operations or management are combined and we may experience unanticipated delays in realizing the benefits of an acquisition. In some cases, we have indemnified the previous owners and operators of acquired assets. Following an acquisition, we may discover previously unknown liabilities associated with the acquired business for which we have no recourse

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under applicable indemnification provisions. An acquisition may require us to assume certain prior known or unknown liabilities.

*Our operations are subject to operational hazards and unforeseen interruptions for which we may not be adequately insured.*

Our operations and those of our customers and suppliers may be subject to operational hazards and unforeseen interruptions such as natural disasters (including hurricanes), adverse weather, accidents, fires, explosions, hazardous materials releases, and other events beyond our control. These events might result in a loss of equipment or life, injury, or extensive property damage, as well as an interruption in our operations. We may not be able to maintain or obtain insurance of the type and amount desired at reasonable rates. In some instances, certain insurance could become unavailable or available only for reduced amounts of coverage. If we were to incur a significant liability for which we were not fully insured, it could materially and adversely affect our financial condition, results of operations, or cash flows.

*We are exposed to the credit and other counterparty risk of our customers in the ordinary course of our business.*

There can be no assurance that we have adequately assessed the credit worthiness of our existing or future counterparties or that there will not be an unanticipated deterioration in their credit worthiness, which could have an adverse impact on us. In those cases in which we provide division order services for crude oil purchased at the wellhead, we may be responsible for distribution of proceeds to all parties. In other cases, we pay all of or a portion of the production proceeds to an operator who distributes these proceeds to the various interest owners. There can be no assurance that we will not experience material losses in dealings with other parties.

*Competition with respect to our operating segments could ultimately lead to lower levels of profits and could materially and adversely affect our financial condition, results of operations, or cash flows.*

We face competition from other pipelines, terminals and crude oil marketers, as well as from other means of transporting, storing and distributing petroleum products. Our customers demand delivery of products on tight time schedules and in a number of geographic markets. If our quality of service declines or we cannot meet the demands of our customers, they may utilize the services of our competitors. If a competing crude oil or refined product pipeline or other crude oil marketer charged lower rates than we do, we could be forced to reduce our rates to remain competitive.

*Mergers among our customers and competitors could result in lower volumes being shipped on our pipelines or products stored in or distributed through our terminals, or reduced crude oil marketing margins or volumes.*

Mergers between existing customers could provide strong economic incentives for the combined entities to utilize their existing systems instead of ours in those markets where the systems compete. As a result, we could lose some or all of the volumes and associated revenues from these customers and we could experience difficulty in replacing those lost volumes and revenues, which could materially and adversely affect our financial condition, results of operations, or cash flows.



*Rate regulation may not allow us to recover the full amount of increases in our costs. A successful challenge to our rates could materially and adversely affect our financial condition, results of operations, or cash flows.*

The primary rate-making methodology of the Federal Energy Regulatory Commission, or FERC, is price indexing. We use this methodology in all of our interstate markets. In an order issued February 24, 2003, the FERC announced that, effective July 1, 2003, the index would equal the change in the producer price index for finished goods (previously, the index was equal to the change in the producer price index for finished goods

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minus 1%). If the index falls, we would be required to reduce rates that are based on the FERC's price indexing methodology if they exceed the new maximum allowable rate. In addition, changes in the index might not be large enough to fully reflect actual increases in our costs. The FERC's rate-making methodologies may limit our ability to set rates based on our true costs or may delay the use of rates that reflect increased costs.

Under the Energy Policy Act adopted in 1992, certain interstate pipeline rates were deemed just and reasonable or grandfathered. Most of our revenues are derived from grandfathered rates on our FERC-regulated refined products pipelines. A person challenging a grandfathered rate must, as a threshold matter, establish a substantial change since the date of enactment of the Act, in either the economic circumstances or the nature of the service that formed the basis for the rate. A complainant might assert that the creation of the partnership itself constitutes such a change, an argument that has not previously been specifically addressed by the FERC. If the FERC were to find a substantial change in circumstances, then the existing rates could be subject to detailed review. There is a risk that some rates could be found to be in excess of levels justified by our cost of service. In such event, the FERC would order us to reduce rates prospectively and could order us to pay reparations to complaining shippers. Reparations could be required for a period of up to two years prior to the date of filing the complaint in the case of rates that are not grandfathered and for the period starting with the filing of the complaint in the case of grandfathered rates.

On July 20, 2004, the United States Court of Appeals for the District of Columbia Circuit, or the D.C. Circuit, issued its opinion in *BP West Coast Products, LLC v. FERC*, which upheld FERC's determination that the rates of an interstate petroleum products pipeline, SFPP, L.P., or SFPP, were grandfathered rates under the Energy Policy Act of 1992 and that SFPP's shippers had not demonstrated substantially changed circumstances that would justify modification of those rates. The court also vacated the portion of the FERC's decision applying the *Lakehead* policy. In the *Lakehead* decision, the FERC allowed an oil pipeline master limited partnership to include in its cost-of-service an income tax allowance to the extent that its unitholders were corporations subject to income tax. The *BP West Coast* decision is likely to be appealed to the D.C. Circuit, and the new tax allowance policy is subject to rehearing and further action by the FERC. The ultimate outcome of this proceeding is not certain, and could result in changes to the FERC's treatment of income tax allowances in cost-of-service. In May and June 2005, the FERC issued a statement of general policy, as well as an order on remand of *BP West Coast*, respectively, in which the FERC has stated it will permit pipelines to include in cost-of-service a tax allowance to reflect actual or potential tax liability on their public utility income attributable to all partnership or limited liability company interests, if the ultimate owner of the interest has an actual or potential income tax liability on such income. Whether a pipeline's owners have such actual or potential income tax liability will be reviewed by the FERC on a case-by-case basis. Although the new policy is generally favorable for pipelines that are organized as pass-through entities, it still entails rate risk due to the case-by-case review requirement. However, on December 16, 2005, the FERC issued its first case-specific review of the income tax allowance issue in the *SFPP, L.P.* proceeding. The FERC ruled favorably to SFPP L.P. on all income tax issues and set forth guidelines regarding the evidence necessary for the pipeline to determine its income tax allowance.

In addition, a state commission could also investigate our intrastate rates or terms and conditions of service on its own initiative or at the urging of a shipper or other interested party. If a state commission found that our rates exceeded levels justified by our cost of service, the state commission could order us to reduce our rates.

Sunoco R&M has agreed not to challenge, or to cause others to challenge or assist others in challenging, our tariff rates in effect during the term of the pipelines and terminals storage and throughput agreement. This agreement does not prevent other current or future shippers from challenging our tariff rates. At the end of the term of the agreement, Sunoco R&M will be free to challenge, or to cause other parties to challenge or assist others in challenging, our tariff rates in effect at that time.

Potential changes to current rate-making methods and procedures may impact the federal and state regulations under which we will operate in the future. In addition, if the FERC's petroleum pipeline ratemaking methodology changes, the new methodology could materially and adversely affect our financial condition, results of operations, or cash flows.



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***Our operations are subject to federal, state, and local laws and regulations relating to environmental protection and operational safety that could require substantial expenditures.***

Our pipelines, gathering systems, and terminal operations are subject to increasingly strict environmental and safety laws and regulations. The transportation and storage of refined products and crude oil result in a risk that refined products, crude oil, and other hydrocarbons may be suddenly or gradually released into the environment, potentially causing substantial expenditures for a response action, significant government penalties, liability to government agencies for natural resources damages, personal injury, or property damages to private parties and significant business interruption. We own or lease a number of properties that have been used to store or distribute refined products and crude oil for many years. Many of these properties also have been previously owned or operated by third parties whose handling, disposal, or release of hydrocarbons and other wastes were not under our control, and for which, in some cases, we have indemnified the previous owners and operators.

Failure to comply with these laws and regulations may result in assessment of administrative, civil and criminal penalties, imposition of cleanup and site restoration costs and liens and, to a lesser extent, issuance of injunctions to limit or cease operations. We may be unable to recover these costs through increased revenues.

***Our business is subject to federal, state and local laws and regulations that govern the product quality specifications of the petroleum products that we store and transport.***

Petroleum products that we store and transport are sold by our customers for consumption into the public market. Various federal, state and local agencies have the authority to prescribe specific product quality specifications to commodities sold into the public market. Changes in product quality specifications could reduce our throughput volume, require us to incur additional handling costs or require the expenditure of capital. In addition, different product specifications for different markets impact the fungibility of the system and could require the construction of additional storage. We may be unable to recover these costs through increased revenues.

***Restrictions in our debt agreements, and in Sunoco, Inc. s debt agreements may prevent us from engaging in some beneficial transactions or paying distributions to unitholders.***

As of December 31, 2005, our total outstanding long-term indebtedness was approximately \$355.6 million, consisting of \$248.9 million of senior notes, net of unamortized discount of \$1.0 million and \$106.6 million of borrowings under our credit facility. Our payment of principal and interest on the debt will reduce the cash available for distribution on our units, as will our obligation to repurchase the senior notes upon the occurrence of specified events involving a change in control of our general partner. In addition, we are prohibited by our credit facility and the senior notes from making cash distributions during an event of default, or if the payment of a distribution would cause an event of default, under any of our debt agreements. The termination of our pipelines and terminals storage and throughput agreements with Sunoco R&M would constitute an event of default under our credit facility. Failure to renew these agreements could lead to an event of default under our credit facility. Our leverage and various limitations in our credit facility and our senior notes may reduce our ability to incur additional debt, engage in some transactions, and capitalize on acquisition or other business opportunities. Since Sunoco, Inc. owns and controls our general partner, we are not permitted to incur additional debt if the effect would be to cause an event of default under Sunoco, Inc. s revolving credit agreements. Any subsequent refinancing of Sunoco, Inc. s or our current debt or any new debt could have similar or greater restrictions.

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*We could incur a substantial amount of debt in the future, which could prevent us from fulfilling our debt obligations.*

We are permitted to incur additional debt, subject to certain limitations under our revolving credit facility and, in the case of secured debt, under the indenture governing the notes. If we incur additional debt in the future, our increased leverage could, for example:

make it more difficult for us to satisfy our obligations under our debt securities or other indebtedness and, if we fail to comply with the requirements of the other indebtedness, could result in an event of default under our debt securities or such other indebtedness;

require us to dedicate a substantial portion of our cash flow from operations to required payments on indebtedness, thereby reducing the availability of cash flow from working capital, capital expenditures and other general corporate activities;

limit our ability to obtain additional financing in the future for working capital, capital expenditures and other general corporate activities;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

detract from our ability to successfully withstand a downturn in our business or the economy generally; and

place us at a competitive disadvantage against less leveraged competitors.

*Rising short-term interest rates could increase our financing costs and reduce the amount of cash we generate.*

As of December 31, 2005, we had \$106.6 million of floating-rate debt. As a result, we have exposure to changes in short-term interest rates. Rising short-term rates could materially and adversely affect our financial condition, results of operations, or cash flows.

*A down-grading in Sunoco, Inc. 's credit rating could result in a down-grading in our credit rating, which could adversely affect our ability to obtain financing.*

Due to our relationship with Sunoco, Inc., our credit rating is partly dependent on Sunoco, Inc. 's credit rating. Any down-grading in Sunoco, Inc. 's credit rating could result in a down-grading in our credit rating, which could, among other things, limit our ability to obtain financing on the terms currently available to us, if at all.

*Terrorist attacks aimed at our facilities could adversely affect our business.*

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Since the September 11, 2001 terrorist attacks, the U.S. government has issued warnings that energy assets, specifically the nation's pipeline and terminal infrastructure, may be the future targets of terrorist organizations. Any future terrorist attack at our facilities, those of our customers and, in some cases, those of other pipelines, refineries, or terminals could materially and adversely affect our financial condition, results of operations, or cash flows.

*Due to our lack of asset diversification, adverse developments in our businesses could materially and adversely affect our financial condition, results of operations, or cash flows.*

We rely exclusively on the revenues generated from our businesses, and dividends from our equity investments. Due to our lack of asset diversification, an adverse development in one of these businesses could have a significantly greater impact on our financial condition and results of operations than if we maintained more diverse assets.

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*We may issue additional common units without unitholder approval, which would dilute our unitholders' ownership interests.*

During the subordination period, our general partner, without the approval of our unitholders, may cause us to issue up to 5,691,820 additional common units. Our general partner also may cause us to issue an unlimited number of additional common units or other equity securities of equal rank with the common units, without unitholder approval, in a number of circumstances. After the end of the subordination period, we may issue an unlimited number of limited partner interests of any type without the approval of our unitholders. Our partnership agreement does not give our unitholders the right to approve our issuance of equity securities ranking junior to the common units at any time. The issuance of additional common units, or other equity securities of equal or senior rank, will decrease the proportionate ownership interest of existing unitholders and may reduce the amount of cash available for distribution and/or the market price of our common units.

*Sunoco, Inc. and its affiliates may engage in limited competition with us.*

Sunoco, Inc. and its affiliates may engage in limited competition with us. Pursuant to the omnibus agreement, Sunoco, Inc. and its affiliates have agreed not to engage in the business of purchasing crude oil at the wellhead or operating refined product or crude oil pipelines or terminals or LPG terminals in the continental United States. The omnibus agreement, however, does not apply to:

any business operated by Sunoco, Inc. or any of its subsidiaries at the closing of our initial public offering;

any logistics asset constructed by Sunoco, Inc. or any of its subsidiaries within a manufacturing or refining facility in connection with the operation of that facility;

any business that Sunoco, Inc. or any of its subsidiaries acquires or constructs that has a fair market value of less than \$5.0 million; and

any business that Sunoco, Inc. or any of its subsidiaries acquires or constructs that has a fair market value of \$5.0 million or more if we have been offered the opportunity to purchase the business for fair market value, and we decline to do so with the concurrence of our conflicts committee.

Upon a change of control of Sunoco, Inc. or a sale of the general partner by Sunoco, Inc., the non-competition provisions of the omnibus agreement may terminate.

*A unitholder may not have limited liability if a state or federal court finds that we are not in compliance with the applicable statutes or that unitholder action constitutes control of our business.*

The limitations on the liability of holders of limited partner interests for the obligations of a limited partnership have not been clearly established in some states. A unitholder could be held liable in some circumstances for our obligations to the same extent as a general partner if a state or federal court determined that:

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we had been conducting business in any state without complying with the applicable limited partnership statute; or

the right or the exercise of the right by the unitholders as a group to remove or replace our general partner, to approve some amendments to the partnership agreement, or to take other action under the partnership agreement constituted participation in the control of our business.

Under applicable state law, our general partner has unlimited liability for our obligations, including our debts and environmental liabilities, if any, except for our contractual obligations that are expressly made without recourse to the general partner.

In addition, Section 17-607 of the Delaware Revised Uniform Limited Partnership Act provides that under some circumstances a unitholder may be liable to us for the amount of a distribution for a period of three years from the date of the distribution.



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*Our tax treatment depends on our status as a partnership for federal income tax purposes, as well as our not being subject to entity level taxation by individual states. If the Internal Revenue Service, or IRS, treats us as a corporation or we become subject to entity level taxation for state tax purposes, it would substantially reduce the amount of cash available for distribution to unitholders.*

The anticipated after-tax economic benefit of an investment in the common units depends largely on our being treated as a partnership for federal income tax purposes. We have not requested, and do not plan to request, a ruling from the IRS on this matter. The IRS may adopt positions that differ from the ones we take. A successful IRS contest of the federal income tax positions we take may impact adversely the market for our common units, and the costs of any IRS contest will reduce our cash available for distribution to unitholders.

If we were treated as a corporation for federal income tax purposes, we would pay federal income tax at the corporate tax rate, and likely would pay state income tax at varying rates. Distributions to unitholders generally would be taxed again as corporate distributions. Treatment of us as a corporation would result in a material reduction in anticipated cash flow and after-tax return to unitholders. Current law may change so as to cause us to be treated as a corporation for federal income tax purposes or to otherwise subject us to entity-level taxation. In addition, because of widespread state budget deficits, several states are evaluating ways to subject partnerships to entity level taxation through the imposition of state income, franchise and other forms of taxation. If any of these states were to impose a tax on us, the cash available for distribution to unitholders would be reduced. The partnership agreement provides that, if a law is enacted or existing law is modified or interpreted in a manner that subjects us to taxation as a corporation or otherwise subjects us to entity-level taxation for federal, state, or local income tax purposes, the minimum quarterly distribution amount and the target distribution amounts will be adjusted to reflect the impact of that law on us.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

### **ITEM 2. PROPERTIES**

See Item 1.(c) for a description of the locations and general character of the Partnership's material properties.

### **ITEM 3. LEGAL PROCEEDINGS**

There are certain legal and administrative proceedings arising prior to the February 2002 IPO pending against the Partnership's Sunoco-affiliated predecessors and the Partnership (as successor to certain liabilities of those predecessors). Although the ultimate outcome of these proceedings cannot be ascertained at this time, it is reasonably possible that some of them may be resolved unfavorably. Sunoco has agreed to indemnify the Partnership for 100 percent of all losses from environmental liabilities related to the transferred assets arising prior to, and asserted within 21 years of February 8, 2002. There is no monetary cap on this indemnification from Sunoco. Sunoco's share of liability for claims asserted thereafter will decrease by 10 percent each year through the thirtieth year following the February 8, 2002 date. Any remediation liabilities not covered by this indemnity will be the Partnership's responsibility.

There are certain other pending legal proceedings related to matters arising after the February 2002 IPO that are not indemnified by Sunoco, Inc. Management believes that any liabilities that may arise from these legal proceedings will not be material to the Partnership's financial position at December 31, 2005.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS**

No matters were submitted to a vote of the securityholders during fiscal 2005.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SECURITYHOLDER MATTERS AND PURCHASES OF EQUITY SECURITIES**

The Partnership's common units were listed on the New York Stock Exchange under the symbol SXL beginning on February 5, 2002. Prior to February 5, 2002, the Partnership's equity securities were not traded on any public trading market. At the close of business on February 28, 2006, there were 91 holders of record of the Partnership's common units. These holders of record included the general partner with 6,371,915 common units registered in its name, and Cede & Co. with 13,702,630 common units registered to it.

The high and low closing sales price ranges (composite transactions) and distributions declared by quarter for 2004 and 2005 were as follows:

Quarter	2004			2005		
	Unit Price		Declared Distributions <sup>(1)</sup>	Unit Price		Declared Distributions <sup>(1)</sup>
	High	Low		High	Low	
1 <sup>st</sup>	\$ 42.20	\$ 34.48	\$ 0.5700	\$ 43.85	\$ 40.30	\$ 0.6250
2 <sup>nd</sup>	\$ 39.75	\$ 31.47	\$ 0.5875	\$ 42.85	\$ 37.01	\$ 0.6375
3 <sup>rd</sup>	\$ 39.36	\$ 36.00	\$ 0.6125	\$ 41.13	\$ 38.05	\$ 0.6750
4 <sup>th</sup>	\$ 43.05	\$ 38.75	\$ 0.6250	\$ 39.10	\$ 37.66	\$ 0.7125

<sup>(1)</sup> Distributions were declared and paid within 45 days following the close of each quarter.

Within 45 days after the end of each quarter, the Partnership distributes all cash on hand at the end of the quarter less reserves established by the general partner in its discretion. This is defined as available cash in the partnership agreement. The general partner has broad discretion to establish cash reserves that it determines are necessary or appropriate to properly conduct the Partnership's business. The Partnership will make minimum quarterly distributions of \$0.45 per common unit, to the extent there is sufficient cash from operations after establishment of cash reserves and payment of fees and expenses, including payments to the general partner.

The Partnership also had 8,537,729 subordinated units issued as of December 31, 2005, all of which were held by the general partner, and for which there is no established public trading market. The Partnership issued 11,383,639 subordinated units to its general partner in connection with the 2002 IPO. The subordination period is generally defined as the period that ends on the first day of any quarter beginning after December 31, 2006 if (1) the Partnership has distributed at least the minimum quarterly distribution on all outstanding units with respect to each of the immediately preceding three consecutive, non-overlapping four-quarter periods; and (2) the adjusted operating surplus, as defined in the partnership agreement, during such periods equals or exceeds the amount that would have been sufficient to enable the Partnership to distribute the minimum quarterly distribution on all outstanding units on a fully diluted basis and the related distribution on the 2 percent general partner interest during those periods. In addition, one quarter of the subordinated units may convert to common units on a one-for-one basis after both December 31, 2004 and December 31, 2005, if the Partnership meets the required tests for the preceding three consecutive, non-overlapping four-quarter periods. When the subordination period ends, the rights of the holders of subordinated units will no longer be subordinated to the rights of the holders of common units and the subordinated units may be converted into common units.

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During the subordination period, the Partnership will generally pay cash distributions each quarter in the following manner:

First, 98 percent to the holders of common units and 2 percent to the general partner, until each common unit has received a minimum quarterly distribution of \$0.45, plus any arrearages from prior quarters;

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Second, 98 percent to the holders of subordinated units and 2 percent to the general partner, until each subordinated unit has received a minimum quarterly distribution of \$0.45; and

Thereafter, in the manner discussed below.

The Partnership has met the minimum quarterly distribution requirements on all outstanding units for each of the four-quarter periods ended December 31, 2003, 2004 and 2005. As a result, a total of 5,691,820 subordinated units have been converted into common units on a one-for-one basis, 2,845,910 each on February 15, 2005 and February 15, 2006. As a result, there are 5,691,819 subordinated units outstanding at February 28, 2006, all of which may be converted in February 2007 as long as the Partnership continues to meet the financial tests noted above for each of the four-quarter periods ending December 31, 2004, 2005 and 2006.

After the subordination period, the Partnership will, in general, pay cash distributions each quarter in the following manner:

Quarterly Cash Distribution Amount per Unit	Percentage of Distributions	
	Unitholders	General Partner
Up to minimum quarterly distribution (\$0.45 per Unit)	98%	2%
Above \$0.45 per Unit up to \$0.50 per Unit	98%	2%
Above \$0.50 per Unit up to \$0.575 per Unit	85%	15%
Above \$0.575 per Unit up to \$0.70 per Unit	75%	25%
Above \$0.70 per Unit	50%	50%

If cash distributions exceed \$0.50 per unit in a quarter, the general partner will receive increasing percentages, up to 50 percent, of the cash distributed in excess of that amount. These distributions are referred to as incentive distributions. The amounts shown in the table under Percentage of Distributions are the percentage interests of the general partner and the unitholders in any available cash from operating surplus that is distributed up to and including the corresponding amount in the column Quarterly Cash Distribution Amount per Unit, until the available cash that is distributed reaches the next target distribution level, if any. The percentage interests shown for the unitholders and the general partner for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution.

There is no guarantee that the Partnership will pay the minimum quarterly distribution on the common units in any quarter, and the Partnership is prohibited from making any distributions to unitholders if it would cause an event of default, or an event of default is existing, under the credit facility or the senior notes (Please see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources).

For equity compensation plan information, see Item 2. Security Ownership of Certain Beneficial Owners and Management and Related Securityholder Information.

**ITEM 6. SELECTED FINANCIAL DATA**

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On February 8, 2002, the Partnership completed an IPO and related transactions whereby it became the successor to Sunoco Logistics ( Predecessor ), which consisted of a substantial portion of the wholly-owned logistics operations of Sunoco, Inc. and its subsidiaries. The selected financial and operating data presented is derived from the audited financial statements of Sunoco Logistics Partners L.P., which reflect the Predecessor for 2001, the Partnership and Predecessor for 2002, and the Partnership for 2003, 2004 and 2005.

For the periods presented, Sunoco R&M was the primary or exclusive user of the refined product terminals, the Fort Mifflin Terminal Complex, and the Marcus Hook Tank Farm. Prior to January 1, 2002, most of the terminalling and throughput services provided by the Predecessor for Sunoco R&M s refining and marketing

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operations were at fees that enabled the recovery of costs, but not to generate any operating income. Accordingly, historical earnings before interest expense, income tax expense, and depreciation and amortization expense ( EBITDA ) for those assets was equal to their depreciation and amortization expense. Sunoco Logistics Partners L.P. began charging Sunoco R&M fees for these services that are comparable to those charged in arm s length, third-party transactions, generally effective January 1, 2002, using the terms included in a pipelines and terminals storage and throughput agreement entered into at the closing of the IPO.

Maintenance capital expenditures are capital expenditures made to replace partially or fully depreciated assets in order to maintain the existing operating capacity of the assets and to extend their useful lives. Expansion capital expenditures are capital expenditures made to expand the existing operating capacity of the assets, whether through construction or acquisition. The Partnership treats repair and maintenance expenditures that do not extend the useful life of existing assets as operating expenses as incurred.

Throughput is the total number of barrels per day ( bpd ) transported on a pipeline system or through a terminal. Total shipments represent the total average daily pipeline throughput multiplied by the number of miles of pipeline through which each barrel has been shipped. Management of the Partnership believes that total shipments is a better performance indicator for the Eastern Pipeline System than throughput as certain refined product pipelines such as transfer pipelines, transport large volumes over short distances and generate minimal revenues.

The following table should be read together with, and is qualified in its entirety by reference to, the financial statements and the accompanying notes of Sunoco Logistics Partners L.P. included in Item 8. Financial Statements and Supplementary Data . The table also should be read together with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations .

**Table of Contents****SUNOCO LOGISTICS PARTNERS L.P.**

	Partnership and Predecessor		Partnership		
	Predecessor	Predecessor	Partnership		
	Year Ended December 31,				
	2001	2002 <sup>(1)</sup>	2003 <sup>(2)</sup>	2004 <sup>(3)</sup>	2005 <sup>(4)</sup>
(in thousands, except per unit and operating data)					
<b>Income Statement Data:</b>					
Revenues:					
Sales and other operating revenue:					
Affiliates	\$ 1,067,182	\$ 1,147,721	\$ 1,383,090	\$ 1,751,612	\$ 1,986,019
Unaffiliated customers	545,822	676,307	1,274,383	1,699,673	2,496,593
Other income <sup>(5)</sup>	4,774	6,904	16,730	13,932	14,295
<b>Total revenues</b>	<b>1,617,778</b>	<b>1,830,932</b>	<b>2,674,203</b>	<b>3,465,217</b>	<b>4,496,907</b>
Costs and expenses:					
Cost of products sold and operating expenses	1,503,156	1,690,896	2,519,160	3,307,480	4,326,713
Depreciation and amortization	25,325	31,334	27,157	31,933	33,838
Selling, general and administrative expenses	35,956	43,073	48,412	48,449	53,048
<b>Total costs and expenses</b>	<b>1,564,437</b>	<b>1,765,303</b>	<b>2,594,729</b>	<b>3,387,862</b>	<b>4,413,599</b>
<b>Operating income</b>	<b>53,341</b>	<b>65,629</b>	<b>79,474</b>	<b>77,355</b>	<b>83,308</b>
Net interest cost and debt expense	10,980	17,299	20,040	20,324	21,599
<b>Income before income tax expense</b>	<b>42,361</b>	<b>48,330</b>	<b>59,434</b>	<b>57,031</b>	<b>61,709</b>
Income tax expense	15,594	1,555			
<b>Net Income</b>	<b>\$ 26,767</b>	<b>\$ 46,775</b>	<b>\$ 59,434</b>	<b>\$ 57,031</b>	<b>\$ 61,709</b>
Net Income per limited partner unit:					
Basic		\$ 1.87 <sup>(6)</sup>	\$ 2.55	\$ 2.29	\$ 2.37
Diluted		\$ 1.86 <sup>(6)</sup>	\$ 2.53	\$ 2.27	\$ 2.35
Cash distributions per unit to limited partners: <sup>(7)</sup>					
Paid		\$ 1.16	\$ 1.9875	\$ 2.32	\$ 2.5625
Declared		\$ 1.6475	\$ 2.05	\$ 2.395	\$ 2.65
<b>Cash Flow Data:</b>					
Net cash provided by operating activities	\$ 27,238	\$ 2,211	\$ 97,212	\$ 106,622	\$ 90,835
Net cash used in investing activities	\$ (73,079)	\$ (85,273)	\$ (39,008)	\$ (95,583)	\$ (180,654)
Net cash provided by/(used in) financing activities	\$ 45,841	\$ 116,902	\$ (41,963)	\$ (8,460)	\$ 58,804
Capital expenditures:					
Maintenance	\$ 53,628	\$ 27,934	\$ 30,850	\$ 30,829	\$ 31,194



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Expansion	19,055	77,439 <sup>(1)</sup>	10,226 <sup>(2)</sup>	64,754 <sup>(3)</sup>	149,460 <sup>(4)</sup>
Total capital expenditures	\$ 72,683	\$ 105,373	\$ 41,076	\$ 95,583	\$ 180,654