PHILLIPS 66 PARTNERS LP
Form 10-Q
October 26, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018
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: 001-36011

Phillips 66 Partners LP
(Exact name of registrant as specified in its charter)

Delaware	38-3899432
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2331 CityWest Blvd., Houston, Texas 77042
(Address of principal executive offices) (Zip Code)

(855) 283-9237
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ]
Smaller reporting company [ ]
Emerging growth company [ ]
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. [ ]
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]
The registrant had 123,811,206 common units outstanding as of September 30, 2018.

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PHILLIPS 66 PARTNERS LP

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Consolidated Statement of Income Phillips 66 Partners LP

	Millions of Dollars			
	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017*	2018	2017*
Revenues and Other Income				
Operating revenues—related parties	$256	222	749	648
Operating revenues—third parties	9	11	26	32
Equity in earnings of affiliates	118	66	316	147
Other income	1	—	2	11
Total revenues and other income	384	299	1,093	838
Costs and Expenses				
Operating and maintenance expenses	84	86	266	239
Depreciation	30	32	87	88
General and administrative expenses	16	17	48	52
Taxes other than income taxes	8	7	27	24
Interest and debt expense	28	24	87	72
Other expenses	1	1	1	1
Total costs and expenses	167	167	516	476
Income before income taxes	217	132	577	362
Income tax expense	—	1	2	2
Net income	217	131	575	360
Less: Net income attributable to Predecessors	—	32	—	61
Net income attributable to the Partnership	217	99	575	299
Less: Preferred unitholders' interest in net income attributable to the Partnership	9	—	28	—
Less: General partner's interest in net income attributable to the Partnership	64	43	172	112
Limited partners' interest in net income attributable to the Partnership	$144	56	375	187
Net Income Attributable to the Partnership Per Limited Partner Unit (dollars)				
Common units—basic	$1.17	0.51	3.06	1.72
Common units—diluted	1.10	0.51	2.91	1.72
Cash Distributions Paid Per Common Unit (dollars)	$0.752	0.615	2.144	1.759
Weighted-Average Limited Partner Units Outstanding (thousands)				
Common units—basic	123,270	110,506	122,362	109,043
Common units—diluted	137,090	110,506	136,182	109,043

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Comprehensive Income Phillips 66 Partners LP

	Millions of Dollars			
	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017*	2018	2017*
Net Income	$217	131	575	360
Defined benefit plans				
Plan sponsored by equity affiliate, net of tax	—	—	—	—
Other comprehensive income	—	—	—	—
Comprehensive Income	$217	131	575	360

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

See Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet Phillips 66 Partners LP

	Millions of Dollars	
	September 30 2018	December 31 2017
Assets		
Cash and cash equivalents	$100	185
Accounts receivable—related parties	112	83
Accounts receivable—third parties	5	3
Materials and supplies	12	12
Prepaid expenses and other current assets	10	9
Total current assets	239	292
Equity investments	2,215	1,932
Net properties, plants and equipment	2,999	2,918
Goodwill	185	185
Deferred rentals and other assets	5	7
Total Assets	$5,643	5,334
Liabilities		
Accounts payable—related parties	$21	21
Accounts payable—third parties	99	39
Accrued property and other taxes	24	15
Accrued interest	32	34
Short-term debt	—	25
Deferred revenues	60	35
Other current liabilities	2	2
Total current liabilities	238	171
Long-term debt	2,922	2,920
Asset retirement obligations and accrued environmental costs	11	11
Deferred income taxes	7	5
Deferred revenues and other liabilities	22	66
Total Liabilities	3,200	3,173
Equity		
Preferred unitholders (2018 and 2017—13,819,791 units issued and outstanding)	746	746
Common unitholders—public (2018—55,051,069 units issued and outstanding; 2017—52,811,822 units issued and outstanding)	2,451	2,274
Common unitholder—Phillips 66 (2018 and 2017—68,760,137 units issued and outstanding)	567	487
General partner—Phillips 66 (2018 and 2017—2,480,051 units issued and outstanding)	(1,320)	(1,345)
Accumulated other comprehensive loss	(1)	(1)
Total Equity	2,443	2,161
Total Liabilities and Equity	$5,643	5,334

See Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows Phillips 66 Partners LP

	Millions of Dollars	
	Nine Months Ended September 30	
	2018	2017*
Cash Flows From Operating Activities		
Net income	$575	360
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	87	88
Undistributed equity earnings	(5)	—
Deferred revenues and other liabilities	(44)	(2)
Other	5	10
Working capital adjustments		
Decrease (increase) in accounts receivable	(9)	13
Decrease (increase) in materials and supplies	—	(1)
Decrease (increase) in prepaid expenses and other current assets	(1)	2
Increase (decrease) in accounts payable	8	—
Increase (decrease) in accrued interest	(2)	2
Increase (decrease) in deferred revenues	29	11
Increase (decrease) in other accruals	9	3
Net Cash Provided by Operating Activities	652	486
Cash Flows From Investing Activities		
Restricted cash received from combination of business	—	318
Collection of loan receivable	—	8
Cash capital expenditures and investments	(410)	(308)
Return of investment from equity affiliates	28	32
Net Cash Provided by (Used in) Investing Activities	(382)	50
Cash Flows From Financing Activities		
Net contributions to Phillips 66 from Predecessors	—	(178)
Issuance of debt	85	1,383
Repayment of debt	(110)	(1,641)
Issuance of common units	114	171
Quarterly distributions to preferred unitholders	(28)	—
Quarterly distributions to common unitholders—public	(114)	(78)
Quarterly distributions to common unitholder—Phillips 66	(147)	(113)
Quarterly distributions to General Partner—Phillips 66	(155)	(96)
Other cash contributions from Phillips 66	—	16
Net Cash Used in Financing Activities	(355)	(536)
Net Change in Cash, Cash Equivalents and Restricted Cash	(85)	—
Cash, cash equivalents and restricted cash at beginning of period	185	2
Cash, Cash Equivalents and Restricted Cash at End of Period	$100	2

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

See Notes to Consolidated Financial Statements.

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Consolidated Statement of Changes in Equity Phillips 66 Partners LP

	Millions of Dollars						
	Partnership						
	Preferred Unitholders Public	Common Unitholders Public	Common Unitholder Phillips 66	General Partner Phillips 66	Accum. Other Comprehensive Loss	Net Investment—Predecessors*	Total
December 31, 2016	$—	1,795	476	(704)	(1)	—	1,566
Net income attributable to Predecessors	—	—	—	—	—	61	61
Net contributions from Phillips 66—Predecessors	—	—	—	—	—	664	664
Issuance of common units	—	171	—	—	—	—	171
Net income attributable to the Partnership	—	78	109	112	—	—	299
Quarterly cash distributions to unitholders and General Partner	—	(78)	(113)	(96)	—	—	(287)
Other contributions from Phillips 66	—	—	—	26	—	—	26
September 30, 2017*	$—	1,966	472	(662)	(1)	725	2,500
December 31, 2017	$746	2,274	487	(1,345)	(1)	—	2,161
Cumulative effect of accounting change	—	13	16	1	—	—	30
Issuance of common units	—	114	—	—	—	—	114
Net income attributable to the Partnership	28	164	211	172	—	—	575
Quarterly cash distributions to unitholders and General Partner	(28)	(114)	(147)	(155)	—	—	(444)
Other contributions from Phillips 66	—	—	—	7	—	—	7
September 30, 2018	$746	2,451	567	(1,320)	(1)	—	2,443

*Prior-period financial information has been retrospectively adjusted for acquisitions of businesses under common control.

	Preferred Units Public	Common Units Public	Common Units Phillips 66	General Partner Units Phillips 66	Total Units
December 31, 2016	—	43,134,902	64,047,024	2,187,386	109,369,312

Units issued in public equity offerings	—	3,323,576	—	—	3,323,576
September 30, 2017	—	46,458,478	64,047,024	2,187,386	112,692,888
December 31, 2017	13,819,791	52,811,822	68,760,137	2,480,051	137,871,801
Units issued in public equity offerings	—	2,239,247	—	—	2,239,247
September 30, 2018	13,819,791	55,051,069	68,760,137	2,480,051	140,111,048

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements Phillips 66 Partners LP

Note 1—Business and Basis of Presentation
Unless otherwise stated or the context otherwise indicates, all references to “Phillips 66 Partners,” “the Partnership,” “us,” “our,” “we,” or similar expressions refer to Phillips 66 Partners LP, including its consolidated subsidiaries. References to Phillips 66 may refer to Phillips 66 and/or its subsidiaries, depending on the context. References to our “General Partner” refer to Phillips 66 Partners GP LLC, and references to Phillips 66 PDI refer to Phillips 66 Project Development Inc., the Phillips 66 subsidiary that holds a limited partner interest in us and wholly owns our General Partner.

Description of the Business
We are a growth-oriented master limited partnership formed to own, operate, develop and acquire primarily fee-based crude oil, refined petroleum products and natural gas liquids (NGL) pipelines, terminals and other midstream assets. Our common units trade on the New York Stock Exchange under the symbol PSXP.

Our operations consist of crude oil, refined petroleum products and NGL transportation, processing, terminaling and storage assets. We conduct our operations through both wholly owned and joint venture operations. The majority of our wholly owned assets are associated with, and are integral to the operation of, nine of Phillips 66’s owned or joint venture refineries.

We primarily generate revenue by providing fee-based transportation, terminaling, processing, storage and NGL fractionation services to Phillips 66 and other customers. Our equity affiliates primarily generate revenue from transporting and terminaling NGL, refined petroleum products and crude oil. Since we do not own any of the NGL, crude oil and refined petroleum products we handle and do not engage in the trading of NGL, crude oil and refined petroleum products, we have limited direct exposure to risks associated with fluctuating commodity prices, although these risks indirectly influence our activities and results of operations over the long term.

Basis of Presentation
We have acquired assets from Phillips 66 that were considered transfers of businesses between entities under common control. This required the transactions to be accounted for as if the transfers had occurred at the beginning of the transfer period, with prior periods retrospectively adjusted to furnish comparative information. Accordingly, the accompanying financial statements and related notes have been retrospectively adjusted to include the historical results and financial position of the acquired businesses prior to the effective date of each acquisition. We refer to these pre-acquisition operations as those of our “Predecessors.”

The combined financial statements of our Predecessors were derived from the accounting records of Phillips 66 and reflect the combined historical results of operations, financial position and cash flows of our Predecessors as if such businesses had been combined for all periods presented.

All intercompany transactions and accounts within our Predecessors have been eliminated. The assets and liabilities of our Predecessors in these financial statements have been reflected on a historical cost basis because the transfer of the Predecessors to us occurred within the Phillips 66 consolidated group. The consolidated statement of income also includes expense allocations for certain functions performed by Phillips 66, including operational support services such as engineering and logistics and allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, information technology and procurement. These allocations were based primarily on the relative carrying values of properties, plants and equipment and equity-method investments, or number of terminals and pipeline miles, and secondarily on activity-based cost allocations. Our management believes the assumptions underlying the allocation of expenses from Phillips 66 are reasonable. Nevertheless, the financial results of our Predecessors may not include all of the actual expenses that would have been incurred had our Predecessors been a stand-alone publicly traded partnership during the periods presented.

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Note 2—Interim Financial Information

The interim financial information presented in the financial statements included in this report is unaudited and includes all known accruals and adjustments necessary, in the opinion of management, for a fair presentation of our financial position, results of operations and cash flows for the periods presented. Unless otherwise specified, all such adjustments are of a normal and recurring nature. Certain notes and other information have been condensed or omitted from the interim financial statements included in this report. Therefore, these interim financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our 2017 Annual Report on Form 10-K. The results of operations for the three and nine months ended September 30, 2018, are not necessarily indicative of the results to be expected for the full year.

Note 3—Changes in Accounting Principles

Effective January 1, 2018, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business," which clarifies the definition of a business with the objective of adding guidance to assist in evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The amendment provides a screen for determining when a transaction involves an acquisition of a business. If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset, or a group of similar identifiable assets, then the screen is met and the transaction is not considered an acquisition of a business. If the screen is not met, the amendment requires that to be considered a business, the operation must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create an output. The guidance may reduce the number of future transactions accounted for as business acquisitions. At the time of adoption, this ASU had no impact on our consolidated financial statements.

Effective January 1, 2018, we adopted ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The majority of this ASU's provisions amend only the presentation or disclosures of financial instruments; however, one provision could also affect net income. Equity investments reported under the cost method or the lower of cost or fair value method of accounting, in accordance with previous U.S. generally accepted accounting principles (GAAP), are now reported at fair value with changes in fair value recognized in net income. For equity investments that do not have readily determinable fair values, we elected to carry such investments at cost less impairments, if any, adjusted up or down for price changes in similar financial instruments issued by the investee, when and if observed. At the time of adoption, this ASU had no material impact on our consolidated financial statements.

Effective January 1, 2018, we adopted ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," using the modified retrospective transition method applied to all contracts. Under the new revenue recognition guidance, recognition of revenue involves a multiple step approach including: (i) identifying the contract with the customer, (ii) identifying the separate performance obligations, (iii) determining the transaction price, (iv) allocating the transaction price to the performance obligations and (v) recognizing the revenue as the performance obligations are satisfied. Additional disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In addition, all but one of our equity-method investees adopted ASU No. 2014-09 as of January 1, 2018. The remaining equity method investee will adopt this ASU in 2019.

We recorded a noncash cumulative effect adjustment of $30 million to increase the opening balance of our equity as of January 1, 2018. This adjustment reflected amounts recorded by us and our equity-method investees related to the acceleration of revenue recognition on certain minimum volume commitment contracts with recovery provisions.

Certain agreements for transportation, terminaling and fractionation services with Phillips 66 are considered operating leases under FASB Accounting Standards Codification (ASC) 840, “Leases.” We identified the separate lease and service elements of our revenue under these operating leases and applied ASU No. 2014-09 only to the service element, while the lease element continued to be accounted for under ASC 840. See Note 9—Operating Revenues, for additional information.

Note 4—Acquisitions

Gray Oak Pipeline Project Acquisition
In April 2018, we entered into a Purchase and Sale Agreement with Phillips 66 PDI to acquire its 100 percent interest in Gray Oak Holdings LLC, a limited liability company that, at that time, owned a 100 percent interest in Gray Oak Pipeline, LLC (Gray Oak LLC), an entity formed to develop and construct the Gray Oak Pipeline system. Under common control accounting, we considered the cash consideration paid of approximately $3 million to be a reimbursement of Phillips 66 PDI’s previously incurred costs, and expensed this amount to “General and administrative expenses” in the second quarter of 2018. At September 30, 2018, another party has the right, but not the obligation, to acquire up to a 35 percent interest in Gray Oak Holdings LLC. Subject to certain conditions, the option expires on November 30, 2018. See Note 5—Equity Investments, for additional information on Gray Oak LLC, including our variable interest entity assessment.

Bakken Pipeline/MSLP Acquisition
In September 2017, we entered into a Contribution, Conveyance and Assumption Agreement with subsidiaries of Phillips 66 to acquire a 25 percent interest in each of Dakota Access, LLC (Dakota Access) and Energy Transfer Crude Oil Company, LLC (ETCO), together referred to as the Bakken Pipeline, and a 100 percent interest in Merey Sweeny, L.P. (MSLP). Collectively, the assets acquired in the acquisition are referred to as the Bakken Pipeline/MSLP Acquisition. We paid Phillips 66 total consideration of $1.65 billion, consisting of $372 million in cash, the assumption of $588 million of promissory notes payable to Phillips 66 and a $450 million term loan under which Phillips 66 was the obligor, and the issuance of 4,713,113 common units to Phillips 66 PDI and 292,665 general partner units to our General Partner to maintain its 2 percent general partner interest. The Bakken Pipeline/MSLP Acquisition closed in October 2017.

In connection with the Bakken Pipeline/MSLP Acquisition, we entered into commercial agreements with Phillips 66 and amended the omnibus and operational services agreements with Phillips 66. See Note 13—Related Party Transactions for additional information on our commercial and other agreements with Phillips 66. Pursuant to the tolling services agreement entered into with Phillips 66 and related to MSLP operations, we received $53 million from Phillips 66 for the prepayment of services related to MSLP’s next scheduled maintenance turnaround, which was recorded as deferred revenue in our consolidated balance sheet as of the acquisition date.

Common Control Transactions
The Bakken Pipeline/MSLP Acquisition was considered a transfer of businesses between entities under common control, and therefore the related acquired assets were transferred at historical carrying value. The aggregate net book value of the underlying acquired assets in the Bakken Pipeline/MSLP Acquisition, at the time of acquisition, was $729 million. Because the Bakken Pipeline/MSLP Acquisition was a common control transaction in which we acquired a business, our historical financial statements were retrospectively adjusted to reflect the results of operations, financial position, and cash flows of the acquired assets as if we owned the acquired assets for the period from February 1, 2017, through October 5, 2017. For periods prior to February 1, 2017, both the Bakken Pipeline and MSLP investments were accounted for under the equity method of accounting by Phillips 66 and, thus, were not subject to retrospective adjustments.

The following tables present our results of operations and cash flows giving effect to the Bakken Pipeline/MSLP Acquisition. The second column in both tables presents the retrospective adjustments made to our historical financial information for the acquired assets prior to the effective date of the acquisition. The third column in both tables presents our consolidated financial information as retrospectively adjusted.

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Consolidated Statement of Income	Millions of Dollars Three Months Ended September 30, 2017 Phillips 66 Partners LP (As previously reported)	Acquired Bakken Pipeline/MSLP Predecessor	Consolidated Results
Revenues and Other Income			
Operating revenues—related parties	$193	29	222
Operating revenues—third parties	11	—	11
Equity in earnings of affiliates	41	25	66
Total revenues and other income	245	54	299
Costs and Expenses			
Operating and maintenance expenses	69	17	86
Depreciation	30	2	32
General and administrative expenses	16	1	17
Taxes other than income taxes	7	—	7
Interest and debt expense	23	1	24
Other expenses	1	—	1
Total costs and expenses	146	21	167
Income before income taxes	99	33	132
Income tax expense	—	1	1
Net income	99	32	131
Less: Net income attributable to Predecessors	—	32	32
Net income attributable to the Partnership	99	—	99
Less: General partner's interest in net income attributable to the Partnership	43	—	43
Limited partners' interest in net income attributable to the Partnership	$56	—	56

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Consolidated Statement of Income	Millions of Dollars Nine Months Ended September 30, 2017 Phillips 66 Partners LP (As previously reported)	Acquired Bakken Pipeline/MSLP Predecessor	Consolidated Results
Revenues and Other Income			
Operating revenues—related parties	$563	85	648
Operating revenues—third parties	32	—	32
Equity in earnings of affiliates	111	36	147
Other income	7	4	11
Total revenues and other income	713	125	838
Costs and Expenses			
Operating and maintenance expenses	188	51	239
Depreciation	82	6	88
General and administrative expenses	48	4	52
Taxes other than income taxes	23	1	24
Interest and debt expense	71	1	72
Other expenses	1	—	1
Total costs and expenses	413	63	476
Income before income taxes	300	62	362
Income tax expense	1	1	2
Net income	299	61	360
Less: Net income attributable to Predecessors	—	61	61
Net income attributable to the Partnership	299	—	299
Less: General partner’s interest in net income attributable to the Partnership	112	—	112
Limited partners’ interest in net income attributable to the Partnership	$187	—	187

	Millions of Dollars Nine Months Ended September 30, 2017 Phillips 66 Partners LP (As previously reported)	Acquired Bakken Pipeline/MSLP Predecessor	Consolidated Results
Cash Flows From Operating Activities			
Net income	$299	61	360
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	82	6	88
Undistributed equity earnings	2	(2)	—
Deferred revenues and other liabilities	(2)	—	(2)
Other	10	—	10
Working capital adjustments			
Decrease (increase) in accounts receivable	13	—	13
Decrease (increase) in materials and supplies	(1)	—	(1)
Decrease (increase) in prepaid expenses and other current assets	1	1	2
Increase (decrease) in accounts payable	—	—	—
Increase (decrease) in accrued interest	3	(1)	2
Increase (decrease) in deferred revenues	11	—	11
Increase (decrease) in other accruals	4	(1)	3
Net Cash Provided by Operating Activities	422	64	486
Cash Flows From Investing Activities			
Restricted cash received from combination of business	—	318	318
Collection of loan receivable	—	8	8
Cash capital expenditures and investments	(227)	(81)	(308)
Return of investment from equity affiliates	28	4	32
Net Cash Provided by (Used in) Investing Activities	(199)	249	50
Cash Flows From Financing Activities			
Net contributions to Phillips 66 from Predecessors	—	(178)	(178)
Issuance of debt	1,383	—	1,383
Repayment of debt	(1,506)	(135)	(1,641)
Issuance of common units	171	—	171
Quarterly distributions to common unitholders—public	(78)	—	(78)
Quarterly distributions to common unitholder—Phillips 66	(113)	—	(113)
Quarterly distributions to General Partner—Phillips 66	(96)	—	(96)
Other cash contributions from Phillips 66	16	—	16
Net Cash Used in Financing Activities	(223)	(313)	(536)
Net Change in Cash, Cash Equivalents and Restricted Cash	—	—	—
Cash, cash equivalents and restricted cash at beginning of period	2	—	2

Cash, Cash Equivalents and Restricted Cash at End of Period	$2	—	2

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Note 5—Equity Investments

Gray Oak Pipeline
As discussed in Note 4—Acquisitions, in April 2018, we acquired Phillips 66 PDI's then 100 percent interest in Gray Oak LLC. Gray Oak LLC is developing and constructing the Gray Oak Pipeline system which, upon completion, will provide crude oil transportation from the Permian Basin and Eagle Ford to destinations in the Corpus Christi and Freeport markets on the Texas Gulf Coast. The pipeline is expected to be placed in service by the end of 2019.

In April 2018, a co-venturer acquired a 25 percent interest in Gray Oak LLC, along with sufficient voting rights over key governance provisions such that we no longer could assert control over Gray Oak LLC. At that time, we began using the equity method of accounting for our investment in Gray Oak LLC. At September 30, 2018, another party has the option to acquire a 10 percent interest in Gray Oak LLC. Subject to certain conditions, including extension by mutual agreement of the parties, the option expires on November 3, 2018.

Gray Oak LLC is considered a variable interest entity because it does not have sufficient equity at risk to fully fund the construction of all assets required for principal operations. We have determined we are not the primary beneficiary because we and our co-venturer jointly direct the activities of the Gray Oak Pipeline that most significantly impact economic performance. At September 30, 2018, our maximum exposure to loss was $72 million, which represented the aggregate book value of our equity investment in Gray Oak LLC.

South Texas Gateway Terminal
In April 2018, we acquired a 25 percent interest in the South Texas Gateway Terminal under development by Buckeye Partners, L.P. This marine terminal will connect to the Gray Oak Pipeline in Corpus Christi, Texas, and will have an initial storage capacity of 3.4 million barrels. The terminal is expected to begin operations by the end of 2019.

South Texas Gateway Terminal LLC is considered a variable interest entity because it does not have sufficient equity at risk to fully fund the construction of all assets required for principal operations. We have determined we are not the primary beneficiary because we and our co-venturers jointly direct the activities of the terminal that most significantly impact economic performance. At September 30, 2018, our maximum exposure to loss was $16 million, which represented the aggregate book value of our equity investment in South Texas Gateway Terminal LLC.

The following table summarizes the carrying value of our equity investments.

			Millions of Dollars	
	Percentage Ownership		September 30 2018	December 31 2017
Bakken Pipeline	25.00	%	$612	621
Bayou Bridge Pipeline, LLC (Bayou Bridge)	40.00		266	173
DCP Sand Hills Pipeline, LLC (Sand Hills)	33.34		591	515
DCP Southern Hills Pipeline, LLC (Southern Hills)	33.34		208	209
Explorer Pipeline Company (Explorer)	21.94		120	118
Gray Oak Pipeline, LLC (Gray Oak)	75.00		72	—
Paradigm Pipeline LLC (Paradigm)	50.00		145	131
Phillips 66 Partners Terminal LLC (Phillips 66 Partners Terminal)	70.00		71	53
South Texas Gateway Terminal LLC (South Texas Gateway Terminal)	25.00		16	—
STACK Pipeline LLC (STACK)	50.00		114	112
Total equity investments			$2,215	1,932

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Earnings (losses) from our equity investments were as follows:

	Millions of Dollars			
	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Bakken Pipeline	$48	25	119	36
Bayou Bridge	2	4	10	8
Explorer	11	7	35	18
Gray Oak	—	—	—	—
Paradigm	2	(1)	6	(2)
Phillips 66 Partners Terminal	6	2	21	5
Sand Hills	34	21	90	58
South Texas Gateway Terminal	—	—	—	—
Southern Hills	12	6	28	20
STACK	3	2	7	4
Total equity in earnings of affiliates	$118	66	316	147

Note 6—Properties, Plants and Equipment

Our investment in properties, plants and equipment (PP&E), with the associated accumulated depreciation, was:

	Millions of Dollars	
	September 30	December 31
	2018	2017
Land	$19	19
Buildings and improvements	89	88
Pipelines and related assets*	1,387	1,372
Terminals and related assets*	702	671
Rail racks and related assets*	137	137
Processing and related assets*	842	837
Caverns and related assets*	584	583
Construction-in-progress	160	47
Gross PP&E	3,920	3,754
Less: Accumulated depreciation	921	836
Net PP&E	$2,999	2,918

*Assets for which we are the lessor.

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Note 7—Debt

	Millions of Dollars	
	September 30 2018	December 31 2017
2.646% Senior Notes due 2020	$300	300
3.605% Senior Notes due 2025	500	500
3.550% Senior Notes due 2026	500	500
3.750% Senior Notes due 2028	500	500
4.680% Senior Notes due 2045	450	450
4.900% Senior Notes due 2046	625	625
Tax-exempt bonds at 1.86% and 1.94% at September 30, 2018, and December 31, 2017, respectively	75	100
Total	2,950	2,975
Net unamortized discounts and debt issuance costs	(28)	(30)
Total debt	2,922	2,945
Less: Short-term debt	—	25
Long-term debt	$2,922	2,920

The fair value of our fixed-rate and floating-rate debt is estimated based on observable market prices and is classified in level 2 of the fair value hierarchy. The fair value of our fixed-rate debt amounted to $2,765 million and $2,918 million at September 30, 2018, and December 31, 2017, respectively. The fair value of our floating-rate debt approximated carrying value of $75 million and $100 million at September 30, 2018, and December 31, 2017, respectively.

Note 8—Equity

Our initial $250 million continuous offering of common units, or at-the-market (ATM) program, was completed in June 2018. At that time, we commenced issuing common units under our second $250 million ATM program. For the three and nine months ended September 30, 2018, on a settlement date basis, we had issued an aggregate of 898,313 and 2,239,247 common units under our ATM programs, generating net proceeds of $47 million and $114 million, respectively. For the three months ended September 30, 2017, we did not issue any common units under our ATM program. For the nine months ended, September 30, 2017, on a settlement date basis, we had issued an aggregate of 3,323,576 common units under our ATM programs, generating net proceeds of $171 million. Since inception through September 30, 2018, we had issued an aggregate of 5,958,115 common units under our ATM programs, generating net proceeds of $306 million. The net proceeds from sales under the ATM programs are used for general partnership purposes, which may include debt repayment, acquisitions, capital expenditures and additions to working capital.

Note 9—Operating Revenues

Revenues are primarily recognized for pipeline transportation, terminaling, storage, processing and fractionation services generated under long-term agreements. A significant portion of our revenues are derived from Phillips 66. The majority of our agreements for transportation, terminaling, storage, processing and fractionation services with Phillips 66 are considered operating leases under GAAP. As part of our adoption of ASU No. 2014-09, we applied the new revenue recognition standard only to the service element of these operating leases. The separation of the lease and service elements was based on an analysis of service-related and lease-related costs for each contract, adjusted for representative profit margins. The lease element continues to be accounted for under lease accounting standards.

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Revenues from fixed minimum volume commitments are recognized over the performance obligation period for stand-ready service contracts. Revenues from the variable element of these stand-ready contracts and other contracts without fixed elements are recognized based on the actual volumes transported, stored, processed and fractionated at contractual rates because the actual volumes specifically relate to our efforts to transfer the distinct services. Generally, our services are billed and payments are received on a monthly basis.

Disaggregated Revenues

Total operating revenues disaggregated by type of service were as follows:

	Millions of Dollars	
	Three Months Ended September 30	Nine Months Ended September 30
	2018	2018
Pipelines	$123	336
Terminals	37	114
Storage, processing and other revenues	105	325
Total operating revenues	$265	775

During the three and nine months ended September 30, 2018, lease revenues were $159 million and $446 million, respectively, and service revenues were $106 million and $329 million, respectively. Lease and service revenues were recorded in the “Operating revenues—related parties” and “Operating revenues—third parties” lines on our consolidated statement of income.

Contract-Related Assets and Liabilities

At September 30, 2018, and January 1, 2018, lease receivables were $51 million and $49 million, respectively, and service receivables were $44 million and $37 million, respectively.

Our contract liabilities primarily represent payments from our customers, mainly Phillips 66, for volume throughput less than the contractually required minimum throughput volumes. These deficiency payments are deferred and recognized at the earlier of the period in which our customers make up the shortfall volumes or when it is probable our customers will not make up the shortfall volumes prior to the expiration of the contractual make-up period. Our contract liabilities are included in the “Deferred revenues” and “Deferred revenues and other liabilities” lines on our consolidated balance sheet. At September 30, 2018, and January 1, 2018, total deferred revenues were $78 million and $93 million, respectively, of which $6 million and $13 million, respectively, were contract liabilities related to the service element. Service-related revenues recognized during the three and nine months ended September 30, 2018, that were included in the contract liability balance at January 1, 2018, were $1 million and $10 million, respectively. For the three and nine months ended September 30, 2018, there were no material differences between the amount that we recognized as revenues relating to minimum throughput deficiency payments compared to the amount that would have been recognized prior to the adoption of the new revenue recognition standard.

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Remaining Performance Obligations

We typically have long-term contracts with our customers, most of which have original durations of up to 15 years. The average remaining duration of these contracts is eight years. At September 30, 2018, future revenues expected to be recognized for the fixed component of the transaction price of our remaining performance obligations from contracts with our customers with an original expected duration of greater than one year were:

	Millions of Dollars
Remainder of 2018	$ 192
2019	758
2020	755
2021	744